



**CABLE & WIRELESS
OPTUS**

Cable and Wireless Optus

Submission to the Productivity Commission's

Review of the Telecommunications Competition

Regime

Case study on local loop unbundling

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Executive Summary

Cable & Wireless Optus welcomes the opportunity to make this additional submission to the Productivity Commission's (the Commission) Review of Telecommunications Specific Competition Regulation.

This submission will make the following points:

- An ongoing pro-competitive telecommunications access regime and a set of sector specific conduct rules is necessary given the natural monopoly characteristics of the fixed local loop and Telstra's dominance of this essential bottleneck facility.
- Access to the fixed local loop is essential if Australia is to achieve competition in fixed telephony services and downstream new economy services such as high speed internet access, data video streaming and pay TV services.
- Telstra's ownership of the fixed local loop threatens the future development of competition for the provision of these services. Telstra being the integrated provider of the fixed local loop and downstream fixed telephony and new economy services has strong incentives to restrict access to the local loop so as to reduce or eliminate competition in downstream markets which are dependant on the fixed local loop.
- To date Telstra has only allowed access to the fixed local loop at unreasonable terms and conditions. Regarding price, Telstra proposed charges for Unconditioned Local Loop Services (ULLS) are 160 per cent higher than benchmark European and US prices. Telstra has also proposed service assurance charges that are over 5 times higher than Cable & Wireless Optus' estimated efficient charges. In terms of non-price terms and conditions, Telstra has sought to implement processes, which result in nonequivalent outcomes for its competitors, putting them at a competitive disadvantage.
- An ongoing pro-competitive industry specific access regime is needed in order to allow competition to develop in downstream markets that are dependent on access to Telstra's fixed local loop. Competition in these markets will be in the long-term interest of end users. Furthermore, the implementation of an effective procompetitive access regime at the wholesale level may eventually reduce the need for regulatory measures being applied at the retail level of telecommunication markets.
- The current record keeping rules play an important part in ensuring effective competition as they seek to address the information asymmetries which characterize the telecommunications industry and reinforce the incumbent's market power. It is therefore important that these rules are retained.

- Competition notices have been effective in enhancing competition. They provide firms with significant market power with a disincentive to engage in anti-competitive behavior that undermines the competitive process.
- Effects based tests such as Part XIB of the TPA are generally regarded by economists to be superior to “purpose” base tests in determining legal liability or otherwise for alleged anti-competitive conduct. This is because such tests better focus on the social welfare implications and effects on the efficient operation of the competitive process of the alleged conduct. Part XIB will be useful going forward in deterring Telstra from engaging in anti-competitive conduct in relation to the supply of ULLS to independent downstream competitors. Therefore, Part XIB of the TPA should be retained, if not strengthened, as recommended in Cable & Wireless Optus’ previous submission to the Commission.

Without a pro-competitive telecommunication specific, access regime the incumbent owner of essential bottleneck facilities such as the fixed local loop, will be able to restrict access to such facilities in order to eliminate or reduce competition in downstream retail markets. This will result in a loss of consumer welfare caused by less competition, innovation and choice, and higher than economically efficient prices.

This submission will draw on our recent experience over access to unbundled local loop to illuminate the crucial importance of the current regime in ensuring competition and promoting consumer welfare. The structure of this submission is as follows:

Part XI C:

Chapter 1 discusses the price-related issues that have arisen for Telstra’s downstream competitors that are presently attempting to gain access to ULLS on non-discriminatory terms and conditions. In particular it discusses the unreasonableness of Telstra’s proposed prices when benchmarked against those in the US and Europe. It will also discuss how part XIC of the Trade Practices Act establishes a process by which access seekers are able to seek arbitration on issues that are unable to be resolved by commercial negotiations. It argues that the present pro-competitive regime, refined to more exclusively focus on areas of significant market power such as Telstra’s control of the fixed local loop, should be retained to ensure competition develops in downstream markets that are dependant on critical upstream inputs such as the fixed local loop.

Part XIB

Chapter 2 will address non-price issues related to ULLS and the ongoing need for the Part XIB regime to promote competitive outcomes in telecommunications markets. Specifically the chapter will address:

- the ongoing need for the present Part XIB record keeping rules as they provide a viable mechanism for determining whether or not the ULL Service provider is treating access seekers on an equivalent basis to its own wholesale and retail divisions in relation to the key technical and operational elements of the ULL Service, and whether or not there are equivalent outcomes.

