

# **Report 1**

## **Telecommunications competitive safeguards for the 2002–03 financial year**

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# 1 Summary

Under Part XIB, Division 11, sub-section 151CL(1) of the *Trade Practices Act 1974* (the Act), the Australian Competition and Consumer Commission (ACCC) must provide the Minister for Communications, Information Technology and the Arts with an annual report on competitive safeguards within the Australian telecommunications industry.

This report covers the 2002–03 financial year and ongoing actions immediately following that year. All the ACCC publications referred to in this report are available at <http://www.accc.gov.au>.

The key findings of the report are outlined below.

## 1.1 State of competition

The development of competition has not met ACCC expectations when the industry was substantially deregulated in 1997. As is evident from the ACCC report *Telecommunications Infrastructure in Australia 2002*, many new carriers operate in niche markets and have relatively few directly connected customers and as such there had been limited success in creating robust and sustainable competition across a range of markets. Competition has also developed unevenly across different areas of Australia and different services.

Contrary to expectations held when the regime was implemented, this has meant that more rather than less regulation has been required over time.

In several services, effective competition is limited principally to access or service-based competition where service providers compete at the retail level only. The ACCC believes this competition, while undoubtedly beneficial, is not as effective in the long term, as facilities-based competition (where economically viable), in driving efficiency, wider choice of services and price competition.

Access or services-based competition is when alternative service providers rely heavily on the access and wholesale services of an incumbent to compete in retail markets rather than their own network infrastructure. By contrast, facilities-based competition involves service providers using their own network infrastructure, often complemented by the use of lower level access services.

It is thought that access-based competition can be an important part of, as well as a precursor to, greater facilities-based competition.

The ACCC believes that in 2002–03 there was more evidence of consolidation in the industry than in previous years. There was some slow-down in investment expenditure by new-entrant carriers in the fixed-line customer access market. In the overall market there was a drop in price reductions, and in some cases, prices increased. Telstra continues to supply most directly connected fixed-line services. Telstra and SingTel Optus combined account for around 99 per cent of these services.

In terms of price trends, the 2002–03 Division 12 report reveals that the average price paid for basic access services increased in real terms by 12.4 per cent in 2002–03, which follows price increases of 13.2 per cent, 15.2 per cent and 9.8 per cent in the previous three years.<sup>1</sup> Overall, since 1999–2000, average retail prices paid for basic access have increased in real terms by 46.6 per cent. Counterbalancing this somewhat is that average retail prices paid for local calls have declined in real terms by 30.3 per cent over the same period. These conflicting price trends for basic access and local call services largely reflect opportunities and incentives for rebalancing under the government’s current retail price control arrangements. These allow Telstra to increase the average price of basic access while decreasing the average real price of other PSTN services (i.e. local call, national long distance and international call services).

However, the ACCC notes that the extent of price decreases for local calls appears to have slowed substantially over the past two years. The Division 12 report reveals that the average retail price paid for local call services decreased by 3.8 per cent in 2002–03, compared to price decreases of 11.7 per cent and 17.9 per cent in the previous two years. It also reveals that price decreases for local calls varied across different consumer groups in 2002–03. For example, ‘other business’ (10.7 per cent) and ‘small business’ (3.7 per cent) consumers enjoyed more substantial average price decreases than ‘residential’ consumers (1.2 per cent).

Regulations which successfully promote competition and efficient investment to overcome Telstra’s market power in traditional services may lead to reduced regulation over time, as these services decline in importance and new more competitively delivered services take their place. This will help ensure Australian households and businesses receive the full benefits of technological change in the communications sector.

## 1.2      **Anti-competitive conduct and consumer safeguards**

In 2002–03 the ACCC conducted 11 investigations into anti-competitive conduct in the telecommunications industry. In all but one the ACCC did not find evidence of a breach of the Act and the investigations were therefore closed.

The investigation into agency arrangements between Telstra and Optus did proceed and the matter was settled between the parties in April 2003.

There were no competition or advisory notices issued during this period.

There was substantive further investigation into seven telecommunications issues, with key investigations involving the following companies:

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<sup>1</sup> Further, Telstra’s 2002–03 *Annual Report* indicated that despite the 4 per cent decrease in the number of retail lines, Telstra’s implied average yield per retail line increased by 10 per cent, or from around \$278 per access line in 2001–02 to \$305 per line.

- Telstra
- National Telecoms Group
- Global Pre Paid Communications and In Touch Networks
- Vodafone
- Alliance WA

## 1.3 Tariff filing, record keeping, monitoring and reporting

In 2002–03 Telstra complied with requirements to give the ACCC tariff filing information.

The ACCC issued record keeping rules to enable it to meet its obligations to provide accounting separation reports for Telstra. The ACCC also amended the regulatory accounting framework (RAF) to meet the requirements of the minister's accounting separation direction. Record keeping rules were also issued to Telstra seeking information to assess the effects of bundling on competition in telecommunications markets.

The ACCC released the first market indicator report based on information it collects via its RAF record keeping rules.

During the year the ACCC produced quarterly statistics on the take-up of broadband services.

## 1.4 Access related activities

The ACCC declared a line sharing service.

It also commenced:

- an inquiry into whether an internet interconnection service should become a declared service
- a review into the declaration of the transmission capacity service
- a review of the domestic GSM and CDMA originating and terminating access declaration (incorporated into the general mobile services review).

