

**SUBMISSION BY AAPT
TO THE PRODUCTIVITY COMMISSION
REVIEW OF TELECOMMUNICATIONS-
SPECIFIC COMPETITION REGULATION ON
ADDITIONAL MATTERS UNDER REFERENCE**

14 February 2001

This submission is the third made by AAPT Limited (“**AAPT**”) to the Productivity Commission (“**Commission**”) Review of Telecommunications Specific Competition Regulation (“**Review**”).

No material in this submission is confidential.

This submission is structured as follows:

1. introduction and overview;
2. responses to the issues raised in the Commission’s Issues Paper 2 of 8 January 2001;
3. conclusion.

1. INTRODUCTION AND OVERVIEW

AAPT supports the full retention of Parts XIB and XIC of the Trade Practices Act 1974 (Cth) (“TPA”) for the reasons set out in its initial¹ and supplementary² submissions to this inquiry. AAPT maintains this view having considered the additional items in the inquiry’s terms of reference. The additional matters are:

- 1 differing levels of competition across Australia and whether a greater recognition of those differing circumstances should be incorporated into competition regulation;
- 2 the implications of current pay television programming arrangements for the development of telecommunications competition in regional Australia; and
- 3 the effect of USOs on competition in regional services.

Differing levels of competition across Australia

AAPT recognises that many consumers in regional, rural and remote Australia do not enjoy access to a full range of reliable and advanced communications services. It further recognises that a contributing factor to this problem is the comparative delay of competition to broaden and deepen in rural areas.

AAPT supports the promotion of competition in rural and regional Australia as the driver of service improvement. Its focus on the needs of rural consumers is evidenced by its initiatives to bring enhanced services to the Bendigo Community Telco project and its VicOne network roll-out.³

However, AAPT submits that the competition and access regimes in Part XIB and Part XIC of the TPA are (subject to the qualifications set out in this submission) sufficiently adaptable to competition problems in regional, rural and remote markets.

While competition is slower to develop outside CBD and metropolitan areas, regional infrastructure roll-out and market entrance by new carriers attest to the fact that the current regime is conducive to competitive development in regional Australia.

Reform of the competition regulatory regime is only one method by which to address concern expressed by Australians in regional areas about service levels. The focus should also be on means to aggregate demand and other industry policy mechanisms so that servicing of regional areas is commercially attractive and viable for new entrants. Regions themselves must be drivers of demand aggregation strategies, with

¹ Submission of AAPT Limited to the Telecommunications Inquiry dated 7 August 2000 (“**AAPT Initial Submission**”)

² Supplementary submission by AAPT to the Productivity Commission Review of Telecommunications-Specific Competition Regulation, dated 3 November 2000 (“**AAPT Supplementary Submission**”)

³ These projects are further discussed below, and in Attachments A and B to this submission.

government partners playing a supporting role.⁴ AAPT believes alternative regulatory tools such as the Customer Service Guarantee (“CSG”) and the contestability of the Universal Service Obligation (“USO”), together with regional specific government funding projects⁵ are likely to assist in raising service levels.

AAPT does however support the analysis of alternative competition models for segments of rural and remote Australia where local monopolies and low levels of investment result in inadequate provision of key services.⁶ It supports the finding of the Telecommunications Service Inquiry (“**Besley Inquiry**”) that the spread of new market models should improve services in many parts of Australia⁷. It also makes recommendations with respect to the application of the existing competition regime to regional-specific competition problems. Broadly, those submissions relate to:

- **market definition** – a telecommunications market should be capable of geographic definition in terms of its regional or remote character where a true analysis of the competition problem requires it. AAPT suggests Part XIC be amended to insert a definition of “market” which expressly recognises regional markets, similar to the proposed amendment to section 50 of the TPA.
- **aggregating demand** – demand aggregation is an effective way to introduce competition into regional areas. In some areas, it is economic to be looking at competition *for* the market rather than competition *in* the market. The competition regime may need to be reviewed to ensure that demand aggregation does not constitute a contravention of Part IV or Part XIB of the TPA.
- **access regime** – the access regime may require modification to ensure that the incumbent is required to provide access to the appropriate mix of services to allow market entry in rural areas. This should be reflected in the declaration process, ensuring that any declaration exemptions do not impinge upon this process. On the other hand, AAPT endorses the grant of access “holidays” where such a competition model is appropriate to competition building in a regional, rural or remote area.

⁴ This has been recognised by the National Forum for “Networking the Nation”. See DCITA website <http://www.dcita.gov.au> – “Outcomes from National Forum - Networking the Nation Factsheet”.

⁵ Two existing government funding projects are the Networking the Nation (NTN) and Social Bonus initiatives which aim to improve services levels in particular regions, or for particular user groups.

⁶ The Commission is referred to AAPT’s submission of 7 August 2000 at page 14, and its supplementary submission of 3 November 2000 at page 4.