- the desirability of retaining effects-based competition tests such as Part XIB of the TPA. Specifically, effects based tests such as Part XIB are generally regarded by economists to be superior to “purpose” base tests in determining legal liability or otherwise for alleged anti-competitive conduct. This is because such tests better focus on the social welfare implications and effects on the efficient operation of the competitive process of the alleged conduct.
- the importance and potential effectiveness of Part XIB competition notices. It argues that competition notices have in the past been an effective incentive in deterring firms with substantial market power engaging in anti-competitive conduct with the effect of substantially lessening competition and reducing consumer welfare. The competition notices have been historically effective in encouraging Telstra to modify its behavior where such conduct significantly impaired the competitive process such as in local call resale and internet interconnection. Therefore it is important that Part XIB is retained to facilitate competitive outcomes in emerging telecommunications markets such as ULLS through the deterrence of such anti-competitive conduct.

1. Part XIC

- 1.1. This chapter discusses the importance of ULLS in the provision of fixed telephony and new economy services and the price-related issues that have arisen when new entrants have attempted to gain access to ULLS on non-discriminatory terms and conditions. In particular it discusses the unreasonableness of Telstra's proposed prices when benchmarked against those in other OECD countries. It will also discuss the usefulness of Part XIC of the Trade Practices Act, which establishes a process by which opposing parties can obtain resolution of commercial disputes concerning the access terms to critical inputs. It argues that the present regime should be retained to ensure that competition develops in those downstream markets that are dependent on key inputs supplied that are subject to significant market power such as the fixed local loop.

The importance of promoting competition

- 1.2. The fixed local loop is an essential service delivery platform for telephony and new economy data services using the DSL suite of technologies. Achieving robust and effective competition in the markets for services such as: telephony, high speed internet access, data and video streaming and subscription TV services, is important if Australia is to reap the full benefits of technological change arising from convergence.
- 1.3. Such competition can be promoted by facilities-based entry, access-based competition over facilities subject to monopoly or significant market power in supply, or a combination of these strategies. All of these forms of competitive entry are desirable and should be encouraged by regulatory competition policy.
- 1.4. For example as discussed in the FCC First Report and Order:¹

"The Act contemplates three paths of entry into the local market -- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale. The 1996 Act requires us to implement rules that eliminate statutory and regulatory barriers and remove economic impediments to each. We anticipate that some new entrants will follow multiple paths of entry as market conditions and access to capital permit. Some may enter by relying at first entirely on resale of the incumbent's services and then gradually deploying their own facilities. This strategy was employed successfully by MCI and Sprint in the inter-exchange market during the 1970's and 1980's. Others may use a combination of entry strategies simultaneously -- whether in the same geographic market or in different ones. Some competitors may use unbundled network elements in combination with their own facilities to serve densely populated sections of an incumbent LEC's service territory, while using resold services to reach customers in less densely populated areas. Still other new entrants may pursue a single entry strategy that does not vary by geographic region or

¹ FCC First Report and Order at paragraph 12.

over time. Section 251 neither explicitly nor implicitly expresses a preference for one particular entry strategy. Moreover, given the likelihood that entrants will combine or alter entry strategies over time, an attempt to indicate such a preference in our section 251 rules may have unintended and undesirable results. Rather, our obligation in this proceeding is to establish rules that will ensure that all pro-competitive entry strategies may be explored. As to success or failure, we look to the market, not to regulation, for the answer.”

- 1.5. Government promotion of service-based competition over incumbent facilities, over a certain range, has a complementary relationship in stimulating full facilities-based competition. The important function served by access-based competition to the establishment of full facilities-based competition becomes clear when one considers the technical and financial requirements facilities-based entry into local exchange markets entails. Facilities-based entry into these markets requires extremely large investments of a sunk cost nature. These sunk costs create a formidable barrier to entry. Thus, simultaneous entry at both the retail and network stages by fully vertically integrated carriers is unlikely due to the large sunk costs required.
- 1.6. It must be recognized, however, that sunk costs constitute a barrier to entry only to the extent that exit looms as a potential consequence of such entry. That is, the potential losses associated with sunk costs prevent new firms from entering a market only to the extent that these firms contemplate exit as a possible outcome. Where firms can obtain buyer pre-commitments to purchase their services or, at least, establish commercial relationships with customers through access based entry, the likelihood of exit is reduced; and, as a consequence, the entry-retarding effect of sunk costs is attenuated. In this way, promotion by government of access based competition through the supply of Telstra’s unbundled local loop services at reasonable prices that reflect the economic cost of provision will actually foster a greater amount of facilities-based entry by counteracting the sunk costs associated with such entry. Observed experience in the US long-distance and Australian marketplaces substantially supports this view.²

The importance of ULLS competition

- 1.7. Convergence, in certain instances, is increasing economies of scope in fixed network infrastructure. For example, technological developments in digital subscriber line technology now allow high-speed data services of 2 Megabits per second to be supplied over the same copper loops used for traditional voice telephony. Therefore Telstra’s ability to leverage market power, arising from control of the only ubiquitous copper network in Australia, into emerging downstream markets, such as high-speed data services and internet access supplied to consumers, is increasing through time as a result of this technological change.
- 1.8. If Telstra’s rivals are able to gain access to ULLS on reasonable, non-discriminatory terms of supply effective competition in downstream new economy service markets