In accordance with the Act, the ACCC released a timetable for the expiry of current declarations. Reviews of each declaration, conducted by public inquiry, will occur in accordance with this timetable.

Following the ACCC's approval of the Foxtel and Optus content supply arrangement, a range of regulatory processes were conducted in relation to pay TV services, including:

- the granting of anticipatory individual exemptions by the ACCC to Foxtel and Telstra Multimedia in relation to the proposed provision of digital pay TV services
- the rejection of analogue access undertakings from Foxtel and Telstra Multimedia that set out the price and non-price terms and conditions upon which access will be provided to analogue pay TV services.

While no new arbitrations were lodged with the ACCC, the two outstanding arbitrations, both relating to analogue pay TV services, were put on hold pending the outcome of the pay TV processes.

In accordance with the Act, the ACCC developed and published model price and non-price terms and conditions for three 'core services'—the public switched telephone network (PSTN), the unbundled local loop service (ULLS) and local carriage service (LCS). Parallel to this process, the ACCC considered 'core service' undertakings lodged by Telstra specifying the terms and conditions upon which it undertook to meet its standard access obligations to supply these services for 2002–03, 2003–04 and 2004–05. Telstra withdrew the undertakings after the ACCC's release of model price terms and conditions for these services and lodged new undertakings for these services outside the reporting period.

The ACCC revised its guide to the resolution of telecommunications access disputes to reflect December 2002 amendments to the telecommunications specific provisions of the Act.

The ACCC continued to develop and release pricing principles to inform the market of its likely decisions in arbitrations. In addition to the core service model terms and conditions, the ACCC released pricing principles for GSM and CDMA mobile services.

More generally, the ACCC commenced a broad ranging review of mobile services to examine what form of regulation, if any, should be applied to the mobile terminating and originating access services, the domestic and international roaming services and third generation (3G) mobile services. As noted above, the review of the mobile services declaration was incorporated into this more general review.

## 1.5 Activities under the Telecommunications Act

The ACCC issued number portability directions to the Australian Communications Authority (ACA) regarding national and premium rate services and issued pricing principles for all portable non-geographic numbers (i.e. freephone, local rate and premium rate numbers).

The ACCC participated as an observer in several code committees of the Australian Communications Industry Forum (ACIF) and the Next General Network Framework Operations Group.



## 2 Overview of the state of competition in telecommunications markets

### 2.1 Overview

In 2002–03 the Australian telecommunications sector generated more than \$30 billion in revenue. The level of competition in the sector influences the price and quality of telecommunications services and investment in new services. As almost all Australian households and businesses buy telecommunications services, both household welfare and business performance are affected either directly or indirectly by the level of competition in the sector.

As observed in last year's report, since open competition was permitted in the Australian telecommunications market in mid-1997, many new competitors have entered the sector along with new technologies and means of service delivery. This has contributed to more choice and reduced prices for telecommunications services.

However, as is evident from the ACCC's report *Telecommunications infrastructure in Australia 2002*, many of the new carriers operate in niche markets and have relatively few directly connected customers. This means that the 1997 telecommunications regulatory regime has had only limited success to date in creating robust and sustainable competition across a range of markets. Contrary to expectations when the regime was implemented, this has meant that more rather than less regulation has been required over time.

Competition has developed unevenly across different areas of Australia and different services. For example, widespread facilities competition in local loop infrastructure outside of central business districts (CBDs) and some metropolitan areas remains elusive.

In several services, effective competition is limited principally to access or services-based competition where service providers compete at the retail level only. These include fixed network voice services and broadband internet services. The ACCC considers that such competition, while undoubtedly beneficial, is not as effective in the long term, as facilities-based competition (where economically viable) in driving efficiency, wider choice of services and price competition.

Access or services-based competition is when alternative service providers rely heavily on the access and wholesale services of an incumbent to compete in retail markets rather than their own network infrastructure. By contrast, facilities-based competition involves service providers using their own network infrastructure, often complemented by the use of lower level access services.

It should be noted, however, that access-based competition can be an important part of as well as a precursor to the emergence of greater facilities-based competition. Carriers and service providers would in practice use a combination of their own and other carriers' facilities, depending on the nature of the services, the geographic markets and the customers they are targeting.

In its June 2003 report, *Emerging market structures in the communications sector*, the ACCC pointed to a number of limitations of access/wholesale based competition and regulation. In the ACCC's view, Telstra's vertical and horizontal integration, and the market power that this gives it, impedes the operation of the access regime and the development of more extensive competition in the Australian telecommunications market.

In light of Telstra's ongoing market power, the ACCC recommended to the government that it introduce policy changes to reduce reliance on access-based competition. These included that the government introduce:

- legislation requiring Telstra to divest its hybrid fibre coaxial (HFC) network and its 50 per cent shareholding in Foxtel unless it can be shown that the costs in doing so would outweigh the benefits
- legislation to increase access to pay TV content to help provide extra revenue streams for broadband networks.

These recommendations were designed to increase facilities competition at the local loop level. This was in turn considered important for helping to boost competition in a number of related telecommunications markets, including the market for broadband access. This reflected a concern that market power in the local loop and pay TV broadcasting markets could be used by Telstra to leverage a position of market power in converged telecommunications and broadcasting markets.

More so than in previous years, the ACCC believes that in 2002–03 there was evidence of consolidation in the industry. There was some slow down in investment expenditure by new-entrant carriers in the fixed-line customer access market. In the market more broadly there was a drop in price reductions, and in some cases, prices increased. Telstra continues to account for the supply of the vast majority of fixed-line services and Telstra and SingTel Optus combined account for around 99 per cent of these services.