⁷ *Telecommunications Service Inquiry, Connecting Australia, Report of the Telecommunications Service Inquiry*. September 2000, at p.138

Implications of current Pay TV programming

AAPT recognises that increasing technical convergence means cable companies' bundling of telephony and television services is a potential means of leveraging market power from one market to another.

It is acknowledged that vertical integration in pay TV programming could be used to deny access to programming which a new entrant needs in order to enter a regional telecommunications market.⁸ Denying access to quality programming to new entrants may have anti-competitive effects in regional markets, including the blocking of revenue sources to fund the roll-out of alternative cable networks.⁹

In considering the prohibitions recommended by the ACCC,¹⁰ a study of the investment effects of both exclusive programming arrangements, and the prohibition of those arrangements may be required. AAPT submits that amendments to the access regimes in either Part XIC or Part IIIA of the TPA to allow for the declaration of the provision of content services in regional markets would be an appropriate and regulatory consistent solution.

The effect of USOs on competition in regional services

AAPT supports the contestability of the provision of universal services. AAPT endorses the finding of the Besley Inquiry that USO contestability may to some extent reduce barriers to entry in regional areas, and should lead to increased competition and service improvement.

⁸ This argument was put forward by the ACCC and Neighbourhood Cable in their submissions to the Telecommunications Services Inquiry.

⁹ It is acknowledged that video streaming and video-on-demand over the internet may provide constraints on the market for pay TV content in the future, but at present these technologies are not competitive.

¹⁰ Recommendations put forward in the ACCC submission to the Telecommunications Service Inquiry Part 2, p 4.

2. RESPONSES TO THE ISSUES RAISED IN THE COMMISSION'S ISSUES PAPER

2.1 Market power in regional markets

What are the regional variations in competition (or market power) between carriers or carriage service providers across regions?

The development of competition in telecommunications markets across Australia has varied significantly. Generally speaking competition in remote and rural market segments is poor or yet to develop. By contrast, CBD areas are becoming increasingly competitive as are, to a lesser extent, metropolitan areas.¹¹

At present Telstra, has an even greater degree of market power in regional Australia than it does elsewhere. This is primarily because:

- (a) **Telstra owns the Customer Access Network.** As a legacy of its statutory incumbency until 1991 Telstra owns the national customer access network. Since restrictions on the number of fixed line network licences were removed in 1997, alternative carriers have rolled out local networks with limited reach in CBD and some regional centres only.¹² Currently around three quarters of businesses and households in Australia do not have a choice of their network provider of local services.¹³
- (b) **lower teledensities and the costs of installing infrastructure create greater likelihood of natural monopoly in regional markets.** Apart from major regional centres, low population density and diminished demand outside commercial business districts has meant that market entry is unattractive to alternative carriers. Costs of providing services in areas of lower population density, particularly facilities based costs, are a clear deterrent to market entry.

AAPT's research suggests that both fixed line and wireless technologies tend to be less costly on a per user basis in more densely populated

¹¹ See the analysis of market contestability in different regions, page 34 in Telecommunications Service Inquiry, *Connecting Australia, Report of the Telecommunications Service Inquiry*. September 2000

¹² *Ibid* p.26.

¹³ *Ibid* page 33.

areas.¹⁴ The Commission recently concluded that average line costs in low density areas of Australia (less than about two lines per square kilometre) are between six and ten times the average cost per line in the rest of Australia.¹⁵ High network costs and the requirement to offer untimed local calls are in many cases prohibitive.

- (b) **uncontestability of the USO scheme.** A number of households in rural Australia are located in USO areas. To date Telstra has been the sole universal service provider to those consumers. In the majority of telecommunications markets the provision of wholesale services in these areas has been uneconomic. According to Frontier Economics competition in local services is unlikely to improve in USO areas until a contestable USO scheme is fully implemented:

To the extent entry is economic in parts of these areas, the entrant must gain an extremely large market share (and hence a large proportion of the USO subsidy). A formal mechanism has been proposed whereby local network providers could compete to be the universal service provider in particular zones within USO areas. Until such a mechanism is in place, it is unlikely any consumers in USO areas will have a choice of their local network provider.¹⁶

While the number of licensed carriers has increased from four in June 1997 to 65 as at 21 December 2000¹⁷ and over 100 non-carrier telephone service providers currently operating in the market, the activities of these new carriers is concentrated in urban areas.