² In the US, the successful transformation of several interexchange resellers into major facilities-based carriers provides a stellar example to substantiate this symbiotic relationship. MCI, Sprint, LDDS-WorldCom, and all other non-AT&T facilities-based competitors initially entered the interexchange market as pure or partial reseller (access-seeker based) competitors. Once in the market, they then developed their own network facilities incrementally over time. Clearly, policies promoting resale of private line and 800 service played an important role in increasing interexchange competition. A similar method of entry has been achieved by Cable & Wireless Optus, who initially resold telephony services supplied over Telstra’s network prior to becoming a full-facilities based competitor.

can be promoted. This type of competition can also encourage, and be used as a stepping stone, to full facilities-based competition. For prospective competitors without alternative local distribution network, access to Telstra's network will be the only method for expeditious entry into the markets for supplying new economy services to consumers.

- 1.9. Telstra, being the single vertically integrated provider of both downstream telephony and new economy services and upstream ULLS, has incentives to lock-out competitors in downstream markets — by using its control of the ULLS monopoly building block to cross-leverage its dominance into these downstream markets. Telstra has limited incentives to voluntarily negotiate fair and reasonable terms of access to ULLS. This is because by denying such access Telstra can maintain higher than economically efficient prices in final markets, obtain new monopolies in emerging downstream markets, and increase barriers to entry and weaken the ability of competitors bypassing Telstra's local network through building competing facilities. As discussed in the Hilmer report³:

“Where the owner of the [essential] facility is also competing in markets that are dependent on access to the facility, the owner can restrict access to the facility to eliminate or reduce competition in the dependent markets.”

- 1.10. The above theory is borne out by practical experience of competitors in attempting to obtain access to Telstra's ULLS service on reasonable terms. This is now discussed.

Telstra's proposed prices verses international benchmarking

- 1.11. Despite the local loop being declared in June 1999, Telstra's proposed access prices, have so far been unreasonable and not based on economic cost of supply. The proposed prices are excessive by international standards and support the case for on-going, pro-competitive access regulation, that establishes reasonable terms of supply for local loop services.
- 1.12. Telstra's proposed charges for ULLS are classified by geographic location. As can be seen from Table One Telstra's calculated charges are made up of several components including ULLS specific charges, an Access Deficit Charge (ADC), a one off connection fee and a service qualification charge. These proposed prices are unreasonable relative to international benchmarks, and relative to Telstra's own retail prices for products supplied using the ULLS as an essential input. These issues are now discussed.

³ The Hilmer Report, p249.

International comparison

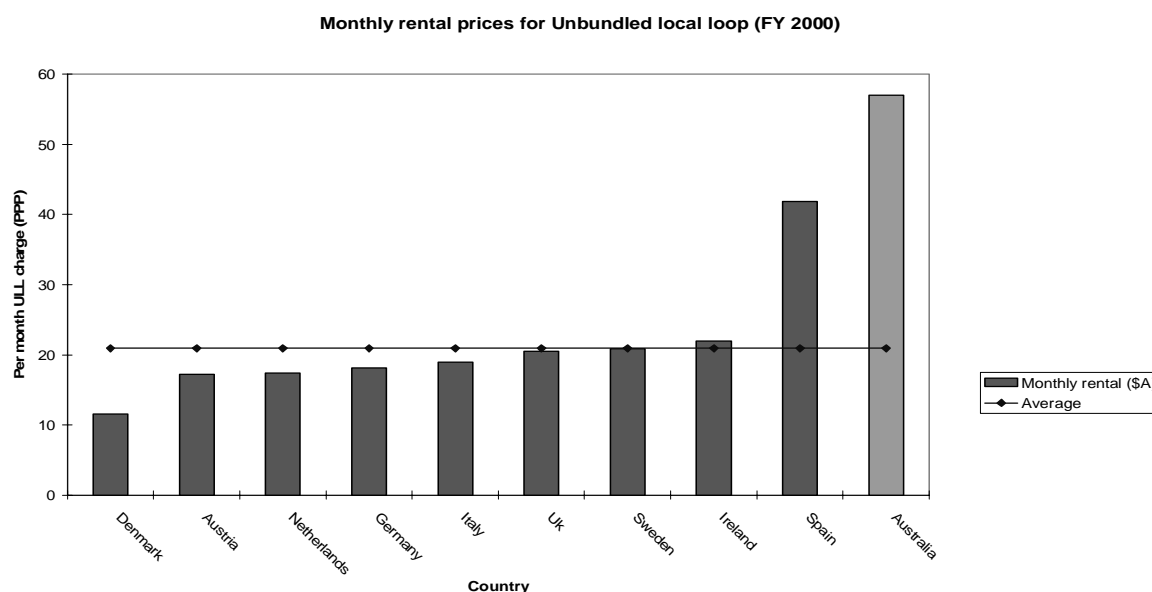
Table One: Telstra's proposed ULLS line charges (\$ per line)