The somewhat sombre view of the state of competition in telecommunications markets outlined here contrasts with more upbeat assessments of the performance of Telstra's rivals by market analysts in the post reporting period. These are based on data which reveals that Telstra is not realising the same level of annual revenue growth as competing providers, particularly SingTel Optus, in newer services markets such as mobiles and data services. Other data also reveals Telstra is facing falling or low annual revenue growth in traditional fixed line voice services. Overall these data are thought to point to a vulnerability in Telstra's revenue streams compared to its rivals.

However this analysis is based on the six months after 2002–03 and looks forward several years. It also tends to discount Telstra's ability to respond to challenges to its market share in new services by using leverage and cross-subsidisation from its traditional services. The ACCC faces a challenge in ensuring new and emerging service providers are not disadvantaged by this ability. How successful it is will have a bearing on the extent to which regulation of new and emerging services is required.

## 2.2 Measures of effective competition

Judging effective competition in markets often involves considering many factors such as the number of firms and their market shares, pricing behaviour, the presence of natural monopoly characteristics, the height of barriers to entry, and the presence of vertical and horizontal integration.

As with previous reports, the ACCC's analysis of competition in various key telecommunications markets is largely confined to considering the number of firms, market share, the extent of vertical and horizontal integration and price movements. Importantly, the ACCC recognises that various factors may contribute to price movements—including competition and improvements in factor productivity—and that isolating these effects is often difficult. More generally though, the ACCC expects that a 'competitive' market can be expected to deliver goods and services to consumers of a given quality at the minimum cost.

In concluding that a particular market is subject to effective competition, it does not necessarily follow that the ACCC has no concerns about competition in that market or parts of it, and that some regulation may still be necessary to maintain or enhance competition. It could also be the case that competition in a market is not considered effective, but there is no regulatory intervention because the costs associated with intervening would outweigh the benefits to end-users. Moreover, the level of competition in markets can change over time precipitating changes in regulatory approaches.

The ACCC regards facilities-based competition as important because competition is over supply of more of the end-to-end service and hence more elements of the price-service package. Facilities-based providers have to compete in how and when they develop new services and invest in their networks. By contrast access regulation, and particularly wholesale service-based approaches, can only go so far in providing this impetus, since competitors rely more heavily on incumbent services and facilities to compete.

As noted above, the ACCC regards access-based competition as an important part of, as well as a precursor to, greater facilities competition in the longer-term, with both based around lower level access services and through the use of stand-alone facilities. Access regulation itself derives from a recognition that in some circumstances facilities-based competition is not viable or only partially so. Reflecting the multiple roles for access-based competition, the ACCC would expect to see a continuum of access and facilities based competition under the telecommunications regulatory regime.

## 2.3 State of competition in telecommunications markets

In accordance with past practice, the ACCC's assessment of the state of competition in telecommunications markets is done on a service by service basis. This reflects in part data constraints, and should not be taken as a definitive view of whether these represent the boundaries of particular markets. In some cases the markets may be more granulated, based for example, on consideration of geography and customer types and in other cases more aggregated, due to bundling and substitution possibilities.

### 2.3.1 Local telecommunications services

The market for local telecommunications services (which includes basic access and local call services) is not effectively competitive. Although a limited degree of competition has emerged since deregulation, particularly at the retail-level, Telstra remains dominant in most areas due to its ownership of the only ubiquitous fixed-line local access network in Australia—the customer access network or ‘CAN’. While growth in traditional ‘voice’ revenues<sup>2</sup> has levelled due to falling retail prices and customer migration to mobile and high-speed data services, there is a risk that high market share in the local telecommunications market still provides an opportunity for leverage into developing markets through bundling, customer inertia and other marketing advantages.

At the end of 2002–03, Telstra remained the dominant provider of local telecommunications services with around 89 per cent of total directly connected (including wholesale) access lines.<sup>3</sup> This compares with 94 per cent in the previous year.<sup>4</sup> Optus’s share of total access lines on its HFC network increased to 10 per cent, up from 6 per cent in the previous year, while ‘other’ carriers accounted for the remainder.

The ACCC has noted previously that a reasonable level of facilities-based competition has emerged in the CBD areas of some capital cities. Indeed, evidence of the increased availability of alternative facilities and lower level regulated access services such as the unconditioned local loop service (ULLS) and local PSTN originating and terminating services, led the ACCC to remove access regulation of Telstra’s local carriage service (LCS) for CBD areas from July 2003. In these areas, the issue is less that alternative infrastructure does not exist and more that many of these networks have few customers connected. Sustainable competition in the long term in these areas is likely to depend on these network owners winning more directly connected customers. There is considerably less facilities-based competition in metropolitan areas and very little in many rural and regional areas.

Consumers can now choose from a number of alternatives when selecting a supplier of retail local telecommunications services, including Optus, AAPT, Primus, TransACT, Powertel and RSL COM. This partly reflects that around 15 per cent of Telstra’s own access lines are resold by competitors.<sup>5</sup> The extent of resale competition appeared to improve in 2002–03. For example, Telstra’s *Annual Report* reveals a 4 per cent reduction in the number of its retail lines which was more than offset by a 17 per cent increase in the number of its domestic wholesale lines—or 230 000 new lines that were resold by Telstra’s competitors.