The Besley Inquiry found that regional providers are increasing in numbers however competitive activity is less visible in those areas. The Besley report states that competition is increasing in rural and regional areas (though mainly in rural metropolitan areas) due to demand growth in communications services, diversification of services and recognition of untapped niche markets.¹⁸

Certainly there have been moves by competing carriers to roll-out backbone networks spanning regional areas,¹⁹ however AAPT supports the Besley finding that competition is relatively immature in regional, rural and remote areas, and that

¹⁴ *Competition in Telecommunications Markets under the Current Regulatory Regime in Australia*, report compiled by Dr Graeme Woodebridge of Frontier Economics October 2000, as commissioned by AAPT for its second submission to this inquiry, page 23

¹⁵ Productivity Commission, *Population Distribution and Telecommunications Costs*, Staff Research Paper, August 2000, p. ix

¹⁶ *Competition in Telecommunications Markets under the Current Regulatory Regime in Australia*, report compiled by Dr Graeme Woodebridge of Frontier Economics October 2000, as commissioned by AAPT for its second submission to this inquiry, p. 28

¹⁷ ACA register of licensed carriers, www.aca.gov.au 23/1/00

¹⁸ Besley Inquiry p. 134

¹⁹ Besley Inquiry pp 139 to 146 canvasses network roll-out plans of the various carriers in Australia

particularly in remote areas, consumer choice in service providers is not likely in the near future. AAPT is pursuing business opportunities in regional areas,²⁰ however it has found that smaller populations mean demand is usually thinner and greater per capital investments per head are required, making it difficult to break local monopolies.

Are there any issues of market power in regions of Australia different from those applying nationally?

- **Do they have different expressions and effects?**
- **Do they have different sources?**

Are there prospective changes in technology that may exacerbate or ease any problems of market power in regions?

Incumbent market power is more accentuated in regional telecommunications markets, primarily due to the “natural” barriers to entry discussed above and entrenchment of historical market dominance through other factors such as uncontestability of USO services and market power leveraged from convergent markets.²¹

As is the case nationally, Telstra’s market power in regional Australia is most visible in the market for local services.²² However as previously submitted, “spillovers” from the barriers to entry in the wholesale local service market can serve to distort competition in the long distance, fixed to mobile, mobile and international voice telephony markets. Spillovers can also diminish competition in regional internet and data markets to the extent those markets are contestable. These “spillover” effects stem from the high degree of vertical and horizontal integration within and between telecommunications markets and the prevalence of network effects, which presently exist in all geographic segments of the market.

In addition to the sources and effects of incumbent market power that exist nationally, disaggregation of demand and regulatory constraints preventing providers charging cost-based prices for services has created the perception that competitive provision of services in some rural areas would be “uneconomic”.²³ To the extent entry is considered “economic” in remote areas, the entrant must gain an extremely large

²⁰ See Attachments A and B describing AAPT’s involvement in the Bendigo Community Telco and the VicOne network roll-out.

²¹ See section 2.2 below.

²² As concluded in *Competition in Telecommunications Markets under the Current Regulatory Regime in Australia*, report compiled by Dr Graeme Woodebridge of Frontier Economics October 2000, as commissioned by AAPT for its second submission to this inquiry.

²³ AAPT’s Initial Submission to Telecommunications Service Inquiry p.7

portion of the market, if not the entire market, to be profitable. The form of competition to develop in these segments is likely to be closer to competition *for* the market rather than competition *in* the market.

AAPT supports community based initiatives to “aggregate” demand to make regional markets more attractive to new entrants, and considers that targeted strategies designed to overcome traditional barriers to entry are desirable in those regional areas where entry is considered “uneconomic”.

New market models

AAPT recognises that the state of economic development in regional Australia varies significantly. In some areas it is characterised by growing metropolitan centres, in others, stable or declining rural communities. As demand for communications services is far from homogenous, the monopoly network supplying a full range of universal services is no longer appropriate to meet regional needs.

Meeting regional needs cannot be achieved solely through competition regulation. AAPT submits that the existing access and competition regimes in Part XIB and Part XIC are adequate however new market business models focusing on limited geographical markets are also important.²⁴

Similar to the conclusions arrived at in the Besley Report, research commissioned by AAPT²⁵ has concluded that the different characteristics of regional markets justify consideration of alternative models which encourage “competition for the market” rather than “competition in the market”.

Among the new market models discussed at some length in Chapter 7 of the Besley inquiry report and accompanying research by Network Economics,²⁶ were those referred to as “community telcos”. The following comments may assist the Commission in its considerations of emerging market models:

The Community Telco model

There is currently no single ‘community telco’ model and the development of the various versions of this model is only in its initial phase. The model appears to have emerged because of dissatisfaction with the competitive processes in the major

²⁴ Alternative market models for regional Australia are described and analysed in *New Market Models for the Delivery of Telecommunications and Online Services in Regional Australia*, August 2000, a study by Network Economics Consulting Group Pty Limited, and others for the Besley Inquiry.

²⁵ *Competition in Telecommunications Markets under the Current Regulatory Regime in Australia*, report compiled by Dr Graeme Woodebridge of Frontier Economics October 2000, as commissioned by AAPT for its second submission to this inquiry.

²⁶ *New Market Models for the Delivery of Telecommunications and Online Services in Regional Australia*, August 2000, a study by Network Economics Consulting Group Pty Limited, and others for the Besley Inquiry.

population centres which have failed to deliver the same benefits to regional Australia.