	Annual IRIM	Annual RSS/RSU	Annual ULL Specific	Annual Access Deficit Contribution	Monthly Total IRIM	Monthly Total RSS/RSU
Band 1	-	272	137	50	-	38
Band 2	414	572	137	50	50	63
Band 3	672	7630	137	-56	63	70
Band 4	989	989	137	-56	89	89

Source: ULLS: Discussion of Pricing with Optus 20/06/2000

- 1.13. Figure 1 compares Telstra's weighted average price for ULLS in Band 1 (25%) and Band 2 (75%) to current per month line rental prices in Europe for ULLS. The average price of renting ULLS in Europe is AUS\$21 per month, which is 170 per cent below Telstra's proposed price of \$57 per month.

Figure 1: European monthly line rental prices for ULLS



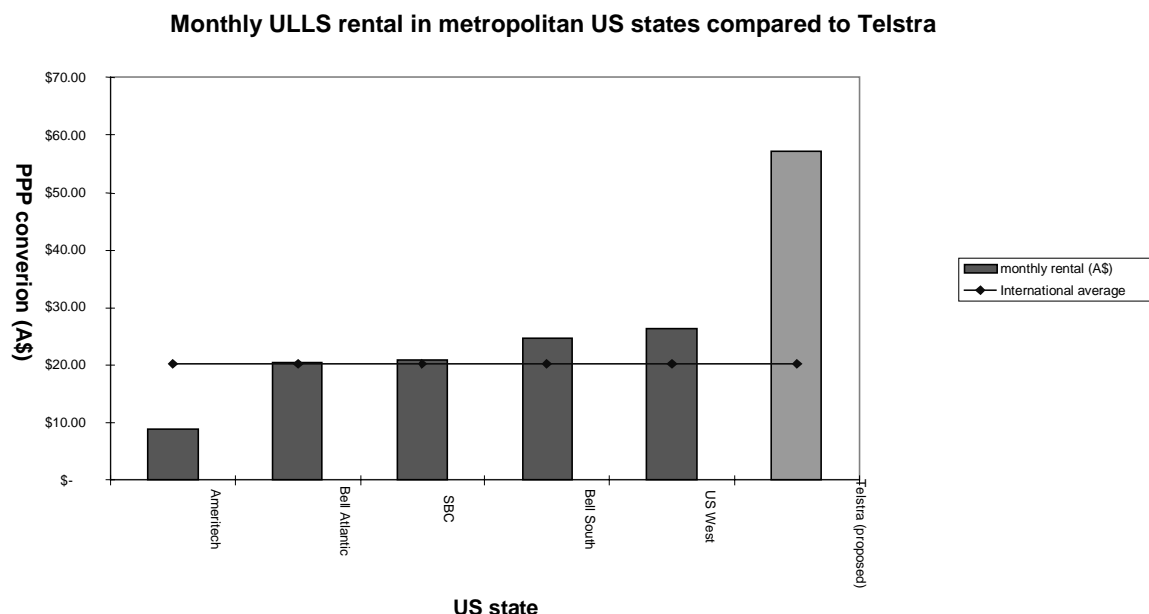
Source: Unbundled local loop tariffs:: <http://www.analysis.com/atlas/series/LLUB.as>

- 1.14. Telstra proposed ULLS prices are also excessive by U.S standards. Figure 2 compares Telstra's prices for ULLS in metropolitan areas to those prices charged by Incumbent Local Exchange Carriers (ILEC) across 49 States of the U.S. The average line rental price across these ILEC's is \$20.21 per month⁴. By contrast, Telstra's prices are 182

⁴ The average ILEC prices have been calculated as a simple weighted average of the metropolitan prices across the states where ILECS provide ULLS.

per cent above the average price of these incumbent carriers for the supply of ULLS in metropolitan areas.

Figure 2



Source: Engebretson, J.(1999) “The Great Wait”, in “Telephony” 4th January 1999
<http://www.internettelephony.com/archive/1.4.99/cover>

- 1.15. A further source of benchmarking international ULLS prices is a Cable & Wireless plc commissioned study by Kelley Drye & Warren, which provides benchmarking data on ILEC prices in the states of Maryland, New Jersey, Pennsylvania and Virginia. The FCC requires ILECs to disaggregate ULLS price by at least three geographic density zones. In practice, many ILECs have disaggregated prices by four or more density zones. Figure 3 compares Telstra prices in band 1 and 2 to those prices in the two highest density zones in these states.

