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A Telecommunications Carrier under the
Telecommunications Act 1997 (No. 23)

A subsidiary of

DAVNET LIMITED



Davnet Carrier Business

- **"Last mile" broadband solutions provider**
- **100 prime CBD bldgs wired for Davnet**
- **Cisco powered network**
- **National network (Syd, Mel, Bris, Per)**
- **National ISP via Magna Data ISP**
- **LD and CDMA reseller via QAI**
- **Davnet carrier-grade IP voice net for Q4 2000**
- **49% owned by NTT of Japan (Davtel)**
- **Davnet rolling out off-shore (US, HK, SG)**

My Credentials for the Inquiry

- **Regulatory and Market Experience**
 - **AUSTEL, Senior Comp. Analyst, 5 years**
 - **ACCC Telco, Senior Analyst, 1 year**
 - **Global 1, ANZ Mgr Reg & Commercial, 3 yrs**
 - **ACIF, Board Member, 2 years**
 - **Davnet, Mgr Carrier & Regulatory, current**
- **Informed comment**

OUTLINE

- **Focus: Telco Competition Regulation**
 - **No sustainable competition in telco**
 - **Current telco regulation not wking**
 - **Problems**
 - **Suggested Enhancements**
 - **Recent Lessons from overseas experience**

Case for Specific Regulation

- **Telco still different v. other networks**
 - technically, structurally, dynamically
 - bottlenecks still with vertical incumbent, Telstra
- **Regulation then should be different**
 - Maintain, at least, current specific regulation
- **This regulation must also be vigilant**
 - Technology has intensified power (local loop)
 - Telstra can uniquely leverage such power
 - Telstra gets 1st mover advtge - tips mkts

Sustainable Competition?

- **"44 New Carriers"? - superficial**
 - all still reliant on incumbent bottlenecks
 - so exposed to squeezing (eg ULL)
- **Network competition then? - risky**
 - incumbent networks' have excess capacity
 - new guys still reliant on incumbent bottlenecks
- **Prices falling in line with costs? - no**
 - rapid fall in Telstra network and op costs
 - yet Telstra "wholesale" prices high
 - retail prices have fallen more, but this part of squeezing strategy (hence not in LTIE)

Telco Law & Reg working?

- **NO sustainable competition**
- **NO timely equal access to bottlenecks**
 - PSTN equal access delayed for 3 years
 - ULL equal access delayed (so far) for 1 year
 - But Telstra gives itself access from day 1.
- **NO timely regulation of Telstra conduct**
 - ACCC won't use or slow to apply Part XIB
- **So NO!**

Problems

- **Telstra has no incentive to negotiate**
- **Regulated negotiation ineffective**
 - **XIC regulation slow and resource intensive**
 - **Plus no effective conduct (XIB) regulation**
 - **Telstra can still engage in conduct**
- **Where ACCC has discretion - ineffective**
 - **in attempting to broker solutions**
 - **“we are keeping an eye on things”**
 - **usually deals only bi-laterally with Telstra**

XIC Enhancements

- **Telco regulation to “create” incentives**
 - **Carrot:**
 - **Telstra restricted until equal access supplied or**
 - **Stick:**
 - **following due consideration**
 - **deem all terms of access (including price)**
 - **immediately deem in this way all services deemed at and from 1 July 1997**

XIB Enhancements

- **More aggressive ACCC approach**
 - **approach XIB like s. 52**
 - **intent irrelevant**
 - **onus of proof on respondent**
 - **thresholds presumed (like “taking adv”)**
- **Gaming or unreasonable delay**
 - **actionable XIB conduct**

Overseas Experience

- **New Zealand coming to its senses**
 - **Industry specific regulation and regulator now likely**
- **Integration benefits outweigh structural separation benefits?**
 - **Microsoft now ordered to separate**
 - **Telstra still “different”?**



Opening Remarks

Davnet welcomes and appreciates the opportunity to contribute to this important Inquiry.

In due course Davnet will make a more comprehensive submission to the Inquiry, but for today's purpose (and given limited time of only one hour) would like to focus primarily on industry specific competition regulation in the Trade Practices Act.

