SPARK AND CANNON

Telephone:

Adelaide	(08) 8212-3699
Melbourne	(03) 9670-6989
Perth	(08) 9325-4577
Sydney	(02) 9211-4077

TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO TELECOMMUNICATIONS SPECIFIC COMPETITION REGULATION

PROF M. WOODS, Presiding Commissioner
PROF R. SNAPE, Deputy Chairman of the Commission

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON MONDAY, 14 AUGUST 2000, AT 9.30 AM

PROF WOODS: Welcome to the public hearings for the Productivity Commission inquiry into telecommunications specific competition regulation. I'm Mike Woods, and I'm the presiding commissioner for this inquiry. I'm assisted in this inquiry by Richard Snape, who is deputy chairman of the commission.

As most of you will be aware the commission released an issues paper in June, setting out the terms of reference and some of the initial issues. The inquiry covers Parts XIB and XIC of the Trade Practices Act, and various part of the Telecommunications Act. The commission is requested to aim to improve the overall economic performance of the Australian economy in its considerations. A copy of our full terms of reference is available just outside the room.

I'd like to express our thanks, and those of our staff, for the courtesy extended to us in our travels and deliberations so far; and for the thoughtful contributions that many of you have made already in the course of this inquiry. These hearings represent the next stage, to be followed by supplementary submissions to be provided by 29 September. A draft report will be issued by early next year, and there will be an opportunity to present further submissions and attend a second round of hearings, based on that draft report. The final report will be provided to government in June 2001.

I would like these hearings to be conducted in a reasonably informal matter, but I remind participants that a full transcript is being taken and will be made available to all interested parties. It will be posted to our Web site within about three days of each of the days of hearing. At the end of the schedule hearings for each day I will provide an opportunity for any persons present to make a brief oral presentation, should they wish to do so.

I would like to welcome to the hearings our first participants, from Telstra. For the record, please, could you state your name and the position that hold.

MR AKHURST: My name is Bruce Akhurst, and I'm the group managing director of legal and regulatory.

MS SHIFF: I'm Deena Shiff, director, regulatory.

DR PATERSON: Paul Paterson, group manager, competition.

PROF WOODS: Thank you very much. Do you have a submission that you wish to make available to this inquiry?

MR AKHURST: We do.

PROF WOODS: Thank you very much. Would you like to make some opening comments.

MR AKHURST: Thank you, and thank you for providing an opportunity to appear before you and this submission on behalf of Telstra. I'm going to outline Telstra's general position before the review, and I'll ask my colleague, Deena Shiff, to make some further comments with regard to operating experience we've had with Parts XIB and XIC.

In broad terms, the purpose of the review is to consider the current level and future prospects of competition in the Australian telecommunications industry, and the value to the public of retaining industry-specific competition rules. Specifically, that includes, the alignment of industry specific rules with general competition law, particularly Part XIB. Part XIB was added to the ACCC's existing powers under Part IV because of a concern about the need for a transition, from managed regulation under Austel during the 1989 to 1997 period, the infant industry period of regulation, to open market competition under the ACCC. The concern was that the change would be too sudden and new competitors may have their entry or expansion blocked during the transition to an open market, this last stage of market liberalisation. Telstra's view is that the current level of market competition speaks for itself. Whatever the virtues or criticisms of Part XIB in the past, the undeniably fierce competitive market means there's no role for Part XIB into the future.

The terms of reference also include a review of Part XIC, and other industry-specific rules providing an opportunity to improve upon their operation. Telstra acknowledges the need to maintain an access regime to ensure competitive access to bottleneck services, either through the retention of Part XIC or some other regime. However, a clearer line needs to be drawn between largely essential services and services in markets that should be treated like markets in other part of the economy.

This review requires an analysis of the industry two to five years out, or longer. It will be a period of enormous technological change for everyone in the industry, not the least the consumers who will face a new world of service offerings which will fuel exploding customer expectations. If industry specific regulations were inserted to protect competitors over the last few years, then looking forward, the Productivity Commission's review should be biased in favour of placing greater emphasis on the competitive process itself. In particular, policy attention needs to turn to promoting investment and investors, because that is the key to meeting consumer expectations in the future.

Let me turn briefly to the current state of the competitive market in Australia. In the words of ACCC chairman, Prof Allan Fels, Australian telecommunications has come a long way from a time when "the industry was dominated by a single vertically-integrated incumbent with enormous market power". Prof Fels told this year's ATUG industry conference in Sydney:

> Less than three years later, 37 licensed carriers are operating in the market, together with dozens of carriage service providers, and hundreds of Internet telecommunications operators. Most Australians now have a choice of at least

two operators for their long distance, international and mobile calls; and competition is now emerging in local calls and data services, as well.

In short, the ACCC rejoices in the number of rivals who are able to compete against Telstra in every market. Whether or not they choose to do so is a separate issue for the commission to consider.

As a result of the infant industry protection period, which facilitated Optus's national network roll-out as a duopoly carrier, Telstra faces another vertically-integrated incumbent, with a national network and a satellite footprint across rural Australia. In fact, Telstra now faces a number of vertically and horizontally integrated competitors, with market power that can be leveraged from adjacent markets. For example, AAPT is owned by, and co-marketed with, Telecom New Zealand, a vertically-integrated incumbent in the New Zealand and trans-Tasman market.

Telstra's major competitors are subsidiaries of larger, foreign multinationals, and are, in many cases, larger than Telstra itself. This applies to Vodafone, capitalised at $431 billion, compared with Telstra's 91 billion; Cable and Wireless, parent of Optus, 69 billion; Hutchison Telecommunications, 109 billion; and AAPT/Telecom New Zealand, 10.1 billion; and Vodafone is part of one the largest companies in the world.

Other competitors, such as One.Tel (a subsidiary of the News Corporation and PBL), Davnet (a subsidiary of NTT Japan, worth $317 billion), and MCT, have all enjoyed tremendous access to capital. Accordingly, the proposition that inspired the introduction of Part XIB, that Telstra could successfully predate and drive competitors out of market, is implausible. Further, any attempt by these large established multinational operators to present themselves as small or start-up operators can only be seen as being calculated to mislead the public and the commission.

Telstra faces competitors with tremendous global-scale economies, notably in Internet and IP backbone networks. In contract to earlier periods of market liberalisation, the present market is characterised by a good deal of differentiation in the functional layers of the market. Telstra has chosen to compete in the wholesale layers, both domestically and internationally, and it's experiencing revenue growth in this sector not matched by its traditional markets. Increasingly, Telstra's financial incentives are heavily weighted in favour of access and wholesale service provision.

Market dynamics. Telstra has lodged in its submission extensive evidence on market dynamics and market entry, offering, in its view, irrefutable proof that it's not dominant in a legal or economic sense in any downstream market within which it operates. These factors also speak for themselves. Telstra has lost substantial market share in mobiles, in STD, in IDD, and even local calls, and has won back market share in some instances. This is what competition should be about. There is fierce competition across all Telstra's traditional services sources of revenues.

In contract, I'm sure the commission will be treated to market share figures, selectively limited by our competitors, to describe the dependence of others on Telstra's fixed customer access network**.** This dependence is largely self-imposed by the competitors, and is in itself a function of the regulatory controls and access pricing arrangements that have been introduced in Australia, that actively discourage bypass investment. When our competitors here today complain about the unfair high price of unconditioned local loop and PSTN access, I hope they'll be asked to explain why they haven't built their own networks to compete against Telstra at the wholesale level, and make some of that alleged unfair high price for themselves.

In relation to investment, it's clear that Australia suffers from very skewed patterns of investment in the fixed network as a result of regulatory distortions. Telstra's competitors, even when they have their own networks, have only really offered access and local call services on their own networks in the CBDs, while relying on regulated access to Telstra's network to provide services elsewhere. This pattern of investment simply cannot continue if the government wishes to improve service quality and data capability in rural Australia, because this social priority means substantially increasing investment in the customer access network.

This pattern is remarkable when it's contrasted with developments overseas. In the UK, for example, alternative network access is now widespread. Even in New Zealand, where population density is relatively low, the development of alternative access networks has outstripped that in Australia, with Clear setting up networks in relatively small centres, such as Christchurch, and Saturn, in joint venture with Telstra, committing to an extensive roll-out of competing local loop. As the draft report of the New Zealand ministerial inquiry into telecommunications notes:

> A significant proportion of the population, at least two-thirds on the basis of current roll-out plans, are likely to be the beneficiaries of fixed-loop competition within about three to five years.

It is surely striking that the roll-out plans announced by Telstra's competitors in Australia are far more limited in scope, and that the access prices have been set at a level that has deterred bypass investment. Looking to the future, Telstra must compete with competitors unburdened by legacy technologies, using packet-switched IP networks and leveraging content as part of their overall mix of offerings.

Finally, and most significantly, as a result of the effects of years of competition and of Part XI(C) regulation of the local loop - regulation of which we see remaining into the future - Telstra has few remaining advantages from its ownership of its customer access network, the fixed last mile to its customers. In fact, this legacy network is a huge drain on capital and resources, because of the need to replace this ageing and outdated legacy copper network at the cost of many billions of dollars into the future, to improve service quality. In addition, the clearest message revealed by the Besley Inquiry is that customers want a much greater service performance and

capability from their copper network. Meeting these mounting aspirations also requires massive investment to replace or extend the copper network.

Now, Telstra is subject to conflicting public policy demands. This pressure comes from the government on the one hand, and from the ACCC on the other. From the government comes pressure to increase investment in all areas, whether economic or uneconomic. At the same time, the ACCC prices access to the CAN, or unconditioned local loop, at assumed hypothetical costs that bear no relationship to the realities of service provision in Australia, and ignores the backdrop of social expectations and the investment burden that accompanies the national USO provision.

The result of this combination, of industry regulation, is to create a kind of investment black hole, where any amount of shareholder investment is drawn in by the gravity of consumer demands, but regulatory decision-making ensures will never see any return on that investment. This regulatory funding gap, between the need for investment and the lack of the return required to find it, is principally due to regulators ignoring real-world costs of meeting regulated service requirements when determining access prices for competitors. It's unfair to shareholders, which are in effect forced to subsidise competitors, and destructive to investment, by both Telstra and rival carriers, whose incentive is to use Telstra's network rather than invest in their own competing networks.

It's also unsustainable in a fully competitive market, because there are no uncontested markets to cross-subsidise investments in uneconomic areas. Accordingly, under the current regime, the only available response for Telstra is that the customer access network be placed at arm's length, so that ultimately all the assets and costs of that business are quarantined and rendered more transparent; and this is in fact now our intention, and we're moving down that path. As a result of this restructuring, there should be no material issues arising from vertical integration of concern to this inquiry. Telstra's retail operations will be transparently accessing the CAN on the same basis as access seekers. Also, the true costs of CAN investment should be fully transparent.

In summary, Telstra is facing an unprecedented level of competition in all product markets. It's a sign of the health of this industry. Against that, some competitors will, no doubt, attempt to use these public hearings to perpetuate ancient myths about Telstra, as the vertically integrated dominant incumbent. But if these claims to be anything more than public mud-slinging, then they'll need to be backed by facts that are, on the one hand, compelling and yet, on the other, capable of forming a case that anything other than the general provisions of the Trade Practices Act should prevail . Otherwise the arguments will be seen as self-serving, emotional rhetoric designed to extend the competitive shelters competitors have flourished under since the market was opened to full competition.

I will now turn to Deena Shiff, and ask her to provide some further details on the operations of Parts XIB and XIC.

MS SHIFF: Thank you. First, I would like to make a number of general observations about the extensiveness and dilemmas of industry-specific regulation, and then turn to, in particular, some of the problems with the overload on Part XIC, and then go back to first principles and the strengths of the present regime, and try and draw out some of the principles against which reform should be based.

In relation to the extensiveness of regulation, Telstra faces more regulation across more of its product sets now and into the future, surprisingly, than it did prior to 1977, when it was part of a duopoly. That is, regulation overhangs the most competitive markets and parts of markets, notably mobiles, Internet, digital, media, broadband, and new infrastructure provision. This phenomenon operates as a tremendous brake on new investment and service innovation, exacerbated by the fact that Part XIB and Part XIC of the act, and all the accompanying apparatus of regulatory controls, in the shape of record keeping rules, tariff obligations - - -

PROF WOODS: Would you mind speaking more clearly for the record? It just wasn't picking up the volume. It's not amplification for the audience, it's only for transcript, it's not amplification. Thank you.

MS SHIFF: This phenomenon operates as a tremendous break on new investment and service innovation, exacerbated by the fact that Part XIB and Part XIC of the-act, and all the accompanying apparatus of regulatory controls - in the shape of record keeping rules, tariff obligations, etcetera - have no effective safe harbours, pre-clearance provisions, no effective exemption process in particular; offer no mechanism to achieve any certainty as the effects of potential access pricing on new forms of infrastructure investment before the investment is committed. In other words, Part XIC is cutting most deeply in relation to those services, even though they're far removed from Telstra's monopoly past.

Secondly, just to reiterate what Bruce said, Telstra supports the retention of Part XIC, or some version of it, based on Part IIIA to deal with access to bottleneck services. It's therefore our expectation that access to the PSTN and the unbundled local loop, the legacy network, will continue to be regulated in some way. However, what is evident is that the manner in which these access services are currently regulated is not working in the interests of consumers and operators or in the way we believe was intended by legislators.

Notably, the legislative criteria in relation to how access prices should be set are so broad as to offer no clear framework for the ACCC. The ACCC has filled this vacuum with its own guidelines, which have offered no effective method of resolving commercial disputes quickly or fairly and has sewn the seeds for many disputes. The practical application of TSLRIC has proven to be one of the great problem areas of regulatory decision-making in Australia, with the ACCC's nearer model open to widely differing outcomes as it has come together over the last two to three years, depending on the modelling assumptions that are fed in. To this day, Telstra has great difficulty reconciling those modelling assumptions with how TSLRIC

modelling is applied elsewhere in the world. The same network modelling controversies that bedevilled PSTN pricing now infect ULL pricing.

It's not fair to blame this three-year history on Telstra. Likewise, it's deceptive to claim that Telstra has somehow taken advantage of the situation by offering access prices four times those of the final offer, which I think is one of the claims that is being made. We have seen some fabulously incorrect statements about access prices in a number of the submissions. In relation to PSTN undertaking, Telstra's 3.6 cents offer in 1997 is entirely comparable to its offer of 2 cents in 2000, as contrasted to the ACCC's final decision of 1.5 cents in 2000; Telstra's differences being attributable to the changes in traffic volumes over the period. In other words, the variation in pricing is a result of traffic growth and, hence, declining unit costs.

Telstra also despairs at the number of arbitrations that are lodged and particularly at the time it takes for the ACCC to make a pricing decision in an arbitration. This appears to be due to a number of factors: the access pricing uncertainty that I've spoken of; the availability of interim determinations; and the perception amongst access seekers that arbitration would generate a lower price than that on offer commercially.

It's notable that since the ACCC has been able to backdate arbitration decisions and make interim determinations, the number of arbitrations before it has ballooned, and we find it more difficult to come to closure with those access seekers who clearly believe they'll get a lower price from the regulator. We estimate 18 access disputes were lodged in the 23-month period between July 1997 and May 1999. In contrast, in the 14-month period between June 1999, when the 1999 amendments came into effect, and August 2000, the number of number of new arbitrations has exploded to 25, and continues to grow.

Many of these disputes do not involve Telstra at all, nearly half of them. Most importantly, in only one arbitration has the ACCC made a final - that is, reviewable - decision. In that case, the ACCC found in Telstra's favour, against Optus. Not a single arbitration on access prices to date has resulted in a final determination. A good proportion of those cases have been in arbitration for over a year. So while Telstra may be accused of contributing to delay, it's important to note that nearly half of the arbitrations and many of the longest-running arbitrations do not involve Telstra at all. For example, the ACCC has still yet to decide disputes lodged by AAPT in June 1999 against Optus in relation to domestic PSTN originating and terminating access, and further disputes lodged by AAPT in July 1999 against Optus, in relation to GSM originating and terminating access.

Where Telstra is a party, delay is under the control of the ACCC, which, for the most part, has already been informed about Telstra's pricing methodology well in advance of offers to access seekers. In every case, a rapid final determination by the ACCC would have led to the price being accepted or challenged as it was envisaged by the legislators, by reference to the Australian Competition Tribunal. Challenge is not possible until the ACCC makes a final determination. So, without an ACCC

final determination, the dispute cannot be appealed to the final arbiter and finally resolved.

In effect, by limiting itself to interim determinations, the ACCC may make decisions which are binding on the parties but are non-reviewable. By limiting itself to interim determinations, in other words, the ACCC's power is like the power to make interim determinations themselves, sweeping in scope, unfettered by statute, even the long-term interest of inducer's test and incapable of judicial merits review. This strikes us as an unsatisfactory way to resolve disputes and is simply not the vehicle by which we want to deal with our wholesale customers or suppliers; that is, when we acquire imports off others, which we do frequently, as an access seeker.

Turning to the prospects for the future, we submit that to be successful, and having particular regard to Australian regulatory conditions, a telecommunications regulated access regime needs to:

Firstly, restore incentives to negotiate, whether on price or non-price terms and conditions; that is, restore the balance away from arbitration, in favour of commercial negotiation. Part of the answer to that may be through greater certainty in relation to access pricing or the envelopes for negotiating access prices;

Secondly, it needs to allow its self-regulatory processes to continue to mature. The ACIF has, in Telstra's view, been the outstanding success story of access regulation in Australia and its processes are being studied by regulators from the UK to Singapore;

Thirdly, it's important that service providers competing in the same downstream markets are dealt with on an even-handed basis; and,

Fourthly, it's important, because of the skewed nature of investment that we've spoken of, to restore incentives to invest, where investment is most desperately lacking.

Just illustrating some of these points, in 1997 the move from duopoly to multicarrier environment required the translation of operational processes, such as churn from Telstra and between other carriage service providers, local number portability, and pre-selection from bilateral to multilateral processes. Some huge tasks have been surmounted in the ACIF, included the establishment of processes and procedures to deal with ULL; and these processes have been achieved in Australia very fast by world standards.

In this environment, however, disputes will invariably arise between carriers and carriage service providers accessing each other's networks. These are not always market power issues and all roads do not lead to Telstra. However, the effect of vesting such wide XIB powers in the ACCC has resulted in an increasingly asymmetric administration of the rules and their use in circumstances that are either unrelated to market power issues or Telstra's monopoly past. These are being used as

a substitute for Part XIC solutions; and Part XIC hasn't been made to work properly. For example the ACCC, armed with its Part XIB powers, when presented with a problem, tends to accuse Telstra whatever the cause of the problem.

In a recent case, an interconnecting carrier failed to correctly forecast demand which resulted in their failure to obtain sufficient capacity to meet their customers' needs. The ACCC has threatened that unless we are able to get the other carrier to agree to our commercial terms, which they concede are reasonable, we, not the other carrier, will get a competition notice. By the same token, if Telstra has a problem with interoperability on another carrier's network then Telstra's customers are left without a remedy as a result of the asymmetric bias of the administration of the regulations.

Consider, for example, mobile origin location information, or MOLI as it's called. This information is required to correctly terminate calls to origin dependent routing services such as 13 numbers. These number provide a national service and are commonly used by franchised businesses so that their customers can dial one number anywhere in Australia to get the local outlet. Problems can arise if the location of the caller on a mobile telephone can't be identified. For example, a Townsville resident using a mobile telephone to call a Pizza Hut 13 number may be switched to a Pizza Hut in Brisbane when in fact the caller wants to speak to a Townsville Pizza outlet.

When Telstra introduced the 13 service in 1995 it sought MOLI from Cable and Wireless Optus and Vodafone. Vodafone agreed to operate the service but Optus refused to supply it. This is because the Optus mobile network was unable to support MOLI for its mobile customers calling our 13 customer service. Cable and Wireless's refusal has really harmed many of Telstra's 13 customers, especially taxi operators. Cable and Wireless Optus still has only provided MOLI for one taxi operator's 13 number, this is since we've been asking in 1995. The ACCC has not used Part XIB against Optus.

Similarly, the ACCC increasingly shows a capacity to confuse competition enforcement functions with helping competitors who complain a lot. This is a dangerous direction for a regulator to head. By preventing Telstra from competing successfully, the ACCC can place itself in the position of harming the competitive process rather than defending it. However, this capture problem is becoming increasingly pronounced even as, or perhaps because, the number of competitors grow stronger. For example, having the ACCC act like a poacher than a gamekeeper in industry self-regulatory forums such as TAF and ACIF will create problems if the ACCC creates heightened expectations and extends disputes by disturbing emerging industry consensus by siding with individual players, and we have seen examples of that.

The need to deal even-handedly with like problems of carriers interconnecting into each other's networks is exacerbated by the rules themselves which impose artificial boundaries between conduct or access issues in converging downstream

markets depending upon whether the upstream supplier is a carrier operating a telecommunications network or not. As market boundaries between broadcasting and telecommunications merge these problems will become more pronounced. By way of example, broadcasting networks are exempted from Part XIC yet inconsistencies of treatment will intensify as digital content and application provided via set-top boxes by broadcasters are regulated entirely differently than like services offered by telcos.

Against this backdrop, and in relation to the specific matters under review, Telstra submits firstly, that Part XIB is a dinosaur provision, it was designed to be transitional and the transition has occurred. It's being used extensively to deal with multicarrier issues for which it was simply not designed. Despite having the evidentiary threshold lowered and the ACCC's powers extended in 1999, breach of the competition rule by Telstra has never been established despite the issuance of notices in relation to Internet peering and commercial churn and even where those notices have been issued a more effective injunctive remedy was obtainable under general competition law. The sole difference in practice, between the two mechanisms, is that Telstra, under Part XIB, is liable to draconian potential penalties before the matter is heard by a court, and the ACCC is not obliged to go to court to establish its case quickly. In Telstra's view Part XIB should be repealed.

In respect of Part XIC we believe it's in need of urgent overhaul: to insert sunset provisions into outdated declarations and to remove some of this overload on the system; to exclude convergent markets from its scope of operations or to harmonise the treatment of operators and service providers in convergent downstream markets; to introduce more effective provision dealing with undertakings; to provide safe harbour for new investment; and to rewrite the access pricing provisions to give greater certainty to the industry and restore the ability to negotiate commercial outcomes.

Telstra recognises that its competitors will assert that conditions are not yet right for a move away from infant competitor protection. Telstra believes that the Productivity Commission should not find this surprising as sheltered infants have never in the Australian experience been supportive of changes that would erode their ability to secure further subsidies and support, nor will it be surprising if the regulators, whose power is maximised by retaining the current arrangements, endorse the need for such arrangements. Yet in summary, many of the complaints, the issues of perceived delay or unequal treatment, as between Telstra retail and other access seekers, will be removed as the internal accounting separation and contracting relationships between Telstra wholesale and Telstra retail are put in place. That process will occur during the life of the Productivity Commission inquiry.

To the extent that there will be persistent disputes or conflicts arising from multiple carriers seeking inputs from each other, Telstra strongly believes that Part XIB exacerbates these conflicts rather than being crafted to help provide solutions and settle disputes. Clearly, improving the framework of dispute resolution under Part XIC would go a long way to doing the work that is presently being required of Part XIB. Thank you for the opportunity to raise these issues.

PROF WOODS: Thank you very much. If I can just clarify: we have a submission before us of some three pages, it makes reference to various sections and refers to, that the detailed matters be commercial-in-confidence. Will you be developing a submission that can go on the public record that spans most of the material envisaged in your references to sections 1 through 4?

MS SHIFF: Yes, we will be placing a more detailed submission on the public record, and indeed we'll be placing a further submission to deal with some matters that we were unable to deal with in the first submission that we haven't spoken about today, such as, technical regulation standards and LMP.

PROF WOODS: Thank you very much. Mr Akhurst, I notice you are giving an overview of the industry, and the submission says that the current telecommunications market in Australia is extremely competitive at all levels. Is that your considered view that competition is extremely active at all levels of the industry?

MR AKHURST: That's correct, yes.

PROF SNAPE: Could I refer you to the Optus submission, there is a table in that where it refers to the national long distance, Telstra market share 75 per cent, local access 86 per cent, international 48, mobile telephony 48, Internet access 50, subscription 50. Do you accept those figures?

MS SHIFF: No, but we will be putting our own version of those figures into the public domain. But I think what's important, there are two things that are important to note at this stage. One is that, the actual market shares are obviously not stable and move around quite a lot, and that what is more important to look at when you look at the total number, is the total number of customers who are moving from Telstra to other carriers and back again. In other words, you can't condemn Telstra if it competes successfully by winning back market share. What's important is how many customers are being won over and back in the market as a whole, which is quite significant.

The second point that we make in our submission is that, even though the market dynamics for local calls have been very strong in the past year, the underlying structural conditions for access - that is, the wholesale layer of the market, the market shares of which are being quoted there - are distorted by the way in which access pricing has had an effect on patterns of investment. In other words, we would have expected to have seen much more wholesale based competition to our local loop over this period of time, consistent with what we see in New Zealand, Sweden, Finland, the UK, the US, where you tend to see a lot more infrastructure investment in the customer access network occurring.

Our proposition is that the high levels of market share that we have, in relation to the customer access network, is a function of the distortions of the regulations themselves, rather than telling you something about other market dynamics.

PROF WOODS: I would like to pursue the question of competition at the facilities level in non-CBDs in a minute. If we just pursue this question of the level of market power, wouldn't it be reasonable that, in fact, market share may understate Telstra's market power, given that, for virtually every service provided by others who have obtained some market share, that in fact they must connect one way or another into facilities that are operated by Telstra, and therefore the market power that you operate would, in fact, be greater than the market shares that are evident in these figures.

MS SHIFF: They have to connect. For example, take international where our market share is relatively low, or take STD for that matter; they, as you will know from the earlier inquiry into international services for the international component, have to interconnect with an originating carrier in the US; they have to make arrangements for the carriage of the call, if necessary, internationally and for the domestic termination overseas. That's just part of the input costs of providing an international service. It hasn't stopped price competition from being furious in international calls. Prices have dropped dramatically.

As far as STD is concerned, the origination and the termination is focused within the Australian market, but the terms of accessing those customers has been, in the case of Optus, regulated since the early 1990s, by way of override or preselection, and then with the open market, for all carriers, through multi-carrier pre-selection. So all the physical terms of accessing the customers who are physically connected to our network have been resolved, and will continue to be in place. I'm not quite sure what sources of market power you refer to.

MR AKHURST: All elements of our business are contestable, so people can come in and use those elements, just as in the international arena Deena has just referred to.

PROF WOODS: I would like to pursue that a little further in a moment, but if we can just stick with these questions of the broad market activity. You seem to be acknowledging that there have been significant gains to Australian end-users of telecommunications services over the last near decade, and particularly over the last three or so years. Doesn't that, to some extent, suggest that the regulatory environment that we have had has played a part in creating that success?

MR AKHURST: Very much so. We support competition, and we support an access regime. We're not suggesting there should not be those things, and we think, clearly, Australia has benefited from that, as has Telstra, and as have the other participants in the market. What we're suggesting now is that subsidised entry by our competitors is a problem in terms of longer terms investment and where telecommunications goes for consumers in a medium to longer term.

PROF WOODS: In fact, in your introductory comments, Mr Akhurst, quoted the chairman of the ACCC, who was giving numbers of carriers and carriage service providers, but I notice in their submission to us, they talk about the market power of Telstra, combined with the development of oligopolistic features in some markets, warrants the retention of strong anticompetitive conduct provisions, and expands a little further on that. Now, there seems to be some different perspective that that submission to us offers, compared to the position that you are putting.

MR AKHURST: That's correct. We don't agree with that.

PROF WOODS: Particular points of difference with the ACCC on that that you want to elaborate on?

MS SHIFF: I think it's up to the ACCC or any other submitter to say why Part XIC has contributed to favourable market dynamics, and what has contributed to favourable market dynamics is an open entry policy, and access to bottleneck facilities.

MR AKHURST: Not XIB.

MS SHIFF: Not XIB. XIB, in our submission, has basically tended to be used by competitors who were complaining because their margins were being squeezed in fiercely competitive parts of the market.