The pre-eminent position of Telstra and Optus is also evident in the provision of local calls. According to industry estimates, Telstra lost market share over recent years, although it still accounted for approximately 81 per cent of revenues earned in 2002–03. Optus accounted for 17 per cent of revenues earned, while other carriers/CSPs accounted for around 2 per cent.<sup>6</sup>

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<sup>2</sup> For example, revenues from local call, national long-distance, fixed-to-mobile and international call services.

<sup>3</sup> The basis for the ACA’s figures for fixed standard telephone services changed slightly in its 2002–03 report. The latest report includes data from ‘other carriers’ while the 2001–02 data were sourced exclusively from Telstra and Optus. This serves to lower Telstra’s share in percentage terms even if the number of its lines has not changed.

<sup>4</sup> ACA, *Telecommunications performance report 2002–03*, November 2003, p. 53.

<sup>5</sup> *ibid.*

<sup>6</sup> For example, see ABN AMRO report, *Australian telecommunications 2004*, p. 21.

In terms of price trends, the 2002–03 Division 12 report reveals that the average price paid for basic access services increased in real terms by 12.4 per cent in 2002–03, which follows price increases of 13.2 per cent, 15.2 per cent and 9.8 per cent in the previous three years.<sup>7</sup> Overall, since 1999–2000, average retail prices paid for basic access have increased in real terms by 46.6 per cent. Counter-balancing this somewhat is that average retail prices paid for local calls have declined in real terms by 30.3 per cent over the same period. These conflicting price trends for basic access and local call services largely reflect the opportunities and incentives for rebalancing under the government’s current retail price control arrangements, which allow Telstra to increase the average price of basic access while decreasing the average real price of other PSTN services (i.e. local call, national long distance and international call services).

However, the ACCC notes that the extent of price decreases for local calls appears to have slowed substantially over the past two years. The Division 12 report reveals the average retail price paid for local call services decreased by 3.8 per cent in 2002–03, compared to price decreases of 11.7 per cent and 17.9 per cent in the previous two years. It also reveals that price decreases for local calls varied across different consumer groups in 2002–03. For example, ‘other business’ (10.7 per cent) and ‘small business’ (3.7 per cent) consumers enjoyed more substantial average price decreases than ‘residential’ consumers (1.2 per cent).

Given the lack of extensive facilities-based competition in this market, the operation of an access regime has been important for introducing retail competition. However, the effectiveness of access-based competition is largely determined by the extent to which competitors can access Telstra’s network on terms similar to those which Telstra provides itself. Telstra’s control over access to its network allows it to influence the retail prices and quality of services (such as network reliability), provided by its retail competitors. To the extent there is any discriminatory treatment, the effect could be to undermine downstream competition in the markets in which access to Telstra’s network is necessary. The ability of access seekers to compete in terms of margins between access costs and Telstra’s retail prices, and the provisioning and fault rectification performance of the basic access service supplied to customers of access seekers compared to Telstra’s own retail customers, are being monitored by the ACCC under the enhanced accounting separation regime which began in July 2003.<sup>8</sup>

During 2002–03 the government required the ACCC to publish non-binding model price and non-price terms and conditions of access for each of the core services. These were released by the ACCC after the reporting period ended.<sup>9</sup> The purpose of these model terms is to address information asymmetries and improve the effectiveness of the access regime by providing clear guidance to industry on what the ACCC considers to be reasonable terms and conditions of access to core services.

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<sup>7</sup> Further, Telstra’s 2002–03 *Annual Report* indicated that despite the 4 per cent decrease in the number of retail lines, Telstra’s implied average yield per retail line increased by 10 per cent, or from around \$278 per access line in 2001–02 to \$305 per line.

<sup>8</sup> Under the accounting separation regime the ACCC undertakes imputation testing to examine if Telstra is pricing access services in a way that could damage its competitors. In its December 2003 Accounting Separation report, the ACCC notes that an imputation test, both on a historic and current cost basis indicated that Telstra fails for local call services (line rental and local calls combined) but passes across fixed line services as a whole. In addition the ACCC compares service performance between basic access services supplied to Telstra’s wholesale and retail customers. The first of these reports indicated that there was no evidence of systematic discrimination between the two customer groups. These trends were also evident in the second report, for March 2004.

<sup>9</sup> ‘Core services’ comprise PSTN originating and terminating services, the ULLS and the LCS.

Core services are vital to providing a number of downstream services, including local call, long-distance and ADSL services. The ACCC believes that the model terms and conditions should assist industry negotiations and encourage access-based competition in these markets.

## 2.3.2 National long-distance and international calls

There are some encouraging signs of competition in the market for national long-distance and international call services. Despite this, Telstra retains commanding shares of these markets (at both the wholesale and to a lesser extent at the retail level). Telstra's high market shares are largely a result of its ownership of the only ubiquitous fixed-network and the fact that many consumers purchase these services in a bundle with local call services. Most of Telstra's competitors continue to rely on access to its network if they want to supply these services, including as a bundle.

Competitors other than Telstra have nevertheless gained some ground in both the supply of national long-distance and international calls over recent years. However, it also appears that Telstra's retail market share in these sectors remained steady in 2002–03.

Telstra's own retail market share estimates show that it has 63 per cent of the national long distance market and 53 per cent of the international call market.<sup>10</sup> Optus, AAPT and Primus account for most of the remaining revenues in these markets. The provision of both national long distance and international call services requires a number of fixed-line cost inputs, including 'transmission capacity' as well as PSTN 'origination' and 'termination' (PSTN O/T) services.