Figure 3: US benchmarking of ULLS prices

Source: Kelley Drye & Warren benchmarking.

- 1.16. The average band 1 per month line rental price for ULLS in these four US states is \$14.77 (\$Aus). By contrast, Telstra's price of \$38.25 per month is 160 per cent above these benchmarks for band 1 areas.
- 1.17. The average band 2 prices for ULLS in the four US states is \$18.37 per month. By contrast, Telstra's band 2 price of \$63.25 per month is 240 per cent above these benchmark prices.
- 1.18. When comparing Telstra's proposed ULLS charges against those of international incumbents, it is evident that Telstra's prices for ULLS are excessive and that a more appropriate price for these services is \$20 per month in bands 1 and 2. There is no reasonable explanation for Telstra's exorbitant prices. The density zones compared are equivalent across countries: CBD and dense metropolitan areas. Furthermore, the international benchmarking shows a remarkable consistency of prices for the monthly line rental of ULLS services across Europe and the United States. The European average in band 1 and 2 is \$21 per month; the US average across 49 states is \$20.21 per month.

Retail comparison

- 1.19. Telstra's proposed ULLS prices are also unreasonable when compared to their retail prices for ULLS services. They are not voluntarily negotiating prices that would be consistent with an ECPR⁵ type methodology. Telstra retail prices for retail ULLS products such as high speed internet access, when compared to Telstra's wholesale ULLS input prices to rivals, do not allow competitors to effectively compete against Telstra in the downstream market due to a price squeeze. Efficient downstream costs plus Telstra's proposed wholesale ULLS prices are higher than Telstra's retail prices for ULLS products. For example, Telstra prices high-speed internet access at the retail level at approximately \$70 per month. Telstra's proposed ULLS wholesale prices are

⁵ ECPR is the efficient component pricing rule that theoretically constructs the maximum wholesale access price that is, in a static sense, permissive of productively efficient entry (allows more efficient access seekers to displace the incumbent in the downstream market). The ECPR does not promote either allocative or dynamic economic efficiency.

approximately \$60 per month, and downstream costs associated with supply of backbone data networks etc to supply the final product (high speed internet access) to consumers are at least \$20 per month. Therefore Telstra's downstream competitors, no matter how efficient, are unable to compete in the supply of DSL based services at the retail level given Telstra's current retail and wholesale price structure.

- 1.20. A further example crystallizes Telstra's inability to commercially negotiate interconnection access at prices even consistent with an ECPR type methodology. Under line sharing the available spectrum of a copper pair is split between voice telephony and high speed data services, such that both services can be simultaneously supplied over the same single copper pair. Voice telephony is inherently valuable since current voice revenues approximately recover the costs of Telstra's fixed network. Essentially line sharing allows an additional service, high-speed data, to be supplied over the same copper pair. Hence, Telstra should be prepared to voluntarily negotiate lower commercial prices to access seekers which line share, where the access seeker supplies high-speed data services to the customer and Telstra continues to supply the voice telephony service to the customer. This is because Telstra retains the inherently valuable voice telephony services (which in itself makes Telstra no worse off), and adds a data revenue stream to the copper pair (which makes Telstra better-off). Hence line sharing adds data revenue to Telstra's current business and should be in its commercial interests.
- 1.21. However, to date, Telstra has refused to commercially negotiate discounted ULLS prices to competitors seeking to undertake line sharing with Telstra. For example, suppose the cost of ULLS is \$20 per month, and Telstra's wholesale price for ULLS to competitors is \$50 per month. Assume the net revenue (revenue less incremental costs of telephony) from supply of voice services over the loop is \$23 per month. Therefore, Telstra should be indifferent between a competitor buying the ULLS at \$50 per month with the competitor doing voice telephony and data services, or the competitor only buying the high-speed portion of the loop for \$27 per month, with Telstra retaining the telephony services. In the latter situation (line sharing) Telstra would earn \$27 per month from the high speed portion of the loop sold to competitors, and \$23 per month of net revenue from its own supply of telephony services, for total revenue of \$50 per month.
- 1.22. However, Telstra has not voluntarily commercially negotiated such line sharing arrangements. When approached by Cable & Wireless Optus to undertake line sharing, Telstra indicated that the price to Optus for ULLS will be the same regardless of whether we purchase the entire loop or just the high speed portion of the loop to supply data-only services. That is, if Cable & Wireless Optus does line share, where Telstra continues to supply voice services over the loop, the price of the high speed portion of the loop to Optus would be \$50 per month (using the numerical example numbers above).⁶

⁶ Telstra's approach is in contrast to that adopted by the ILECS in the United States who have voluntarily negotiated commercial prices for line sharing with downstream DSL providers of approximately \$5 - \$8 per month per loop. The US ILECS recognized the inherent value in enabling extra products to be supplied over the copper loop at low incremental cost such as through voluntarily negotiating line sharing arrangements with DSL companies. The different commercial dynamic may be partially explained by the higher level of facilities-based competition in the US provided by cable TV providers that are presently updating their networks to supply high-speed data services into the home.