PROF WOODS: On this question of market power, then, if we can just pursue it a little further: submission 2 to the inquiry, which constitutes your letter to me of 12 July and my response the day following, you say that Telstra would forcibly argue that:

> While it is the largest carrier in Australia, it is often the largest supplier in individual service markets. It does not have substantial market power in most of those markets.

Which ones does Telstra have substantial market power in?

MS SHIFF: I'm not sure that we can say. We certainly wouldn't have substantial market power in relation to long distance, domestic or international, we would submit; or in relation to mobiles, in relation to Internet. The problem is much more complex when you look at local calls, and that's because, as you would appreciate, the extensiveness of price competition there has been derived from the ability of competitors to subsidise their pricing outputs from other services. We ourselves are offering wholesale services at retail rates that are below the long-term costs of supply.

Whether that's a function of the regulatory system and the interaction of the price controls and the access arrangements, or whether it's a function of market

power, is a difficult question. We would submit, quite forcibly, that it's actually a function of the interaction of the regulatory arrangements that are in place.

PROF SNAPE: That even the local retail rates are not covering your costs?

MS SHIFF: The ACCC's calculation of the forward-looking costs of a local call would place it at about 22 cents, and the access prices have been set well below that.

PROF SNAPE: A moment ago I thought you said that, even at your retail rates, you are not covering costs?

MS SHIFF: Sorry, I meant the wholesale rates, but the retail rates are also problematic, because if we follow down competitors who are subsidising from other sectors, we are being forced into that situation.

DR PATERSON: The figure 22 cents is the wholesale cost of providing that service. It doesn't include retailing expenses that we incur in providing that service. So with our retail price capped at 22 cents, then clearly we're providing service below cost.

PROF SNAPE: Thank you.

PROF WOODS: You actively promote the removal of XIB and reverting to the general provisions in the Trade Practices Act. Is there another way of looking at that section to try and define which components or aspects of the telecommunications market it should apply to, or is that not a feasible option? At the moment, it refers to the telecommunications market generally.

MR AKHURST: I think our view is that the section 46 provision that deals with market power across all of the economy should be the one that's relied upon. If there is market power and it's being used for anticompetitive purposes, then that's the provision which should be used, as it applies to every other industry. There is no need for XIB which is all about lower levels of proof and draconian penalties.

PROF WOODS: All right. Anything further on XIB at this point?

PROF SNAPE: You want to come to investment in a moment, do you?

PROF WOODS: Yes.

PROF SNAPE: Okay.

PROF WOODS: Let's pick up some of your commentary relating to facilities investment, and what I understand you're saying is that the regulatory regime should be structured so as to promote facilities-based competition. Is that the general thrust of your point in that area?

MS SHIFF: The thrust of our point is that where competitive outcomes seem to be less than what they might be, it paradoxically seems to us that it's because regulation is inhibiting investment in precisely those areas of the market, particularly access networks and particularly access networks outside of CBDs in metropolitan Australia.

PROF SNAPE: We have a tension here, don't we? I mean, if there were no access provisions at all then of course a competitor would have to duplicate some facilities. It may be quite uneconomic from a national point to do so, and some people point to the duplicated roll-out of a broadband for pay TV, and it's exactly that, whereas if in fact there had been an access provision from the beginning of any roll-out of pay television cable we may have, so some people argue, saved billions of dollars for the country; moreover, perhaps, had more investment than we do at the moment.
MS SHIFF: Let me talk to that issue because it's something that concerns us quite deeply, and that is, when you look at what is happening to customer expectations and to the need for servicing investment in Australia coming out of the Besley Inquiry, it's basically to have much higher data speeds and service quality than the customer access network, the good old kind of legacy copper network, was designed for in the first place. So as an investor Telstra looks at that situation and has to decide between a number of competing technologies that are out there, which may or may not be appropriate to deal with that future investment situation.

We can pour lots and lots of money and sort of replace the CAN in its entirety. We can accept the fact that the copper network and all the derived technologies, such as ULL and ADSL, are not going to actually achieve higher data speeds for a significant proportion of the population, especially a population outside of metro Australia, and on long cable runs, or we can go for an alternative technology such as wireless local loop, satellite, LMDS, third generation sort of mobile.

We don't know what the answer to that is. It isn't like it's one bus and you can have two buses running down the same street, or one pay TV network and two HFC networks down the street. It strikes us that what the ideal situation would be that people go out there and they provide their technology of choice in areas where they think they can make a go of it, and that ultimately the market will sort out amongst these diverse possibilities - DSL fibre to the kerb, wireless ADSL - what the best technology is. But at the moment what we're seeing is just a paucity of investment and it's very unrepresentative of the situation in other OECD countries.

I mean, in the US you've got a variety of technologies supporting high-speed data access, telephony, Internet - you name it - subscription television over a variety of transmission media. In Australia the customer access network needs to be duplicated, it needs to be experimented with. That does not ascribe a natural monopoly in large part.

PROF SNAPE: But the use of almost identical technologies, or extremely similar technologies, for pay television then, and duplicating it, essentially with two buses running down the same street with the virtually identical technology is a historical

accident that was due to there being not enough alternatives technologically at that time, rather than the absence of access being declared on it?

MS SHIFF: I think if we were rolling out pay TV today we would have a lot more technology platforms to choose from and would have perhaps placed more emphasis on non-terrestrial, non-fixed network technologies. I mean, this is a very technologically dynamic industry.

PROF SNAPE: So it is a historical accident?

MS SHIFF: It's not an accident; it's a creature of history that, at that time, those were the technologies.

MR AKHURST: And also it's important to recognise we're not saying there should not be an access regime. There should be an access regime. It's question of what the price for use of somebody's investment should be set at, and at the moment we say we're not recovering our costs for use of that, which deters investment. It deters investment by the incumbent and it also deters experimentation in new technologies; and duplicative, if that's appropriate in particular circumstances.

PROF SNAPE: That we do have a balance, don't we?

MR AKHURST: Correct.

PROF SNAPE: We came in on this, and I mean it's not a matter of saying no to access regime because it deters investment, because - - -

MR AKHURST: Yes, that's right.

PROF SNAPE: - - - you don't want that duplication of investment.

PROF WOODS: We don't want wasteful investment.

DR PATERSON: I think the basic tenet we make in our submission is that alternative investment is efficient when others can provide service at lower cost than Telstra. Our complaint with the current regime is that those right signals don't get through; that is, it's quite feasible that an alternative service provider could, through its own infrastructure, provide service at a lower cost than Telstra. However, they would not be incentived to provide infrastructure if our excess price are below cost.

PROF SNAPE: How does a regulator test that? Because if one is in fact deciding whether to place an access regime in, one then has to decide what the costs of the competitor are, and you've been criticising the use of hypothetical costs. That's exactly what the regulator would have to do in order to make the decision that you're asking the regulator to make.

DR PATERSON: That's not how we'd see it, deputy chairman. The way we would see it is that the price that should prevail is the cost that Telstra incurs on an efficient forward-looking basis, but the cost that we would incur in providing service. Competitors themselves can then ascertain whether they can provide service at lower cost and, if so, it makes sense for them to provide their own infrastructure and provide service in that way.

PROF SNAPE: Only Telstra would have - this comes to the heart of much of it, doesn't it? It's asymmetric information. Who has that information; only Telstra.

DR PATERSON: I think, again, with respect we'd beg to differ in that regard. In our submission we'd point out that many of our competitors come from very large multinational companies that are very experienced in providing service around the globe. In that sense we believe that they have a good feeler and can identify what their costs would be; as is demonstrated in the various submissions they've put in on access pricing issues, where they profess a high degree of knowledge of what are appropriate costs.

PROF WOODS: Perhaps we could explore this conversation by breaking it into, for simplicity sake at least, two types of markets: one is the CBD and the intercity trunks markets versus metropolitan/suburban, and rural/regional as a separate one. If we take the first and you use the phrase, Dr Paterson, "of where others can provide at lower cost than Telstra", is the extensive roll-out of fibre optic by a number of players now both between and within CBDs therefore a reflection of them able to provide that at lower cost to you? Is that the conclusion that you come to from your proposition?

DR PATERSON: I believe that that's part of the story, that they've got that understanding; that they can roll out and provide service at a low cost by providing their own infrastructure.

In terms of CBDs and providing telecommunications service, there's another critical driver at play here as well, and that's the constraints that we face in terms of our local call pricing, and the fact that we need to go with an averaged price because we're capped in our local price. So we're offering an average price for local calls, which means we can't price low in low-cost areas, and high in high-cost areas, but rather an average price, which gives a significant arbitrator opportunity. I think that factor is also at play in that decision to roll out infrastructure in CBDs.

PROF WOODS: But you would agree it's becoming a much more competitive market, with significant replication of facilities, both for trunk fibre optics and within CBDs.

DR PATERSON: Indeed.

PROF WOODS: Where, then, would you consider that there might be natural monopoly. Is it the customer access network in rural/regional areas or outer suburbia, or do you see even those as not representing any form of natural monopoly?

MS SHIFF: No. I think it's important to distinguish between less profitable and uneconomic, and what we see is that less profitable areas, where you would expect to see investment, has been starved of investment.

PROF WOODS: What about developments such as, say, TransACT in the ACT, which is rolling out, or intending to roll out, fibre optic towards homes, and then with a copper final connection; and, I think, Cooma is now looking at fibre optic, in fact, to the kerb. Are there other examples of this that you're aware of?

MS SHIFF: There is; there's a bit of - there's neighbourhood cable and various other investment roll-out in high population areas in major towns. So where the tele-densities are very high you're starting to see a small amount of this, but it's not anything like the scale of what you'd see overseas.
PROF WOODS: Do you envisage, though, that it will develop?

MS SHIFF: Not if the current regulatory arrangements persist.

PROF WOODS: And yet, within the current regulatory arrangements some have perceived that there is an opportunity.

MS SHIFF: In very selected high population density areas.

PROF WOODS: Australian suburbs are probably the most spread out in the world, and overseas comparisons may or may not be relevant in this case.

MS SHIFF: Sweden and Finland and New Zealand have areas of very low tele-density, and yet we're seeing high levels of investment.

PROF WOODS: Yes, but in rural areas rather than in suburban areas.

MS SHIFF: I mean, I can take that on notice and give you more information on that, but - - -

PROF WOODS: Pursuing this issue just a little further, if we take TransACT as an example. A new suburb is developed in Canberra, and TransACT chooses to roll out its fibre optics, and then to provide a copper connection - I think it's intending multiple pairs of copper to the home, so that it can access data and provide a basic telephony that has battery back-up to meet emergency service standards and the like. What will Telstra's action be in those respects? Will you still then go through and duplicate your facilities in those suburbs so you will cover all homes irrespective of whether there already exists a network that you can have access to. I understand it's not intending, apart from telephony, to provide any other services in itself, so that it

will offer a price to all participants who may wish to utilise facility. But you will be duplicating in all respects in every case?

MS SHIFF: We've got an existing copper network - - -

PROF WOODS: No, I'm talking new green field suburbs.

MS SHIFF: In Canberra?

PROF WOODS: In Canberra. TransACT declares that it will build its cable, including copper paired telephony, to the home from its fibre optics. Would your approach be to duplicate that facility?

MS SHIFF: It may well be. It will depend on - - -

PROF WOODS: Depend on what?

MR AKHURST: The interconnect price.

MS SHIFF: How much they charge us for interconnect. We'll still be the USO provider so we'll have to acquire services from them; so it will be their access price to us. It will depend on the normal business case of rolling out infrastructure, but in the ordinary case we would expect to be duplicating that investment.

PROF WOODS: But I think you've highlighted the point that it's access price that will determine whether you make that investment.

MS SHIFF: That's right; just as if we were - - -

PROF WOODS: Presumably others in the industry take exactly that point.

MS SHIFF: That's right. Which is exactly right; so that if we go into a green field site, and the access price on our network is very low, it would be foolish for somebody to come in and duplicate that network. That's exactly right. Somebody else goes in there and the access price is very high, we will duplicate that network.

PROF WOODS: Or if your access price is very high - - -

MS SHIFF: If it's very low, we won't.

PROF SNAPE: For the same technology; and of course technology may not be the same and may have other advantages.

MR AKHURST: That's true, you'd need to look at that.

MS SHIFF: You'd need to look at all of that.

PROF WOODS: That's very helpful. With the local loop, you are identifying that in a number of areas as still appropriately subject to an access regime of some form? You see that as one of the core components of the telecommunications network infrastructure that deserves that level of regulatory treatment?

MR AKHURST: That's correct. I think our complaint is, with the design of the current regime, as Deena outlined, we think there is some modification that's required to make that work more effectively.

PROF WOODS: And being the owner of that facility, does that allow you any first mover advantage in new services by owning the local loop? Is Telstra, with its legitimate business interests, able to maximise the benefit to its shareholders from having that ownership?

MR AKHURST: No; because the way that we deal with our - if you're referring to the retail level of the market, the way that our retail business accesses that network from the wholesale of the infrastructure group that build and operate it, is pretty much the same way as our wholesale competitors would do the same thing, or our retail competitors would do the same thing. So the ordering, the provisioning, the forecasting of services, all those sorts of things, our objective is to treat those on a purely even-handed basis; so we have queues of orders that come in, and forecasts, and things like that.

PROF WOODS: It's sufficiently transparent so that I wouldn't expect anyone else to come to a contrary view on that, that they would feel that the treatment - that they're equally treated to your retail arm.

MR AKHURST: I think you'd have a lot of controversy about that because it is not visible externally - - -

PROF WOODS: Is that part of the problem, the lack of transparency?

MS SHIFF: Yes; yes, it is.

MR AKHURST: Yes, it is, yes; and that is one of the reasons why this suspicion and fear, that this is what Telstra is up to, is why we've separated the company in the way we have, and we're making those arrangements transparent in the way we're talking about them. So if you look historically, we had all the businesses all sort of jumbled up together; now we have moved to separate them in the way I'm describing - - -

PROF SNAPE: Could you just elaborate on that separation, please?

PROF WOODS: Yes, that would be useful.

MR AKHURST: We've basically put our retail businesses together. We used to have a large corporate and government business unit that also dealt with provisioning and servicing customers. We also used to have what was called commercial and consumer, a separate business unit that dealt with the residential customers; and it had its own workforce, and the people driving around in the vans and coming and connecting your telephone network would have been working in that business. Our network and technology group was the group that built and operated the switches, and the major links between the switches higher up in the architecture of the network.

The restructure that we've put in place takes all that service and operating capability and puts it in the infrastructure group which also has now the wholesale group in it, and the retail businesses have been combined together, so they're effectively a sales and marketing function if you like rather than a operation of the network part of the business. So we've separated those two functions quite clearly apart and we're putting these arm's-length transfer pricing arrangements in place that reflect what's happening externally.

PROF SNAPE: Will this be transparent externally?
MS SHIFF: Yes.

PROF WOODS: Could you elaborate on how that would be achieved? How would a competitor feel assured that the price it's getting and the service times and other things are equal to that which are provided to your retail arm?

MR AKHURST: What we're having is a similar system, if you like, to the interconnect regime that exists for our wholesale customers which is done on a contractual basis where the terms and conditions of the interconnection and the price and all of those sorts of things are set out. We'll have a similar set of arrangements, if you like, between the wholesale groups and the retail groups where the ordering and the provisioning and the quality of the network and the commitment to buy and the price that responds to that commitment and the terms of the contract is set out quite explicitly. So in time, as that's developed, that will all be visible.

PROF WOODS: Does that mean you'll be posting prices?

MR AKHURST: I don't know that we've - - -

MS SHIFF: No.

PROF WOODS: I'm just wondering what degree of transparency that you're on.

MS SHIFF: The regulator would have the transparency.

MR AKHURST: Yes, the regulator can have a full view of it, but we haven't got to the point where everyone could come in and audit it or something like that, if that's what you're contemplating.

PROF SNAPE: If we go back from the wholesale - upstream from the wholesale, if you like - are you getting another structural separation between your wholesaling and the construction and the research and development and what have you?

MR AKHURST: The wholesale group, as I see it, is like the sales and marketing front-end of the network, internally and externally.

PROF SNAPE: But in terms of developing the network, that's all in the wholesale package, is it?

MR AKHURST: It is except that, just as wholesale customers might come along to Telstra and say, "We'd like this feature," or, "We'd like you to build this," or, "We'd like you to build that," we contemplate that the retail business might want to do the same thing, and they will have their balance sheet and profit and loss accounts where the risk of that investment lies there rather than it's all just part of the wholesale group. So there will be innovation and development that I think can occur at multiple layers in this business.

PROF SNAPE: Some people might think it looks like structural separation.

MS SHIFF: The one significant difference is that there is nothing in the act; indeed, the act encourages the exploitation of economies of scope. So, what it does enable you to do is to match similarly situated acquirers if they can also achieve those economies of scope. In other words, you don't need to put complex interfaces for particular types of services.

PROF SNAPE: So the walls will be jumped at times?

MS SHIFF: No, no. What I'm saying is that, the difference between a contracting situation at arm's length, which is like quasi structural separation, and full structural separation is that, is that you still can achieve efficiencies of economies of scope.

PROF WOODS: Could you give us some examples? I mean, is ADSL perhaps an example of that; or what examples of economies of scope are you envisaging?

MS SHIFF: There might be a shared database between a retail and a wholesale arm that you can't replicate for - I'm not saying that that is what's happening - between yourself and a third party or you may be able to do it between some third parties and not other third parties. So you get some scope economies and how the configuration works. There may be a greater desire to absorb risk on a take or pay basis by retail and some of your larger acquirers of services. The feature of this is that the differentiation between similarly situated customers is transparent.

PROF WOODS: What happens if there is a technical innovation say in relation to the copper pair though? Does your retail arm get first mover advantage through the economies of scope that you're referring to by being able to develop it and introduce it before others in the marketplace have similar access?

MR AKHURST: I think it very much depends on what the nature of that innovation is. If it's something that the network group has commissioned and worked on for the benefit of the industry and that investment sits on their balance sheet, so they're carrying the risk of that, then that is available to everybody. If the retail group has made that investment and it's for the benefit of their retail customers, then I think that's a different thing.

PROF WOODS: That sounds a little difficult in practice to work out who would have come up with the particular idea, whether it was service driven or technologically driven or some interaction between the two.

MS SHIFF: Not if you've got greater accounting separation and you know who owns the assets and bears the risk.

MR AKHURST: I think the basic point that we've come to is that exposing all of this, what is the cost and what are the prices that are being transferred, we'd quite like that to get out and for people to see that and for the regulator observe it because we don't believe we're hiding anything. So we'd like to make it as clear and unambiguous as possible, while at the same time having the opportunity to benefit from economies of scale for example. If Telstra was able to commit to the wholesale and infrastructure group to take a particular volume of output then we see that maybe they'd get a better price than somebody who buys at an ACCC spot price that is no risk, you can take it or leave it sort of thing.

PROF SNAPE: Would an outsider be able to contract with your wholesale group in exactly the same way?

MR AKHURST: Yes, exactly.

MS SHIFF: Yes, absolutely.

PROF SNAPE: So that they would get facilities - they'd be able to secure the economies that you were just referring to?

MR AKHURST: That's right. Yes.

PROF WOODS: I'm struggling still a little with the concept of transparency that you used three different phrases in your one response of, for the public to see, not hiding anything, but for the regulator to know. I'm just not quite sure where the transparent boundary is in this process, because I understood a previous answer from you was that it wouldn't be the public, ie, other competitors and users, who would see, it is the regulator who would see.

MR AKHURST: Yes, and the public and others would get confidence from that scrutiny.

PROF WOODS: Right. So that the transparency stops at the regulator and then the others have confidence that the regulator can see.

MR AKHURST: That's correct.

DR PATERSON: And in that sense it's - perhaps if I could just make a further point there.

PROF WOODS: Yes, please.

MR PATTERSON: The confidentiality of some of those dealings is seen as important in terms of market mechanisms so that we can actually confidentially and confidently strike agreements with different players in the market without that jeopardising broader bargaining positions across the market. So we believe it's entirely consistent with our commercial approach to have transparency to the regulator and market getting general confidence from that rather than transparency deal by deal, if you like.

PROF SNAPE: But, in your comments before, if I understood them correctly, you were critical not just of the act, particularly XIB, but you were also very critical of the implementation by the ACCC of their powers.

MR AKHURST: That's correct.

PROF SNAPE: I'm not quite sure what solution you were suggesting to what I think you perceived to be an attitudinal problem, but here you're prepared to trust the ACCC with this confidential information - with the information..

MR AKHURST: I don't think we've got any complaints with the ACCC in terms of breaching confidentiality.

PROF SNAPE: No, I wasn't suggesting that, no.

MR AKHURST: But I think our complaint with the ACCC is that in 40-plus arbitrations there's only ever been one decision over several years, and we think that doesn't add to certainty and clarity of outcomes for anyone.

PROF WOODS: If we can come back to the regulatory overreach in a minute. You just reintroduced the access dispute regime. Where do the incentives lie? The participants to an arbitration are the access provider, the access seeker and the ACCC, and there have been delays that you've referred to. You've also made very clear the point that you're not party to all of them. For those that you are - and so you therefore have some understanding of those - where are the incentives for each of those parties that cause such delays?

MR AKHURST: That cause the delays?

PROF WOODS: We have long delays in getting final arbitration, that it must be to the benefit of one, at least, of those parties of that outcome, otherwise good will on all parts would lead to speedier resolution.

MS SHIFF: If you're an access seeker, once you've achieved your interim determination, you've basically achieved your result, because that set the price and is immunised from appeal at that point. So you don't care if it takes three years after that, at first instance; you've achieved your result.

MR AKHURST: I would be surprised if there is any incentive on the part of the players within the industry to delay proceedings before the ACCC. I don't think that's necessarily the issue here. I think it's more that the complaint is that the ACCC hasn't made a final decision. You can speculate about why that may be the case, whether it's resourcing issues, whether it's a lack of desire to be held accountable for their decisions, I don't know. The facts are that the decisions haven't been made.

PROF WOODS: Are you saying there would be general agreement in the industry that coming to the interim decision, ie, establishing the price, happens in a fairly timely manner?

MR AKHURST: I think we all think it takes too long.

PROF WOODS: Which gets me back to my earlier conundrum then, of in whose interest is that delay, and what's causing it.

MR AKHURST: The other is, these issues are complex and the analysis that needs to be done is complex, the modelling that needs to be done is complex. There are legitimate disputes, I think, between the parties as to what the correct methodology should be, including the ACCC, and what the outcomes should be. So there's quite a bit of debate there that, in the ACCC's defence, they need to sort through. I guess each party wants to put their best case forward, to make sure that the outcome suits them most appropriately.

PROF SNAPE: Delay is not used as a tactic?

MS SHIFF: Once the application has been made, the conduct of the proceedings is not driven by the parties, as such.

PROF SNAPE: The supply of information, etcetera, the parties have some control?

MS SHIFF: That's subject to directions by the arbitrator. I think that what has enormously complicated a lot of the disputes is that they are invariably about price, almost always, and the pricing rules have not achieved sufficient clarity and certainty about the right way of doing it. The ACCC has used a model that is highly subjective, so every element of the model, or at that modelling, when it's applied in relation to whatever product they're looking at, will be subject to varying

interpretations. There is just not enough objectivity in the techniques that are being used to determine access prices. Do you want to add to that, Paul?

DR PATERSON: Our position is that the costing basis that should be used is Telstra's actual network, rather than a hypothetical forward-looking network, to remove that large element of uncertainty in the costing exercise as to what a hypothetical network would look like, how you would optimise around that across all the customers across Australia, etcetera. We say that if we use the actual network, then that removes a large element of uncertainty, and allows the commission to come to closure quickly, on arriving at what it considers the appropriate costs, than is the case at present.

PROF WOODS: You've acknowledged that if you get higher volumes of traffic down those particular cables, that in fact you're prepared to concede a lower cost - and that was part of your evidence earlier. If, in fact, you're sharing some costs, whether they be trenching or otherwise, with other services you provide, presumably that also reduces the cost that you would attribute to, say, the PSTN specifically.

MR AKHURST: That's correct.
PROF WOODS: You've been one of the parties to these arbitrations. One of the other parties that has been there throughout them, being the ACCC, says in its submission, that:

> This negotiate-arbitrate model, with provisions for undertakings, was intended to provide maximum flexibility and reliance on commercial processes for participants. However, it has proved problematic in practice. Commercial negotiations on the pricing of important declared services have not exceeded (and perhaps should not have been expected to succeed) because of market power and information imbalances among the parties, and because of incentives for both parties, but particularly access providers, not to conclude agreements or otherwise to delay access to services. Such problems are, after all, among the reasons for declaring services in the first place.

That seems slightly at odds from the evidence that you were - - -

MR AKHURST: Yes, we wouldn't agree with that.

MS SHIFF: We wouldn't agree with it at all.

PROF WOODS: They have been a party to all of the negotiations, the arbitrations, so that's their perspective as one of the parties.

MS SHIFF: They haven't been party to the negotiations. They've been party to disputes.

PROF WOODS: No; through the arbitration process. Yes.

MS SHIFF: What we've said in the evidence this morning was that the liberalisation of getting into an arbitration has caused an increase in the number of arbitrations. The overhang of not knowing what the right access price is, by the part of access providers or access seekers, and the subjectivity of it, and the certainty that if you go into arbitration it's always going to be less than what you're getting, has created a funnel towards arbitration and away from commercial negotiation. The other problem, I think, that our industry has, relative to other industries, is that we don't have an effective undertaking process, and undertakings were meant to set prices for big ticket access services.

For a number of reasons, partly due to the way the legislation has been drafted, it's just not working as a process, and it's not sufficiently available. I noticed in the Part XID bill that's gone up for Australia Post that they've made substantial changes to the framework of Part XIC, including to deal with the time at which you can make an undertaking. We can't make an undertaking until a service is declared. In most other sectors governed by Part IIIA, or now with XID, you can make it at any time, in respect of anything you like. There are also differences between industries in the way undertakings are treated procedurally, and the sort of review rights you get in relation to it.

So there are a number of levers that need to be pulled in the Part XIC arrangements that draws dispute into negotiation, or into non-dispute based mechanisms for resolving issues, pricing issues.

PROF WOODS: But doesn't the sheer number of disputes that are ending up through the arbitration process suggest that the access seekers have some confidence - I think you recognised this yourself - that the price arising from that process will be less than the offered price. Why is there that constant bias in the outcome?

MR AKHURST: Because the regulator cannot really be proven wrong if an investment doesn't take place, because you never find that investment. It's not there. So to look at short-term competitive gains, in terms of market entry and hugely reduced prices, is their measure of success.

PROF WOODS: But, presumably, the rest of the industry is developing some confidence that the price arising from this will always be less than yours. Isn't that suggesting some bias in pricing, either - - -

MR AKHURST: Yes.

PROF WOODS: - - - by one party or the other?

MR AKHURST: I mean, it's important - the fact that there hasn't been final determinations on these matters - - -

PROF WOODS: It's allowed to then go through the subsequent processes.

MR AKHURST: Yes; and the fact that we've got some very serious disagreements with the ACCC on the methodology that they've implemented and the way they've gone about implementing that - we think they've made some grave mistakes - means that while those issues are unresolved there will always be an expectation that the ACCC's price will be less.

PROF SNAPE: And your response to that then, I assume, since this is, in the technical sense, a game, that is that each is acting on the assumption of how the other would act, then your opening price would be above what you really expected it to finish up at; that is, you would bias your offer upwards because you expect them to knock it down?

MR AKHURST: No, that's not the case.

DR PATERSON: In fact, when we go into the market with wholesale prices for declared services, we're very mindful of the fact that we may well end up in arbitration proceedings and need to be able to justify our price on a cost basis. Hence, from the start, there's, in a sense, no degree of ambit in the prices that we go to market with but they are, as we see it, genuinely cost-based prices; costed in the way that we think is appropriate for our business.

PROF SNAPE: But there are a number of assumptions that one can make. I think you were referring, before, that there are always a number of assumptions that one can make in determining the prices, and you wouldn't be surprised if you chose the ones that gave you the higher figure to start off with.

MR AKHURST: That's not the case with each element. As we say, we expect this to be reviewed and determined at some point and we want our propositions to stand the test of time here. But, it's true, we think the ACCC is pricing these interconnection charges below cost and we don't think it's responsible on our part to be putting below-cost charges out in the marketplace.