The model is based on the premise of demand aggregation in the region improving service delivery and pricing. Variants of the model include establishing separate facilities and entering a wholesale/retail relationship with an established carrier. AAPT's relationship with Bendigo Community Telco is of the latter type. The competition regime may need to be reviewed to ensure that demand aggregation in sanctioned circumstances does not constitute a contravention of Part IV of the TPA.

For these reasons AAPT would support a greater level of consideration of differing levels of competition across Australia being incorporated into the application of competition regulation.

Technological changes

AAPT generally supports the proposition that new technologies can potentially provide enhanced opportunities for consumer access to telecommunications services outside urban Australia. New technologies designed to transmit more information across networks at a cheaper price and at a higher speed clearly have application in rural, remote and regional Australia. DSL, LMDS and MMDS all have the potential to deliver enhanced services in high population density areas, although they are of limited use in areas of sparse population.²⁷ CDMA and satellite may be more efficient ways of delivering data and telephony services at lower cost. In most cases it remains to be seen how effective these technologies will be in attracting competition to rural markets.

If a telecommunications carrier can earn excess returns in remote regions, how does this arise?

In what ways, other than price, is market power in telecommunications apparent in regional Australia?

Have there been any access problems specific to a telecommunications service in regional Australia?

Are there matters of market power in regional Australia that require different regulation or processes that apply under Parts XIB and XIC of the Trade Practices Act or the relevant parts of the Telecommunications Act under review?

What is the rationale for any such differential regulatory treatment?

If treatment were different, what impacts, if any, would that have on efficient

²⁷ The limitations of particular technologies is discussed in *New Market Models for the Delivery of Telecommunications and Online Services in Regional Australia*, August 2000, a study by Network Economics Consulting Group Pty Limited, and others for the Besley Inquiry.

resource allocation?

Excess returns in remote regions

Telstra asserts that it has not been able to earn excess returns in remote regions. It claims that it is unable to sustain the necessary level of infrastructure in remote areas “because there are no uncontested markets to cross-subsidise investments in uneconomic areas”.²⁸ As identified by Access Economics²⁹, provision of USO services should not rely on subsidies from other regions, other than those made available by the USO mechanisms. The level of competition that emerges from competing carriers’ tender for the USO subsidy, and the use of alternative methods of efficient delivery of services in remote areas remains to be seen. The Commission is referred to AAPT’s comments regarding USO contestability below.

Effects of concentrated market power in regional Australia

Other than price, Telstra’s market power is apparent in regional Australia through the lack of competition in many areas. As mentioned above, consumers in more remote areas rarely have a choice of carriers. Approximately 30 per cent of all submissions received by the Besley Inquiry were from the six per cent of Australians who live in remote areas, reflecting the frustration experienced with inequitable access to services in those areas.³⁰ Inadequate service levels with respect to faults and provisioning services are also a source of great concern for rural Australians. It is far more difficult to have basic and reliable telephone services connected quickly and repaired in a timely manner.³¹

Concentrated market power in regional Australia, and the consequential lack of competition on those areas has meant that consumers outside urban and metropolitan areas have not enjoyed the benefits of expanding choice in service provision, products and price packages in traditional voice telephony, internet and data markets. Telstra’s substantial market power also creates problems of information asymmetry, rendering it more difficult for competing firms to negotiate access and interconnection arrangements on an informed basis. The experience of alternative providers in regional areas is generally more limited than in urban areas, leading to a greater asymmetry of information. Telstra has clear incentives to overstate the cost of

²⁸ Bruce Akhurst, Telstra group managing director of legal and regulatory, on page 6B of the transcript of proceedings of the Inquiry in Sydney on Monday 14 August 2000.

²⁹ Access Economics, *Australian Telecommunications Investment Under the 1997 Regulatory Regime*, prepared for AAPT, October 2000 as included in AAPT’s supplementary submission to this inquiry, at p 13

³⁰ Besley Inquiry page 1. Also see the research undertaken by Gibson Quai for the Besley Inquiry on levels of consumer satisfaction with telecommunications services in regional Australia. <http://www.telinquiry.gov.au/consult.html>

³¹ Besley Report, page 2.

infrastructure, historical investments and future investments and to obtain the highest possible price for access.³²

Differential regulatory treatment

Whilst in AAPT's submission incumbent market power is at present more pronounced in remote Australia, particularly where economies of density are least possible, AAPT maintains that the principles in Parts XIB and XIC of the TPA are generally appropriate to stimulate competition to the extent that it is efficient in these areas for the reasons stated in the AAPT Initial Submission and the AAPT Supplementary Submission.

That is not to say that differences in market features do not warrant different regulatory treatment. Rather, the current regime provides for an appraisal of specified factors to determine whether the principles and policy objectives of the regime are upheld in the circumstances. Differences in the application of the existing principles as they relate to market definition, demand aggregation and access principles are desirable, as proffered in other parts of this submission. The Commission is also referred to AAPT's comments above in support of the development of new market models for regional Australia.