While competitors continue to be able to access intercapital transmission services from a variety of carriers (e.g. Telstra, Optus, Powertel, Nextgen) on competitive terms,<sup>11</sup> they are generally limited to acquiring PSTN O/T from Telstra if they want to provide these services. This reflects the complementary inter-play of facilities and access-based competition in this market and how regulation has been applied accordingly.

As noted earlier, in accordance with legislative requirements, the ACCC released its draft view (the final view was released in the post-reporting period) on model PSTN originating and terminating prices for fixed-line services for 2003–04, 2004–05 and 2005–06. This was designed to reduce uncertainty on the wholesale pricing of these services in order to encourage parties to settle their differences more quickly through commercial negotiations and without recourse to ACCC arbitration.

Retail pricing trends for these services suggest that a reasonable degree of competition is being sustained in this market. For example, the Division 12 report reveals that the retail prices paid for national long distance calls decreased by an average of 4.7 per cent during 2002–03, compared to 8.7 per cent, 6.3 per cent and 9.5 per cent in the previous three years. For international calls, the average retail price paid decreased by an average of 5.8 per cent during 2002–03, compared to 15.3 per cent, 17.2 per cent and 27.0 per cent in the previous three years. These figures tend to suggest that the extent of price competition has slowed in 2002–03.

<sup>10</sup> Telstra presentation, 'Telstra Corporation Limited first half fiscal 2004 results', Dr Ziggy Switkowski, 12 February 2004.

<sup>11</sup> The ACCC continued to monitor prices on all 'intercapital' routes during 2002–03. The results of the monitoring program suggest that transmission prices on these routes have declined significantly since 2001. This suggests that competition is operating effectively in these markets. In addition, the ACCC noted in its recent final report in relation to the review of the transmission declaration that there appears to be effective competition on certain non-intercapital routes.

In isolation, price decreases are not necessarily indicative of reduced competition. They may reflect that the market has reached a certain level of maturity. However, the ACCC believes that prices remain well above cost for these services. For example, the ACCC's December 2003 Accounting Separation report suggests that there is still a significant gap between the revenues earned by Telstra in providing these services and the associated costs. This report showed that the imputed margin<sup>12</sup> for domestic long distance was 58 per cent for residential and 64 per cent for business customers. For international call services, the imputed margin was 24 per cent for residential and 40 per cent for business customers.

### 2.3.3 Mobile services market

The mobile services market is showing greater signs of competition than the market for fixed-line PSTN services. Relatively strong facilities-based competition has produced numerous product offerings and price rivalry with resulting benefits to consumers.

However, indicators of the extent of competition suggest some stabilisation of market shares and diminishing pricing gains to consumers in recent years.

At the wholesale level, the ACCC remains concerned that mobile network owners have the incentive and ability to keep mobile termination rates above-cost. An important implication of above-cost mobile termination prices is that they may feed through to the retail level and create above-cost prices for both mobile-to-mobile (MTM) and fixed-to-mobile (FTM) calls. This is because mobile termination remains an important input for providing both these services.

There are mixed signals about the effectiveness of competition at the retail level in this market. There are currently four national mobile network carriers (Telstra, Optus, Vodafone and Hutchison) which between them own and operate six mobile networks.<sup>13</sup> In addition, there are a number of mobile resellers and mobile virtual network operators that offer retail mobile services.<sup>14</sup> In 2002–03 the ACA noted more than 700 different mobile service plans on offer from the numerous carriers/ CSPs operating in the market,<sup>15</sup> though it has previously noted that only around 10 per cent of all mobile services are billed by resellers.<sup>16</sup> This suggests that while many retail consumers purchase a mobile service from a wide variety of resellers, the four mobile network carriers continue to dominate the retail market.

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<sup>12</sup> In this context, imputed margin means the difference between Telstra's average retail prices and the access prices plus retail and other costs faced by access seekers in providing the same services.

<sup>13</sup> From April 2003 Hutchison began operating a 3G network utilising the W-CDMA standard.

<sup>14</sup> An MVNO is a value adding entity that uses an existing mobile network to sell a service, which is usually linked to other branded services.

<sup>15</sup> ACA, *Telecommunications performance report 2002–03*, November 2003, p. 88.

<sup>16</sup> ACA, *Telecommunications performance report 2001–02*, November 2002, p. 161.

However, an analysis of the retail prices paid for mobile services reveals that the extent of price competition has declined in recent years. The 2002–03 Division 12 report shows that, while the overall index for mobile telephony services (which includes GSM and CDMA) has decreased by 24.1 per cent over the last five years, average real retail prices paid for mobile services increased for the first time in 2002–03, by 0.9 per cent.<sup>17</sup> This follows a slowing in the rate of decrease for average prices paid in both 2001–02 (2.0 per cent) and 2000–01 (6.8 per cent) from a peak reduction in the overall mobile index of 13.2 per cent in 1999–2000.<sup>18</sup>

The main reason for the increase in the overall mobile index was the real increase in the average price paid for GSM services (which increased by 1.1 per cent). In particular the increase was due to post-paid GSM services, which increased 2.2 per cent largely due to an increase in real prices paid by very frequent consumers of mobile services who make around 8 to 10 calls a day.<sup>19</sup>

In addition, as networks reach higher levels of capacity, there are likely to have been diminishing cost reductions, possibly as a result of economies of scale being less significant.