PROF SNAPE: What pricing model would you advocate?

DR PATERSON: Perhaps I could come in there. We're advocating, in our submission, a pricing model that essentially keys off our actual network, the network we have to provide service; that is - - -

PROF SNAPE: That is, your historical costs.

DR PATERSON: No, it's not. No, it would be our network on a forward-looking basis; so it would be our network costed on a replacement cost basis and used in an efficient way.

PROF SNAPE: Taking into account sharing of - - -

DR PATERSON: Yes, indeed; yes.

PROF SNAPE: - - - use of wires, trenches and - - -

MS SHIFF: There would be an efficiency dividend but you wouldn't get this huge gap that opens up, where the ACCC extrapolates - and this is a cause of some difference between us - extrapolates a network that we don't have and could never build, or is not the subject of the access service itself; it's a different technology.

PROF SNAPE: But, on the other hand, when you said in fact it would be on a replacement of your existing one, that's a network you don't have either, because you've said before that you wouldn't rebuild the network in the same way that it is built at the moment. So, therefore, you are also working on a hypothetical network.

MS SHIFF: We are, but there indigenous conditions which, in a real-life situation, that we would have to design to. We would have to design to actual Australian population densities, not something that exists on Mars or Montana. We would have to design to actual customer service guarantees that require us to have a network with more than 1.3 lines per service in operation. We would have to be constrained by an efficient optimising model, not a completely abstracted model.

PROF SNAPE: But on the quality of the lines themselves - you would also be upgrading those, I gather. As I understand, your inherited technology or your inherited quality of lines is not necessarily what you would want to have in the future.

DR PATERSON: They're not largely because of the technology. We would still very much go with existing technology and existing network architecture and topology. It's, in a sense, the degree of dimensioning, the degree of maintenance we've been able to carry out to ensure waterproofing and technical factors like that that's important in terms of service quality.

PROF WOODS: You made mention that this will be covered in your more detailed submission. Will that be covered in the public submission that will be available?

MS SHIFF: Yes.

PROF WOODS: Thank you very much; it would be helpful. While we're talking about access disputes, let's bring together two bits of arguments: there's how to get more timely outcomes from them; and then there's the transparency issue that you were developing a little earlier. Would publishing the outcomes of the arbitrations assist in transparency and might it have some beneficial effect in speeding up resolution of the backlog of disputes?

PROF SNAPE: And overcoming the asymmetry of information where it exists.

PROF WOODS: Indeed.

DR PATERSON: I really think that public disclosure is the role for undertakings rather than arbitrations. Arbitrations, by their very nature, of course, are influenced

in their outcome by the particular circumstances of the two parties that are in dispute, in that sense. Publishing the price may not be a price that's relevant for the broader market. The appropriate mechanism is undertakings - - -

PROF WOODS: Can I just clarify that? By "undertakings" you mean those that have been accepted by the ACCC or just merely those that you are offering?

MS SHIFF: What we're saying is - - -

PROF WOODS: How are you defining "undertaking" in this respect?

MS SHIFF: In the sense that they were, or ought to be, designed within the framework, the statutory framework. The undertaking is meant to be sort of a price that is capable of applying to all. In an arbitration you may confront an access seeker who imposes very different costs on you or has a very different traffic profile to the next access seeker. Hence, posting the price of that arbitration is not necessarily going to do the work of an undertaking that is the work of an undertaking.

PROF WOODS: Yes. I'm just trying to understand, though, whether you see the undertaking in terms of a price that you are prepared to offer to the general market or a price that's been accepted by the regulator as being appropriate to offer to the general market.

MS SHIFF: Both, in an ideal world; yes.

PROF WOODS: In an ideal world, but would you anticipate any problem in - - -

DR PATERSON: I think, essentially, for the price that's offered to bring certainty to the market, then it needs to be ultimately accepted by the regulator, either directly or through appropriate processes.

PROF WOODS: Let's take some regulation out for the moment, for the purpose of pursuing this. What prevents you from posting a price in public at the moment, at your wholesale level, to all others that would meet this criterion of being a generally acceptable price in the marketplace?

MS SHIFF: We do that.

PROF WOODS: But it doesn't seem to be generally accepted, because that's why we then go through the process - - -

MS SHIFF: No, because there's a fundamental arbitration to get a better deal from the ACCC.

PROF WOODS: That's exactly the point then, again, isn't it? The industry is saying, "But hang on, that's not the best deal," so it really isn't representing a price that is generally accepted as a basis for bilateral or non-regulatory negotiation.

They're not taking your posted price and saying, "Well, we've got a bit of extra volume here, we think we can come to a decent deal with you, outside of regulation - - -"

MS SHIFF: Mind you, we've probably overdrawn the situation. I mean, there are many wholesale customers - - -

PROF WOODS: You actually do achieve sometimes, don't you?

MS SHIFF: - - - where we achieve commercial settlement. We have, you know, hundreds of wholesale contracts out there.

PROF WOODS: Yes.

MS SHIFF: There are some who will exploit the dispute mechanism to the nth degree, there are some who will conclude a commercial negotiation, subject to a regulatory review clause.

PROF WOODS: I guess there are some who say you're so big, if they can get a deal with you, then, for their other market interests, that's good, that they've resolved that interconnect issue, and then go and pursue other aspects of their particular business. So, yes, there are all sorts of people coming with different perspectives to you. I think it's quite useful that you say - - -

MS SHIFF: The thing I think it's fair to say is that in markets where the threat of investment bypass is genuine, we have much better opportunities to do commercial deals. I mean, there is a huge incentive by wholesale, to get the deal that will put people on our network rather than their network. The spiral that you're getting with the PSTN services and derived services is that the sort of regulatory overhang of it means that we can't post a price that is going to recover our long-term costs of investment, particularly given the service issues that we face going forward, and there will always be a better deal from the ACCC. So you don't get that sort of absent regulation; and with a higher threat of investment bypass, you actually achieve better outcomes, paradoxically

PROF WOODS: You keep referring to this phrase, "You'll always get a better outcome from the ACCC," and I guess that's what is driving behaviour.

PROF SNAPE: When you have this structural separation - shorthand - that you were talking about before, the wholesale prices that you would be offering to your retailing arm, will you post those and let anyone else come in on those same prices and conditions as your retailer?

MR AKHURST: We weren't proposing to post them publicly, no, but we were expecting that they would be scrutinised and looked at by the regulator, yes.

PROF SNAPE: That your internal price will be - yes.

MR AKHURST: Yes, and we were expecting that those prices and terms and conditions would be available to third parties.

PROF SNAPE: Why not post them? I mean, if in fact you can get as good a deal from your retail arm, from a third party, why not take it? Why not just post them?

MR AKHURST: We may well but I guess we weren't mandating that.

PROF SNAPE: I mean, it would seem to be, on the surface of it, in the interests of your shareholders that you do that; that you say, "This is the deal we're offering the retail. This is what we reckon our full costs are," etcetera, etcetera. "If anyone else wants that, they can have it."

MR AKHURST: The deals that are offered to each individual wholesale customer will be different, because they're all different circumstances and they'll want different - - -

PROF SNAPE: No, I said with the same conditions. Yes.

MR AKHURST: We think that's a thing for the commercial people to do and work out. If that helps them sell their services, great. We don't think we should sort of have this totally managed economy approach, that you could regulate everything that we do.

PROF SNAPE: I was not trying to regulate that; in fact, it was really getting away from it. If you just post it publicly, then anyone can - it's just like putting a price in the front of a shop, and you come in and you buy your meal at that price.

PROF WOODS: Picking up this point of how far the regulatory arm should reach, I mean, a theme of your submission seems to be that there is regulatory overreach, that it's extending beyond the core elements that should be subject to regulation in the public interest or in the long-term interests of users or whatever is the appropriate criteria. In your view, has that led to regulatory errors? Do you want to sort of elaborate on some of that?

MS SHIFF: I guess the biggest regulatory errors in an economic sense is the effect on - if we're looking at Parts XIB and XIC, as they tend to kind of converge - both what we're prepared to invest in the future and what other people are prepared to invest, in the areas of what we perceive to be under-investment. I mean, that is, in terms of welfare gains and losses, a dramatic welfare loss on the scorecard, given that we think that service quality and service capability is very bound up with high quality range of infrastructure going forward.

There are also, I think, issues around the fact that because the ACCC has regulated so many upstream services with overlapping downstream sort of services, it distorts the choices between access seekers as to which - and they'll pick and choose

between them so that people will put their very, very long-held data calls into local call resale, because that's untimed and capped. Whereas you get an average call duration on a normal local call of about eight minutes, you can get something around the 40-minute range with data. Then what we're seeing is that the short-held calls get groomed off into PSTN. So that you get a pretty good deal if you've got a three-minute call and you've got 2 cents at either end; so you've got basically 12 cents for your input costs, you're doing much better than on local call resale.

This is just regulatory arbitrage now that we're seeing, and it sort of enormously complicates - if you kind of get rid of all these distortions - how you can manage the migration to new networks that are going to offer local calls and high-speed data services, because it's setting up paradigms that don't bear any relationship to the underlying costs for the calls that are being carried on those different access services.

PROF WOODS: The telecommunications market is moving, as we all recognise, and you're starting to get elements of competition in such areas as your trunk fibre optics and the like. It's a question that we'd certainly like you to apply your mind to in subsequent public submissions, as to what is the essence in the access - and you've touched on some of it; but what is the essence of regulatory requirement in the access regime, and how do you differentiate by geography, by product, by service? We certainly don't want to do a technological regulatory regime; that doesn't meet anyone's needs. The convergence with broadcasting - I mean, once you've got a fibre optic cable, it really doesn't matter what's going down it, whether it's streaming videos or whether it's telephony or whatever; it's just a facility.

MS SHIFF: But most new technologies - not most but many new technologies - third generation, CDMA, broadband wireless, local loop, DSL technologies, fibre, you name it; they're all going to offer potential multiple applications.

PROF WOODS: Yes. So we need to somehow distinguish what is the core matter that needs to be dealt with in access in telephony and whether telephony as such remains the defining characteristic, and that's to any nature, or whether it's some other perspective, whether it's meeting emergency needs of rural and regional Australia, to have access to a voice connection, or whether it's ability for every home to have data connection of some form - I mean, there are ways of looking at the model and you've explored a few of them this morning, but I'd certainly appreciate some more refined and detailed thinking into that, and to challenge this question of regulatory overreach - - -

DR PATERSON: Of course, in doing that, we'll be coming back to the basic economic principles of barriers to entry and barriers to exit, in thinking about particular service and particular markets.

PROF WOODS: Yes; in one sense, in that you can look at general competition law doing one thing, but what is a defining specific telecommunications - if that's the right umbrella - access regulation that we need to pursue.

You've given grand accolades to ACIF in your submission this morning as being a successful model of self-regulation and how others are coming to look at it. What are the features of ACIF that have been favourable to Telstra, such that you'd have such a positive report on its outcomes today?

MS SHIFF: I don't know that it's been especially a win for Telstra. I think it's been successful for an industry which has moved from bilateral commercial and operational processes and relationships to, in 1997, an industry that had to deal with multiple operators, and have common platforms to deal with number portability and preselection and network performance across each other's network. The real work of removing the structural barriers to entry, I think, was really performed by ACIF and the huge number of working groups and the large number of people throughout industry, not Telstra, although Telstra dedicated a large amount of resource to bring those things to fruition.

It also has operated on an ad hoc basis, to deal with disputes that required a multilateral solution. Our suggestion is that, going forward, that is the nature of disputes. I mean, there can be the appearance of a dispute between us and Optus over local number portability but there is as likely, sitting behind that, to be a dispute between Optus and other competitors about what it offers them by way of local number portability. You can't just deal with it as what's Telstra doing. It's about what is the industry doing to each other; the same with slamming, the same with churn, the same with lots of other operational and networking arrangements that need to be resolved multi-laterally.

In an IP environment, where interconnection is done on Internet protocols with packet switching, you will see more networks of networks, and more need for multi-lateral solutions. So it does seem to me that a forum that can generate outcomes in that area is to be encouraged.

PROF WOODS: Do you have a power of veto in the ACIF process?

MS SHIFF: No, it operates on consensus. It needs to - - -

PROF WOODS: I'm just trying to work out that distinction.

MS SHIFF: It operates on a consensual model, where it tries to bring everybody to the table, which means that it doesn't always, at the end of the day, operate as quickly as everybody would like it to, but it does sit people in a room until they agree, to the extent that they possibly can, on a code before it goes out to public comment. In that sense, it's consensual, but there is no individual power of veto. There isn't one player that can say, "If I don't like this, the code doesn't go out to public comment."

PROF WOODS: Except if it's a consensual model, and a significant player says, "Well, I'll sit in the room with you until we get agreement that's more consistent with my desired outcomes," presumably they continue to sit in the room.

MS SHIFF: In some circumstances, we have not liked codes that have gone out for public comment, and we haven't achieved everything that we've wanted, and they've still gone out for public comment. There is a reserve power in the ACA, if the standards aren't working, to step in, but by and large, they do achieve outcomes. It's assisted by the fact that in some of the big ticket technology transitions, like LMP and mobile number portability, the ACA sets deadlines, so everybody knows that they have to achieve by a certain deadline, and everybody knows, say with mobile number portability, who it is that's holding up the works in the industry.

PROF WOODS: You mentioned churn. Coming back to an earlier conversation, do you think that the churn and peering cases would have proceeded under section 46 of Part IV, if we hadn't had XIB?

MS SHIFF: I think that they could have been taken under Part IV. It's debatable whether churn shouldn't have really been dealt with as an access issue on day one, and dealt with under XIC.

PROF SNAPE: Would the same outcomes have occurred, if they'd been taken under other parts?

MS SHIFF: It's hard to speculate on that. I think, with Internet peering, with the benefit of hindsight, there wouldn't have been any regulatory action at all. It's proved to be too dynamic an industry to attempt to predict the model for interconnection between Internet access providers. I think probably the ACCC would share that view.

PROF WOODS: Given your extensive database - most of the customers were initially yours and still are - do you identify those who churn and target them to discourage churn?

MS SHIFF: Sorry, what's the question?

PROF WOODS: The question is: do you identify customers, from the database that you have, who are prone to churning, and therefore target them to discourage that churn?

MS SHIFF: This was not, as far as I know, the issue in the commercial churn case.

PROF WOODS: No, I'm just asking the question.

MS SHIFF: The answer is that there are Chinese walls between competitive information that's acquired through the wholesale arm of the company, and the information that's available to retail marketers, as to who they try and win back. There's been no evidence, that I'm aware of, that's been established that we are exploiting the wholesale information at a retail level.

PROF WOODS: No, it's just a question to you whether that is - - -

MR AKHURST: That's separate.

PROF WOODS: Industry plans: anything you want to comment on?

MS SHIFF: We haven't said anything in our submission about it, but I should note that, in the context of the Besley Inquiry, we've asked that industry plans, which don't provide any useful information about regional investment by our competitors, be required to outline regional investment in the future.

PROF SNAPE: Undeclaring: would you like to speak on undeclaring?

MS SHIFF: Sorry?

PROF SNAPE: Would you like to tell us what you think about undeclaring? Is this the new wave of the regulatory trend, to in fact progressively undeclare items?

MS SHIFF: We believe that certain declarations have an obvious lifespan, like local call resale, and that like Part IIIA, there ought to be a time limit given at the beginning of a declaration for how long it's going to last for, so that it doesn't become an end in itself. The ACCC itself said that local call resale was a migration path to something else, facilities based competition. There is no inbuilt requirement to set sunset arrangements in place. However, what we would submit is that that is not the end of the matter. The problem with our regime, relative to other sectors' regimes, is that there is a sense that some services just shouldn't have got declared in the first place, and an uncertainty as to what services and infrastructure that you're about to invest in is going to get covered.

That to us is as big a problem, if not a bigger problem, than the issue of undeclaration. It's the problem of no lines in the sand about what is covered and what isn't covered by Part XIC, and what falls into Part IIIA, and what falls into some convergent, harmonised framework. There is no mechanism, if you're contemplating investment, to say, "Well, can we get a pre-clearance or a safe harbour; or what's the access price going to be like?" It's just a huge area of uncertainty and risk, and that marks down the investment in question.

PROF SNAPE: If you do have sunset provisions, which you mentioned then - or sunset time - is that consistent with very rapidly developing technology? May it not be worse to have a specified time, when it's going to be undeclared automatically, than to have the provision for undeclaring it as the technology changes?

MR AKHURST: Are you contemplating a regime where it would be, once undeclared, not able to be redeclared?

PROF SNAPE: You would have to go through the whole process again, is what I would be contemplating, to say, "Okay, we're going to declare the local loop for five years, because we think within five years there will be substitutes." That's one way of

going about it. Another way would be to say, "Okay, we declare the local loop, realising that substitutes could come in at any time, and when the substitutes come in, then we go through an undeclaring process." It would see to me, in this very rapidly changing industry, having a specified sunset time is not necessarily superior to having undeclaring at will.

PROF WOODS: Unless it was a cap, so that five years, or such earlier date - - -

MR AKHURST: Yes, you could have both systems running at once, could you not?

PROF SNAPE: That would add to the confusion, I think. You could say five years or earlier, yes, that would be one way.

MS SHIFF: The regulator could be required to either specify a date or specify a set of objective circumstances, but at the moment it just runs on.

PROF WOODS: Even that foresight is problematic, as all in the industry are recognising that we're never quite sure what's 12 months out, let alone six months.

PROF SNAPE: You have spoken about the problem with investing and investment disincentives. Then some people have suggested that that could be overcome by access holidays, that you guarantee a free time of no access; but I gather you're not too keen on that. Would you like to tell us why?

MS SHIFF: We're not keen for the reasons that we've set out: that we're wary of bandaid solutions being applied to XIC, when what needs to be done is to look at the declaration criteria and scope itself. An access holiday is - if you were considering investment with very high risk, uncertain demand technologies, typically, you will try and stimulate consumer demand in the early years and backload your returns in the later years. So the access holiday doesn't necessarily correspond with the way the investment is structured from the commercial point of view.

PROF SNAPE: And it would depend upon the length of the holiday, I think, wouldn't it?

MS SHIFF: That's right, but that's basically an exemption; and it really means you go back and look at the basis upon which exemptions are granted and redraft those.

MR AKHURST: We do think there needs to be a more effective exemption process.

PROF SNAPE: Okay. That would be an undated - that would be time - exemption that would go on forever or?

MS SHIFF: We don't mind if it's at large, and that element is at the discretion of the regulator. What we mind is that the criterion for determining exemptions haven't

been carefully drawn, and they can only cut in when something is declared, so that they can't be used at all, in our view, if you're contemplating an investment.

PROF SNAPE: So you would then go for an up-front exemption for a particular time or - - -

MR AKHURST: You may well.

MS SHIFF: It may be at large whether you get it indefinitely or for a period or whatever.

PROF SNAPE: It sounds pretty much like an access holiday, doesn't it?

MS SHIFF: Maybe it's - - -

MR AKHURST: Yes, the specifics of that made to be - - -

MS SHIFF: Tipped to work through, yes.

MR AKHURST: What are the criteria for the access holiday coming in; how long. You don't want it too rigid, things like that.

PROF WOODS: Your submission that you had before us doesn't give us a handle on your views on the amendments of the legislation that were taken through parliament in 1999, but presumably you'll deal with those in a subsequent submission. Is there anything you wish to say this morning in relation to your views on those amendments?

MR AKHURST: For part XIB, we think it went in the wrong direction. We don't think those amendments were necessary or have proved to be effective or useful in any way whatsoever. XIC, Deena and Paul might like to comment.

MS SHIFF: XIC we have covered off by saying that, by creating an interim determination process has created an escalation in disputes going through to arbitration; that's the net effect. It hasn't dealt with the underlying problems.

PROF WOODS: They do, to an extent, for the market, represent an intention of parliament as to what it wants to achieve from regulation; but if you'll cover your views on it in subsequent submission, that would be helpful. Any more matters that you wish to deal with?

PROF SNAPE: Generic conditions for an undertaking. Would you like to comment on whether you think that generic conditions for undertakings would be the way to go?

MS SHIFF: "Generic" meaning?

PROF SNAPE: Broad brushed rather than specific, so that undertakings, there would be conditions of a generic nature which could be set out by the ACCC, rather than going on at a case-by-case basis.

DR PATERSON: I think by its very nature I couldn't - for undertakings, they do need to have a degree of generality about them, so they do have a wider applicability than any particular party in the market; otherwise it seems to me to prohibit the value of them.

PROF SNAPE: Perhaps you might like to contemplate that a little bit more.

PROF WOODS: Are there any other matters that you wish to raise with us this morning?

MR AKHURST: Not at this time.

PROF WOODS: Thank you for your answers. We look forward to receiving further submissions from you. Can I stress, for yourselves and other participants, that it is our strong desire to have matters in the public domain, that submissions are not identified as in-confidence where they need not be; and in fact we will only accept

commercial in-confidence submissions where we agree that that constitutes the heart of those matters put in those. Thank you very much for the time this morning. We'll take a short break before we call the next participant.

PROF WOODS: Our next participants are from Vodafone. Could you please identify yourselves by name and by position in the organisation.

MS MALKIN: Yes, I'm Joan Malkin, and I'm the group legal and regulatory director for Vodafone.

MR CLARKE: Good morning, David Clarke, I'm general manager, carrier affairs.

MR DALTON: Chris Dalton, general manager, regulatory policy.

MR WOODWARD: Luke Woodward, partner, Gilbert and Tobin.

PROF WOODS: Thank you very much. Do you have an opening statement you wish to make?

MS MALKIN: Yes, I do, thank you. Thank you for the opportunity to speak today about the future of telecommunications markets in Australia, and more specifically to the submission that we lodged a little bit late last week.

The issue of the proper framework for the regulation of telecommunications in Australia, and elsewhere for that matter, is a very complex issue and one that Vodafone takes very seriously. Vodafone, through its related companies, is participating in various reviews of industry regulation around the world. The outcome of the Productivity Commission's review has the potential to influence very significantly the evolution of telecommunications industry in Australia; and indeed it has the potential to impact, perhaps less directly, the regulation of telecommunications markets globally. For some time now Australia has been very much in the forefront of enlightened regulation, and the rest of the world regularly takes note of market dynamics and regulatory outcomes here in Australia.

The range of matters we have considered in developing our submission is large, and, in many cases, of a pioneering and highly speculative nature. What will the telecommunications industry be like in two or five or seven years' time? What should the role of government in ensuring optimal consumer welfare and enabling sustained industry development be? Is regulation the best way to promote these objectives? Can regulation keep up with a dynamically changing industry? What are the costs, both immediate and longer term, of regulation? And what, if anything, is so special about the telecommunications industry, that it warrants a unique regulatory framework?

Of course, these matters are relevant, not only here in Australia but also globally. The commission will be aware of the current regulatory review in New Zealand, in which we have participated; and the recent draft directive by the EC on regulatory reform, and Austel's July 2000 report on communications regulation in the UK, which states, among other things, "When effective competition exists rules should be reviewed and removed."

In Australia, the last 11 years of micro-economic reform in the telecommunications industry has witnessed a quantum shift in the delivery of telecommunications services to customers, who now have a wide range of choice of carrier, technology, products, price. The evolving regulatory framework has doubtless played a significant role in this, and this is why the current review is so timely. With the current hype surround 3G services, online interactive broadband services, high-speed Internet access, substitution between fixed and mobile services, the convergence of telecommunications media and computing services - the list just goes on - the key question to be answered is, what impact will industry-specific regulation have on the economic and efficient evolution of the communications industry, and its ability to deliver innovation to the benefit of consumers?

Our review, and, importantly, one that we have consistently taken in all markets in which Vodafone operates, whether we are a new entrant or a player with significant market player, is that regulatory forbearance, as an overarching principle, will produce optimal consumer welfare and industry development.

The adoption in Australia of regulatory tools to promote the growth of competition has been both measured and progressive. While the legislative regime has been amended over the course of the last decade, it is fair to say that the overarching philosophy has remained constant, and primary focus has been placed on the development of facilities based competition, with service based competition seen as complementary, all assisted by industry-specific competition regulation. Vodafone believes that Australia is now ready to embark on the next phase of regulatory evolution, namely, a winding back of the regulatory measures that have affirmatively facilitated the growth of competition, and their replacement by a framework that enables competition to develop in an economically efficient manner.

The foundation for further regulation in Australia should be the application of general competition policy, as set out in the competition principles agreement between the state and Commonwealth governments; in turn, drawing on the work of the Hilmer Committee. Relevantly, Australian competition policy provides for: competition conduct rules in Part IV of the Trade Practices Act, which applies generally; structural reform of public monopolies to separate the competitive and monopoly parts of the businesses; and regulated rights of access to facilities which are uneconomic to duplicate, and which are necessary to promote competition in upstream and downstream markets.

Before I go on, I should note that the nature of our comments is largely conceptual. We have not laboured over the details of the current legislative regime,

nor have we made specific recommendations as to precisely what a new regime should look for. Instead, our submission proposes a framework for regulation comprising the following principles:

(1) government should be guided by a general principle of forbearance; that is, a presumption against regulatory intervention rather than in favour of it;

(2) general competition regulation, such as the competition conduct regulation in Part IV, and the principles of access regulations set out in Parts IV and IIIA of the Trade Practices Act, should be the default position, in essence, the starting point;

(3) industry-specific regulation should only be considered where general competition regulation is inadequate to address durable market failures;

(4) if regulation is to be imposed, it should be the best solution for the delivery of policy objectives, thus the cost of regulation should be explicitly considered, and intervention should be limited to that which is strictly necessary to achieve those objectives;

(5) the regulatory regime should be responsive to changing conditions, and particularly changing market conditions, thus regulation should be easily removable once the market failure has been resolved.

At the centre of Vodafone's proposals is reliance on general competition principles, to be complemented by industry-specific regimes only in the case of durable market failure; and thus, in relation to anticompetitive conduct, Vodafone believes that Telstra's continued dominance in multiple markets justifies an industry-specific regime. However, there is no justification for that regime to extend to non-dominant market participants, whose conduct should be judged by industry-neutral principles; that is, Part IV of the Trade Practices Act.

In relation to access, Vodafone believes that competition principles which apply generally to industry in Australia should apply to telecommunications. In short, access should be required where the facility is uneconomic to duplicate - in essence, a natural monopoly - and it is necessary to promote competition in upstream or downstream markets. This test should be affirmatively applied to the existing service declarations, which should be terminated unless they satisfy this new test. In short, a sunset provision should apply to all services which are currently declared.

Why are we confident in saying that the telecommunications industry in Australia is ready for this next phase in its evolution? There are several reasons. First: competition has the track record of being effective in delivering customer benefits, particularly in new and emerging markets. Our experience in the mobile industry is that competition has been the primary driver of exponential growth and the very significant increase in consumer benefits that have been achieved. The industry is over five times bigger than it was forecasted eight years ago. Coverage is well above the licence obligations imposed on the carriers. Network performance

and service quality continues to improve. Significant price reductions have been achieved. Increasing service and product proliferation demonstrates a strong emphasis on innovation.

Second: the foundations for a sound industry in which competition can thrive have largely been laid. There are now multiple networks and multiple competitors in many sectors of the industry. There are a multitude of declared services representing the key building blocks for downstream competitive telecommunications services. Commercial imperatives are adequate to ensure that any-to-any connectivity will continue to characterise our industry going forward.

Third: with the increasing rate of technological and market change in an already fast-moving industry, there is a very real risk that regulation will adversely distort the development of the industry in a way that will discourage investment and innovation and produce sub-optimal benefits for consumers. With mobile technology as an engine of growth for the future, confidence can be placed on market forces delivering the greatest consumer welfare. In comparison to this, the wholesale retention of the existing industry-specific regulatory regime runs the risk of causing unforeseen dysfunctional constraints on the development of the industry, to the overall disadvantage of the customer.

It would take a brave person to paint a definitive picture of the industry in five years' time and, from this, to conclude that the current industry-specific regulatory regime remains and, more importantly, will continue to be warranted. Fostering the entry of competition is no longer a key justification for industry-specific regulation. Many market segments have multiple viable competitors. The fast pace of technology development will likely solve some of the more competition-resilient sectors. Any legislative amendment resulting from this review is unlikely to be implemented in 2002, when competition will be even more well developed in this industry.