Other pricing issues

- 1.23. Another area where Telstra's proposed pricing for ULLS related services is excessive is in the area of service assurance. Service assurance essentially covers maintenance, fault detection reporting and rectification.
- 1.24. Not only are Telstra's proposed prices for ULLS charges excessive they have been put forward in a complete absence of transparency. This is to the detriment of achieving reasonable pricing. The experience gained from assessing Telstra's proposed PSTN prices, and charges for the commercial churn processes for local call resale, has shown that transparency is essential to the proper assessment of charges. This is because the Australian Competition and Consumer Commission (ACCC) often does not possess all of the information necessary to assess the veracity of Telstra's cost claims.
- 1.25. For example, under local call resale, Telstra previously sought to charge competitors \$30 per service to transfer its customers to competitors' local calling service. Telstra claimed this charge was levied to recover the costs of churning customers to competitors. Cable & Wireless Optus was able to detail to the ACCC the costs of its own churn process; this indicated the efficient costs of customer churn were no more than \$4 per customer. This helped enable the ACCC to issue a Part XIB competition notice on Telstra for levying anti-competitive customer transfer charges that had the effect of undermining the competitive process in local calling.
- 1.26. As another example pertinent to current circumstances with ULLS, Telstra has claimed that it has incurred "specific costs" in order to allow access seekers to supply ULLS, and that these costs should be recouped. However, to date, Telstra has not released information regarding what systems it has built or what changes it has made to its core systems. Telstra is not even prepared to release to access seekers the total quantum of "specific costs" it claims to have spent. It has simply levied an \$11 per month per loop charge on all access seekers to recover its alleged "specific cost" expenditures.
- 1.27. Telstra, before the declaration of the ULLS, had systems in place for processing its own orders for ULLS service. If a new system has been constructed so that access seekers must apply different systems to those used internally by Telstra's downstream operations, to effect different and inferior outcomes for access seekers, it should not be allowed to recover these costs. The establishment of processes which result in different and inferior processing outcomes for access seekers represents anti-competitive, discriminatory behavior
- 1.28. Telstra should not be able to recover from its downstream competitors the costs of building unnecessary systems or making unnecessary changes. Even more importantly, it should not be able to recover money, which it has spent to achieve discriminatory and anti-competitive outcomes. A fundamental principle of TSLRIC is that access seekers should only pay for the efficient cost of access. As the ACCC has stated in its press release on the final determination of PSTN access for AAPT and Primus:

"Telstra should not be entitled to pass on its own inefficiencies to its competitors. This would provide weak signals for efficient investment in infrastructure, encouraging inefficient duplication of infrastructure by competitors and would increase the ability of the access provider to shift

costs from competitive areas to less competitive ones, thereby undermining efficient competition” (ACCC media release 21 September 2000).

Why Part XIC need to be retained

- 1.29. Part XIC establishes an industry specific regime for regulating access to carriage services and is designed to promote the long-term interests of end-users of carriage services or of services provided by means of carriage services. In relation to ULLS the processes established by Part XIC of the Act, is thus far, moving towards its intended goal of establishing fair and non-discriminatory terms of access to essential upstream inputs for all downstream competitors. This would not have been achieved in the absence of Part XIC as evidenced by Telstra’s current voluntary commercial offers.
- 1.30. The ACCC’s draft pricing principles proposed a set of ULLS access prices that represent a 32 per cent reduction on Telstra’s proposed prices for Band 1 and Band 2 charges. In this sense Part XIC, while being a process that can take considerable time, is an effective tool in allowing new entrants, such as Cable & Wireless Optus’ subsidiary XYZed, to access the local loop at prices which are fairer and closer to European and US benchmarked prices.
- 1.31. Furthermore, experience suggests that the ACCC’s issued determinations to Telstra’s PSTN network give parties to an access dispute the incentive to work more quickly to a final commercial outcome. Whether an outcome is reached through commercial negotiation or through the issuing of a final determination, it is in the interests of the incumbent as well as other parties to finalize the outcome. Previous experience suggests that interim determinations to access Telstra’s PSTN network on fairer terms can be a positive step for the competitive process. This is because such determinations have brought down Telstra’s commercial wholesale prices to levels that are more permissive of productively efficient entry and closer to economic costs of service supply. The determinations also create more certainty concerning likely final prices, which is important for the fostering of ongoing competition and the promotion of investment.
- 1.32. In the case of ULLS, Part XIC is proving an effective regulatory tool for several reasons. The first is that it has, through the declaration of the local loop, allowed access-seekers to gain supply of an essential building block service. Telstra is unlikely to have supplied the ULLS to access seekers in the absence of declaration. This has been in the long-term interest of end users because competition in downstream DSL markets, dependant on the ULLS input, will benefit consumers.
- 1.33. Second, Part XIC provides the future prospect that independent access seekers will eventually gain access to Telstra’s ULLS on fair and non-discriminatory terms that are reflective of the economic costs of supply of the service. Access seekers can therefore enter downstream markets without the significant threat of being uneconomically price squeezed by Telstra’s voluntary commercial offerings at the wholesale/retail level of the DSL market. Moreover, Part XIC establishes a process that seeks to identify and act upon anti-competitive behavior by the incumbent access provider, such as non-compliance with the standard access obligations (SAOs) which attempts to prevent uneconomic quality degradation of the declared service supplied to access seekers.