These developments may partly reflect that the mobile services market has reached a certain level of maturity after a period of intense price competition during which mobile service providers competed aggressively to capture new subscribers. Accordingly, this market may be entering a period of consolidation, influenced by the following developments:

- Australia's mobile penetration rate reached around 73 per cent at the end of the reporting period
- subscriber growth has slowed since a peak rate achieved in 1999–2000<sup>20</sup>
- a high percentage of new subscribers are lower-value prepaid customers<sup>21</sup>
- total growth in mobile revenues declined in 2003
- average revenue per user (ARPU) continued its downward trend over recent years.<sup>22</sup>

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<sup>17</sup> Price increases for GSM services contributed 1.0 points to the overall increase in the index of 0.9 per cent, while CDMA services contributed –0.2 points. This result can be explained by the fact that GSM services have a revenue share of approximately 94 per cent when determining movements in the average price paid for retail mobile services. Hence, on a weighted average basis, GSM services account for most of the variation in the overall index.

<sup>18</sup> The overall index for mobile telephony services was changed in the 2002–03 Division 12 report to include CDMA services. In addition, the index has been constructed on updated service bundles which now include text messaging services. To ensure that the change in prices for 2002–03 include only pure price change—rather than the effect of changes to the underlying methodology, prices in previous years have been recalculated based on the new methodology.

<sup>19</sup> The GSM postpaid index for the 'very high user group' increased by 3.5 per cent in 2002–03, the only GSM postpaid index by respective users group (i.e. very low user group, low user group, average user group, high user group and very high user group) to increase over this period.

<sup>20</sup> Although the total number of mobile subscribers increased by around 14 per cent in 2002–03, this was substantially less than the 32 per cent growth in 1999–2000.

<sup>21</sup> The ACA estimates that approximately three out of four new mobile phone services and that 38 per cent of all mobile phone services in Australia are now pre-paid—up from 33 per cent in previous year.

<sup>22</sup> For example, see ABN AMRO, *Australian Telecommunications 2004*, November 2003, p. 29.



On the strength of these developments, a number of industry analysts have predicted a lower growth environment for the mobiles industry with the completion of major projects and ongoing cash-flow pressure.<sup>23</sup> Nevertheless, while some mobile carriers continue to adopt a highly disciplined approach to capital expenditure, substantial investment may be necessary to increase existing customer spending and attract new customers to the network through the provision of new services. An example of such expenditure is the move by some carriers to invest in 3G technology, such as Hutchison, which has been closely followed by the installation of 2.5G technology by Telstra, Optus and Vodafone.<sup>24</sup> There were some significant capital expenditure projects undertaken by mobile carriers in 2002–03, which appeared to be related to these developments. For example, Optus and Vodafone installed a number of new GSM base stations across Australia, while Telstra’s capital expenditure on mobile infrastructure increased by 76 per cent from the previous year, largely due to it building additional CDMA base stations in all capital cities.<sup>25</sup>

The ACCC estimates that at the wholesale level, Telstra remained the leading mobile network carrier at the end of 2002–03 with around 46 per cent of total subscribers connected to its networks (including those who subscribe to resellers that use the Telstra network). Optus remains second with 34 per cent of subscribers, while Vodafone and Hutchison’s shares were 18 and 2 per cent respectively.

In September 2002 the ACCC updated its pricing principles for the declared mobile termination service to include termination on CDMA mobile networks.<sup>26</sup> The pricing principles are based on a retail benchmarking approach which stipulates that prices for wholesale services should decrease at the same rate as retail prices for mobile services. Importantly, the ACCC observed that control over access and a lack of consumer awareness provide an incentive for mobile operators to sustain above-cost access prices for mobile termination.<sup>27</sup>

The ACCC began a broad ranging mobile services review in March 2003 to consider whether regulation of a number of mobile telephony services (including mobile terminating and originating services; and domestic and international inter-carrier roaming services) was appropriate under the Act.

### 2.3.4 Fixed to mobile services (FTM)

The market within which FTM calls are supplied remains far from being effectively competitive despite multiple suppliers at the retail level. This appears to be largely influenced by above-cost wholesale mobile termination prices which may be preventing retail prices from being driven towards underlying costs. This issue is being considered as part of the ACCC’s mobile services review.

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<sup>23</sup> For example, see ABN AMRO, *Australian Telecommunications 2004*, November 2003, p. 29.

<sup>24</sup> 3G is a different category of mobile services as it is based on broadband technologies (as opposed to 2G technologies which are based on narrowband technology). In contrast, 2.5G technologies are designed to overlay existing 2G networks with minimal additional infrastructure and investment by (generally) using existing spectrum and packet-based technologies.

<sup>25</sup> Information sourced from mobile carriers’ annual reports and ACA *Telecommunications performance report 2002–03*, November 2003, p. 90.

<sup>26</sup> Those carriers that own and operate a GSM or CDMA network are required to provide, upon request, a mobile termination service to access seekers. This service was originally declared in 1997 and the ACCC released pricing principles for this service in July 2001.

<sup>27</sup> For further information see ACCC’s *Mobile services review terminating access service draft decision*, March 2004.

At the retail level, the ACCC understands that around ten carriers/CSPs provide FTM services.