The reforms must, of necessity, be forward looking, and it is largely with this in mind that Vodafone is advocating the adoption of regulatory forbearance. Vodafone is confident about the future of the industry, its own ability to compete, and the effectiveness of competition as being the primary tool for optimising consumer benefit. This public hearing is just the first step in the debate about regulatory reform, and we look forward to being an active participant and providing the commission with perhaps more detailed recommendations as we move forward. Thank you.

PROF WOODS: Thank you very much. We have read your first submission with some interest, noting the various references that you draw upon in support of good regulatory principles. We do look forward to further submissions. As I stressed to a previous participant, we encourage those, strongly, to be in the public domain and to be available so that all can benefit from your thinking and so that the transparency of our processes are upheld, being an important principle in itself.

You paint a picture of there having been some regulation to date. The market has now reached a stage where, forward looking, we may not be talking tomorrow, but over the next three to five years, there is a need for a progressive pull-back of regulatory intervention, specifically to telecommunications. Yet, I'd like to explore, in a little while, some of the tensions that seem to come through in your submission. But, overall, what would be your assessment of how the market is now and in the next year or two, compared to, go back, five years when you were one of three providers of mobile telephony? I mean, has the market matured and developed and various new entrants come in and competition increased?

MS MALKIN: In a word, yes. There are those who maintain that there is perhaps not as aggressive competition in the mobile market as is desirable. I don't accept that, but I also think it's no longer relevant to focus on what the mobile market has looked like and what it looks like as of this moment, because it certainly promises, without a doubt, to be probably the most competitive market in the world, for mobile services, in terms of at least the number of competitors. That bodes well for the kind of innovation which will lead to consumer welfare.

PROF WOODS: Some of that is because of increasing the transmission of data, rather than just being a voice service?

MS MALKIN: It would be the promise of the increasing significance of data which is perhaps the carrot for the industry; but with six or seven networks, and we're not into the data explosion yet, we are making investments which are risk investments in anticipation of a profitable enterprise.

PROF WOODS: But the market has come to where it is and you are making investments, as a number of parties are, very significant investments, in the current regulatory environment. Does that suggest that the system is broke and needs fixing? If the current regulatory environment has produced this outcome and the foreseeable outcome, which you paint in fairly positive terms, it raises the question: well, perhaps it's actually achieving what it intended to achieve.

MS MALKIN: Yes. I think perhaps, actually, the mobile market has developed in spite of the regulatory regime, and hasn't - - -

PROF WOODS: Interesting perspective. Could you elaborate?

MS MALKIN: - - - and hasn't laboured under the same difficulties that the fixed-wire environment has. With the increasing availability of spectrum and lower barriers to entry, there is a more reasonable expectation of opportunity.

PROF WOODS: Would you agree that uncertainty is one of the principal concerns when looking to forward investment within a company? Does uncertainty play a part in the calculation of whether to invest or not?

MS MALKIN: Absolutely.

PROF WOODS: Regulatory uncertainty, is that a matter of concern?
MS MALKIN: It always is a matter of concern. It's a question of trying to quantify that in each case, and it's difficult to do that.

PROF WOODS: It's just that it is a matter that, as a commission, we need to take into account. You have a regulatory environment, it has produced certain outcomes, you've identified that the future under the current environment, in itself, is forward looking - you've interestingly referred to it almost as "despite" the regulatory environment. But introducing uncertainty by a change in the regulatory environment, I'm just wondering if that in itself is a factor that needs to be taken into consideration.

MR DALTON: Perhaps I could just offer one comment there; and that is, as was alluded to in the previous session, we have convergence within the industry and the boundaries between the mobile sector and the fixed sector are blurring. There is less regulation of the mobiles industry than there is of the fixed industry, but it raises a question mark about regulatory creep. So we would see that there is a potential for regulatory uncertainty with regard to our own operations, as we see convergence occurring. We want to make sure that this regulatory creep doesn't move over into the mobile sector. That could constrain our future investments.

PROF WOODS: Even within the current legislative form, you think that oversight by regulatory bodies might progressively encompass some of your domain, or could?

MR DALTON: There is one very simple example of that, if I may.

PROF WOODS: Please, that would help.

MR DALTON: That is with regard to untimed local calls. Because of a technological differentiation within the act, we are not subject to providing untimed local calls, but that is a regulatory differentiation that you would expect, in time, to disappear. So that might imply that as services converge, that condition might be put upon us.

PROF WOODS: That convergence being, for instance, the identification of local calls from mobile handsets that some may choose to offer in the marketplace?

MR DALTON: No, I'm saying that the party carrying might feel free to offer that, and that's fine, and that might be in response to consumer demand.

PROF WOODS: Yes, but should not be caught up in - - -

MR DALTON: But to impose that - - -

PROF WOODS: Yes.

MR DALTON: - - - is what would concern us.

MS MALKIN: Can I go back and perhaps explain what I meant when I said "in spite of regulation"? The current regulatory environment, the regime, is sort of facially neutral as to which technologies it covers. Therefore, there is always a level of uncertainty as to whether or not the regime will capture what we view as our principal focus in the marketplace.

Through a number of decisions, the mobile market has been determined to be reasonably competitive or reasonably susceptible to adequate commercial arrangements. Although there is the potential of the regime catching the mobile market, it has remained outside of the scope of that net.

PROF WOODS: Other than interconnect?

MS MALKIN: Yes, other than access, essentially; originating or terminating access. So it has been able to move forward, not without uncertainty as to how that net may or may not capture it. That level of uncertainty, it seems to me, is probably unwarranted and unnecessary. In the future, there should be no mistake about whether or not the mobile industry should or should not be regulated.

PROF SNAPE: But there is a problem here, isn't there? I would assume that you would favour regulation which is technologically neutral as far as possible.

MS MALKIN: Yes. I'm not suggesting - - -

PROF SNAPE: And yet that untimed local call throws up a problem, doesn't it?

MS MALKIN: Yes.

PROF SNAPE: I mean, if you are wishing to insulate yourselves or insulate the mobile sector - and I don't know whether you want to go down the path which Orange is going down, in terms of the local calls, but if you wish to insulate the mobile sector from that untimed local call charge, then you are in fact endorsing technologically-specific regulation.

MR DALTON: If I can just respond to that, I think there are other regulatory solutions to address the government's objective that untimed local calls need not be technologically dependent.

PROF SNAPE: Could you elaborate, please?

MR DALTON: Well, quite clearly, you have a primary universal service provider. The untimed local call option resides just with one party, not all parties providing the standard telephone service. So you make it specific to a role that a carrier is fulfilling, rather than the technology they're using to deliver a service.

PROF WOODS: Doesn't that entrench that particular business structure with a form of regulation? I mean, you're quite explicit about it in your submission, where you say:

> The rules governing anticompetitive conduct should be aligned with the general competition principles, except in cases of specific concern arising from the potential anticompetitive use of Telstra's substantial market power, derived from its vertically-integrated incumbent monopoly.

I mean, that's the same approach that you're proposing; ie, that there be one current business structure that provides these services and has these features and that it should be subject to regulation that other business structures and organisations, who may merge or converge or may take different paths, should be free of it.

MS MALKIN: First let me say that we would not be advocating technology-specific regulation. Then let me say that I think we've gotten off on a bit of an aside on the untimed local call, because there are a number of reasons to regulate. If you are regulating to achieve economic efficiencies and to introduce competition, it's quite a separate issue from regulating for social policy objectives, to have universal service or to enable "reasonably affordable" service; thereby ordering untimed local calls.

Very deliberately - and indeed your charter is on the first angle of regulation, not the second - our response, both here and in our written submission, is really premised on the objective of efficiencies and regulation and fostering competition and how best to do that in a maturing industry. We deliberately have not looked at social policies which may underlay different kinds of legislation.

PROF SNAPE: But we also, under our charter, do consider the best ways of achieving social objectives, and are required to do so. You could see perhaps in the broadcasting inquiry how we went about that, taking the social and cultural objectives in that, and then considering various ways of achieving those social and cultural objectives. I think we're facing the same sort of question here. There are various social objectives which the government and parliament has made quite clear. It's a question of: if those social objectives are to continue, if they are to continue, what is the best way of achieving them? I think that's what we're running up against here; that, in terms of these untimed local calls, for example, the objective which is lying behind that and also the universal service obligations or requirement, what is the best and most efficient way of achieving those objectives?

MR DALTON: If I can respond to that as well, another part of what we have been suggesting to government about the universal service obligation is the introduction of competition, which is very consistent with the theme put through our paper here; that we believe that it is through the competitive processes in the marketplace and access to the USO subsidy - with not just one carrier being entrenched in its position of being the universal service provider but ultimately through a competitive process - that it will deliver the optimum result, the optimum benefit to the customer.

PROF SNAPE: It does get a bit more complicated, doesn't it, than, say, for a bus route where there will typically be one bus provider and you'll have competition for providing that service, and you're tendering? Here, you're actually wanting to have competition between technologies, going on all the time. Isn't it rather more difficult to tender for that for providing?

MR DALTON: I would see that, with the universal service obligation, you can have multiple bus routes, multiple providers; you don't have to have a tender just for one provider of that service.

PROF SNAPE: I think we'd like a bit more elaboration of that point, if you could; a development as to how one might go about it in practice, and yet adhering to the sort of principles that you were elaborating, of technology, neutrality, etcetera.

PROF WOODS: Looking at the market, just to finish that area, the ACCC, in its submission, refers in part to the development of oligopolistic features in some markets.

MS MALKIN: I heard you comment on that earlier.

PROF WOODS: Any comment?

MS MALKIN: I mean, sort of, by definition, the mobile market, has been characterised, as a matter of fact - has had three competitors, and only three, at the network level, but - - -

PROF WOODS: Three participants.

MS MALKIN: Three participants.

PROF WOODS: It's a question of whether it's competitors is the essence of the issue.

MS MALKIN: Yes. You interrupted me, because I was going to get to that part.

PROF WOODS: My apologies.

MS MALKIN: I can only speak for Vodafone but I can guarantee you that we believe we are in a very, very competitive marketplace. Numerous examples but I think that perhaps indicative was the race to come out with WAP services, and it was a matter which all three companies had been planning. I think probably all three of us, each of us, separately, thought that we were going to beat the other to market. This is not a matter solely within our control, we rely on our suppliers to help make these things possible. Although we all came out within several months of each other, it was certainly devastating for us, because we had been anticipating being first, not

to be; and it was, we felt, you know, sort of the success of competition but, nevertheless, a very, very aggressively fought battle

That's just one area. The pricing plans that come out are very, very different, and very, very carefully crafted to attack a different area of the marketplace. So I would have to dispute aggressively any observation that perhaps the mobile market is one of those - - -

PROF WOODS: Presumably the ACCC was thinking of something else.

MS MALKIN: Must have been thinking about something else, and certainly nothing that we're participating in.

MR DALTON: Could I add one other comment there, and that is, you look at the bidding for the spectrum, six months ago, where two new players prepare to come into the market, paying $1.3 billion. Now, we've been hearing earlier about investment incentives. That, on the face of it, seems to be, we have a regulatory environment and we don't have the characteristics of an oligopoly, where people are not prepared to come in. We have new players prepared to come in, to put a lot amount of money up in order to develop their services. To put it in comparative terms, we have spent $1.5 billion over eight years rolling out a network. New players are coming in, putting upwards of 600, 700 million dollars just to get the spectrum. So I think that in itself is saying the market is open to new players coming in.

PROF WOODS: What's your attitude to providing a competitive form of retail resale by new entrants? Is that a market that you take seriously and allow others to come in as resellers? Is that to the advantage of Vodafone?

MS MALKIN: You mean wholesaling opportunities?

PROF WOODS: Yes.

MS MALKIN: It is something that we - I just want to be very careful here, I don't to disclose any company secrets.

PROF SNAPE: We encourage that.

MS MALKIN: I could tell. I think that the natural evolution of competitive markets opens up wholesale opportunities. When you start in a marketplace you probably don't focus your energies on wholesale opportunities. You're building out your network, you are trying to decide which part of the market you are most successful at capturing on your own; but when you have a network business - not just a network business - and you have excess capacity, you being to look at ways of utilising that capacity in ways which you can't as effectively directly operate yourself. It is, I think, a matter of self-inquiry that most players at this stage, having been operating now for seven, eight years, are looking at ways of increasing capacity with their network facilities, and wholesale is a very logical opportunity.

PROF WOODS: How would you describe the commercial negotiations that happen at the wholesale price level of new entrants or small players? Is there an active market that resolves itself commercially without need for regulatory intervention?
MS MALKIN: Yes. I think the answer to that question is yes, but as that's not my specific responsibility, I might ask Dave to comment.

MR CLARKE: I think more, and moreso, the wholesale market is developing. We've seen there's evidence of new players entering the mobile market at a resale or wholesale level, rather than as network operators. Perhaps one of the high profile ones is Virgin entering the market; there are quite a few other examples. It's probably something that is evolving and will get more and more competitive. I'm sure as new network operators roll out their network, they'll also be keen to take on wholesalers.

PROF WOODS: Did you want to elaborate, gentlemen? No.

MS MALKIN: I think that developing a wholesale model, as I indicated before, is something which happens in the evolution of a market; but also, we have a bit of a complicated market, and the way we offer our products and services is complicated; it's a bit more straightforward than a can of beans on a shelf. As a consequence, the wholesale model takes time to come to grips with. My personal - I suppose I shouldn't speak personally - my professional view is that you'll see a significant increase in wholesale opportunities.

PROF SNAPE: Implicit in that is that there are going to be significant investments going ahead, so whereas we heard earlier the view that the regulatory system was adversely affecting investments, at least out of the main areas, you are taking the attitude it's not; or what?

MS MALKIN: Again, you remember that we are a company that is focused entirely on the mobile market, and so, when we speak of our experience, we're speaking of our experience in the mobile market, and our own incentives to invest. In Australia, the trend has been to find that there is less need to regulate our marketplace, and there are greater opportunities for investment and innovation. Certainly, we are looking towards opportunities for investment driving innovation in the mobile market.

PROF SNAPE: Throughout the country or just in the main capitals?

MS MALKIN: We have recently made a significant investment in Globalstar, which is a mobile vehicle which is not principally designed for metropolitan centres, which is a much sounder solution for less populated areas. So, yes, I think we are willing to look at investments throughout the country, and our investment in Globalstar would certainly be testimony to that.

PROF SNAPE: Globalstar does what, if you could?

MS MALKIN: Globalstar is a satellite based mobile telephone service which is integrated with our GSM network, and so with a handset you may receive a call essentially anywhere in territorial Australia; and it utilises satellite facilities when you are beyond the reach of our GSM network.

PROF SNAPE: Will that provide a return path for interactive broadcasting?

MS MALKIN: Not in the immediate term.

MR DALTON: Not in the immediate term. It will have a 9.6 kilobit per second data rate, but is not for interactive broadband services.

PROF SNAPE: No; while you couldn't perhaps be receiving in the broadband, it would be a path back nevertheless.

MS MALKIN: Right, yes.

MR DALTON: It could provide a return path, yes.

PROF SNAPE: A return path for what you were - - -

MR DALTON: Yes.

MS MALKIN: Definitely.

PROF SNAPE: So it would be interactive in that sense.

MR DALTON: It could provide that, yes.

PROF WOODS: Within the mobile market is market share a useful indicator of market power? We can look at market share data that's sort of generally available, but does that really illustrate the market power that's occurring?

MS MALKIN: Not necessarily for horizontally or other vertically-integrated entities.

PROF WOODS: So if we were to look at Telstra's share on mobile, being their 48 per cent, are you suggesting from that that underlying that, though, is more considerable market power?

MS MALKIN: Yes, I'm suggesting that that could understate their influence.

PROF WOODS: And to what extent is there ongoing issues requiring resolution between you and Telstra? You've targeted them as being the entity that should be the focus of future regulation in this time of forbearance that you propose for the future, so that's a reflection of that view presumably, that their market power extends beyond

market share. I assume that you're proposing that regulatory focus be on Telstra, not for the benefit of others and for the market generally, but that there's some specific issues that would be of benefit yourself if Telstra was subject to regulatory control?

MS MALKIN: First let me say, we were not making comments because of specific concerns but rather making comments more of a principled nature, and that having regard to the competition principles agreement where the philosophical approach was to, say, vertically separate incumbent monopolies, we would view then, say, part XIB as a reasonable substitute to deal with the aspects of Telstra which it has inherited by virtue of its legislated monopoly.

PROF WOODS: So you're seeing this as a solution in the absence of vertical separation of Telstra?

MS MALKIN: Yes.

PROF WOODS: But that you don't have specific issues that such a continuing regulatory focus on Telstra would resolve?

MS MALKIN: In part the problem with XIB is that by its terms it extends to fix potential problem areas that we would say should not be necessarily addressed by industry-specific regimes; that is, it extends to any player with significant market power rather than just attacking what is that market player which came to the party with an historical incumbency.

PROF WOODS: So you'd keep it generic in the sense of, if there was any entity that evolved or historically brought to the market power, that it should be subject to that.

MS MALKIN: Right.

PROF WOODS: So it's not a historic versus acquisition of power question; the fundamental principle of whether it has power is the point.

MS MALKIN: No. In fact, the acquisition of power in a competitive marketplace would suggest that you should be treated like any market participant in any industry who acquires power.

PROF WOODS: I thought that was your perspective (indistinct)

PROF SNAPE: So therefore you would, in fact, go for an amendment of IIIA which explicitly took that into account, and substitute that for XIB?

MS MALKIN: IIIA?

PROF SNAPE: Yes.

MS MALKIN: No.

PROF SNAPE: The generic principles of access, etcetera, or 46?

MS MALKIN: 46. I mean, in terms of anticompetitive conduct we would say that section 46 was an adequate mechanism - I'm not sure I understand your question but - to police, if you will, market participants other than Telstra to the extent that it exercises significant market power which it has, you might say, inherited.

PROF SNAPE: My point there was to go beyond telecoms and to say what you were describing there, as an inherited market power is present in the terms that you were describing it in other industries beside telecoms. It is in fact, if you like, from a number of privatised industries, or industries which are in the course of being privatised, and what you described, I thought, sounded like that you were setting up a general economy-wide principle for any industries which had come in that same path as Telstra had come, and therefore I said in terms of IIIA.

MR WOODWARD: I think the position, as we understand it, is that the general principle for companies in the situation of Telstra was that there should have been some vertical separation but a policy decision was made not to do so. Therefore an alternative regime to address particular concerns about that special form of market power that companies in the situation like Telstra might have, and in other industries with similar characteristics, that those concerns were to be dealt with through Part XIB, and we're simply saying that Part XIB should be limited to that.

PROF SNAPE: But if you were in fact to make that a more general provision then for, as you say, the companies that come out in similar paths of government regulation where there was natural monopoly characteristics, etcetera, etcetera, then you could dispense with XIB and be using that more general access provision specified in terms of those characteristics.

MR WOODWARD: It's difficult to respond. Effectively, if I understand what you're saying is, if you changed other parameters of the broad competition policy in Australia you mightn't need XIB?

PROF SNAPE: Yes.

MR WOODWARD: That may be right.

PROF SNAPE: No, but I think that it's open for you to be able to consider this and saying, "If you say that XIB should be amended so that it only deals with these inherited characteristics that have come with Telstra," and then you say, "This is not the only industry in which this is occurring," it would be better, in fact, to design a general provision that doesn't single out telecoms for special consideration. It's rather the characteristics that are associated with that bit of telecoms which should be addressed and so let's have a piece of generic legislation which addresses those characteristics.

MS MALKIN: That sounds like a workable approach. What we were striving to do was to, in essence, pare back regulation to that which applies generally; and in recommending that part XIB be limited in its application to Telstra it was on the theory that that was a modification but a generally applicable competition principle for incumbent monopolists which ordinarily might be reflected in vertical separation, but for policy reasons was reflected in part XIB. Then let's simply pare back the regulation so that it matches its original intent.

PROF SNAPE: I mention this in part because it is likely that part IIIA will also be up for review shortly, and so one was looking over one's shoulder, if you like, to the other reviews which are scheduled to take place in the near future, and that there are overlaps here that it is wise to take account of.

PROF WOODS: Certainly, you've referred to IIIA as being an acceptable default. It does raise the question of whether you have any views on IIIA in itself and, if so, that would be useful in that respect. I notice in terms of XIB you referred in your submission that it's application has had some limited success in relation to Telstra. Where hasn't it had success in relation to Telstra?

MS MALKIN: Where hasn't it?

PROF WOODS: Yes.

MS MALKIN: I'm not sure that I'm going to be able to answer that, but again because we sit as observer to many of the goings on in the fixed wire marketplace and have significantly less vested interest, if any, in some of the disputes between those market participants, I'm sorry, I don't think I have anything particularly useful to contribute.

PROF WOODS: I had assumed that those were carefully crafted words and that there was a view. Later on you talk about acquiring market power shouldn't generally be subject to industry-specific regulation.

When we look at XIC you say that, "One of the key features of the telecommunications industry is the need to establish interconnection and access arrangements for the supply of end-to-end carriage services." I assume one could redefine that as meaning any-to-any connectivity. So you identify that as being a key feature of the industry and I suspect there's no dispute on that. Then when we go back earlier in your submission you put forward the proposition that any-to-any connectivity is a questionable focus of regulation. I don't understand the two viewpoints at once.

MS MALKIN: Of, I think, continuing regulation. Again, perhaps it's illustrative if we look at the mobile market and I think, possibly, initially when competing networks were being established there was a benefit to having the access regimes, or mandated access, available when Telstra had a dominant network, but we seem to be

reasonably well beyond that, and there seemed to be, in the absence of having a dominant network provider, adequate commercial incentives to interconnect. As we have progressed, it seems unnecessary to keep as a prong of the test for whether or not a regulation is necessary the any-to-any connectivity objective.

PROF WOODS: But isn't any-to-any an inherent characteristic of the telecommunications market? I mean, isn't that one of its fundamental defining elements?

MS MALKIN: Yes, I don't dispute that. Certainly it is a characteristic of the marketplace, but whether it continues to have relevance for regulation I think is a separate issue.

PROF WOODS: You place great faith in the marketplace and in parts of your submission you talk about a strong incentive by participants to reach interconnect agreements. Why would a major carrier necessarily have a strong commercial incentive to have an interconnect agreement with a small new entrant? I can understand the new entrant wanting to have an interconnect agreement to get its customer base in to the network. But why would a major carrier necessarily offer a price, or a technical capacity, to interconnect? What's its driving motivation?

MS MALKIN: Once there's interconnection with one carrier then the new entrant, whatever you want to call them, has connectivity essentially with all the other carriers through transit arrangements. So it's not like you can - you haven't - - -

PROF WOODS: As long as you break open somewhere - - -

MS MALKIN: Right. And it's not like the rest of us could have some sort of anticompetitive animus and think that we were going to exclude a competitor from the market; that's no longer really feasible. The structure of access charges - and, Dave, you feel free to break in - over time is such that it may be more advantageous to arrange direct connection with a carrier, rather than having that carrier, say, transit overseas for an international entry into the marketplace; just in terms of the cost structures. Although I'm not a technical person, I understand that there are some technical considerations which would make entering interconnection arrangements a desirable thing from a commercial vantage.

PROF WOODS: Can I take up that invitation to explore the access charges and elaborate at this hearing; tell us more.

MR CLARKE: If I can pick up a related point. I think there's commercial incentive to interconnect. A good illustration of that is the roll-out of CDMA networks. CDMA services, access services, aren't declared services. They're not picked up by XIC, yet there has not been a problem as far as I am aware regarding any-to-any connectivity between a CDMA network and, say, a GSM network, or other fixed networks. The commercial drivers are there. If we didn't have

connectivity to, say, Orange CDMA network we'd have a lot of very unhappy customers.

PROF WOODS: But is it of such defining importance in the industry that the regulator should say there must be any-to-any, or is it sufficient for government to say there's sufficient commercial incentive and, if in some cases it doesn't happen, it doesn't matter, that there be any-to-any? I mean, are there opportunities for there not to be any-to-any connectivity for new entrants? Are you establishing a commercial hurdle to entry?

MS MALKIN: You mean which regulation might eliminate?

PROF WOODS: Yes.

MS MALKIN: I guess I would say it's not our - I don't think - I haven't looked at it that way. We've looked at it from the premise that there are adequate commercial incentives; that it is unnecessary for government to regulate, and relying on an over-arching principle of forbearance, I think we would say that the government shouldn't regulate, just on speculation that the commercial prostheses are not adequate. They certainly haven't demonstrated themselves to be inadequate.

PROF WOODS: Thank you.

PROF SNAPE: I suppose that Vodafone's entry has been in fact significantly assisted by regulation in the start-up and also in the guarantee that the analog system would be switched off, so Vodafone has been helped, I think it's correct to say.

MS MALKIN: If we look at Vodafone being helped by the analog network being shut down, that was part of the deal, if you will; it was part of what went into the value proposition for Vodafone.

PROF SNAPE: That's what I meant in fact; yes.

MS MALKIN: I mean, it certainly did. It would have impacted - had the AMPS network not been - had we not been assured that that network would be closed down, it would have changed the value proposition and what Vodafone was willing to pay for its licence back in 1992.

PROF SNAPE: You don't see other areas, emerging technologies, emerging areas, where regulation may in fact assist the entry in the way that it did for you?

MS MALKIN: I hope I can come back to that, but what I - whether regulation aided Vodafone in 1992 with the promise that AMPS would be shut down, it seems to me that a bargain was cut at that time, which I think is a little bit different than putting in place a regulatory regime which has the propensity to repeatedly insert itself into markets which are potentially competitive and potentially very dynamically so. I didn't answer your question and, sorry, but you're going to have repeat it.

PROF SNAPE: It was, you have been helped by regulation; in fact of getting a guarantee of a switch-off, and you came in with a contract, if you like, at that time, that assisted Vodafone in starting up; and as you said, you put a higher value on it because of the guarantee, etcetera. Are there not new technologies which may be coming in, just as mobile phone was a new technology at that time, which would be similarly assisted by regulation which assists a small number of new entrants to enter?

MR DALTON: If I could just say, the circumstances today, perhaps in the first place, are different to eight years ago when there was virtually no mobile networks except analog AMPS. We now have an environment in which there are six players that have ready communication spectrum, and in fact the government deliberately took an action to limit the amount of spectrum that we could acquire in order to allow other entrants to come into the marketplace. So you could argue that the role has already been reversed; that the government has taken action to assist further players coming into the market.

I suppose secondly I'd ask the question: why would the government actively want to take further positive regulatory action to assist further market entry? Is that what the priority for regulation is at the moment?

PROF SNAPE: I'm trying to think of new technologies which may or may not exist at the moment, but you're saying, "Get rid of the specific regulatory framework as far as possible." I'm trying to say, "Now, you have been helped in the past with the new technology. May it not be that there is a case for assisting the entrants in the new technology in the future?"

MS MALKIN: I think the answer to that question is, no. Obviously initially Telstra was the sole provider of fixed and wireless communications, and there was a deliberate policy move to open up that market in a way in which the government felt it was appropriate to do so, that is, by allowing two mobile players initially and then subsequently, with the additional licensing of Spectrum, to allow others to participate. It seems to me no longer necessary for the government to provide, what I referred to in my opening remarks as, an affirmative helping hand to new entrants and, more particularly, I would find it inappropriate for government to pick a technology to support because I think that that is what the competitive marketplace is all about; that people invest in technologies, and when they do so they accept the risk that it might turn out to be flop and, on the other hand, it might turn out to be a great success.

But that is the whole essence of a competitive marketplace, where companies make the decision as to what's going to be a winner, and some of them are and some of them aren't. If you've created a marketplace where people are interested in investing for innovation you've done your job. Whether somebody in this - take the mobile marketplace - goes out of business I don't think the government should worry about that. I think that is the indication of the dynamics of competitive marketplaces, people succeed and, unfortunately, not us, some people don't.

MR DALTON: If I could just add, a recent debate has been about video and audio streaming and here there's been debate, at the political level, about what regulation should apply to that, and the government has taken a decision, essentially to assist video and audio streaming, to assist the business case that new players might have coming into the market if they're going require Spectrum. So I think again, we see an action there that the government is creating that environment to maximise the opportunity of the new players without constraining existing players.