2.2 Access, declaration and other Part XIC processes

Currently, there is a market definition applied in determining whether competition will be promoted under Section 152AB(2)(c) of Part XIC of the Trade Practices Act.

- **How does this definition of the markets for listed services effect the declaration of services in regional Australia?**
- **Does it mean that some services are not declared when they should, because a wider geographic market is used to test the existence of market power? Or**
- **Does it mean that some services are declared when they should not?**

The relevant "market" for the purposes of Part XIC is defined with reference to principles of substitutability and competitiveness of goods and services in accordance with section 4E of the TPA. In addition, the Commission purports to take account of "commercial reality" to ensure that the market which it identifies accurately reflects the area of competition.³³ A "purposive" approach is taken to market definition, which

³² Access Economics, *Australian Telecommunications Investment Under the 1997 Regulatory Regime*, prepared for AAPT, October 2000 as included in AAPT's supplementary submission to this inquiry, at p 13

³³ *Declaration of an analogue subscription television broadcast carriage service*, ACCC Inquiry Report, October 1999 at page 11.

requires a consideration of the competition problem being analysed, before markets can be defined.

AAPT submits that regional areas of competition have attained sufficient definition to warrant express recognition in Part XIC. This proposal is in line with amendments in the *Trade Practices Amendment Bill No.1 2000*, (“**Bill**”) with respect to the meaning of “market” in section 50. The Bill is currently under Senate review.

Section 40 of the Bill proposes that section 50(6) be amended to extend the definition of “market” to include a substantial market for goods or services in a region of Australia. At present the section only refers to substantial markets within Australia or a state or territory of Australia. AAPT proposes the insertion of a definition of “market” in Part XIC which would mirror the proposed definition in section 50.

Market definition which excludes regional markets in Part XIC can lead to services not being declared which may otherwise be declared. An example of this is roaming. Roaming enables the customers of one mobile network to make and receive calls from areas that are covered by the mobile networks of other providers. In the absence of roaming agreements in some regional areas, people living in regional areas cannot use their mobile phones. In AAPT’s submission, incumbent refusal to enter into roaming agreements can, and does constitute anti-competitive conduct. If the roaming service could be analysed within a particular regional market, rather than on a national basis, the ACCC may be more inclined to find that declaration is within the Long Term Interest of End-users (“LTIE”).³⁴ A regional market definition would allow the fact that ACA spectrum allocation over vast areas, can sometimes be prohibitive of investment in network roll-out, resulting in roaming agreements being the only method of entry into regional markets for the provision of mobile services.

The above is an example where the analysis of a competition problem would be quite different if markets were defined to better reflect regional factors. Failure to acknowledge regional-specific factors can lead to outcomes contrary to the long-term interest of end-users.

Finally, in addition to the suggested amendment to Part XIC, consideration of regional markets should also be included in the Part XIB. This would allow the competition rule in Part XIB to be applied more effectively in non-urban areas where concentrated incumbent power gives rise to a greater need for competitive safeguards.³⁵

³⁴ The ACCC previously found that mandatory roaming would act as a disincentive for GSM infrastructure deployment because it would effectively negate competition and ultimately decided not mandate it. See ACCC, *Public Inquiry into Declaration of Domestic Inter-carrier Roaming under Part XIC of the Trade Practices Act 1997*, March 1997.

³⁵ See page 31, First submission of AAPT to this inquiry

To what extent is it likely that investment in bottleneck facilities in regional Australia would be at risk were they declared?

Have there been any examples where the risk of subsequent access by competitors has deterred (or scaled down) such an investment in telecommunications?

As discussed in detail in the AAPT Supplementary Submission, AAPT supports the retention of the current criteria for the declaration of services under section 152AL and has suggested certain reforms to the regime concerning incentives to commercial negotiation. This position remains unchanged after considering the additional terms of reference the subject of this submission.

The Commission is referred to AAPT's analysis of the effect of Part XIC on investment in its supplementary submission of 3 November 2000, including the accompanying report prepared by Access Economics. AAPT will not repeat its submissions here except to note that there is no evidence to support Telstra's claim that part XIC has, in any way, proved to be a disincentive to infrastructure investment. On the contrary, available evidence is that investment has grown in spite of the existence of the competitive regime, including in regional areas.³⁶

AAPT recognises that some investments in regional Australia are likely to be close to marginal and that investors may be cautious of reduced viability in areas where it would not be efficient for more than one provider to supply services. In this regard, AAPT notes that the LTIE test represents a balance of a range of considerations, of which efficient investment is one.

In AAPT's view the ACCC generally takes a balanced approach to weighing up the relevant considerations. Carriers have the opportunity to apply for declaration exemptions in situations where they can show that the LTIE would be prejudiced by the introduction of competition. AAPT acknowledges that "access holidays" may be appropriate where an access provider proposes to engage in a risky investment. Access holidays are discussed further below.