As introductory comments I would like to highlight certain principles that underpin Davnet's views on regulation generally and on telco-specific competition regulation:

- Davnet has probably one thing in common with all commercial, market participants – it prefers commercial market orientated outcomes to regulated ones.
- Where market outcomes, however, are discretionarily unavailable due to the exercise of market power, Davnet will seek recourse to regulation that attempts to deal with this conduct. Hence, regulation is sought only when it is the only possible substitute to a discretionarily unavailable commercial market outcome, and even then it is far from a perfect substitute. Regulatory outcomes are uncertain, resource intensive, require commercial disclosures and tend to be blunt.
- Where national bottlenecks are not subject to Part IIIA and/or are not separated, like at least Telstra's access network, such bottlenecks should be regulated for the same reasons, at least, as why Part IIIA networks are regulated. Non-Part IIIA specific regulation includes the regulation of access and specific conduct regulation, as apart from the potential of equal access being restricted by non-structurally separate entities, they can also leverage this market power into downstream markets (objectionable conduct).
- Effective competition is not flourishing in Australian telecommunications as many commentators and access providers either superficially or "strategically" believe.
- Commonly quoted "competition" intensity measures like the numbers of new carriers entrants, with reference to the large number of carrier licensees, or to the number of participants in the mums and dads LD market or to the number of ISPs (800 or so now) is extremely superficial. Most of this "competition" refers to either marginal downstream retail "competition", to other niche retail competition, apparent wholesale contestability or niche CBD wholesale contestability.

- From a strategic perspective, this representation of apparent dynamic competition, is a clear example of proponents like Telstra and the other incumbents – Optus and Vodafone to some degree – attempting to identify markets without regard to a purpose - to identify market power. From a Trade Practice point of view, they should and do know better.
- With regard to retail telco services to end-users (the main game for all telco providers) this provision is still heavily reliant on the terms and conditions of access to Telstra's – and to a lesser but still significant extent the other incumbents' – bottleneck inputs. So retail "competition" is still very much vulnerable to incumbent market power misuse (like margin squeezing). Where retail competition is not exposed to this market power, the segment is usually a niche one, either no longer or not yet of interest to incumbents.
- Regarding wholesale competition, there is no national end-to-end wireline network "competition" (contestability). Even with its 1992-97 "access holiday" Optus enjoyed, even it cannot compete with Telstra on a complete national network basis. For other pre-1997 protected duplication, like in mobile networks, there remains no equal access to these new vertical networks. As for post-1997 network "competition", due to the historical Telstra and then the additional 1992-97 network incumbencies, new infrastructure entrants are now exposed to at least one or two extensively rolled out incumbent networks. But also to the post-1997, immediacy of equal access (there are now no sanctioned access holidays) and also the re-pricing of incumbent capacity on or before new entry. Further, new entrants will still require generally some equal access to Telstra CAN regardless.
- Further, from my experience as a buyer (access seeker) of wholesale capacity in the market place there has been no significant reduction in Telstra's transmission prices and only limited reductions in Optus prices. Judging by the proximity or in some cases lower retail prices, Vodafone does not supply wholesale termination services to access seekers. Accordingly, Telstra's and most probably the other incumbents rents on services to access seekers are super-profitable – especially as incumbent network and operating costs have fallen sharply (especially Telstra).
- Where there has been some apparently dynamic wholesale network "competition" in the roll-out of east-coast capital-city CBD access networks, this has provided some control over market power in these niche markets. The value of last mile relationships with CBD corporate clients in these areas and the volume of their spends seems to justify to some extent the risks of multiple access network roll-out. These networks and their customers, however, still require end-to-end services within Australia, which means a reduced reliance but nevertheless some continued reliance on non- CBD or other CBD incumbent bottlenecks. Further, new access entrants are also usually vertically integrated and hence in any event restrict their supply of network services to customers (access seekers) which compete downstream.

- So there is no sustainable or effective telecommunications competition now or is there likely to be, unless there is commercially available equal access and control over incumbent's leveraging their historical or protected access. In the absence of market forces delivering these requirements, the only recourse is specific access and conduct regulation.
- The above discussion also emphasises the point that the legacy of 1992-97 policy intent, and its inherent protection and privileges must not be forgotten in current considerations about the future of specific regulation.
- Another view that seems to have entered into the analytical folklore is that new technology can overcome market power by say conjuring up a new by-pass opportunities. The logic then goes that new technology markets should not be unduly regulated as this could interfere with new dynamic market forces.
- While this may be true, it should be also stressed that technology can also intensify market power. For instance, Telstra had previously complained about carrying the apparent sunk costs of its "legacy" copper CAN network (see following case study for further details). With the advent of new xDSL modem technology applied to this network, however, Telstra can now further immediately control the supply of downstream services, content and applications which require use of copper based xDSL – like the market for all e-services to every household and business connected to its copper network. Technology enabling the convergence of telco, streaming or broadcast services onto one digital IP network, will also intensify Telstra's market power in a myriad of downstream markets.
- Whilst by-pass investment may reduce Telstra's control in the future, the important thing to remember is that Telstra already now has (or soon will) a national IP capable network through its network upgrade (FMO and DMO) programs. Others will have to build such, in a deregulated environment.
- In cases like this it is imperative that regulation should occur from the outset, so that new, high growth markets are not skewed from day one to Telstra's (first mover) advantage. That is, in fact regulation should be more intense in such dynamic markets not more passive or non-existent, as argued by Telstra and others.
- Another myth is that declaration or the threat of it has a dampening effect on access provider investment. This has simply not occurred, as incumbents and new access providers continue to make significant post-1997 network investments in declared markets like in various access and transmission markets. Indeed, the post –1997 environment if anything has been characterised by over-investment in telecommunications infrastructure.