PROF SNAPE: I think that they may have expressed it in a different way of saying, not to obstruct, rather than to assist.

MR DALTON: I'll change my language.

PROF WOODS: Noting the careful use of words in your submission, you state in part that - this is still on XIC - "some form of ongoing regulation will be needed to ensure access is provided to such facilities" - and you were talking about fixed-line network - "may be required". You've said that some form of ongoing regulation "may be required", not "is required". Can you envisage a circumstance where it isn't required?

MS MALKIN: I don't want to not appear courageous.

PROF WOODS: Appear courageous.

MS MALKIN: You're right, we did think very carefully about that word. I think we thought it was unnecessary to take a definitive view as to whether there are facilities, under our proposal, to which access should be given. I think we have some concerns about some transmission capacity. We are in the market for that service. We hear the clamour by many in the industry for continued access, regulation of access, to the local loop and understand those arguments, but from our own experience don't offer a view about that.

PROF WOODS: I would have thought that your customer base would have a view about access to termination of calls through the - - -

MS MALKIN: PSTN termination?

PROF WOODS: Yes. It's obviously an integral part of your business that that be available; but you're saying that the regulation of such, that it's a problematic issue in to the future, that it's not - you don't see that you'd have to have regulation of that.

MR WOODWARD: I think the situation is simply that Vodafone recognise that there are arguments that certain facilities are uneconomic to duplicate but, certainly looking forward, there might be a debate about that. But they recognise at this point in time that there are certain facilities that would be uneconomic to duplicate and therefore they don't have to be concluded about that because they think the principle

is that, if you put that principle in the act and they turn out to be uneconomic to duplicate then access will be provided.

PROF WOODS: I appreciate the focus that Vodafone has had on principles, but to understand what that will translate to in the marketplace it would be useful if in further submissions to us you could give concrete examples of what is the essence of actual market behaviour that you would be regulating by applying the principles that you're proposing here so that we can understand the pragmatics of it as well as the principles.

MR WOODWARD: I'm sure Vodafone would be happy to elaborate on that, but I think they do, in the submission, say that they accept that at this point in time, the Telstra fixed customer access network is something that would be uneconomic to duplicate. So there is that view there.

PROF WOODS: Are there matters that you would like to raise with us at this point? We look forward to further submissions from you. Are there areas where you'd like to clarify with us where you can best invest your time in responding to this inquiry or do you have a clear enough perception of where we're heading?

MS MALKIN: You've given us some guidance in a few areas that you will be looking for us to contribute further, and we'll be happy to do that. I think that was one of the things we were hoping. We do sit on the sidelines in a number of sectors.

PROF WOODS: And wish to remain so.

MS MALKIN: Just wanted to know where we could be helpful.

PROF WOODS: All right. Thank you very much. We appreciate your time and the contribution you've made.

MS MALKIN: Thank you.

PROF WOODS: We'll take a break for lunch and we're due to resume at 2 o'clock. Thank you.

(Luncheon adjournment)

PROF WOODS: We welcome our next participants, being Optus. Could you please identify yourselves and the positions that you hold.

MR FLETCHER: Paul Fletcher, director of regulatory and public affairs.

MR FRANCIS: Derek Francis, manager, regulatory economics.

MR SUCKLING: Adam Suckling, group manager, regulatory.

PROF WOODS: Thank you very much and welcome to the inquiry. Do you have an opening statement you wish to make?

MR FLETCHER: Yes, we're going to ask Mr Francis to make our opening statement.

MR FRANCIS: Thanks very much, Paul. They say you should open these things with a joke, so maybe the best start is that economics is a discipline where two economists can win a Nobel prize for saying the exact opposite thing. So with that in

mind we'd like to present what we think to be the core issues attached to our submission to the Productivity Commission.

Basically, our position is that there are key characteristics of the telecommunication industry which means that Telstra wields significant market power in many of the markets in which it operates, and that this market power is not adequately addressed by general competition, and specifically by Part IV of the Trade Practices Act. So to Optus's mind, and this is the position we've taken with respect to this inquiry, the inquiry shouldn't necessarily look at whether general competition and provisions are the best, or adequate, remedy for this significant market power, but the focus of it should be what, if you were designing a set of provisions, would be that set of provisions that were pro-competitive and in consumers' interests and able to handle the unique features of the telecommunications industry.

What I'd like to do is outline some of the salient points in our submission and some of the key features of the telecommunications industry that we believe requires the continuation of communication sector-specific competition in consumers' interests, and those key features are outlined in chapter 1 of our submission. The most pertinent one, I guess, is the natural monopoly cost characteristics of the fixed local loop.

The fixed local loop is probably the largest single investment in infrastructure in Australia. It is subject to pervasive economies of scale, scope, density and connectivity. It was developed over 100 years, funded at taxpayers' expense, and it's an investment that we're not likely to see duplicated to a significant degree where facilities based competition becomes prevalent over the terms of this inquiry, over the next five to 10 years. So, going over some of those features, specifically the pervasive economies of scale of the local loop, there is what's called local natural monopoly in the local subscriber area. The reason why this is the case is that the predominant investment costs of that infrastructure are the trenching and cable costs, and those cable costs are fixed with respect to the number of subscribers that are connected in the area.

The ACCC cost model has modelled this and outlined some of those costs at approximately 11 to 12 billion dollars, and because they're fixed costs the more subscribers you connect the lower is the average cost. What that means is that the cost technology derives large economies of scale over the range of demand, meaning that that's a natural barrier to new entry. So what we observe is in practice the fixed local loop hasn't been duplicated to a significant degree in terms of market structure. Telstra still has over 95 per cent share of direct market connections in the fixed local loop. So what we say is that this pervasive natural monopoly cost structure means that Telstra wield significant market power in the local loop.

There are some other special features of the local loop. One of the more interesting ones is the economies of scope that are derived over the local loop. The fixed local loop: what we say is that that is the key delivery mechanism of most telecommunication services; and going into the future, our fundamental thesis is, on

available evidence, that the key delivery platforms of the new multimedia and convergent services are likely to also be delivered over the fixed local loop, and so in some respects there is an increase in market power over the fixed local loop because of that increased economies of scope.

So to give you an idea, previously in 1989, when we were back there, Telstra just had a basic monopoly over standard local telephony services, a voice in international, long-distance and local. If we move to 99 now we see that that market power has been leveraged to obtain a relatively dominant position in a lot of the new economy markets that we're now witnessing. Examples of that are: the Internet, where Telstra has the biggest ISP in Australia and has 50 per cent market share; subscription television services where Telstra again, using the same trench and infrastructure has 50 per cent market share; high-speed Internet access, this promises to be a new market where Telstra, being the only supplier at the input level of unbundled local loop services, could achieve quite easily a dominant market share unless there is appropriate equivalent access for competitors to the fixed local loop input.

So, going forward, in terms of technological advancement, what we say is that because of economies of scope that fixed local loop is the key delivery platform for current telephony services and also new telephony services, that in fact market power could very well be increasing, and therefore the need for pro-competitive regulation remains as strong today as it did in 1997.

There are a couple of other characteristics of the fixed local loop that we would like to talk about as well, which probably means you won't observe significant facilities based competition into the terms of this inquiry, into the foreseeable future. There are large fixed and sunk costs of entry. The sunk costs of entry are very important because they're a barrier to entry. What that means is if I go rolling out a local fixed network and I don't get very many subscribers; I get or 5 or 10 per cent of the market, then that investment is basically sunk; it's lost money and I can't redeploy that in alternative use. That's different to what we observe in a lot of other markets. An example might be wireless technology, where if I go in rolling out a mobile network it's not necessarily sunk if I fall over because it's got redeployment value, because there are competitive secondary markets for such services. So, there are very large fixed and sunk costs.

I've also talked about the fact that we don't observe duplication of the local loop. Optus is the most significant facilities based competitor, but still Telstra does have 95 per cent of the market share.

PROF WOODS: That's of the customer access network?

MR FRANCIS: Of the direct connections to the customer access network; 95 per cent market share.

PROF WOODS: Not for all of the - - -

MR FRANCIS: In the retail market, we'll go over those market shares a bit later.

PROF WOODS: Okay.

MR FRANCIS: That's right.

There are a few other special characteristics associated with telecommunications markets that also do require different competition or treatment; say, a textiles industry. One of these features that we outline in our submission, in chapter 1, is what's called positive network effects. The idea behind that is the concept that the value of the network is in part determined by the number of subscribers that you're able to contact on that network; so the number of subscribers connected to that network.

These positive network effects are a peculiar feature of telecommunications or of network based industries. It's different to bread where I don't necessarily care when I go down and buy my local bread how many other people have bought that same loaf of bread, but in telecommunications what positive network effects mean is that - - -

PROF SNAPE: I bet you do - - -

MR FRANCIS: Maybe I do, who knows. You'd like to know you've got better bread than your neighbour, anyway. What it essentially means is that the larger network can attract customers and also exclude smaller networks through anticompetitive conduct.

So a classic example is: Optus rolls out a local network and Telstra just point blank refuses to interconnect to us. Let's say that as a hypothetical example, what would happen: we don't have very many subscribers from day one; our subscribers can only contact the Optus subscribers; so when you're trying to sign up someone they'll say, "By the way you can only contact the other five Optus subscribers, you can't contact anyone in Telstra's network," and we wouldn't necessarily get any business if there was this refusal to provide interconnect. Then what will happen is our customers will gravitate to the bigger network, you'll get positive feedback, and you'll get a locking out of our network and an entrenched monopoly because of the positive feedback associated with these network effects.

PROF WOODS: Can I just clarify? Are you talking fixed and mobile in this context?

MR FRANCIS: It could be applied, in my belief, if Telstra refused to interconnect our mobile network to their fixed network.

PROF WOODS: Can we just put that one on notice then?

MR FRANCIS: Yes.

PROF WOODS: I wouldn't mind exploring that.

MR FRANCIS: We can come back to that. That's all for that one. So, that's a specific feature.

There are some other features as well that are important: that requirement I was talking about with positive network effects and any-to-any connectivity; the need for subscribers to be able to contact other subscribers on the network. What Optus says in its submission is that where there is an overwhelming dominance then there probably is a requirement that any-to-any connectivity does need to be regulated, because otherwise the largest market player can exclude more efficient and more competitive entrants.

The final two points are that telecommunications markets can be subject to tipping and path dependence. What some of these new theories on economics look at is where you've got increasing returns to scale models and you've got a network operator that controls one market being able to cross leverage that market share into another market. An example might be that Telstra, because it has high market share in local networks, is able to cross leverage that market share into a higher market share in mobiles. There's also path dependence associated with that, because quite often some of these markets are subject to increasing returns, so once you get over the tipping point then you can lock in a further monopoly.

I guess, just briefly referring to the slides we've got at page 5, some of this is borne out by what we look at, the imperial evidence with Telstra's market share, where what we observe is in local network services they have 95 per cent market share, and if long distance was appropriately regulated you wouldn't necessarily expect that they'd have any higher market share than other players, but what we still observe that in the long-distance market Telstra still maintains 75 per cent market share, and I think, Mike, you also suggested in the morning, that underestimates Telstra's market share, and the reason is that it doesn't include Internet; so that's just retail market share. So, if you add Internet - - -

PROF WOODS: If we can explore a bit later the difference between market share and market power.

MR FRANCIS: Yes, we'll explore that later. Even in international we're at 48 per cent share; subscription TV we're at 50 per cent; mobiles we're at 48 per cent. So what it's suggesting is that because of this monopoly building block input that they've got in local telecommunications that they're able to cross-leverage that market to achieving substantial market share, market power and dominance in the new markets emerging.

Okay, so we've outlined what we believe to be the economic features requiring sector-specific pro-competitive regulation. What this all means, and this is what the Optus thesis says in chapter 1, and chapters 3 and 4 especially, is that because of

these distinguishing features of the telecommunications industry there is a need for pro-competitive regulation of the fixed local loop for three principal reasons. The first is to promote facilities based entry and competition in local loop services. The second is to promote fair and effective competition in downstream markets that are dependent on the local loop, so the long distance market, Internet and the new DSL markets, high-speed Internet access that are opening up - all of them require fair and effective access to the local loop. The final reason for regulation is to prevent monopoly prices being charged for the fixed local loop input service; so this is to prevent people paying more than is economically efficient for the fixed local loop services.

Our position that we're taking to this inquiry we think is reasonably consistent with what we would describe as a relatively settled and standard approach internationally to regulating telecommunications. In our submission, in chapter 2, we refer to the international trends in telecommunications regulation, and if I could briefly refer to some of those outcomes.

The European Commission is holding a review of the sector-specific regulation in telecommunications and the results of that inquiry, which has now been going for one year, have basically recommended the following requirements in terms of sector-specific regulation. The European Commission has said that now is not the time to wind back telecommunication-specific regulation because the entrenched market share of the incumbent telephone monopolists has not been eroded to a significant extent to where we can say there is effective competition in local loop services.

So what the European Commission has recommended, and their four principal recommendations are, that operators with significant market power offer non-discriminatory access and interconnection arrangements. In general, the European Commission defines this for fixed local loop services as being consistent with a long run incremental cost model, some sort of forward looking, long run incremental cost, so they require that. The significant market power test that they used, they propose to increase the threshold of that from a 25 per cent market share to around 40 to 50 per cent market share. So that would quite easily capture Telstra in terms of its own market share because in the local network that's up at around 90 to 95 per cent.

Other things the European Commission recommended are requirements to prevent margin squeeze. A vertically-integrated operator can still offer cost based interconnect, but if it plummets its retail rates it can get rid of competition by margin squeeze. Also, preventative measures to prevent unfair cross-subsidy in competitive markets. The final thing that the European Commission recommends is placing the onus of proof on the incumbent if they're undertaking any discriminatory action in relation to key bottleneck services such as the fixed local loop. So what the European Commission says is their principal requirement is non-discriminatory interconnection and, if there is any discrimination, it can't be undue and the onus of

proof would be on the incumbent to show why that discrimination exists otherwise it's apriority not allowed.

The other review that we think is important is the review in New Zealand. The reason why we think this is particularly important is because New Zealand, I guess, was the empirical experimental case where they attempted to rely on general competition law up to 2000. I think the results of that particular inquiry are particularly pertinent and important to this inquiry. What that inquiry found was that reliance on general competition law had proven to not quite be adequate in respect to telecommunications in terms of promoting effective competition.

What they said was that there was a lack of an effective framework to agree dispute resolution, and the disputes, in the absence of that, were protracted and the legal mechanisms set out in section 36 of their Trade Practices Act, which their equivalent to section 46 of our Trade Practices Act, which is what would happen if there was just general competition law. What the New Zealand inquiry found was that that was inadequate to regulate telecommunications.

Basically the New Zealand inquiry draft report recommended a slimmed down version of our own access regime and competition policy framework where you have incumbent services that are basically monopoly inputs, they are subject to declaration, where you have an independent third party commission or arbitrator that would determine (indistinct) terms and conditions in the event of disputes between an access seeker and an access provider.

What I'll very briefly talk about is our own experiences with part XIC which is one of the topics that the commission is reviewing. Basically our own experiences are that with interconnection, in the absence of the ACCC - and this is slide 1 that you have in front of you - that interconnection problems would not have gone away in the absence of the ACCC setting fair and efficient terms of interconnection.

So just briefly going through this history. In 1991 Austel set the price at 3 cents, Telstra then raised it to 3 and a half in 1995. 1997 the new regime comes in; Telstra submits an undertaking with proposed prices of 4.7 cents per minutes, and at the time these were approximately four to five times above world's best practice. The reason Telstra does this is reasonably obvious from an economic sense, the higher the access price, the less able competitors are able to compete in long distance and international services because they have a higher cost base, and so therefore Telstra can maintain retail margins and limit and stifle competition.

PROF SNAPE: By "best practice" do you mean lowest costs?

MR FRANCIS: Yes, they were rates set by regulators worldwide, so these were the rates in the UK and the US at the time.

In 1999, after about a year and a half of analysis, the ACCC rejected Telstra's undertaking and what the ACCC said, and these were their actual words, "The prices that Telstra proposed were at least 100 per cent above reasonable levels, and that all

prices needed to be at least halved." The ACCC then proposed an interconnect rate of 2 cents per minute. Telstra then resubmitted an undertaking and it came out at about 2.3 to 2.7 cents a minute. ACCC again rejected that and set an interconnect rate of 1.5 to 1.8 cents a minute for last financial year and this financial year. That's now getting us pretty close to international best practice. The graph on the next page shows the international best practice which basically - - -

PROF WOODS: Just before we turn the page. You have a future interconnect price if XIC was repealed.

MR FRANCIS: This is right. This is outlined in our submission. This is the interconnect price arising under the efficient component pricing rule. So what this basically says is, if Part XIC is repealed then the existing competition law, in terms of general competition law, the best it could probably do is something equivalent to an ECPR price equivalent to the Privy Council decision in New Zealand Telecom and Clear, where they said that an ECPR price is not necessarily anticompetitive. Telstra itself did the calculation of what they believed was the ECPR price and they said they were 7 cents per minute. So what we basically say is that, if Part XIC was repealed, what we could expect is that Telstra would move interconnection prices towards 7 cents per minute which is the price under the efficient component pricing rule.

What we do in our submission is, then we calculate the welfare loss generated if such a price was to come out into the marketplace, and we generated the static welfare loss from such a measure at around $1.8 billion per annum in terms of the loss of consumer welfare. So we can see that's fairly large. So we can see the benefits from having this pro-competitive regulation are fairly large.

Mike, just bearing out on some of that thesis on the ECPR price, what we'll notice on the next graph on page 2, is that New Zealand, relying on general competition law, you will notice that they are an outlier that have an interconnect price of 3.5 cents per minute which I would imagine is probably reasonably close to the ECPR price in the New Zealand environment. It is also consistent with Telstra's observed commercial behaviour where, what we saw in 1997 was an attempting to put a price in the market of around 4.7 cents per minute.

PROF WOODS: Although as I understand Telstra's evidence this morning, they were saying that the 3 and a half cents mediated price in 95 is roughly the equivalent of just over 2 cents that they're undertaking.

MR FRANCIS: Yes.

PROF WOODS: So the graph, in the sense of bringing a past price in different volume circumstances onto the current chart, might be slightly misleading.

MR FRANCIS: The 1997 offer was unreal. The 1995 price, I mean, we'd probably agree that if volume accounts had been taken into account that the regulator - it's probably not unequivalent, but the point is that didn't there through laissez-faire in

the commercial negotiation, it got there through the regulator setting the price, and Telstra always sought to raise the price notwithstanding volumes were going up. So it didn't get there by voluntary commercial negotiation.

What we say in terms of Part XIC is, there is still a large job to be done. Basically there are three paths to full facilities based competition. One is interconnection. The second is local loop unbundling. The third is local call resale. These two jobs, local loop unbundling and local call resale, are yet to be done. The current discounts offered off the local calling product by Telstra don't allow for effective competition in local calling services, they don't reflect avoidable costs. The second things is, the local loop services which are particularly important in the key delivery mechanism for the future convergent world, Telstra's proposed prices were around $700 per annum, from memory, and that is probably at least - the ACCC themselves found in their draft decision, that that was 75 per cent too high; that those prices of $63 per month should be reduced to $36 per month.

So without proactive regulation you're unlikely to get, in the absence of an access regime, Telstra supplying the bottleneck local loop on equivalent terms to its own downstream operations as it does to other competitors. You're like to see cross-leverage, margin squeeze and monopoly prices to new entrants to prevent them from entering those new markets such as high-speed Internet access supplied over DSL services.

Having said this, what our submission does go on to say is that, we do think that the Part XIC access regime has been extended, it's been overreached, so we are consistent with some of the earlier submissions put in by Telstra and Vodafone that its reach has become too extensive. The two areas where we think it's become too extensive is that it's been extended, in contrast to Part IIIA, to regulate markets that we say are fundamentally competitive, but also been extended, contrary to world's best practice, to new entrants' services where new entrants don't actually have market power.

So the three markets where we say it's been extended into fundamentally competitive markets, where we say the access regime really shouldn't have been, are: mobile networks where you've got six networks currently; inter capital city transmission networks where you've got multiple sources of independent supply; and even subscription television services, and the reason is that you have full duplication of those between Cable and Wireless Optus and Telstra.

So the reform that we suggested, which is hopefully reasonably consistent with some of the terms of this inquiry, is we are suggesting a more aligned approached for Part XIC where the declaration test, the test for declaration, be a substantial market power test which we think might exert a slightly greater competition focus on the ACCC in terms of its declaration decisions. So what we think is, at present, some of the areas where XIC has been extended to is properly left to market forces rather than regulation.

The final major issue that we wish to touch on in this opening statement is Part XIB and the competition rule. What Part XIB does is, it sets up a competition test which basically says that a carrier with substantial market power can't take advantage of that power with the effect of substantially lessening competition. In itself it's a fairly - - -

PROF WOODS: Or even the likely effect.

MR FRANCIS: Effect or likely effect of SLC. In itself it's a fairly unobjectionable test, and what we're essentially looking for is the promotion of competition in markets and carriers not using that market power. What we say is that Part XIB has been effective in dealing with anticompetitive conduct as a quicker fix than the Part XIC access regime. The Part XIC access regime is a very lengthy process. We've heard from Telstra, and you'll hear from ourselves, that the actual declaration process takes probably a year and then the actual arbitrations take one or two years more. So all up you're dealing with a three-year process; whereas Part XIB can be used to get very quick and tangible competition into the market.

The example where this was in the Internet peering case where, what happened there was, Telstra was charging 19 cents per megabyte for data that they transferred to other networks, but was refusing to pay the same or similar amounts when other carriers transferred data to their networks. The ACCC issued a competition notice saying this behaviour from Telstra was anti competitive. Immediately that competition notice was issued, Telstra did enter into peering arrangements with its three largest peers, where it essentially then made equivalent terms of interconnection for Internet services between its peers, and that produced tangible results that led to significant drops in wholesale prices. It meant that the wholesale interconnect market wasn't artificially monopolised by Telstra, because it was raising rivals' cost base.

The second example where the competition notices had very beneficial, pro-competitive effects is the local call resale commercial churn case. Some of the more pertinent facts of that case were Telstra was charging $30 per customer transfer, and making our own customers liable for past debts incurred to Telstra. The issuing of the competition notices saw a reduction in the transfer charge to $6 per customer, and also no liability for past bad debts in the introduction of the Telstra wholesale billing system. That produced tangible benefits.

After that, competitors had a more viable local call product, and we did see for the first time, after that competition notice issue was resolved, competitors entering the market and offering local call prices below Telstra, which then required Telstra to respond with more competition itself, so for the first time we did have competition in that monopoly market, after the competition notice.

So what we basically say is that Part XIB has useful going backwards. There's no evidence going forwards that it's not going to maintain usefulness, because Telstra still maintains significant market power in the markets in which it operates, and then the new converging of that market power is perhaps increasing, and so the need for

Part XIB remains as exactly it was in 1997. A present example of where it could usefully be applied is perhaps local number portability for large businesses, where if Telstra doesn't allow Optus to have number portability for large businesses, the ACCC could think about, when we're trying to direct our customers and Telstra doesn't terminate calls correctly to them, the ACCC could think about using them in areas such as that, we would throw open as an example.

In summation, what we would say is: the fixed local loop is an evasive monopoly that is supplied by one carrier. We haven't observed significant duplication and we're unlikely to see that for the foreseeable future, and so the case for sector-specific regulation, in line with international best practice, remains compelling.

PROF WOODS: Thank you. You've certainly covered a wide range of areas, and your submission is somewhat extensive in that respect as well, for which we thank you, for tackling of each of the various issues that we address in our paper, and providing additional material as well.

Let's look at market behaviour at the moment. It's a question I've posed to others, and I would be interested in your response. Looking at where the Australian market is at the moment and where it is likely to be under the current regulatory regime over the next couple of years, would it be reasonable, from your perspective, to say that there has been growth in a range of services, in the number of carriers, carriage service providers, other service providers; and that there is a degree of innovation that's occurring in the marketplace? Is that a reasonable summary of where the market's at and where it's likely to head to?

MR FLETCHER: Yes, we would agree with that.

PROF WOODS: What conclusions do you, therefore, draw about the current regulatory environment, given that outcome?

MR FLETCHER: I think we would draw the conclusion that, in the context of the current regulatory environment, it has been possible for large players, like ourselves, and other large non-Telstra players to grow, to develop into new geographical markets, into new ranges of products. It has also been possible for other players to enter the market and establish particular niches of various sizes, and in our view, the regulatory regime has been a significant component in the growth and vigour that we've seen in the telecommunications market in Australia in the last three years.

PROF WOODS: Does that give a persuasive case, then, for changing the regulatory environment?

MR FLETCHER: I think, as is evident from our submission, with the exception of some incremental improvements, we don't believe that fundamental change is yet appropriate, and we reached that view based upon our analysis of the market power that the incumbent, in particular, enjoys and the view that we hold, that in

consequence, it would continue to be the case that absent telecom-specific regulation, you would see that power exercised more comprehensively to restrict the growth of players other than the incumbent.

PROF WOODS: You've been in the marketplace for a decade or so, and you had a protected position up until 97. You've been in a more liberalised environment since then, but are still actively pursuing markets during that time. What's the time frame that you envisage that you need to be sufficiently confident of your market position and the general competitive nature of the industry that you would start advocating a wind-back of regulation?

MR FLETCHER: I don't think that we would express it in terms of time so much as in terms of where do the objective indicators of market power sit. So, indicators. We've referred constantly in our submission, in the remarks that Derek has made, to Telstra's market share in local access services. We regard that as absolutely critical, not only because, across a wide range of services that we provide to our customers, we need to originate and terminate over Telstra's network, but we also regard it as critical because, as Derek has said and as our submission has made it clear, Telstra's dominance in the local access market - the traditional telephony local access market - then equips it to move rapidly to very strong positions in markets for new products, as those develop, which draw on the local loop.

PROF WOODS: Do you want to give an example? Presumably we're talking some combination of economies of scope and some form of first-mover advantage. Do you want to illustrate?

MR FLETCHER: The example that we've cited in our submission is Telstra's position as the dominant ISP, and the fact that, if you look at a range of OECD economies, you see the dominant telco also being dominant in the ISP market. What is very interesting is that, if you look at the role of the local loop, the arrival of DSL technologies suggests that, rather than the local loop being a diminishing part of the overall telecoms picture over time, in fact it's enjoying a sudden and spectacular resurgence as technologies are developed that allow much higher bandwidth to be delivered over the local loop. That suggests to us that what we can expect for the future is a series of products and markets to develop that are delivered over the local loop, and therefore, where the player with massive dominance in the local loop will continue to be in a very strong position.

PROF SNAPE: Telstra is through Big Pond, which is not using the twisted copper pair, is it?

MR FLETCHER: It depends whether you talk about the high-speed Internet access or the dial-up Internet access.

MR SUCKLING: You can take a premium service where you use the cable, which is faster, or you can take a sort of - - -

PROF SNAPE: What proportion is on the broadband?

MR SUCKLING: The figures, I think, are in Telstra's investment - - -

PROF SNAPE: One can't talk about Telstra's dominance of the ISP, linking that to the local loop, without separating out those two things.

MR SUCKLING: That's true.

PROF SNAPE: The fact that you also have got an HFC cable, which, of course, you can use - you do use - for ISP as well; and if one is talking about the relationship of Internet provision to the local loop, then one has to separate out the broadband, presumably.

MR SUCKLING: It's a premium service which is a very small percentage of their market.

MR FLETCHER: That's true. The Big Pond is several hundred thousand. We've got the number in our submissions, haven't we?

MR FRANCIS: I think they've got a million total Internet users versus next largest around 400,000.

MR FLETCHER: Certainly, in terms of the cable modem services, the position is much less clear-cut at this stage, bearing in mind that both Optus and Telstra deliver those services over their respective HFC networks. I don't think that - - -

PROF WOODS: But that's investment that's open to anyone to provide. I guess we're trying to come back to this essence of dominance through their historical incumbency on the ship of the local loop.