To what extent has access to bottleneck facilities in regional Australia encouraged new network extensions?

In AAPT's experience, access to bottleneck facilities has assisted it in the roll-out of network extensions. The declaration of DDAS and ISDN services has been a factor which has enabled AAPT to roll-out network extensions into regional Australia. AAPT has had to resort to arbitration in relation to the DDAS service in order to cost

³⁶ Besley inquiry, chapter 7 – section entitled "Network Roll Out" p.139

effectively provide access for its roll-out of the VicOne network in Victoria. An inability to use the access regime would have resulted in an impediment to AAPT's development of the network.

By contrast, failure of commercial negotiations with Telstra with respect to access to CDMA roaming in regional areas has contributed to the delays in the roll-out of AAPT's CDMA network.

What are the advantages and disadvantages of allowing “holidays” for marginal telecommunications investments in regional Australia?

Under Part XIC, an access provider which is bound by a declaration may seek an exemption from that declaration (which can be seen as an access holiday).³⁷ The ACCC can only grant an exemption if to do so would be in the LTIE. AAPT acknowledges that there may be a need for an exemption (including an access holiday) to be granted in some instances, such as where an access provider proposes to engage in a risky new investment.

However, AAPT notes that applications for exemption under Part XIC create the potential for “regulatory gaming”. AAPT would argue that the access provider should be required to show that such a protection would be in the interests or welfare of consumers of the ultimate services to be provided to end-consumers.

Access holidays may in some circumstances be important to the implementation of the new market models, such as the “community telco” model discussed above.

What are the advantages and disadvantages of appointing a regional Commissioner to deal with the regional dimensions of telecommunications competition policy? What would be the appropriate functions of such a Commissioner?

In AAPT's view the ACCC is not the proper forum for the creation and funding of a region-specific Commissioner. The appointment could potentially be used as a tool for narrowly-focused lobbying on matters that are not properly competition issues, effectively complicating the ACCC's national competition objectives through the prioritisation of particular community interests.

AAPT considers the identification of regional issues and the monitoring of the success and failures of the current regime important, but that the current inquiry and consultation process is adequate.

³⁷ Section 152AT.

Other initiatives such as the Commonwealth government's Networking the Nation strategy, community lobby groups and the ACA regional office complaint monitoring scheme are appropriately aimed at the economic and social development of regional, rural and remote Australia. AAPT notes that it is more properly the responsibility of the Department of Communications, Information Technology and the Arts to monitor and develop policy initiatives to address regional telecommunications issues. This should include the maintenance of information relating to provision of services in regional and remote areas to assist in defining regional markets.

2.3 Pay TV and regional telecommunications

AAPT acknowledges that vertical restraints in pay TV program supply could potentially limit facilities-based telecommunications competition in rural and regional Australia.³⁸ This is primarily because access to quality programming or content is needed to secure subscribers and the necessary investment for roll-out of a competitive cable network³⁹ which is based on a business model of providing fully integrated services.

With the advent of digital convergence and the consequential bundling of communications services, certain cable networks are capable of supporting a mix of data, voice, and television services. If incumbent pay TV operators render it difficult or impossible for these new cable entrants to gain access to pay TV channels, market power in the pay TV market could be leveraged to maintain or gain dominance in markets for telephony and data services in rural and regional Australia.

The ACCC has inquired into cases of program exclusivity and difficulties in gaining access to programming.⁴⁰ Despite its finding that vertical integration has been used to hinder or foreclose competition in regional pay TV and related telecommunications markets, the ACCC has not been able to find a breach of sections 45, 46 or 47 of the TPA.⁴¹ The ACCC has therefore proposed a special access regime based upon the prohibition of exclusive program supply agreements unless such agreements are in the public interest.

In principle, AAPT does not object to the ACCC recommendations, provided there is strong evidence that any specialised regime would be likely to promote competition and result in *efficient* infrastructure investment. In that regard, AAPT makes the following broad comments:

- (a) In the interests of regulatory consistency, any attempt to address the competition ramifications of exclusive programming agreements should be incorporated into the access regime in Part XIC of the TPA. This could be achieved by making appropriate amendments to sections 152AF and 152AL to explicitly provide for declaration of pay TV content supply in regional areas;

³⁸ See ACCC arguments in injunctive proceedings instituted against The News Corporation Limited, Telstra Corporation Limited, and Australis Media Limited in October 1997, and ACCC comments on the Neighbourhood Cable case in Submission by ACCC to the Telecommunications Service Inquiry, Part 2, page 5.

³⁹ Neighbourhood Cable asserts that an important factor in signing up subscribers is the quality of programming which is available in its *Prospectus* for the offer of shares in national Investments Limited (to be renamed Neighbourhood Cable Limited) March 2000, p.6.

⁴⁰ See Submission by ACCC to the Telecommunications Service Inquiry, Part 2. Neighbourhood Cable and other cable operators have approached the ACCC concerning difficulties in gaining access to programming.