In the absence of clear market share figures, a proxy is required. The ACCC has used the information it collects under the regulatory accounting framework (RAF) and other sources to estimate market shares based on the number of fixed minutes that are terminated on mobile networks.<sup>28</sup>

This indicates that Telstra accounts for around 65 per cent of all fixed minutes terminated, Optus 15 per cent, AAPT 8 per cent and 'other' 12 per cent. As an alternative proxy, market share figures for national long-distance calls can be used since the preselection determination requires this and FTM call services (as well as international call services) to be taken as part of a bundle.<sup>29</sup>

Regardless of which proxy is used, there appears to be a high level of concentration in this market, with Telstra retaining a sizeable market share followed by Optus, AAPT and Primus. Using the Herfindahl Index of market concentration, this implies a concentration level of 0.46, which indicates a level of concentration only slightly less than that of two equal-sized duopolists (0.5).

The price trends for FTM services also indicate that competitive forces in this market remain relatively weak, and if anything, are subsiding. For example, the Division 12 report shows that prices paid for FTM services have decreased by less than all other fixed-line PSTN services over the last six years. The real price of FTM calls declined, on average, by 22.7 per cent over the period from 1997–98 to 2002–03. This compares with decreases of 37.1 per cent for local calls, 30.9 per cent for domestic long distance calls and 61.7 per cent for international calls. Perhaps of more concern, the rate of decrease in the average real price of FTM calls has slowed considerably in recent years. For example, the real price of FTM calls declined by 2.4 per cent in 2002–03 compared to decreases of 3.2 and 6.2 per cent in the previous two years.

While these price trends in isolation are not necessarily indicative of an ineffectively competitive market, the ACCC also has evidence to suggest that the average yield on FTM calls is well above cost. For example, according to Telstra's 2002–03 *Annual Report*, its average yield on FTM calls was 38.5 cents per minute (the same as in the previous year). Data available to the ACCC for the purposes of the Division 12 report indicates that the average yield received across Telstra, Optus, AAPT and Primus for residential FTM calls, is in the order of 46.3 cents per minute. In comparison, the ACCC estimates that based on a range of domestic and overseas information, the underlying cost of the mobile termination service is substantially lower.<sup>30</sup>

The retail market for FTM services continues to grow strongly in revenue terms. FTM revenues for the five largest telecommunications carriers in Australia grew by 7.3 per cent in 2002–03.

This has created a situation where FTM revenues now exceed revenues derived from national long-distance calls, even though the four largest carriers reported more than double the number of long-distance minutes compared to FTM minutes.

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<sup>28</sup> For this purpose the RAF only covers the four largest fixed-line carriers—Telstra, Optus, AAPT and Primus.

<sup>29</sup> It is more instructive to look at long-distance call service market shares as opposed to international call service market shares as several carriers only supply international calls using override codes.

<sup>30</sup> In addition, the ACCC's first accounting separation imputation report released in December 2003 revealed that the imputed margin that Telstra earned on FTM services was 20 per cent for business customers and 36 per cent for residential customers.

As the ACCC noted in its 2001–02 report, the likelihood that FTM prices are significantly above cost appears largely the result of mobile termination input costs, and more specifically the price of wholesale mobile termination services.<sup>31</sup> The ACCC re-stated this view in its April 2003 mobile services discussion paper by noting that consideration needed to be given to the probability that mobile network carriers' control over mobile termination services—the key wholesale input in providing FTM services—has resulted in a lack of effective competition in the supply of FTM services.

For example, at the retail level, fixed-line operators that wish to supply a FTM service, but do not own the mobile network on which that call will be terminated (referred to as an 'off-net' call), must purchase a termination service from the relevant mobile operator. In this instance, the ability of the FTM service provider to set prices close to underlying cost will be limited by the extent to which they can acquire mobile termination services at cost. During the reporting period, the ACCC received complaints that the two vertically-integrated operators were using their control over access to the mobile termination service to engage in price-squeeze behaviour in the market within which FTM calls are provided. The ACCC is currently investigating these complaints. This issue has also been raised in the specific context of the corporate segment of the market. The ACCC is undertaking continuing work on pricing practices in this part of the market.

There is also evidence that there is a significant degree of price discrimination with regard to the price of FTM calls being offered to residential and business consumers. For example, the Division 12 report shows that the average price paid by residential consumers of FTM calls is 46.3 cents while the average price paid by business consumers (other than small business) is 36.4 cents.

The issue of mobile termination prices, and the extent to which they have an impact on retail FTM prices, was one of the main issues being considered as part of the ACCC's review of the mobile services market. A draft report was released in early 2004.

### **2.3.5 Data and internet services**

The sustained growth in the markets for data and internet services highlights the increasing importance of non-voice traffic revenues. By the end of 2002–03 revenues from data and internet services represented an estimated 18 per cent of total telecommunications revenue and it is expected that this will continue to grow strongly.<sup>32</sup> Rather than provide definitive views on the scope of the market for data and internet services, this section aims to provide a broad overview of the competitive environment and highlight emerging issues the ACCC is currently considering in this area.

Broadly speaking, data and internet services achieve data transfer (text, still images, video, voice and high-quality sound) from one location to another. A variety of technologies can be used to deliver these services to business and residential consumers but with varying speed and reliability. They include ISDN, frame relay, ATM, leased lines, ADSL, HFC and optical fibre cable, microwave and satellite. These technologies often rely on fixed-line access and transmission services as key inputs.

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<sup>31</sup> The other two key inputs are origination and transmission.

<sup>32</sup> For example, see ABN AMRO, *Australian telecommunications 2004*, November 2003.