MR FLETCHER: And indeed on the HFC network you would ask yourself, okay, well, it's open to anybody else to come in and build a broadband network, as Cable and Wireless Optus, and its predecessor organisations, did in recent years. Has that been a successful strategy or, I guess, more to the point, would you expect, based upon that experience, that others would come in and do the same thing? I think you'd have to say, given that it's still not EBIT positive as a business, that it's unlikely that there'd be others who would be - - -

PROF SNAPE: I take that point, but what I'm trying to say is that I think that much of what you have said about Telstra's position relates to the local loop, and I think maybe just about everything you said, in terms of what you refer to as "their dominance", relates to the position with the local loop. Now, if one is looking at the Internet position, for example, one can't throw into that comparison Telstra or your own use of the broadband cable when it's talking about the local loop only; and the dominance, as you put it, of Telstra on Internet is not so high when one simply relates it to that which is using the local loop rather the broadband.

MR FLETCHER: I think that depends what view you take of the ISP market. If you look at the numbers of people who are currently receiving narrowband dial-up Internet services, and compare them to the number of people who are currently receiving high-speed cable modem services, high-speed Internet access, the conclusion is clear that the dial-up ISP market is vastly, vastly bigger, and that remains the way that the vast majority of people, particularly residential customers, receive Internet services. So then you ask the question, how do you ensure that that market is a competitive one? That's the policy question you've got to ask. You then have to go back and ask yourself, who has a pervasive advantage in delivering those services, as a result of having a ubiquitous local telephony connection to just about every customer in Australia.

PROF SNAPE: I see your point, but, as I was saying, I think it does come down to that local loop. We then, I guess, ask the question whether one needs a telecom-specific regulatory framework to deal with that, or whether it can simply be dealt with under the more general access provision of Part IIIA or a revised IIIA. If this is the essence of what you perceive to be the problem, why does one need telecom-specific legislation, rather than a generalised access, specific access, to essential facility legislation? Why does one need the telecom-specific rather than just IIIA?

MR FLETCHER: I suspect that that question is so important that all three of us would like to have a go, so why don't I lead off and ask my colleagues - - -

PROF SNAPE: Or a suitably revised IIIA.

MR FLETCHER: Yes.

PROF SNAPE: I say because, as you know, IIIA will be reviewed shortly by someone.

MR FLETCHER: Yes. I think there's a range of reasons. I think certainly we think that under the current institutional arrangements the ACCC has been able to build up a considerable body of expertise in telecommunications, and it has taken them some time to do that. It would be a great shame to lose that.

I think, additionally, one of the things that we've argued is that the network nature of telecommunications means that there are competition issues which arise in telecommunications which don't necessarily arise in other kinds of industries. One of the consequences of that is that change can occur very rapidly, change in competitive position can occur rapidly. Derek has made reference to the phenomenon of tipping and of path dependency. We believe that one of the features of the present regime is its capacity, which hasn't always been achieved but sometimes has, to respond relatively quickly, and we point to the competition notice arrangements particularly as improved by the amendments last year.

So we think a speed of response is a very important factor, particularly given the network nature of the telecoms industry. I'll make those comments.

MR SUCKLING: Having said that - I mean, Paul's absolutely right - but what we said in our submission, and as Derek outlined previously, is that we do have a belief that in some instances the ACCC has cast the net too broadly in its declarations; and you've seen Allan Fels at various conferencings saying, "We've got too many arbitrations on," or "We've got too many - more than the frames of this legislation intended."

We have said in our submission - I was just looking for reference, I can't find it immediately - but we've said in our submission that the Productivity Commission could look to some of the provisions in Part IIIA as guidance as to how the current regime, not in process terms but in the test declaration terms, could be sort of streamlined to ensure that future declarations applied just in particular to bottlenecks or facilities which provided significant market power.

PROF SNAPE: One way to do that, of course, would be to roll it into IIIA.

MR SUCKLING: Well, yes; I mean, I suppose we haven't given huge thought as to why melding those two together - we always saw Part XIC, for the reasons Paul has outlined, staying there because of the particular characteristics of telecommunications, and drawing some inspiration from IIIA.

MR FRANCIS: If I can just make a couple of comments as well. As Adam and Paul say, we do have some sympathy with the tightening. The basic difference between IIIA and XIC is the declaration test, and we do have some sympathy with the tightening of the declaration test to only substantial market power.

But in some respects, to my mind, the question is around the wrong way; and the reason why is that Part XIC has been shown to demonstrably work. It has, in many respects, at least with the interconnect problem, got us towards world's best practice; but in terms of Part IIIA there isn't actually any empirical evidence of demonstrable workability of it, and it's partly because of some of the institutional processes attached to the declaration process. We have a separate organisation, the NCC, actually declaring and it being subject to appeals at every level. It then goes to the minister to confirm the declaration, that can be appealed; and then after that, you have disputes going at the ACCC. So it actually sets up Part IIIA a fairly unwieldy process.

To date there have only actually been two declarations under IIIA, and I think there have been some airport services, and even they have been appealed. What you actually observe in IIIA, it's a bit of an anomaly to say that that's the general competition law for regulating access, because what you observe under IIIA is a whole set of different sector-specific and industry-specific regimes subsisting off IIIA. So I don't think you can actually say that IIIA is this overarching general

competitional framework for regulating. Where IIIA has been successful is in gas and electricity, but they themselves do have their own sector-specific regulations.

So I'd say XIC is working; Part IIIA hasn't been shown to work, so it's probably not necessarily the right way of framing it.

PROF SNAPE: So amend IIIA to be closer to XIC?

MR FRANCIS: Exactly. Substantial market power test, and probably realign some of the institutions so you get some of that unwieldiness in the administrative process, and we'd be in agreement.

PROF WOODS: You've placed a great deal store on speed of response. In your opening comments you talk about protracted resolution of disputes in the New Zealand model.

MR FRANCIS: Yes.

PROF WOODS: Are you therefore arguing that XIB and, particularly, XIC have produced timely absence?

MR FRANCIS: More timely than general competition law.

PROF WOODS: I'm interested in what you'd base that on.

MR SUCKLING: I think the point Derek was making was, in the case of the Internet interconnection notice, that took nine months, I think; in the case of the local call resale one, the commission handed down lots of competition notices all around the same behaviour; but there was one set first which led to a change of behaviour, which didn't rectify things, and then there was another set of competition notices. We've always said that they were too slow and it didn't work as fast as the regime had thought that they would work. They weren't expeditiously handed down. I guess the point Derek was making is that compared to the alternative, they have worked better than we think the alternative would have.

We said in our submission that we'll come back to the commission with some sort of suggestions on streamlining those things to speed them up, but I guess we're concerned to try and get you over the hump of, "Yes, let's keep this," before we come in with suggestions on improving it.

PROF WOODS: I wouldn't have though timeliness currently the defining factor.

MR SUCKLING: No.

MR FLETCHER: No, but the issue is relative timeliness. It's a perfectly serious point. If you're contemplating a change to a regime, and what you're arguing is, "We're going to get rid of this one because it's too slow, but we've got another one that's whizz-bang, and we can assure you it's going to be much, much quicker," I

think the experience of people in this industry and others would be, "Well, we're a little sceptical about claims that other ones are going to be quicker."

MR FRANCIS: Just on that, some of the other jurisdictions internationally do put specific time limits on the regulators making decisions. We haven't actually suggested that in our submissions. I think part of the problem, we think, is because the access regime has been extended into competitive markets. A lot of the ACCC resources are tied down in trivial, competitive issues, where they should be actually focused on the important bottleneck issues and churning out the decisions on those key competition issues more quickly. So that's probably part of the area where - and that's because of the extension of the access regime into those competitive areas.

MR SUCKLING: You'll note from our submission we had a dispute from one carrier over a $12 bill that went all the way to the commission, and there lots of submissions. When we finally pointed out it was $12 the party decided it would be better just to settle commercially.

PROF WOODS: I'd like to go back to market share and market power. Is there anything you want to finish off on that? You've been using the phrasing of substantial market power. You also were suggesting the benefit in having some objective assessment of market power. To that extent, is market share the relevant objective assessment or are the two not necessarily synonymous?

MR FRANCIS: Market share is a very good start indicator. To give you an idea of the European Union, in some respects they - - -

PROF WOODS: You're talking about the 30 - - -

MR FRANCIS: Yes. They look at (indistinct) market power 25, and they're planning an increase to 40. It is a good start but it's not the overall catch-all - I always get back also to my first year economics, which Richard taught me - so if I get this wrong we have him to blame. But also a necessary condition for market power, I guess, is the ability to derive supernormal profits, which means pricing above cost. For example, while we might hold a reasonable share in broadband, it's not necessarily demonstrably profitable, so you wouldn't necessary go out regulating that just yet because you might be deterring some future investment. Market share in general is a very good indicator.

PROF WOODS: How does market share help test where there are oligopoly practices occurring?

MR FRANCIS: Market share, where there is an oligopoly, will lead you to a more concentrated share than, say, in a completely perfectly competitive market where you've got a lot less concentration. Our general position is that the monopolies themselves are hard enough to regulate, and we don't see that there's any existence in the genuinely competitive sector, such as mobiles, that there is any oligopolistic or collusive-type behaviour not in consumers' interests. The mobile sector is very, very

highly competitive and people act independently in terms of rivalry, and will bring consumer benefits. We've got natural incentives to do so, because fixed costs are relatively high relative to margin costs. If there is some sort of oligopolistic, collusive-type bargain, Part IV of the act is probably a reasonable way of dealing with that.

PROF SNAPE: Just dropping back to the local loop for a moment. You would want to maintain regulation in respect to the local loop and access. Is there anything else, beside the local loop?

MR FLETCHER: In other words, are you saying that, rather than there being a power that applies to all carriers, for example, you have a power that might legislatively apply to particular designated telecommunications markets?

PROF SNAPE: Yes, it may be that way. As I think - as I read through your submission and listened to you - that where you say there is the concentration of power, where there is a problem, if you like, it is in relation to the local loop. Is that the only area?

PROF WOODS: If I can add to the question, and that's that you make that point in some cases, and in others you say that regulation should, as far as possible, be targeted at incumbent operators with market power. Is there an organisational focus to where regulation should be targeted, or a facilities focus? In that sense, we can then look at mobile and your argument that that shouldn't be regulated, but that seems to be a facilities based or technological focus of whether to regulate or not. We're having trouble just trying to identify precisely what you see as the essence of where regulation should be focused.

PROF SNAPE: You said that the pay TV should not be - the cables shouldn't have been declared, so it does seem to bring it down to the local loop.

MR FRANCIS: The fundamental reason for that is that you observe fairly extensive facilities based competition in a lot of other areas, such as mobiles, whereas in the local loop, you're yet to prevalently see significant facilities based competition. So that's the area of pervasive market power, but I think we would also want to keep reserve powers for where you do observe substantial market power in other areas. It's just, in terms of the current market conditions, probably we don't necessary see that.

PROF SNAPE: So you may want to draw the regulations in a more generic basis or technologically neutral basis, or whatever; but the only point of problem at the moment is the local loop.

MR FLETCHER: Can I just respond to that. I think there are a couple of things we would say to that. I think we would say firstly, that there are other markets where the incumbent, in particular, retains very substantial market power.

If you look at a map of our network, and where our network backbone runs - running as it does from Perth up to Brisbane and then on up to Cairns, and ours is the most extensive of anybody's other than Telstra - what that will tell you is that there are still plenty of regional areas around Australia where the only trunk carriage is provided by Telstra. That will tell you that customers in those towns don't face competitive supply or long distance services to the same extent as those in the city. It will also tell you, for example, when you bear in mind that we would typically have a mobile base station in many country towns - as do our competitors - and those base stations have to be connected into the network, then that requires a leased line, which is typically acquired from Telstra.

I think we would say, okay, there are other markets where the incumbent retains substantial market power because we and others, for various reasons, have chosen not to enter those markets. I think that's the first point: that there are markets other than the local loop. I think the second point is that, the way that the regime operates presently is that the ACCC has a general power to intervene, if you like, in telecoms markets, and the test as to whether there is a need for intervention is in the hands of the ACCC.

If the point you're making is the bulk of where the action has been has been in the local loop, that's clearly right. That's clearly right, but does that mean that we would be comfortable saying, let's, for example, specify in legislation a much narrower scope of activity so that it was, for example, only the local loop where you retained telecom-specific competition regulation? As a company, we would be very uncomfortable with that proposition.

MR SUCKLING: I suppose our experience also, professor, is that the way you put it, it's the only local loop. It makes it sound all very humdrum and not really very - you know, that it doesn't bring the problems that we've experienced.

PROF SNAPE: I wasn't suggesting it was humdrum.

MR SUCKLING: Perhaps I misinterpreted you. Certainly, in our experience of trying to get into the markets, the rather innocent piece of copper between the customer's house and the local exchange replicated into every house around the country, is really such a fundamentally, fundamentally difficult thing to overcome in competition terms. As we've suggested to you, to our mind, it is interconnected with many other services that Telstra offers, going into the future.

MR FRANCIS: A lot of the operation and support systems that exist off the local loop also are critical to get access to. An example is with unbundled local loop services. It's not just access to the copper, but access to fault reporting and fault provisioning to build the informational database that we need on equivalent terms, to actually supply in competition with Telstra.

PROF WOODS: You've got an HFC cable that passes a couple of million homes. Why isn't that an alternative for telephony for you? Why doesn't that constitute an alternative telephony to the local loop? It couldn't be just the technical capacity.

MR FLETCHER: It clearly does.

PROF WOODS: Do you use it as such?

MR FLETCHER: Absolutely.

PROF WOODS: Local telephony is connected into - - -

MR FLETCHER: At our most recent annual results, we announced we had 415,000 customers on our broadband network.

MR FRANCIS: Telephone events.

MR FLETCHER: Yes, we are clearly out there selling local telephony services to anybody who that cable passes, and we're obviously working that asset as hard as we can, in accordance with good business practices. I think there remains a host of reasons why, for the moment at least, Telstra continues to have significant structural advantages in providing local access services, as compared to us. It remains the case that the vast majority of people, whose homes that network passes, don't take local telephony, even though they receive regular mail drops and other visits from us. In part, that goes back to the advantages that Telstra enjoys as the incumbent.

Do we view that network as a means of competing in local access telephony? Absolutely. Are we marketing to people whom that cable passes as hard as we can? Absolutely. If you just take the population of people past whom that network passes, do we have a 50 per cent market share, or anything like it, in local telephony in that kind of market of people? No, we don't. Why do we say that is? We say it's because of the market power and the entrenched advantages of the incumbent.

MR FLETCHER: If I could just add one point to that as well. We're doing pretty well here, but the experience that we have, and also the measures that we're suggesting be implemented, are consistent with facilities based competition.

In our submission, we refer to the areas with the most facilities based competition - the UK and the US - which also have the lowest interconnection prices, and part of the reason that is, and we've said this, is that, even though we might connect X number of people, we're still competitively depend upon Telstra because most of those people, when they make out calls, will be terminating on Telstra's network, so we'll have a high cost base with high interconnect prices. Actually, low interconnect prices or cost-oriented interconnect prices do lead to increased facilities based competition. In the UK and the US, where they probably do have the most facilities based competition, they also are consistent with (indistinct) interconnect

prices. What we're suggesting is perfectly consistent with facilities based competition.

The final point we will make is that, in terms of our experience, it isn't actually different to the international experience. The most facilities based competition is in the UK, where you have three cable networks and you have penetration extending to about 75 or 80 per cent of the country. As of yet, the cable companies still only, after about four years of extensive facilities based competition, only have 15 per cent share of the total market. BT still retains 85 per cent of direct connections in the UK. So, it is a market where there is a lot of entrenched market power.

PROF WOODS: So, for new entrants who will have their customer base connecting primarily to the major holder of market share, the lower the price of termination, in fact, the greater the encouragement to invest.

MR FRANCIS: Yes, exactly; and that's consistent with the UK experience.

PROF SNAPE: Do any other telco companies use your HFC?

MR FLETCHER: Yes, they do.

PROF SNAPE: Do you provide access for that?

MR FLETCHER: We do.

PROF SNAPE: That's able to be negotiated commercially and satisfactorily, in the sense that they presumably do some sort of - - -

MR SUCKLING: Well, it varies, to be honest.

PROF SNAPE: - - - negotiation between Telstra and yourselves?

MR SUCKLING: Yes. We have commercial arrangements with a suite of companies, and we have an arbitration with one company over access to the network.

PROF WOODS: Presumably you do have fibre optic that passes a number of major regional centres. Do you then connect that into their local consumer access network, pick up local calls that way, or is there some - - -

MR FLETCHER: No, we don't.

PROF WOODS: Any particular reason?

MR FLETCHER: Well, again it comes down to the fundamental economics. If you've got an optical fibre passing through, you know, Dubbo, does that give you any advantage in then building a local loop in Dubbo? It doesn't. It gives you an

advantage in hauling long-distance traffic between Dubbo and Sydney or anywhere else, but you face the same economics in saying, "Will we start from scratch and build a local loop in this town? This is the cost per household past to do it, this is the penetration we'd expect, this is the payback," and so on. Presently it's not an economic proposition.

PROF WOODS: Are you watching the propositions of organisations such as TransACT and down at Cooma, and the like, who are intending to put out some form of CAN in their areas? Does that represent an opportunity for you; or do you see that as not a significant innovation that's likely to be significant?

MR FLETCHER: I think we would say that they are attempting, within particular geographical markets, the same entry strategy that was tried with the Optus broadband network, which is that you build a network which has higher bandwidth than the existing Telstra local access network, and that has a couple of advantages: firstly, it enables you to go to customers and offer a broader range of services so you've got a better chance of winning customers away from the incumbent; and, secondly, because you're generating multiple revenue streams, potentially, from each customer, you get a quicker payback.

Right now, where we sit as a company is that we've spent our money on building that network, and our business challenge is to increase utilisation of that asset. We watch with interest the efforts that others are making in other markets - yes, we watch them with interest.

PROF WOODS: That covers that one. In your graphs for access pricing, you draw on TSLRIC and you, in your submission, identified, in section 3, various authorities that gave theoretical support for that; although, as I understand it, there is now some questioning of that through the US courts. Do you want to comment on that?

MR FRANCIS: I think that it's a personal perspective but the case for a TSLRIC-type approach, in terms of economics for the local loop, is reasonably well internationally supported; it's being deployed by the Europeans and the Americans, and the ACCC approach has been consistent with forward-looking economic costs. The long-run concept means that there is the tendency to avoid actual network design, and the reason for that is because in the long run all construction, previous construction, is avoidable because you assume that all sunk assets are replaced.

If you're asking for the specifics of the Iowa decision, that's probably significantly worse for Telstra than it is for us, because what the judge said in that actual case was that it should be actual incremental costs, not long-run forward-looking costs. So what that means is you ignore a cap or return on sunk assets, some sort of marginal cost approach. It was a specific interpretation of the statutory legislation in the US but that will end up with significantly lower prices than a long-run TSLRIC type approach, with essentially an average cost which does include a cost of capital. It's not necessarily especially relevant here because they're attempting to interpret specific statutes there that are - section 251 of the US act,

which is different to the criteria the ACCC use but what we'd say is that the theoretical support for TSLRIC is reasonably well established.

MR SUCKLING: We'd also make this point, I think, that the way in which Telstra are seeking to characterise the way in which the commission have interpreted TSLRIC is they sort of set out with this blank piece of canvas and drawn up this fanciful, absolutely crazy network of technology which doesn't exist, and then sort of got this funny gadget and whacked in a set of figures and popped out a price that bears utterly no relation to the real cost of them running their network. That's untrue, the commission haven't done that.

The commission, in the first instance, have said that they will adopt a scorched node approach to determine the TSLRIC costing; that is to say, they'll accept the Telstra network topography where the different network nodes are. The second thing the commission have said is they had three technologies they could use, they could have taken actual, they could have taken best in use and they could have taken forward looking. Forward looking is slightly more fanciful perhaps. The commission chose to take best in use technology, which was just sort of looking at a small-time horizon.

The third thing is, in relation to TSLRIC, a pure application of that principle wouldn't allow the allocation of common costs to the incumbent, and the commission hasn't done that either. So, really, it's - sorry, the ACCC - I should not confuse our commissions here - haven't developed a totally, totally fanciful model, totally, you know, divorced from reality. They've taken the steps (indistinct)

MR FRANCIS: Telstra will say they have large disputes with the way it's been implemented in practice. We have large disputes where we say, in actual fact, they've taken too much of their actual network design and the inefficiencies associated into account, and we ran our own greenfield model which produced significantly - pure greenfield model which produced significantly lower costs than where the ACCC is ending up.

PROF WOODS: What views do you have on their approach for cost-sharing of trenching and the like?

MR FRANCIS: This is getting into detail. I think, in our submission what we basically said is their current approach to the trench-sharing allocations actually gives Telstra the advantages or claims of scope, because they're not charging us for trenches multiple times over when you take into account the - - -

PROF WOODS: I remember the phrase you wrote, yes.

MR FRANCIS: - - - multiple products allocated over that trench, say, because they allocate all of the trench costs to telephony services.

PROF SNAPE: I don't think that's the way Telstra saw it this morning but - - -

MR FRANCIS: No. There's a very long debate that we're involved in.

PROF SNAPE: Perhaps we could get a bit more detail on that debate, because at the moment we've got one party saying one thing and another party saying another thing.

PROF WOODS: If you could sort of cite particular instances and demonstrate that point, that would be very helpful.

MR FRANCIS: I'll send you our submissions.
MR SUCKLING: We'll send you the highlights of our submissions, I think.

PROF SNAPE: On page 82 I notice that you have apparently discovered that, for long-distance calling, the price elasticity of demand is unity.

MR FRANCIS: As?

PROF SNAPE: One.

MR FRANCIS: As one.

PROF SNAPE: Is that well established?

MR FRANCIS: No.

PROF SNAPE: But it's the basis of your calculations of - - -

MR FRANCIS: It depends where you start on the demand curve, whether you're going up or down.

PROF SNAPE: I am aware of that. Nevertheless, you have a demand curve drawn there which is a very nicely drawn demand curve.

MR FRANCIS: Yes.

PROF SNAPE: I presume it's as well estimated as it is drawn.

MR FRANCIS: Yes, good point. There are a few estimates in the literature that are around .8. The Industry Commission itself, in that 97 paper, I think, used something like about .8 for the elasticity of demand. Some of our own estimates are around that area, so - - -

MR SUCKLING: As to the price capital here.

MR FRANCIS: With this particular graph it depends on whether you're going up and down. You end up with one going, I think, up to down but going the other way you end up with about .5. So it's around .8 for the whole thing. That's where it comes from.

PROF SNAPE: The calculations - I think it assumes that if Telstra had an interconnect price of 7 cents a minute and there are just the two of you, you wouldn't collude.

MR FRANCIS: No. What it actually is - Telstra sets the interconnect price of 7 cents per minute; that forces us to raise our price. We've got a higher cost base and then the competitive pressure is on Telstra less, so they can rise their own prices. So the industry-wide price has risen because everyone's cost base has risen. That's the basis - I mean, that's consistent with the ACCC approach which says that if they pass on price falls in interconnect - there are about 15 competitors in the long distance-market, probably, and that Telstra will be forced to pass on costs reductions to competitors and lower-priced competitors - Telstra will be forced themselves to respond competitively to that. That's where the ACCC get their own estimates.

PROF SNAPE: What is the price-setting behaviour in there? Just run through that.

MR FRANCIS: The price-setting behaviour?

PROF SNAPE: Who has market power?

MR FRANCIS: Well, Telstra has market power - - -

PROF SNAPE: Only Telstra has market power?

MR FRANCIS: In the local loop it has market power.

PROF SNAPE: Here we're talking about long-distance calling, but the local loop is the interconnect, of course.

MR FRANCIS: The local loop is the input for that; that's right. The local loop, to give you an idea, Richard, that's actually - the ACCC says it's about 40 to 45 per cent of our cost base of supplying long distance product. So if that goes up to 7 cents a minute, I think I'd do a calculation which shows our cost base goes up over 100 per cent.

PROF WOODS: You were drawing on positive network effects as a rationale for the need for regulation, and you applied that principle in relation to fixed networks. Why doesn't the same hold in mobile, where you're arguing, in fact, that there shouldn't be regulation? Isn't the same concept of positive network effects for mobile customers - doesn't that apply equally?

MR FLETCHER: I think what we say there is that the - if you take the fixed-line case first, if you take a sample of our customers, almost of them all, 95 per cent of them, are going to have to terminate on Telstra, which therefore gives Telstra very substantial leverage over us. If you look at us, Vodafone and Telstra, the market shares are respectively, I think, Vodafone has about 18 per cent - 17 or 18; we have about 34; and Telstra has about 47 or 48. So the key point is that in that market, if you weigh up where the proportion of our customers who need to terminate on Telstra, as opposed to the proportion of Telstra's customers who need to terminate on us, then you've got a much more even playing field.

So we would still say apply the test, but the way the test operates in that market is such that you say, okay, the network effects do not indicate to you that there is a need for regulation or regulatory intervention; but in a situation where you've got a massive imbalance, then that says to us the network effects indicate that there is a need for regulatory intervention.

PROF WOODS: The network effects apply irrespective of who has got what shares. You're just reverting back to a market power concept as to where the regulations should lie?

MR FLETCHER: Not really. I mean, I think the network effects principle says that, as you add in each additional member of a network generates value by more than one.

PROF WOODS: Brings externalities to - yes, I understand that.

MR FLETCHER: So therefore, if you've got a very small network and a very large network, the benefit that the very large network is denying to the very small network, and saying, "No, we won't interconnect," is very substantial; but the respective amounts of damage - if you want to think about it in those terms - to what roughly similar networks can do to each other, is such that neither of them is going to be in a position to want to use that power to deny the other the right to interconnect.

PROF WOODS: So you'll be arguing that there are strong commercial interests to have interconnection in the mobile?

MR FLETCHER: Yes.

PROF WOODS: We heard this morning from Telstra that it was going to engage in greater transparency by having some form of internal separation, and that that would be revealed to the regulator. Does that make you more confident?

MR FRANCIS: Just for the benefit of Adam and Paul, I think Telstra's position was that they were planning to separate their network business from their retail business; deal independently; strike independent deals; and make all of that transparent to the regulator but not to other players.

PROF SNAPE: Everything up to wholesaling in one camp; retailing in the other camp.

MR FRANCIS: That's right.

MR SUCKLING: I suppose what we've always said there is that every year there seems to be - or maybe even every six months - a reorganisation of the Telstra wholesale division, and suddenly it's going to be more customer focused, more transparent, and we're all going to be happy and Nirvana will be reached; and every year that's not the case.

So, say for instance, in the case of interconnection, for example, and the PSTN undertaking, we found that regulators who have to deal with information asymmetries are very, very pushed to understand the figures that are given to them by the incumbent; and it is very easy to roll in 20 engineers and 50 experts in allocating common costs and bamboozle even the smartest people at the ACCC. So I suppose we would say that transparency to the regulator probably isn't enough, and he'd always argue quite strongly that, as in the case as happens in BT, that transparency needs to be to everyone and it needs to be tested with people who actually run networks and deal with these costs on an everyday basis.

MR FRANCIS: Just adding on that, it's a little bit of the typical hollow promise, because if they were genuinely interested in establishing this nondiscrimination between their network and retail side, then they would try and make it transparent to other players, so they'd actually discipline their wholesale network to deal equivalently with retail; they wouldn't just reveal it to the ACCC and the ACCC only. They'd use the competitive market discipline by transparent revelation to other players, to actually make sure that there were non anticompetitive and nondiscriminatory dealings.

MR FLETCHER: The interesting thing there actually is that they have used that approach in relation to NDC, the company that does the digging of trenches and so on, and they've said that that company won't be guaranteed of receiving the construction work that Telstra delivers. So, given that they've imposed actual market discipline there, one would have thought that it's not that much of a stretch to take a similar approach to separation of wholesale and retail, and allow their retail operations to purchase wholesale capacity from non-Telstra operators, if they find they can do it more cheaply.

PROF WOODS: In fact, the trenching company that you referred to has contracts with other telcos - - -

MR FLETCHER: Correct.

PROF WOODS: - - - on an arm's length basis.

MR FLETCHER: Yes, absolutely.

PROF WOODS: The question of transparency, if we then take that into access arbitrations, do I assume therefore that you'd support the publication of outcomes from that process in the interests of transparency?