⁴¹ Submission by ACCC to the Telecommunications Service Inquiry, Part 2, pages 3 – 6.

- (b) Alternatively, the definition of “services” could be amended to include pay TV content supply services in Part IIIA of the TPA. However the Commission is referred to AAPT’s Part IIIA submission⁴² with respect to certain improvements that would need to be made to that regime to render it more effective. In particular the Commission is referred to AAPT’s recommendation that the national significance criterion be amended to ensure regional services are explicitly regulated by the regime⁴³.
- (c) the “public interest” exception in the proposed prohibition on program supply contracts in the pay TV operator’s service area would need to be drafted in detail so as to avoid uncertainty and delay in ascertaining whether the exception applies;
- (d) arguably, the onus of proof that an exclusivity arrangement is within the public interest should lie with the cable TV operator. The cable operator seeking the exemption is likely to have more immediate access to relevant information, and should bear the cost of establishing that an exception applies to it;
- (e) providing incentives for a particular type of cable roll-out in rural, regional and remote Australia gives rise to questions of industry policy which might properly be addressed as part of Networking the Nation or other government funding initiatives.

AAPT recognises that it may be desirable to open up quality programming to new entrants. However, this should only be the case if it will result in efficient facilities-based investment and the promotion of competition in rural and regional Australia.

In AAPT’s submission a fuller inquiry into the potential impact on competition and efficient investment of any new regime should be conducted prior to its implementation.

⁴² AAPT Submission to the Productivity Commission’s Review of Part IIIA of the Trade Practices Act 1974, 22 January 2001.

⁴³ *Ibid* at page 8.

2.4 The effect of USOs on competition in regional services

What impact does the operation of the USO have on telecommunications competition in regional Australia?

Are there ways in which the USO, the framework for its calculation or its financing, can be improved in a way that produces better outcomes for competition in regional Australia?

Impact of the USO on competition

AAPT is of the view that the most appropriate form of USO funding to minimise its impact on competition would be direct budget allocation to end-users. However, successive governments have indicated a preference for industry funding and AAPT accepts this.

Within a framework of industry funding AAPT believes that the current USO arrangements work reasonably well with their impact on competition in regional Australia being kept to an acceptable level. In this regard there are two key issues:

- (a) definition of the USO and the range of services, including quality of service delivery; and
- (b) supply and funding arrangements.

Regarding the first of these issues, it is self evident that the outcomes define the extent of the social obligation and that the impact on competition flows through the supply and funding arrangements.

As stated above, the current USO supply and funding arrangements work reasonably well, although improvements can be made. AAPT fully supports the current avoidable cost / revenue foregone methodology based on efficient forward looking provision and believes that this methodology, compared with other possible methodologies, minimises the impact of the USO on competition in regional Australia. However, because of the potentially adverse effect of USO costs on new entrants, AAPT remains concerned about the level of USO costs.

For this reason AAPT supports the planned pilot scheme for contestable supply of the USO.

In its submissions to the ACA on the proposed arrangements for the pilot zones AAPT has stated its view that there are two essential principles for the operation of the contestability pilots:

- (a) The first is that the transaction costs of the scheme must be minimised;

and

- (b) The second is that the total cost of providing the USO in the contestable areas must not be higher than the cost without contestability.

If these conditions are not satisfied then AAPT believes that competition in regional Australia will be adversely effected.

USO Cost methodology

The Commission has indicated that any errors in the cost methodology for determining the USO, where Telstra is the single supplier, would provide transfers between Telstra and rival carriers. The Commission then comments that such transfers may have potential effects on competitive neutrality and incentives to provide adequate facilities. These comments need to be put in perspective.

For 1999/2000 the total USO cost was estimated to be \$280 million. Telstra's operating revenue for that year was \$19,840 million so that the total USO cost equated to approximately 1.5% of this figure. In terms of total industry revenue the figure would have been lower.

Most recently the ACA projected a total USO cost for 2002/2003 of approximately \$240 million which should by that time equate to approximately 1% of Telstra's total revenue and an even lower figure for total industry revenue.

Telstra has a greater level of profitability than other licensed carriers due to the start up nature of most new entrants. At Telstra's level of profitability in 1999/2000 even large percentage changes in total USO cost would have had only a modest impact on Telstra profitability. By way of contrast, these same changes would have a very significant impact on the bottom line of the newer entrants. Therefore errors in USO cost methodology are more likely to effect the service and investment decisions of the newer entrants than those of Telstra. It is for this reason that AAPT has actively participated in the development of the USO cost methodology and in the proposed new arrangements for USO contestability.

Improving the USO arrangements

AAPT believes that this matter has been thoroughly canvassed in other fora, and therefore does not wish to make any further comments to those set out above.

3. CONCLUSION

AAPT is of the view that the competition and access regimes in Part XIB and Part XIC should be retained and that they are, for the most part, sufficiently adaptable to cope with competition problems in regional, rural and remote Australia.