CASE STUDY

TELSTRA'S CONDUCT IN SUPPLY OF LOCAL COPPER LOOP OR "ULLS" FOR xDSL.

The long and sorry history of the complete failure of local copper unbundling regulation - a chronological summary of events

- Competitors had been using Telstra retail leased copper links (known as PAPL) since the mid-nineties to provide low cost, broadband connectivity in capital cities to corporate clients via High-bit rate Digital Subscriber Line (HDSL) modem technology. The rents on the functionally equivalent Telstra managed service, MegaLink, essentially drove competitors to this by-pass solution. MegaLink was also a fully Telstra managed service, which also gave Telstra (and not access seekers) control over key quality of service aspects.
- Around 1996, Telstra attempted to intimidate its competitors into discontinuing their usage of PAPL and hence the HDSL solution through spurious technical reasons, casting doubt on the continued supply of PAPL. For example, Telstra "could no longer guarantee DC continuity" (Telstra had several version of what this was supposed to mean), this copper service was only ever meant by Telstra for voice communications, it is expensive to maintain, or Telstra is replacing copper in the local loop with fibre. On the contrary, Telstra was in fact installing and upgrading copper in key cities in preparedness for, amongst other things, its own roll-out of xDSL services.
- In 1998, with the support of other carriers, service providers and ISPs, I requested that the Commission (ACCC) to investigate Telstra's conduct under Part XIB of the TPA.
- Following its investigation, in mid-late 1998 the Commission decided it could (or would) not mount an action under Part XIB (according to its legal advice). The Commission also appeared to give weight to the fact the copper local loop service would soon be likely to be declared under Part XIC in any case.

- The Commission also attempted to broker an agreement between Telstra and aggrieved competitors. In my dealings with Telstra they, however, remained unreasonable. I understand though some other parties (for example, vulnerable ISPs), probably thinking something was better than nothing, accepted Telstra's slightly modified conduct.
- The Commission in July 1999 declared the copper loop service as the ULLS. It however, remained unavailable to at least me. The main excuse for this is that Telstra had discretionarily made ULLS availability conditional, primarily on the completion of ACIF (where Telstra is a key protagonist with veto rights) development of self-regulatory procedures for Telstra's deployment of *Asymmetric Digital Subscriber Line* (ADSL) service which also relies on a copper access line – PAPL, ULLS etc. There is nothing in the TPA, however, which allows Telstra to refuse to supply a declared service, due to ACIF guidelines (??)
- Telstra also expressly communicated to me that its refusal in supplying due to the necessity to develop ACIF procedures, was an approach it believes was endorsed by the Commission. Then on 22 March 2000, the Commission issued a press release highlighting Telstra's commitment to supply ULLS when Telstra was ready to supply its high-speed, ADSL services. That is, not apparently according to the legislative standard access obligations in Part XIC of the TPA.
- Shortly after ULL declaration also, amid much Telstra PR hype, Telstra then announced the launch of a commercial, wholesale copper-based service for HDSL – HDSL-Link. This was significant, because firstly it confirms that Telstra had no technical concerns with carrier-deployed HDSL. Further, whilst apparently denying ULLS to its competitors under the guise of ACIF procedural development, Telstra was blatantly using ULLS to supply a ULLS dependent service. Not surprisingly though, given Telstra Wholesale's track record, as a commercial product HDSL-Link is restrictive and expensive relative to the PAPL solution, yet it uses exactly the same copper infrastructure. On this basis, HDSL-Link is more a strategic product to lock up ULLS HDSL customers before ULLS is made available by Telstra.
- And now it is likely that this "hoped" coincidence in supply for declared ULLS and retail Telstra ADSL will not even occur, as Telstra ULLS pricing is unreasonably high (absolutely and relative to retail Telstra ADSL), probably requiring arbitration to resolve. Meantime Telstra can launch its retail ADSL service, with impunity.

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