MR SUCKLING: Yes. In broad terms we've always taken the view that in the first instance you should seek to set commercial rates with players, and that contracts can vary between players, given the events of the contract and the volumes that one brings to it. But in those instances where there is an access dispute, such as PSTN, which is a fundamental input into everything, we've supported the commission's move towards a more transparent process.

PROF SNAPE: That is, to publish the conditions - - -
MR SUCKLING: Yes.

PROF SNAPE: - - - including the price.

MR FRANCIS: I mean, in practice just - the arbitrations are a private process by legislation, but in practice the commission has tried to de facto institute a semi-public process by the way they've inquired into Telstra's undertaking, and published their full results and indicative prices, so they are attempting to move to that more public process for doing it. I think we do think it's a problem that essentially the ACCC has several arbitrations on exactly the same issue, and it's possible within that framework you might get some inconsistency in the way they deal with those multiple arbitrations on the same issue. It's a bit of a cumbersome process.

MR FLETCHER: I think it's worth making the point, too, that the regime, as designed, was intended to allow for an open and multilateral process, I guess, by using the undertaking approach; but it doesn't appear to have been very successful because the rates that Telstra has lodged as undertakings have never been as attractive to industry participants, as they've been able to get out of arbitration.

PROF WOODS: That certainly seems to be the perspective of industry, still currently given the number of disputes that are being lodged; that industry says it's a fair bet that you'll come out with something better - - -

MR FLETCHER: That's right.

PROF WOODS: - - - through the arbitration process. But presumably, if the excess pricing between yourselves and Telstra was posted, that would wash out an awful lot of other disputes; others could say, "I'll take that, thank you"?

MR FLETCHER: I suppose that's conceivable. To perhaps put it another way, is our interest in the arbitration process a reflection of the fact that it's bilateral and confidential? It's not, so much as the fact that it has produced better results in terms of the rates we've got. So how important is confidentiality? Yes, of course, it's nice

to have but, for us, what's driven the relative appeal of arbitrations is that you get a better rate than you do out of relying on the undertaking process.

PROF WOODS: But if the results were to be made public you'd be perfectly happy with that as an outcome? You'd put up with that?

MR FLETCHER: I doubt if we could say we're perfectly happy with it, but it's probably hard to come up with policy justifications to be opposed to it.

MR FRANCIS: I mean, there are a few things as well, like, price might not be a problem, but definitely things such as volumes, etcetera, might be fairly commercially involved, so it'd just be sort of a bare minimum.

PROF SNAPE: The point that you were just making about getting a better rate of arbitration is, of course, a point of criticism. I have to say that if you can always do better out of arbitration, you'll always go to arbitration; and that's a failure of the process.

MR SUCKLING: I guess that's what we were saying, professor, though, that the commission have taken the view - and you'll see this in our submission - that they should sort of adopt a declare-all approach, and then grant exemptions. A classic example of that is in the local call resale declaration, where they declared Telstra's network, plus ours, plus AAPT's, plus anyone else who had a network - and they said it's up to parties to seek an exemption under the exemption provisions, either the class exemption or an individual exemption, in order to be not covered by that declaration.
We'd also say with inter capital city, for example, they've erred on the declaration.

So we said they've drawn the net too wide and they've therefore opened the gate to more arbitrations than they need have had in the first instance if they had been a bit stricter on the industry and themselves in the first instance.

PROF SNAPE: Nevertheless, let's draw it back to where there should have been declaration; you've still got this bias that you will always feel you could do better out of an arbitration, than you can out of negotiations, so you've got an incentive to go for it.

MR FLETCHER: No, that is not what I said in fact. What I said was that we've historically done better out of arbitration than out of undertakings; that was the comparison I was drawing.

PROF SNAPE: I see, yes.

MR FRANCIS: It's probably better that we just clarify that because the only actual issue where the commission has delivered fairly firm pricing guidance is with respect to one product, and that's long-distance interconnect; and that has been the one where Telstra - in the terms of the rates they've offered in the marketplace - they've been

significantly above the ACCC's rates. So everyone there has known that if they go to the ACCC they'll get a better rate than Telstra with arbitration.

If I can just characterise, there's one other market, inter capital city transmission, it's competitive, it's been declared, but they haven't even had one arbitration on it. So it's not this thing, a catch-all across all markets, everyone thinks, "Great, offer it up for arbitration," it's just that one product.

The only other point I would make is, probably because of that one product, I think there is an expectation amongst some access seekers that, on the basis of that experience, they might be able to do better in some other products.

PROF WOODS: While we're talking transparency, record keeping rules; they have a very low profile in the current application of the regime and yet they exist in legislation. Any thoughts on whether there's scope to use them, use them more, any benefits of that?

MR SUCKLING: I think we'd argue that there are benefits to those record keeping rules, in the sense that they do provide a little bit more transparency than if they didn't exist. We think they should be applied both to non-price and price issues; and it does theoretically provide the commission with a sort of theoretical benchmark in which to, (1) establish costs, and (2) establish whether Telstra is being nondiscriminatory in its conduct.

I guess the truth is that the record keeping rules have become bogged down in processes, and made far more complex; and, without wishing to point the bone, certain players have insisted on long meetings, lots and lots of documents being exchanged, and it has caught the process in a swamp and there hasn't been a great deal of disclosure from those powers.

PROF WOODS: Is that regulatory game playing that you were describing?

MR SUCKLING: Yes, I think that's what you'd call it.

MR FRANCIS: Yes. The thing is that fundamentally our principle is that the idea of record keeping rules is a very effective regulatory tool for detecting cross-subsidisation, predation and margin squeeze; but the problem is that the rules that we had were derived from Austel and had probably served their use-by date. There were plans for reforms to have focus on bottleneck inputs and downstream markets, but to date those proper and better focused record keeping rules haven't yet been implemented. We'd fully support their actual implementation so they can be useful.

Current record keeping rules don't have that focus on bottleneck and downstream services, and that's the essential problem. It doesn't mean that record keeping rules aren't important.

PROF WOODS: Do you want to make any comment on industry plans?

MR FRANCIS: Adam, you go.

MR SUCKLING: I get the good bit.

The idea of the industry plans is that we've had very, very firm advice from the department that you can't put in binding targets in to your industry development plans, and so while you're under an obligation to provide an industry development plan, you aren't under any obligation to provide binding targets of where you will source - or the extent of content that you've got to source from Australian industry. The reason for that is that it's argued that that is in breach of some provisions of the World Trade Organisation protocols that we're signatories to.

I suppose we would say we already, as it is, source quite extensively from Australian industry. I think a vast spend of almost $6 billion, 77 per cent of it was spent in this country, and that the industry development plans are just a sort of costly administrative overhang which don't have a great deal of effect of where we source our materials from. The guiding light is obviously whether people are competitive and provide inputs which are in the lower price in other places.

PROF SNAPE: I wonder if I could refer you again to page 82 in the diagram, but trying not to talk about it very much, except to say that it's very clear in that diagram how you have separated an efficiency consideration from a distributional consideration.

MR FRANCIS: Yes.

PROF SNAPE: That is more profits for one party, fewer profits for other parties; a distributional - I think - then, there's also quite separately a cost element, that is an efficiency cost which you've carefully specified. I think through the rest of the submission that same distinction is not always quite so clearly made; nor is it, I might say, in some other submissions, that the distinction between what is essentially a transfer from one party to another party within the country, as against a cost to the community as a whole. I think you are contemplating further submissions.

MR FRANCIS: Yes, we can separate that from those other ones; that's no problem.

PROF SNAPE: I think that if you and, indeed, if other parties also could keep that in their minds as they are writing the submission - now, you may want competition for reasons other than efficiency and it may not only be for efficiency, but nevertheless I think that that distinction between the transfer element and the efficiency costs element of any policies is a very important one which we need to understand and you need, I think, to help us through it if you would.

MR FRANCIS: I would point out also: I guess one of the deficiencies of them is that they are static measures, and that somehow - I mean, people have a generalised

belief that competition is good, but some of those dynamic efficiencies are a little bit more speculative in terms of putting numbers around them. I mean, we tried to allude to them in our paper without sort of attempting to say that we have some scientific approach that so far - - -

PROF SNAPE: I understand that.

MR FRANCIS: Yes, point taken.

MR FLETCHER: I'm not sure I understand. I'm sure I could ask Derek discreetly to explain to me afterwards. But could you give me a clearer understanding of the distinction you're drawing?

PROF SNAPE: One is profits for you or profits for Telstra - - -

MR FLETCHER: Yes, I understand that.

PROF SNAPE: - - - versus using an inducement to use the technology - which was not the best technology, and therefore was using community resources that would otherwise waste - you know, "wastefully"; or imposing costs on consumers so that they are in fact changing their behaviour in a way which is distorting their choices - and, again, not just a transfer from a consumer to a company with the consumers' behaviour unchanged except for paying more, but in fact changes of behaviour on the production side, or the consumption side, and the efficiency consequences of that.

MR FLETCHER: Is this an argument, for example, about loss of economies of scale, if you - - -

PROF SNAPE: That is one possibility, yes, certainly.

MR FLETCHER: We will think about that now that we understand it.

PROF SNAPE: Thank you.

MR FRANCIS: Also, just on that, we wouldn't characterise it - I mean, it's basically a transfer from consumers to Telstra in that particular thing and the ACCC have said that their market is actually competitive and any prices are passed through to consumers, on that particular - - -

PROF SNAPE: You threw that elasticity of demand which I pointed out before. That was the element that gave you your efficiency costs, as you pointed out.

MR FRANCIS: Yes, that's right. Well, if it's perfectly inelastic you don't get any - yes, that's right.

PROF SNAPE: There wouldn't be any cost; it would be all transfer.

MR FRANCIS: Yes.

PROF WOODS: Other matters?

MR FLETCHER: No.

PROF WOODS: Any other matters that you wish to raise with us?

MR FLETCHER: No. I don't think we want to waste the commission's time.

PROF WOODS: Absolutely not.

MR FLETCHER: We've said all that we need to say, and we look forward to further dialogue.

PROF WOODS: I appreciated the time you have given and the answers that you've provided and we look forward to your subsequent submissions. Thank you, very much. We'll take a short break and then call our next witness.

PROF WOODS: If you could, please provide your names and the positions that you hold.

MR HAVYATT: I'm David Havyatt, the regulatory manager at AAPT.

MR PERKINS: Brian Perkins, group director, regulatory and legal.

MR HUGHES: Paul Hughes, partner, Corrs Chambers Westgarth.

MR HOWARTH: David Howard, senior associate at Corrs.

PROF WOODS: Thank you very much. Do you have an opening statement you wish to make?

MR PERKINS: Yes, thank you, chairman, gentlemen. We understand you've read our submissions, so we're certainly not going to belabour the submission. What we want to do today is simply to really focus on four main matters. David Havyatt, on my left, will talk about just the broad theme of our submission, and then go on to talk about investment by and in the telecommunications industry. David Howarth, on my far right, is going to address issues relating to the access regime and some comments on the operation of Part XIB. We welcome your questions. If you want to ask questions on the way through, I know you will feel free to do that, please do. David Havyatt.

MR HAVYATT: Thank you, Brian. AAPT, in its submission, apart from addressing the issues paper that the productivity commission put forward, has highlighted four key themes about the current regime. These are:

Firstly, that competition has yet to broaden and deepen. Where we are seeing competition is fundamentally in the market for business services, and in certain long-distance services where you've got extensive competition. Really, competition is still fairly thin in most other markets. AAPT believes the existing regime must be preserved to ensure that all Australians benefit from strong and effective competition.

The second theme is that access based competition leads to infrastructure based competition. Overall, AAPT's experience is that, in those market where access services have promoted competition, investment opportunities are created. In fact, investment does follow declaration of access services.

The third is that the administrative costs of the regime are less than the alternatives, and are more fairly distributed. The alternatives, of course, are extensive legal processes that fall inequitably. The current regime's administrative costs are borne fairy equally across the industry.

Finally, it is our general feeling that the competition protections need to be made stronger, not weaker. Carriers which possess market power have adapted to the advent of competition by seeking to protect the markets in which they dominate, and to leverage this power into related markets. This is opening up some of the questions of convergence, as well as the existing provisions that have been touched on before, such as, how the local loop affects the market for, say, Internet service provision.

We've also emphasised in our submission that the review needs to focus on how well the existing regime achieves the government's policy objectives of promoting competition and encouraging the efficient use of an investment infrastructure. AAPT has commissioned further studies in these areas, but I just want to briefly touch on some aspects of investment.

It is our observation that declaration has not affected the levels of telecommunications investment adversely. In our submissions, we have detailed some of the investments that have been made over recent times. These include: new mobile networks; investments in local access networks via fibre loops and wireless local loop accesses; and most significantly, some very, very large investments in interstate transmission, including the recently announced Nextgen fibre across the continent, and also, more recently, NTL's decision to invest in a further broadband Internet state transmission network through New South Wales and Victoria. Interestingly, these are in markets that are declared.

Further, some indications that we've got initially -and these are things that we want to review in our further submission on investment - are ABS figures on investment from 1987 to 2000. They show that investment in telecommunications fell significantly below the level of investment in Australia generally, in both 1991 and 1997. The investment level has grown strongly since mid 1999. So it appears that, in fact, it is not the declaration process or things being declared that has the greatest impact on investment. It is the regulatory uncertainty created by changes in legislation that impacts investment, and in fact, the greatest growth in investment has been after there's been more certainty about what the regime will bring forward, because the majority of the declarations in fact took place before the investment has occurred.

AAPT, of all participants in the market, is the most affected by the some of the build versus buy decisions. Having built a large business, principally through service competition, AAPT is now investing heavily in its own infrastructure. AAPT has plans for $1 billion worth of investment over the next two years, and this investment is principally in access networks. Our CDMA network in all areas outside of Sydney and Melbourne will have a wireless local loop capability, similar to that being developed by Orange. We have been investment in our LMDS network, or fibre in

the sky, which is a high-speed access that takes us beyond the CBDs. We look forward to being able to invest in DSL, given the resolution of certain outstanding issues. Of course, we have also been investing in CBD fibre.

Another great story is AAPT's Vic 1 network, which is a network built in partnership with the state government of Victoria, which is an IP network linking over 3,500 sites with a daily user population of 700,000. As I said, this is an IP, Internet protocol, network, and the only voice services it provides is voice-over IP. In this network, there are now 3800 tail circuits, that is, links from our points of presence into premises. 2750 of those are over Telstra tails; but 777 are AAPT microwave links, 250 are AAPT fibre, 22 are delivered by V-Sat and one by LMDS, so far.

PROF WOODS: What's the customer base?

MR HAVYATT: The customer base is principally the Victorian government, but it includes all their schools, all their agencies, the Catholic school network in Victoria, councils, and it is open for commercial business as well.

PROF WOODS: So some of it is the equivalent of small business?

MR HAVYATT: Some of it is the equivalent of the small business, but it's being principally driven by the Victorian government. So you see from that mix of access technologies that we are, in fact, in the middle of build versus buy decisions on a daily basis, and have, in fact, already made a number of build decisions for those accesses - including, as you can see, by 22 satellite services - accesses in quite remote areas of Victoria.

At that point, I would like to hand over to David Howarth to talk about the access regime.

MR HOWARTH: I'll first of all talk a bit about XIB. We see, through our submission also earlier this morning, that the key areas of interest are the Trade Practices Act provisions, which cover both anticompetitive conduct and access. AAPT's experience is a bit unusual in this market, in that we are the largest non-incumbent. We obtained our carrier licence in 1997, and since that time we've been attempting to provide, in many cases, as David's pointed out, succeeding in providing full service, but very much reliant on access to existing networks. The results of our experience demonstrate how important it is to have a telecommunication-specific regime, both in relation to anticompetitive conduct and to access, and that's what I want to cover today.

On XIB, we think it's important to take as a starting point not so much the introduction of that regime in 1997, but the last time it was considered by the parliament, which was last year. The tenor of those amendments, and the substance of those amendments, was very clearly in favour of strengthening that regime. At that time, the government, and indeed the opposition, was clearly of the view that

competition had not sufficiently broadened and deepened such that the regime could be removed. So we take that as our starting point.

Some of the reasons which we consider are important, and which the parliament may have taken into account last year, are that not all competition issues can be dealt with under an XIC regime, and in particular, the discussion this morning, and our experience over the last two or three years, has shown that delay in providing access is not always efficiently dealt with under XIC, and I'll come back to those points a bit later. There are also a range of traditional anticompetitive conduct which can't be satisfactorily dealt with simply through an access regime, and in particular, the sorts of anticompetitive effects that you see in communications networks through leverage, either in the form of bundling or in taking advantage of vertical integration in various ways, can't necessarily be dealt with under an XIC regime.

The other thing I should say there is that we consider XIB is likely to become more important in the short to the medium term, rather than less important. The first round, if you like, of deregulation of telecommunications generally - and that's the experience overseas as well as here - will focus on access issues and particularly pricing issues. As David has pointed out, the incumbents have modified their behaviour in certain ways to lessen the impact of competition on their own organisations, once the access has been provided. So we're likely to see other forms of conduct which are better dealt with under XIB rather than XIC.

The two key differences between XIB and Part 4 we see, first of all, in the substance of having an effects test rather than a purpose test; and secondly in the procedural aspects, through the competition notice regime. Looking first at the substantive issues, in a regime where it is important to ensure the long-term interests of end-users, and that is likely to remain the government's objective, we don't consider that a purpose test will guarantee that outcome. The purpose test is quite unusual in competition law, and it is certainly very different to the approach which has generally been adopted in the United States, in analysing monopolisation questions, where the focus is very much more on the effect of the conduct.

We see that, particularly in a rapidly developing industry and one which is increasingly characterised by convergence and vertical integration in various forms, an effects test is entirely appropriate We don't necessarily say that that couldn't be incorporated into Part IV. This morning, the chairman raised the possibility of introducing some of those elements into the general regime, and we'd certainly be happy to address those.

The second aspect, the procedural ones, we see the competition notice regime and more recently the advisory notice regime as being significant in at least three ways. The first point is that it has provided protection for incumbents against vexatious, if you like, litigation, in that, it creates a structure whereby the regulator is brought into the process very early and allows the regulator to provide some clarity and an administrative consideration of competition questions. In some cases, notably, the peering case, we've seen that the involvement of the ACCC through the

competition notice regime resulted in an improvement in competitive conduct in the market without the need to recourse to the courts. So that's the first point, and we see it as being fundamentally protective of carriers with substantial market power against unnecessary action.

The second point, and this is related, is the clarity that that process involves, and this has been improved last year with the advisory notice regime, that rather than relying on litigation through an extremely lengthy process to come up with a principle, it allows the regulator to set out very clearly and specifically the conduct which has caused a problem, and it may be either the kind of conduct under a Part A notice or a specific instance of anticompetitive conduct. Now, with the advisory notice regime it allows the regulator to set out the sort of activity or the sort of corrective action that a party with substantial market power can take to remove the problem.

The third aspect is speed. We see, and this is again related to the clarity issue, that the competition notice regime allows the regulator to take very decisive and very quick action where anticompetitive conduct is clear. That was one of the reasons enumerated in the explanatory memorandum.

So we see that the Part XIB has worked very well over the first three years, in particular, in preventing anticompetitive conduct and we consider that there are good reasons to expect that the importance of XIB will remain for some time.

Turning to XIC, AAPT again has been in the position of being on the brink, if you like, of the build-buy decision. In may instances we are investing heavily in our own infrastructure but also do rely on access. As David pointed out, we think that an access regime leads to investment. There is certainly nothing contradictory between an access regime and efficient investment. An access regime allows a carrier, such as AAPT, to build expertise and customer base in some areas where access is granted under the regime, which in turn then provides the ability and also the incentive to undertake its own investment. So we see it as very important.

The key difficulties which have been experienced under the XIC regime, or the key difficulty, is delay, and we were very pleased to see Telstra raise that issue themselves this morning. A good example is AAPT's PSTN arbitration against Telstra. The service of course was deemed in 1997. 18 months later, in December 98, AAPT, having attempted to negotiate access to that service, notified an arbitration, and it's now more than 18 months since that arbitration was commenced that we've finally had an interim determination. At this point it's certainly not an end point to the arbitration.

Incumbents may consider the interim determination an easy option for access seekers. The fact is that an interim determination involves considerable risk to an access seeker accepting that interim determination, because there's the prospect that on the making of a final determination, if it is in variance with the interim determination, then the difference will have to be made up effectively to the

incumbent. So there's a contingent liability that goes along with an interim determination and that's why the legislation makes it possible for an access seeker to refuse to accept an interim determination, because of that risk.

The key issues we see in making delay under XIC a problem are: the continuing market power of incumbents - and I'll come back to that in a second because there's different forms of market power in this market; secondly, the information asymmetry, which has been discussed extensively; thirdly, we think that there is a level of vertical integration in this market which increases the incentive to delay access; and finally, there's a degree of conservatism, administrative conservatism, which is imposed upon the regulator through the structure of the regime.

On the market power issue, there has been some discussion this morning about market share being a benchmark. We consider that that is a useful starting point but it certainly does not answer the question of market power in communications markets. One of the reasons for that is the presence of network effects, and we agree with Optus's comments on that point. Secondly, AAPT considers that there is fundamental market power in termination markets, and it's important here to separate the different functional levels in this industry. It's not sufficient to talk about the mobiles market. There is a retail mobiles market and there is a wholesale mobiles market, and the competitive dynamics in those two markets are very different.

For a company, such as AAPT, seeking to provide full service, we must, by the dictates of both competition and the any-to-any connectivity importunity in the legislation, we must provide termination to those networks for our customers. We don't then make the decision about how many times that network is utilised. Our customers make that decision, and we are left in the position of having to pay whatever it is to obtain access to those networks. So there is a degree of entrenched fundamental market power which we don't think can be removed by the presence of different networks, certainly not - just to take the mobiles market for the moment - with three supposedly competitive networks.

PROF WOODS: Presumably, termination is still mainly on fixed-line terminations, or decreasingly so?

MR HOWARTH: I couldn't tell you as a proportion of the traffic, but it's still a significant impact.

MR HAVYATT: I don't think the actual proportion itself is that relevant, in the sense that when a person is making a call they are making a call to a specific number, and what kind of network it resides on doesn't actually change that market dynamic, which is that, "I don't have a choice."

PROF WOODS: It doesn't change the pricing?

MR HAVYATT: It does change the pricing.

PROF WOODS: That was the point I was getting at.

MR HAVYATT: I don't have any figures. I mean, the current figures are: there's 10 million fixed access lines and 8 million mobile access lines. Because of the relative pricing, I think there is a significantly greater proportion still generated to fixed lines, but I don't have a number of that.

MR HOWARTH: We'd say it wouldn't affect the market power in either of those markets by the existence of the other as well. The problem then for reform of this part of the act is to somehow move from a command and control, if you like, structure to something based more on incentive. It was a point raised in the Productivity Commission's issues paper, a point which we addressed briefly, although, in retrospect probably too briefly, and we'd like to come back to it today.

In America, of course, there is use of incentive regulation in the interconnect regime by opening the possibility for the regional Bell companies to have access to additional markets, notably long-distance markets, in return for satisfying a competitive check list. That situation is a result of the US history through the line of business restrictions imposed in the outcome of the AT and T case. In Australia we don't have the luxury of that. Essentially, Telstra can continue to operate as a stand-alone monopoly without requiring dealing with its competitors on an equal basis in any market.

What we then have tried to do is to raise some possibilities for reform of the regime which will introduce some incentives, primarily to deal with that market power, and also the information asymmetry issues. What we suggest to the Productivity Commission is that this may be an area where further forums can be held to address what obviously everybody accepts is a fundamental issue, and that is the delay in the arbitration process.

The first possibility is the idea of having mandatory undertakings once the service has been declared, and this would essentially be a time limit at the end of which every carrier that provides that service would be required to give to the ACCC an access undertaking, rather than to have that undertaking process being a voluntary one, as it is now.

The second proposal, and this is a related idea, is the idea of an ACCC code being mandatory, rather than the current situation in which the ACCC can make a code which then an access provider can decide whether or not to adopt. The instance of the TAF code is a very good example of the failure of this aspect of the regime, because after a considerable period of negotiation between Telstra and other industry participants, the code was accepted. The code was accepted then by the commission, and Telstra, in its first undertakings, departed in virtually every significant respect from the dictates of that code. So the second option we see as being some sort of compulsion to that industry agreed code.

The third suggestion is to impose some time limits in the legislation on the regulator. There are existing voluntary time frames. However, we still have a situation where arbitrations continue for far too long. There are some disadvantages with that proposal, which is essentially that having speediness doesn't necessarily guarantee you the right result. However, it's a possibility.

The fourth is to introduce some incentive into the information requirements under the legislation. Here we would encourage the Productivity Commission to explore a series of presumptions in the assessment of undertakings, such that, in every case where there is uncertainty - and we've seen this in a number of instances in the context of the PSTN undertaking - that that uncertainty is resolved against the access provider, subject to two things: first, the access provider having the opportunity to rebut the presumption on the basis of verified information, which is likely only to be available to the access provider; and secondly - and I'll discuss this in a minute - the access seekers taking that price, much in the same way as a current interim determination is taken now; that is, with a guarantee of payback if the final result is incorrect, or is different, rather.

The fifth one is to introduce a notion of pricing flexibility in the XIC regime for the regulator, so that the conservatism imposed by the existence of merits reviews is removed, and in conjunction with those presumptions, there is the ability for the regulator to side on the favour of the access seeker, subject to rebuttal of those issues, that price.

The sixth - and this we see really as the logical conclusion to this process - is the setting of reference prices in this industry, again on the basis of following an industry process of consultation and subject to rebuttal by the access provider in any individual case.

That's probably a far too long expurgation of our general views. I suppose the thrust of AAPT's submission, as you will appreciate, is that both aspects of the trade practices regime are still required and, in the case of XIB, probably more so now than ever.

PROF WOODS: Thank you very much, and thank you for a substantial and well-focused submission, which we've had the opportunity to go through. One comment, just at the start, is that, under Purpose of the Review, you make comment that the "terms of reference also make it clear that the review's scope is limited to the competition question, within the context of the established economic, social and environmental objectives". I would have thought that by having economic, social and environmental objectives, in fact, it's not a limitation. It's a fairly broad perspective that we're bringing to this particular inquiry.

The thrust, as you say, is to support pro competitive regulation, rather than avoidance or prevention of anticompetitive conduct. Where is the market at at the moment? We had a submission this morning from one participant, who said, "Telstra's view is that the current telecommunications market in Australia is

extremely competitive at all levels." That would seem to be inconsistent with needing a form of regulation that is pro-competitive at this stage. Any reaction?

MR HAVYATT: We would, first of all, indicate that what we have asked a consultant to do some for us work for us, to actually scope the level of competition in the market, to address that from a more specific aspect.

Mention has already been made, however, of some of the specifics of the extent to which there is a large amount of the market held by one specific player, who is a participant in virtually all product markets, and that is the former government regulated Telstra. The figures that were mentioned earlier is that they have 95 per cent of the access lines in local, still 75 per cent of the long-distance market, 48 per cent of the Internet market, 48 per cent of the mobiles market. So that's at least an initial indication that there is still a significant way to go to entrenched competition.

The second thing is that, where that competition has had its effect, is geographically dispersed. There is, without doubt, still greater competition in some of the capital city markets than there is some of the regional markets, and there is a greater focus on some of the business markets than there are on some of the residential markets. The second point is the extent to which, at least on the network elements - the network interconnection elements - there is an extremely long way to go because of the fact that the network externality runs irrespective of just market share. There is a level at which that operates potentially forever whenever there's any imbalance between the size of the two networks. It's not just a straight market power question.

PROF WOODS: Presumably, though, there is a threshold above which it would be commercially disadvantageous for the larger to ignore the smaller.

MR HAVYATT: There would be a figure, and where that figures lies I'm not sure we can actually work out.

PROF WOODS: But in theory, then.

MR HAVYATT: Yes. One of the difficulties that does emerge, is that that model of interconnection ultimately requires a number of cycles of the negotiate-arbitrate regime to work before we'll get through the inherent market power issues, and actually have had enough conversation about what the market and the cost actually looks like. I think that's our fundamental concern, which is we haven't even finished one negotiate-arbitration cycle on PSTN access, and yet people are talking about competition here is alive and well. Whether you agree with the figures that CWO provided or not, there are still no doubts at all that, in the absence of regulation, the interconnection price from Telstra will be significantly higher than it would be with regulation. There are implications that that would have a welfare cost, however it's quantified.