At the same time, it is recognised that the features of regional markets which have given rise to subsisting local monopoly power can be quite different to those existing in urban and metropolitan markets. While the USO scheme and certain aspects of the access regime need to be applied, and in some cases improved to take account of these differences, it is submitted that the competition regime in the Trade Practices Act cannot be the primary driver to remedy inequitable and substandard delivery of telecommunications services in regional Australia.

Rather, government policies and funding, together with community demand aggregation and cohesion in consumer negotiation strategies are paramount in attracting better service to remote areas.

Attachment A

VicOne Network Roll-Out

VicOne is an initiative of the Victorian Government. The aim of VicOne is to provide regional and rural Victorians access to multimedia technology at substantially lower prices. AAPT was awarded the VicOne contract in September 1997 and has invested approximately \$60 million in building the VicOne network. The VicOne network has benefited schools, hospitals, farms and businesses.

The network is one of the most advanced switched data communications networks in the world with over 3,500 sites connected to 44 points of presence across Victoria. AAPT provides a range of bandwidth services from 64 Kbps upwards and which allows over 98% of the population to use local call dialup. AAPT offers virtual private networks and quality service. This makes VicOne suitable for security sensitive clients such as clients with financial and customer data. VicOne is also able to support advanced multimedia applications such as desktop videoconferencing.

Multimedia technology has simplified services in rural areas. A telephone call, video conferencing session over the Internet and a wireless IP connected Pen-based tablet can run on the same IP infrastructure. Traditionally, these technologies would have required three separate infrastructures. Users of the 7900 series IP phones who use VicOne can unplug their phone in one location and plug it in at another in the network with the extension number and all pre-programmed features following the user to the new location. There are also many value added services in the VicOne network such as centrally managed electronic directories, integration with data applications and increased flexibility in adds, moves and changes.

The South West Alliance of Rural Hospitals ("SWARH") has used VicOne to link 12 separate hospitals with a high-speed Internet based switched network allowing broadband connectivity to the site. This has enabled the participating hospitals to shift all their data, voice and video records onto a single network and save \$400,000 annually. The staff of SWARH are able to make many calls for free and most STD phone calls are charged at local rates. Victorians living in regional areas can also benefit from online medical diagnosis through the VicOne network. This service allows people living in remote locations to access specialist services currently only available in city hospitals.

VicOne is used to provide Victorian schools with access to on-line services, multimedia and curriculum support. The VicOne infrastructure provides a secure way to connect both the schools' Administration and Curriculum Local Area Networks into a single VicOne service. A range of support services, Internet Service Providers and curriculum multi media resources are also being constructed. Schools also have the option of upgrading the basic 64 Kbps service to higher speeds to support new multimedia applications or larger numbers of simultaneous users.

Attachment B

Bendigo Community Telco Group

AAPT was chosen as the commercial and strategic partner for the first Australian regional telecommunications company, the Bendigo Community Telco Group in August 2000. The Bendigo Community Telco Group was established to provide communications services tailored to meet local needs. AAPT is working to help the group evolve into a regional telecommunications provider. The aim of the project is to shift the provisioning model from supply driven to demand driven so that the user, rather than the provider, will decide which services will be provided.

The project is essential to maintain and enhance telecommunications in Bendigo and other regional areas as telecommunications companies are currently abandoning regional Australia. Historically regional Australia has had less access to telecommunications services than metropolitan areas. This project reflects AAPT's commitment to delivering telecommunication services to rural Australians and AAPT's intention to expand their network infrastructure in rural Australia. If the Bendigo Community Telco Group is successful in becoming a regional telecommunications services provider, it will be a model for other rural communities which are facing similar telecommunications problems.

AAPT has several roles in this project. It is currently working to provide an initial group of 15 consortium members, which include many of Bendigo's leading businesses, with basic voice and data services. It will conduct negotiations with other carriers to provide savings to the group. In the longer term AAPT will extend the program to other members of the community, utilising its existing Victorian regional infrastructure. AAPT will expand fibre, microwave and high speed fixed wireless LMDS technology networks and will deploy other local access initiatives to deliver enhanced telecommunication services.

AAPT has also established a customer care facility in Bendigo, Victoria which employs over 400 staff to support AAPT's development of regional Australia's telecommunications and its growing customer base of over 500,000 clients. The centre incorporates 300 workstations, training facilities, staff entertainment, printing and imaging centres and the most advanced customer care technology including web based customer management applications. AAPT has allocated \$4 million for location upgrade, equipment and project management of the call centre.

AAPT is providing services to regional Australia which will further enhance telecommunications in the Bendigo Community.

In addition to the telecommunications benefits to the community, the Bendigo Community Telco Project has resulted in the employment of Bendigo community members. AAPT also supports several local organisations and local events, including a major sponsorship deal with the Bendigo Football League.