2. Part XIB

- 2.1. Part XIB of the Trade Practice Act establishes a competition test that deters carriers with a substantial degree of market power in a telecommunications market from taking advantage of that power with the effect of substantially lessening competition in a telecommunications market (the competition rule). The competition rule is equivalent to the effects-based anti-trust legislation long-established and used in the United States. Sections 1 and 2 of the Sherman Act that prevents firms with market power from using that power to undermine the competitive process.
- 2.2. Economists generally regard effects based tests, such as that embodied in Part XIB of the TPA, as superior to purpose based tests such as Section 46 of the TPA. This is because under effects based tests such as Part XIB the Courts are required, in determining legal liability, to focus on the effects of conduct on social welfare and the competitive process. In contrast, purpose based tests require courts to determine whether the firm has a mental purpose or “intention” to harm competitors. Hence Part XIB can be considered a significant economic improvement to the anti-trust jurisprudence tests embodied in Section 46 of the TPA.
- 2.3. Part XIB is a complementary tool to Part XIC in facilitating the competitive process in telecommunications markets. In relation to ULLS, Part XIB will serve a useful forward-looking function in deterring Telstra from engaging in discriminatory practices of supply of the ULLS input that favor its own downstream operations and damage the competitive process. This chapter discusses why Part XIB needs to be retained; specifically it will discuss
 - Why there is an ongoing need for the preservation of the present record keeping rules;
 - The importance and potential effectiveness of competition notices in deterring anti-competitive conduct.

Why the record keeping rules need to be maintained

- 2.4. The ACCC has issued two sets of record keeping rules relating to ULLS. The first set of record keeping rules was issued in August 2000 and related to access to exchanges. At the time these rules were issued, the ACCC stated that:

“if this information indicated Telstra is attempting to obtain a substantial anti-competitive advantage over its competitors in the provision of these services, the ACCC will move to take further action.”⁷
- 2.5. The second set of record keeping rules was issued in November 2000 and related to service delivery (ordering, provisioning and customer transfer). The ACCC stated:

⁷ ACC media release dated 21 August 2000

“For historical reasons, Telstra is both the owner of this new broadband highway as well as a retailer of services that rely on the pathway, so there is always the possibility or perception that it might give its own products the inside running. The requirement to provide the ACCC data on Telstra’s wholesale and retail service delivery for local loop services will make Telstra’s role in the delivery of high speed data services more transparent... Requiring Telstra to report regularly on its performance in the delivery of services both to itself and its competitors will greatly assist the ACCC in discharging its Telecommunications functions under the Act”⁸

- 2.6. The retention of these record-keeping rules is important in ensuring that Telstra complies with the standard access obligations (SAOs) under Part XIC of the Act. The SAOs attempt to promote non-discrimination in the quality of supply of declared inputs between access seekers and the incumbent. There are presently no systems in place that enable the ACCC or Access Seekers to identify whether Telstra is complying with the standard access obligations under Part XIC in relation to the ULLS. It is unlikely that Telstra would voluntarily provide information that indicates it has complied with the SAOs.
- 2.7. Accordingly, the record keeping rules are essential to the enforceability of the standard access obligations (SAOs). They provide the only viable mechanism for determining whether or not the ULL Service provider is treating access seekers on an equivalent basis to its own wholesale and retail divisions in relation to the key technical and operational elements of the supply of ULL Service. This equivalence of supply is a necessary condition for the promotion of efficient entry and an effective competitive process in downstream markets.
- 2.8. The enforcement of the current record keeping rules may also provide evidence for the issue of a competition notice. Such notices have proven to be an effective tool in previously changing Telstra’s anti-competitive market behavior in relation to other services.
- 2.9. It is clear therefore that the record keeping rules play an important part in ensuring effective competition as they seek to address the information asymmetries which characterize the telecommunications industry and reinforce the incumbent’s market power. Therefore, at minimum the current rules should be retained.
- 2.10. However given that information asymmetries are more significant in those markets where the incumbent, Telstra has significant market power, making available to other market participants the incumbents records that are required to be kept under the existing record keeping rules, would strengthen their effectiveness. Such records if made available to industry participants would increase the transparency of the incumbent’s market behavior regarding bottleneck facilities and ensure efficient downstream entry and competition.