So we see that there's a need for pro-competitive regulation for quite some time, because it's not just a matter of seeing some competition happen. It is actually entrenched competition we need before we can really move forward and say, "Now it's only an anticompetitive test we need to worry about."

MR PERKINS: If I could just add to that, chairman. When you look at the market shares, it leads you to realise very clearly that the ownership of the local loop is a powerful, extremely powerful - and it's probably the most significant thing in our entire industry. 95 per cent of the local market, 75 per cent of the long distance, international and mobile, are all related to ownership of that local loop and the access that that gives to customers.

Until that changes, Telstra's market power is going to be retained, at various levels in different markets admittedly, but it won't wane in any particular market, until such time as the access to the customer changes hands, and that figure of 95 per cent starts to fall significantly. That's where it starts. Whilst we are looking at the future of unbundling of the local loop, we've still got a long way to go to make that a reality, and to turn that into a significant distribution of market share amongst the competitors. There's a long way to go. I think we can't overstate in our industry the critical importance of the market power that ownership of the local loop gives.

PROF WOODS: If we can explore that one in a moment. Does AAPT consider that it's been a successful new entrant into the telco market over the last few years?

MR PERKINS: Yes. Certainly not as successful as we think we might have been. Certainly if we'd been able to get in at the early days in 1991, it would have been a different company today. We were, in fact, the first competitor to Telstra. We were there in the market place before Optus, and before Vodafone in the mobile area. The fact that we are still small by comparison with Optus, I think, speaks volumes about the advantages that that first six years of duopoly gave to Optus. We would be a very different company today if we had had those sort of opportunities.

We've been going full bore since 1997, when we really could become a competitor, and we've still got a long way to go. We're optimistic, and we're very pleased with what we've done, but we are held back. There are things that we cannot get resolved, like the determination of mobile calls, for example. That remains a triopoly, an oligopoly if you like, market, and nobody can break into it. Until such time as an arbitration is resolved in that area, nobody's going to make very much progress in that marketplace, just to take an example.

PROF WOODS: During the course of today, if my memory strikes me correctly, we've had three lots of participants who might have actually comprised part of what you're describing as an oligopoly, but none of them claimed that that was the case. What are the features of the market, at that wholesale level for you, that lead you to that conclusion and that that might counter some of the other evidence that's been brought before us today?

MR PERKINS: We offer a very simple test. It's a very practical test, a very commercial test, that the price of termination between the three differs by about 1 cent per minute, in an apparently openly competitive marketplace; that's unbelievable, and, what's more, it hasn't shifted in a very long time. In fact it's hardly moved at all over the period of three years that we've been trying to negotiate. I can't go too much further because we are in arbitration but that's just an indication to us that there is an oligopolistic behaviour going on here.

MR HAVYATT: The other aspect is, as far as we can see from the pricing information available to us, the price that we're charged for terminating access per minute is significantly above what half the price of a mobile-to-mobile call on any of those networks. So, we're being charged significantly more than half the retail cost of a call that fundamentally just involves adding two of those things together. That tends to imply that the price that we're being charged is not a cost based price.

PROF SNAPE: A point on the prices being so similar was that, in practice it's extremely difficult to distinguish collusion from high competition, because if all the prices are the same it could be because it's an extraordinarily competitive market with instantaneous adjustment; or, on the other hand, an extraordinarily uncompetitive market with an agreement.

MR PERKINS: Of course, commissioner, and if the prices were close to cost that's what you would expect, that they would be very close; but in fact they're, in our view, very significantly, probably 100 per cent, above cost, or a bit more than that, by our calculations, and we have very limited information, as usual.

MR HUGHES: I think the second part of that is also that the pricing has been fairly static, whereas the retail prices have been quite dramatic, have moved. If there was a competitive market we would have expected to see some move in those termination prices.

PROF WOODS: What's the way through for you, then, in that particular instance?

MR PERKINS: Sadly, arbitration.

PROF WOODS: With the expectation - - -

MR PERKINS: We are in arbitration against all three mobile carriers because we had no choice. We couldn't break through and negotiations didn't produce any change in their positions, and so we were forced to go to arbitration in all three instances.

PROF WOODS: With the expectation that the price outcome will be less than what's available in the marketplace?

MR PERKINS: With what information we have, based on the pricing that they - their retail pricing, what we think is a reasonable price, derived from overseas

experience, we think that is very inflated; and, yes, we have a very strong expectation that we will get a much better price.

PROF WOODS: You describe what could be termed information asymmetries in that process. Looking to greater transparency, are you heartened by Telstra's advice this morning that they will be undertaking some form of internal structural separation and increasing transparency accordingly?

MR PERKINS: That transparency, according to Deena Shiff, would be only disclosed to the regulator, and not to competitors.

PROF WOODS: Does that cause you great comfort?

MR PERKINS: Only insofar as we still have to go to arbitration, and the answer is "no". If it were exposure, transparency, to all competitors it would be a very different situation.

PROF WOODS: Would you promote the publication of outcomes of the arbitration process?

MR PERKINS: Absolutely.

PROF WOODS: Is it possible that if publication were an outcome, the delays in the arbitration process could in fact be even longer than they are?

MR PERKINS: It's hard to say. I know one thing; there would only ever be one arbitration and that would be the end of the matter.

PROF WOODS: But could that arbitration in fact result in an outcome that is worse for some of the market participants than they might individually get under bilateral private outcomes?

MR PERKINS: That may well be true, chairman; but the fact is we have a very strong view that there should not be competition at this level, at the access level. It doesn't make sense to have competition there. Competition should be at the service level. We all buy at the same price. The R-box operate such a regime in the United States. Everybody in a particular LATA pays the same price for interconnect; it makes a lot of sense. People will argue that there's a volume-related component. We've yet to see volume-related costing in this, but we'll accept that there might be a volume-related component. Let it be known; make it public, and then fix the price, and then let's get on and compete at the service level.

The problem with the current arrangement is that the access provider in fact has the ability to favour certain competitors over others. I'm not saying that necessarily happens, but the power is there to do it, and we see no value in that as far as end users are concerned, and as far as competitors are concerned. Let's buy at the same price and get on and compete downstream.

MR HUGHES: I might just make one or two comments in elaboration on that publication point. The answer might lie in exactly what is published, at the end of the day. I don't think we need to equate publication with results in arbitrations necessarily being all the same, or not taking account of specific circumstances for a particular access seeker, or what have you. The answer might lie in exactly how you fashion the publication. It may be that what the regulator does is publish a headline rate, but not the detailed matrices that go to make up the particular pricing formula for a particular access seeker.

It may be that there is some brief abstract of the principles employed, which is calculated by the arbitrator in some sort of agreement with the parties to give some indication to the market of the factors that have been taken into account. In that way, you may be able to strike a balance which is actually sending the right sort of signals to the parties in the market, without necessarily signalling that this is the yardstick which will actually fix price for everybody. But a combination of those measures, I think, might be a useful formula for getting a balance between a degree of transparency from arbitral outcomes and taking advantage of them; at the same time, not tying everybody's hands.

PROF WOODS: You aggressively promote the use of record keeping rules. Is this part also of your theme for transparency? You make reference in your submission that the ACCC should be encouraged to use these powers more assertively.

MR PERKINS: Who wrote that? I think, chairman - and others will jump in if they want to - a great deal of work was done by the ACCC and the industry in developing the record keeping rules, as a successor to the COA/CAM, which existed during the days of Austel, prior to 97, and those record keeping rules have not been implemented. Part of the penalty for not having done that is the very long time that the ACCC has taken in gathering data in relation to PSTN; and they had to go through really quite a separate exercise using NERA to gather that data. We don't want to have to ever go through that again because that was a very, very long process. The alternative, as far as we can see, is to use the record keeping rules and the data that that would produce for future arbitrations, and hopefully the ACCC would then have the data it needed on hand to proceed.

PROF WOODS: Is the ACCC persuaded by your views, and is therefore acting accordingly and pursuing record keeping rules more vigorously?

MR PERKINS: Not as far as I'm aware; the rules have been agreed but never been implemented. I mean, it's not that long ago that they were agreed, but one would have thought that possibly by now they would have been implemented.

MR HAVYATT: More generically, we'd like to see record keeping rules, or the information provision, part of the incentive regulation, if you like; that in the absence of somebody who's trying to make a position being able to provide evidence of their position, then you assume that they're wrong. That would potentially get around the

question of having to keep sets of records that are unnecessary because they're never used; but if you want to be an access provider and involved in lots and lots of conversations - otherwise known as arbitrations - about what your price should be, then you have an obligation to be keeping records that demonstrate your case. In the absence of building that into the process, the alternative is that you enforce the record keeping rules as they stand.

PROF WOODS: Mr Perkins, you characterised the market power of Telstra as fundamentally relating to their control over the local loop, which is a particular segment facility related but pervasive in its influence; at the same time you're promoting a pro-competitive regulatory regime; and in fact in part of your submission you encourage the Productivity Commission to consider new mechanisms to control the extension of power into evolving markets, ie, continue to extend the reach of regulation further and further into new product services and the like. Why do you see it important for regulatory reach to keep wave-like expanding when the ripple was caused by ownership of the local loop in the middle?

There seems to be a tension between the two perspectives. If you focus regulation on the local loop, why do you need to continue to extend regulatory reach wider and wider whenever there's new service, new product, new innovation, further and further away from that central component?

MR PERKINS: There have been two points - - -

PROF SNAPE: This goes into the sort of discussion that we were having in the last session. If the local loop is the core of the problem, then is the way to go just to tackle that core?

MR HOWARTH: The Trade Practices Act provisions are essentially about markets and regulating competition in markets; the local loop is not itself a market. The impact that the local loop has spreads into a number of markets, and that's why we say, if you like, the ripple spreads out. There's a good example of that which I'll come back to in a second.

The point that we make through the submission - and it was the point that Professor Snape made this morning as well - the inquiry should be as to the competitive principles, rather than the particular form that the anticompetitive conduct takes. We would say that it's not an extension of regulation into new markets, it's simply the application of the same rules where the same competitive problem exists. It's similar to the position raised earlier, of bringing into Part IV some of the Part XIB factors, where it's relevant in those markets.

The example I would give is the ADSL pricing for access to Internet, which has only recently been released. You can observe from the way in which those prices are constructed that Telstra is well aware of the market power at the local loop, and therefore the power over ADSL gives it; because the pricing for those services is not based on any sort of horizontal or vertical disaggregation, it's very much a bundling

approach. So, first of all, there's the use of long-term contracts, lowering the immediate access and installation fee in return for longer-term contracts, thereby tying customers in; and, secondly, substantial discounts for customers providing their preselected services to Telstra, or requiring their preselected services from Telstra.

In the same way that Telstra is obviously aware that it can leverage some of that local loop power - I should also say that's quite apart from the ISP market, where Telstra is only providing the ADSL, of course, into the ISP market, but that's probably unavoidable - but in the same way that Telstra recognises that it can leverage that local loop power into new markets, we say that if they're engaging in anticompetitive conduct, then the regulation should follow.

PROF SNAPE: But if we turn it around and say that the essence of the problem, as you describe it, arises from access to the local loop, and that is the core issue, then won't the competitive difficulties that you're alluding to, which you perceive - wouldn't they be solved by access provisions?

MR HOWARTH: No, not in - - -

PROF SNAPE: By adequate access - what you would regard as adequate access provisions?

MR HOWARTH: Adequate access provisions may extend beyond what you would normally think of - - -

PROF SNAPE: The terms and conditions of access, yes.

MR HOWARTH: The problem which AAPT has encountered in the industry on a number of cases is that the access provisions, to the extent that they are effective, are effective in providing the basic right to access and some of the basic terms and conditions; but you will often have a situation where, further down the track, very significant aspects are not dealt with, and the churn case is an example, where the churn charge is imposed as a condition of obtaining customers and were not dealt with through access. Any response through an access regime is going to be extremely lengthy. The response that XIB provides, in dealing with those particular instances of anticompetitive conduct, rather than starting from scratch and having an entire access hearing or an access arbitration, is a far more effective way to deal with those instances of conduct.

PROF SNAPE: Nevertheless, you are getting, I guess, to case by case and spreading, to take the ripple analogy, to be catching these things as they arise, as you see them, rather than solving them at source.

MR HOWARTH: We would advocate both, but recognise that you can't always stop the ripple before it has spread.

MR HUGHES: One way of looking at the perspective of both of them is to say that there's a timing element here. It may be the case that if there were fully developed

competition in respect of the local loop, and there were adequate access in that sense, all or a lot of other problems might fall away. I think what we're saying is that we're a long way from that at the moment, and on the road from where we are now to that point, there is still a tremendous amount in the outlying areas to be dealt with, if we could put it that that way.

PROF SNAPE: You referred, I think, to Orange's activities, which would be at the local level; and I think you foreshadowed that you would be doing something similar or intending to do something similar. Will these activities erode the relevance for the power of the local loop?

MR PERKINS: Certainly over time, they must do that.

PROF SNAPE: When do you anticipate that they will get to a critical level that would have the negative tip on the local loop?

MR PERKINS: Professor, it's very hard to say; this is a very, very new market, this. Orange are really targeting the second-line market in their campaign, and I strongly suspect that AAPT might do the same, although we haven't made that decision yet, but that seems to be a fairly logical way to approach it. After all, mobile phones don't, right now, substitute very neatly for fixed-line phones in the home, where people like to have multiple extensions and things like that; mobile phones don't do that. There are perhaps some technological developments before we even get a really competitive product using mobile phones, but it's a start to breaking down that monopoly in the local loop.

Getting access to the copper is only part of it, of course. At the pricing that we're looking at nobody, I doubt, would try to provide a telephone service over that line. Most people who want to get access to the local loop want to use it for DSL-type products, on which they may run the telephone service, as well, but certainly not alone. I think it's going to be quite a while before we see much impact on the unbundling of the local loop, on markets such as long distance and mobile, and other markets like that, international. I don't think that that's going to change very dramatically, very quickly. Eventually, yes, but I think we're looking at some years away, some considerable number of years, probably, before that has any real effect. I think Telstra can feel pretty comfortable about that.

PROF WOODS: Is Optus's HCF cable running past 2 million-odd, part of this breaking down the monopoly of the local loop, from your perspective as a player in the market?

MR PERKINS: We haven't been very successful in negotiation with Optus on access to their cable. It's another arbitration.

PROF WOODS: You have a few?

MR PERKINS: Yes, we do, unfortunately. It's not something that we're very proud of or pleased about. It's very resource consuming, but it seems as though it's the only way that we can proceed.

PROF WOODS: What about developments such as TransACT in the ACT, or other areas where an access provider is putting out facilities in a service-neutral capacity, so that you or anyone else is able to have access? Is that a development that you support and that you can see some benefit from?

MR HOWARTH: It's a good and useful development. There's an awful long way to go, though, before you have a significant impact upon the local loop activities. On the local loop characteristic the second thing to remember is, of course, it comes back to the termination argument again, which is, that it doesn't matter how much ability we've got to suggest to customer they might choose another network, we still have an issue about when we're trying to deliver traffic to those 95 per cent of people who are still connected to a Telstra network. Interestingly when they are in some kind of resale arrangement with somebody else at the retail level, on that wholesale termination basis, you still wind up dealing with the network operator, which is also true of mobiles where you might have resale at the retail level but the termination business is still just run by the three networks.

The second issue, to go on, is just another one of these aspects of where this scope creep takes place. The history and experience of the two HFC networks is quite interesting and instructive, and Telstra's motivation for building out its HFC network when it did. I think Frank Blunt, in his little book with Bob Joss, touches on it, so I won't go into it in more detail than I have to otherwise I might be breaching confidences. When you actually start looking at that history you look at the extent to which there is a content player that has now then driven that business, and the extent to which how much pay TV content was involved in what networks.

With it being mentioned a couple of times today, about the potential of building new access networks - but if I was to build a new HFC network and wanted to bundle pay TV into that network, I'm actually confronted with a significant problem, which is, I can't get any content. How did Telstra get all that content? Because they had access to the ability to build that network that no-one else had. So that's how that double-stepping through of the processes of the scope actually embeds the market power considerations; and that's the sort of thing that David was alluding to. So TransACT is a great development, but they are going to be struggling to necessarily be able to put on to their network the range of services that the incumbent can deliver.

MR PERKINS: I think those little things like Neighbourhood Cable, even the abortive Northgate Cable, TransACT, these are all good initiatives. Macrocom was actually one of the first to build - a very small company - built a microwave link between Sydney and Melbourne; and it wasn't very long before, all of a sudden, interstate cable prices started to move. Really, their efforts were quite small but

effective in causing a movement in the marketplace which hitherto there had been no move whatsoever.

PROF WOODS: You talk about termination. What about the situation, say, if you had a provincial city in regional Australia that decided to pool its service requirements and put them out to tender; would a successful provider still be faced with the impediments of having to then terminate the traffic that that generates, and, does that put you at a disadvantage in competing for those sorts of tenders?

MR PERKINS: It would depend, Mr Chairman, I guess, on how you do arithmetic. You've been reading our press releases obviously. We've just won just such a tender in Bendigo.

PROF WOODS: Tell us about it.

MR PERKINS: I'm glad to have the opportunity to talk about it. Yes, Bendigo is the case in point. Yes, you are at a disadvantage, but on the other hand what you have to do is to look across the whole range of products that you can sell and see where you're going to take your margins, and that's what we had to do. So we're taking a bath in local, I don't mind saying so, we do it every day. But in order to get a customer base we have to look at a broad commercial approach to this, and that's exactly what we did in Bendigo. We hope that better things will come one day, that we will get a sensible price for local call resale, because it's going to be a long time before we'll have any sort of infrastructure of our own in places like Bendigo.

PROF WOODS: That raises an interesting broader issue. You say you take your margins where you can, ie, you price efficiently, depending on elasticities across a range of products, and that's an efficient approach. But if you, going back to an earlier point you raised, just had a single access price at the wholesale level, doesn't that reduce the capacity for the total price that's being offered on a range of products? Doesn't that limit the capacity to efficiently price each of those products, that you're setting a base wholesale price, as you were proposing, but you also support the principle of ultimate retail price being efficiently set according to the situation in individual markets? Isn't there a tension there?

MR PERKINS: There is, but I guess the practical approach is it's an incentive to manage your cost structure very effectively, and we do. That's one of the things that we've done since the day we started. We have been very good controllers and managers of our costs and that gives us the ability to get a working margin that we can use to provide pretty competitive pricing.

I don't think that our interconnect prices are very much better than anybody else's. I doubt it very much. After all, the commission has actually put out guidelines on what it believes the prices should be: 1.8 cents per minute in 1999-2000; 1.5 this year. Everybody knows what the commission's guideline is, and I suspect that everybody is driving towards that price anyway. So the commission, in some sense, has done an open arbitration but in a different way, in its final assessment of Telstra's

undertaking. No, we don't fear that problem; we think that's a challenge to good management and we accept that challenge. As you say, we take our margins where we can.

PROF SNAPE: You would like to continue with that sort of guideline, for the ACCC to continue that type of guideline?

MR PERKINS: Yes, I think that's perfectly acceptable.

PROF SNAPE: You mentioned earlier the investment that you are contemplating undertaking, and you questioned whether investment was in fact being deterred by access provisions; and you also foreshadowed a study, I think, that you're having done. The study will also, I assume, be looking at what deterrents it might have had on Telstra's investment.

MR HAVYATT: Yes, that is the intention of the study. Getting access to appropriate data will be hard but that is our intention, to look at the total investment in the industry.

MR PERKINS: To the extent we can we will, yes.

PROF SNAPE: You advocate cease and desist orders.

MR PERKINS: The colleague on my right would probably address that.

PROF SNAPE: I wonder if you would like to elaborate on that for a little while, please?

MR HOWARTH: Again, this can be viewed in terms of incentive regulation. Currently, under XIB the proposal would be that in the interim, between issuing a cease and desist order and having an XIB heard and decided, the conduct impugned by the ACCC would cease and desist. The idea underlying that is that currently there is the potential for that anticompetitive conduct to continue for some considerable time. As I'm sure you've heard so many times today, but I'll say it again for the sake of it, in this rapidly evolving industry delay is almost the worst form of anticompetitive conduct, partly, again, feeding into those network effects. By the time you finally get into the market on fair terms the opportunity is lost. So rather than allowing the situation to persist where the incumbent can maintain that anticompetitive conduct, the conduct would be stopped.

We see that, again, the incentives would operate far more effectively in that situation because the impetus would be with the incumbent to get the case to court and have it proved and decided, rather than the current situation which we've seen in relation to churn, where everything was done very slowly.

MR PERKINS: Professor, could I just add something to that?

PROF SNAPE: Yes.

MR PERKINS: Something came up earlier about IDs, interim determinations. I think there is a feeling abroad, and not necessarily in this inquiry, that interim determinations and backdating are the solution to all these delay problems; in fact, they offer no real solution at all. Backdating certainly gives you some benefit of financial benefit for the delay that you have experienced, if you get backdated determinations. Interim determinations pose a significant risk to the access seeker in taking them and these are real risks. When we are offered an interim determination we have to look at it and decide whether the business risk is worth it, versus the alternative, which is that we don't have a price with which we can actually compete very effectively.

So we have this business decision we have to make: are we going to take on a contingent liability of unknown proportions, or are we going to take the interim and price accordingly, and try and gain market share that way? This is a difficult decision in business. It really doesn't meet - or doesn't help us in overcoming the effects of delay.

Delay, as David said, is a real killer in business, and if we could get faster decisions through other processes, such as the ones that we have outlined today - and which will be, by the way, putting flesh around in our future submissions - if we could find the way of getting rid of this delay, it would be a far better alternative than IDs and backdating, and other mechanisms that have been put in place. That doesn't directly answer your cease and desist, but it sort of came out of what David was saying. But cease and desist is the same thing; if you can get some control of a behaviour quickly and stop it, then that is the best answer. It's always better to get certainty and get something done quickly.

PROF SNAPE: Your position really today is rather different from the other three participants, in that it may be - even though theirs also have differed amongst themselves - but I think that your opposition is a bit that you're outside the tent and the other three are inside it. You are really calling for more regulation, aggressively more regulation, and chasing them, rather than stepping back and setting sort of generic principles of a simplified nature.

MR HOWARTH: I don't know that we'd quite agree with that. What we say is that the substance of the regulation currently, the effects test in XIB, the declaration test in XIC, and the processes which support that, are entirely appropriate, save for some procedural difficulties, which Telstra has acknowledged this morning, and we certainly argue are very difficult. That difficulty is essentially delay.

The extensions, to the extent that we're talking about extensions, that we're arguing, are to improve those processes; and rather than the current position, which has been very much based on this idea of more rules to compel disclosure of information, or to somehow require the incumbent to do something, what we're arguing is that the rules should reverse the incentive so that both sides in a

negotiation have a desire to get the problem out of the way; whether that's an XIB problem or an XIC problem. Yes, that does involve some changes to the regime, but in terms of the substance we wouldn't say that it's an extension of regulation.

MR PERKINS: In fact, what we're trying to do, particularly in relation to XIC, is try to think of innovative ways that would reduce delays without extensive further regulation, through, say, incentive regulation.

MR HOWARTH: The same results could be achieved by incorporating the principles into the general parts of Part IIIA and Part IV, then we'd support those. But we think that the significant differences would simply result in Part IIIA and Part IV being made to look like XIB and XIC.

PROF SNAPE: Yes. I think that, as a general principle, I suppose, one would like to move towards regulations which are generic and not platform-specific, so that they're not in fact inhibiting technologies because they're not discriminating between technologies. So one tries to move to that type of regulation, because that's a good regulatory principle, to try and move in that way. In the broadcasting inquiry that's the way we tried to go in our recommendations, to make them not platform-specific.

I think that the feeling I certainly get out of your submission is that it's not really going in that direction, and indeed it could even be going in a different direction. I may be getting the wrong impression out of it, and I need to go back and look at it more carefully, including your oral elaborations this afternoon. Am I getting the wrong impression?

MR HOWARTH: There's a timing element there. I think we generally do support the idea of moving, eventually, towards generic regulation. I think the first issue we'd say is, we're not convinced that there's anything that deals with network externality sufficiently in existing regulation, and we need to figure out how to deal with that, and that is a new economy issue. We've got effectively caught up in telecommunications because of the any-to-any connectivity test, but telecommunications is not the only part of the economy that demonstrates network effects.

I'm looking forward to the ACCC's consideration of various EFTPOS matters because that's got exactly the same issues; the fees that banks charge to non-bank participants looks awfully familiar to a telco person. So that's an area where we believe there may well be, down the track, some way of resolving it. The only thing is we can't see that, and so we wouldn't recommend sailing off into that kind of work at this point in time.

The second thing is, as we've mentioned before, the benefits of this regime presumably occur once we've had some cycles of negotiate-arbitrate. It was very unrealistic to expect that commercial negotiation would be successful the first time round. Since we don't seem to have completed a single cycle, it is not surprising that, from our point of view, we're saying, "What we need to do is improve the process so

we can get that cycle working," so we can then look and say, "Now we're starting to get to a more effective platform."

The third part is that, the way the regime itself is constructed, it self-removes. The processes of undeclaration exist and have been commenced on some services. There is a provision for exemptions, that presumably would allow for things like access holidays for new entrants, just no-one has actually bothered testing them at this point in time.

So the regime itself seems to have enough triggers to allow for its own withdrawal, once the pro-competitive intent has been achieved; and so it's another reason why you wouldn't say you need to make a big decision now about changing the regime to something more generic. The regime will take care of that itself.

PROF SNAPE: You're content with the provisions for undeclaring or exemptions or whatever?

MR HOWARTH: At this stage we certainly seem to think the undeclaration process looks sufficient. We'll find out how well the exemption process works because the first application has been lodged, but the rules appear to be quite logical. How the ACCC manages them is yet to be seen.

PROF WOODS: Thank you. Any matters that you wish to raise with us that we haven't explored to date?

MR PERKINS: No, chairman, I don't think so. I think perhaps, yes, there is one, and that's a question on self-regulation; it was raised earlier.

PROF WOODS: Yes, tell us about ACIF. We've heard glowing reports.

MR PERKINS: Yes. I think ACIF has been a pretty successful forum for the industry. I suppose the reservation I would have is I think possibly too much was expected of ACIF in the very beginning. I think people saw that ACIF was the forerunner of industry taking over total control of itself and running it beautifully, and everybody would sail off into the sunset, and of course that hasn't happened, not surprisingly.

I think that if we put the ACIF in terms of realistic goals, I think ACIF has been very successful. Somewhat less successful has been the TAF, the Telecommunications Access Forum, which I must say I am bitterly disappointed about; but on the other hand, again, I think the expectations were probably far too high for the TAF, because the TAF deals really with market power; it deals with declarations of services.

It did its first job, which was to the write the access code, which was subsequently registered by the ACCC, and it did that within a very short period of time, and very successfully. I think it was a credit to our industry that we were able

to do it; I think we did it in about four months. I think the electricity had been going - or gas, or somebody - for two or three years at that time, so we felt pretty chuffed about that. But having done that, the TAF has never made another positive decision in the time it has been operating.

So we're a bit of a mixed bag, I think, in terms of self-regulation and I think that needs sorting out. I think the reality is that the ACIF, in writing the codes that it is and writing the standards that it does, is probably doing about as much as industry self-regulation can actually achieve. When it comes to pricing and commercial issues, changing of market power through declarations, that is never going to be done in my lifetime, which isn't all that long; never going to be done in the foreseeable future, anyway, by an industry self-regulatory body. That's something that has to be done elsewhere. I do think that the ACIF has been successful in what it can do, and that is to write codes and standards.

PROF WOODS: I would like to place on record that I and members of the commission attended a meeting with ACIF, and that they were very generous with their time and information in explaining their role and activities to us. We found that very helpful. No other comments then?

MR PERKINS: No, thank you.

PROF WOODS: Thank you very much as participants. Is there anyone present at the hearing who wishes to make a statement to this inquiry at this stage? That being the case, we will resume at 9.30 in the morning.

AT 5.18 PM THE INQUIRY WAS ADJOURNED UNTIL
TUESDAY, 15 AUGUST 2000

INDEX