Competition notices are an incentive to change behavior

- 2.11. Through the issuing of competition notices the ACCC and other parties are able to enforce the competition rule that prevents carriers with market power using that power

⁸ ACCC media release dated 17 November 2000.

to undermine the competitive process.⁹ Experience regarding issues such as local call resale commercial churn and internet interconnection suggests that the issuing of competition notices is an effective incentive for firms to change their behavior of using their significant market power to undermine the competitive process.

- 2.12. For example the issued competition notice regarding internet interconnection resulted in Telstra entering into peering arrangements with other carriers such as Cable & Wireless Optus. The peering arrangements allowed for equivalent compensation between carriers for equivalent interconnection services supplied between carriers. Previously Telstra was seeking to charge competitors 19 cents per megabyte for data carried on its network to other carrier networks, and refusing to pay other carriers for the data they carried on their networks and provided to Telstra. Such a discriminatory charging practice would have resulted in Telstra's competitors have an artificially inflated higher cost structure, which would have allowed Telstra to have an anti-competitive cost advantage. This would enable Telstra to further monopolize the supply of internet services to consumers. Further, it would have allowed Telstra the greater opportunity to charge monopoly prices to consumers for internet services.
- 2.13. Following the issuing of the competition notices Telstra immediately reformed its behavior and entered into peering arrangements with its internet backbone competitors. Following this, immediate price reductions in wholesale data access occurred and a more competitive market structure in the supply of internet services to consumers developed. It should be noted that Telstra did not have to change its behavior if it believed its conduct did not breach the Part XIB competition rule and undermine the competitive process. If this had been the case, Telstra could simply have continued its conduct and allowed the allegations of the breach of the competition rule to be tested and proved or otherwise in Court. However, Telstra did chose to modify its conduct and desist from its proposed discriminatory internet interconnection arrangements.
- 2.14. Similarly, the competition notices issued in respect of Telstra's local call resale commercial churn services resulted in Telstra amending its conduct. This allowed the promotion of competition in local calling and single bill/one stop shop telephony services in 1999-2000. Prior to this Telstra was the monopoly supplier of local calling and single bill/one stop shop telephony services. This was because the local call resale product offered by Telstra was not viable for competitors.
- 2.15. In particular, and among other things, the threat and issuing of the competition notices for local call resale resulted in Telstra making the following changes to its conduct:
 - A reduction of the customer transfer fee from \$30 per customer to \$4.50 per customer;
 - Telstra no longer made competitors liable to Telstra for customers' previous debts owed to Telstra;
 - Telstra greatly simplified the customer transfer form;

⁹ It is important to note that the issuing of a competition notice does not determine legal liability. A competition notice merely activates the competition rule that exposes carriers to a legal liability if their conduct specified in the notice is, in fact, found by the Courts to be in breach of the competition rule.

- Telstra paid \$4.5 million into a compensation fund to assist other service providers in developing their technical capability to churn customers.
 - Telstra accelerated the launch of its more efficient and fully automated customer transfer system known as the “Wholesale Billing System”.
- 2.16. Furthermore, the issuing of competition notices can bring about more immediate and stable changes in Telstra’s behavior than arbitration, which involves extensive analysis by the ACCC, as well as drawn out litigation
- 2.17. This chapter has argued that the problem of asymmetric information relating to non-price issues is significant in the telecommunications industry and therefore the present record-keeping obligations should be retained. It also argued that competition notices have been effective in enhancing competition and that they provide firms with significant market power with a disincentive to engage in anti-competitive behavior that undermines the competitive process.
- 2.18. Effects based tests such as Part XIB of the TPA are generally regarded by economists to be superior to “purpose” base tests in determining legal liability or otherwise for alleged anti-competitive conduct. This is because such tests better focus on the social welfare implications and effects on the efficient operation of the competitive process of the alleged conduct. Part XIB will be useful going forward in deterring Telstra from engaging in anti-competitive conduct in relation to the supply of ULLS to independent downstream competitors. Therefore, Part XIB of the TPA should also be retained, if not strengthened, as recommended in Cable & Wireless Optus’ previous submission to the Commission.