Data services are primarily supplied to, and used by, large corporate businesses. These include ISDN, frame relay and ATM services as well as data and leased lines. To date the ACCC has received few complaints from industry or business about the competitive supply of these services. None of the complaints received has raised competition concerns. However, as directed by the minister, the ACCC is undertaking more comprehensive corporate market monitoring under the accounting separation regime.

Internet services are supplied to a wide range of consumers including large corporate businesses, small to medium enterprises and residential consumers. These include narrowband dial-up internet services supplied over the fixed-line network (primarily used by residential consumers and small businesses) as well as high-speed internet services commonly referred to as 'broadband' which can be supplied using DSL, HFC microwave or satellite technology. Internet services are supplied to consumers by a large number of internet service providers (ISPs), although there was further consolidation in the number of ISPs in 2002–03—with the number decreasing from 571 in March 2002 to 554 in March 2003.<sup>33</sup>

Throughout 2002 the ACCC continued to receive complaints about the nature of 'internet interconnection arrangements'. This is the manner in which ISPs connect to each other's backbone networks and transfer internet traffic between each other, otherwise known as 'peering'.<sup>34</sup> Generally, the complaints were from ISPs that claimed they were excluded from domestic peering arrangements since none of the four largest ISPs (Telstra, Optus, Connect.com and WorldCom/Uunet) paid for the use of their networks, yet the complainants were required to pay these ISPs. The ACCC is currently conducting an inquiry into whether or not an internet interconnection service should be declared and expects to finalise the decision in 2004.<sup>35</sup>

The ACCC continued to monitor broadband deployment in Australia during 2002–03. The number of broadband connections grew by 82 per cent (which took total broadband uptake to 516 800) although this was substantially lower than the 130 per cent growth in the previous year. ADSL continued to grow almost twice as fast as cable (consistent with international trends), while supply to residential customers remains the largest part of broadband take-up at about 57 per cent of connections.<sup>36</sup>

Both the OECD and ITU have expressed concern about the development of broadband competition in countries where the incumbent telecommunications carrier also owns a cable network. For example, a recent OECD report states that although overall growth in broadband penetration represents one of the fastest adoption rates for any new communications service:

... broadband markets (in the OECD) ... are being held back where the cable networks are not providing independent competition with the PSTN.<sup>37</sup>

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<sup>33</sup> ACA, *Telecommunications performance report 2002–03*, p. 98.

<sup>34</sup> The ACCC has been monitoring interconnection arrangements since it issued competition notices to Telstra in 1998 for the interconnection of internet networks. These notices were issued when Telstra charged competing internet access providers for supplying their internet traffic over Telstra's network, but refused to pay when competitors carried Telstra traffic.

<sup>35</sup> This inquiry follows previous consideration of these issues by the ACCC and other organisations. A discussion paper seeking industry comment on this issue was released in April 2003.

<sup>36</sup> The ACCC collects quarterly data on the number of broadband connections from the major carriers of broadband services. This disaggregated information is provided on a 'commercial-in-confidence' basis. The ACCC periodically publishes this information in aggregated form.

<sup>37</sup> OECD report, *Broadband and telephony services over cable television networks*, November 2003, p. 5.

The ITU reached similar conclusions when it noted that in the case where a major telecommunications provider also own cable network:

... (that) provider has disincentives from rolling out both DSL and cable ... as the two would compete against each other.<sup>38</sup>

In its *Emerging market structures* report, the ACCC noted that Telstra's divestiture of its HFC network would introduce a new infrastructure competitor into the market, creating conditions for increased rivalry and innovation in the supply of a full range of telecommunications services, including broadband.<sup>39</sup>

At June 2003 Australia's broadband penetration rate (broadband access per 100 inhabitants) of 2.65 per cent lagged well behind the OECD average of 6.06 per cent.<sup>40</sup> This left Australia ranked 20th out of the 30 OECD countries, compared to 18th in the previous year. The ACCC's disaggregated broadband statistics also suggest that despite the existence of around 200 ISPs providing broadband services, Telstra's retail market share is substantial (around 45 per cent) and remained relatively constant in 2002–03.

The ACCC has undertaken a number of initiatives to promote broadband competition and take-up in Australia, including the declaration of the unconditioned local loop service (ULLS) in 1999 and line sharing service (LSS) in 2002. It was believed that the declaration of these services would encourage efficient infrastructure-based competition in the provision of xDSL services. However, to date, the ACCC considers the take-up of these services continues to be slow. For retail competition the preference of both carriers and carriage service providers remains wholesale ADSL services.

The release by the ACCC of final model price and non-price terms and conditions for the ULLS in October 2003 may help to boost utilisation of this service in the supply of broadband services. As a potential substitute to the non-declared wholesale ADSL service this could also help ensure that pricing of this service reflects costs and remains a viable alternative.

## 2.4 Competition and regulation moving forward

As a result of legislative changes in December 2002, the minister issued a direction to the ACCC to make a record-keeping rule and to publish reports to implement enhanced accounting separation of Telstra's wholesale and retail operations. Initial record-keeping rules were issued in June 2003, requiring Telstra to provide the ACCC with information on current costs, key performance indicators (KPIs) for non-price terms and conditions and imputation analysis of Telstra's retail services with respect to core telecommunications services. The ACCC released the first of its reports based on this information in December 2003 and the second quarterly report (on imputation and KPIs only) in April 2004. The ACCC intends to widen Telstra's accounting separation reporting through the introduction of replacement record keeping rules during 2004.

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<sup>38</sup> ITU report, *The birth of broadband*, September 2003, p. 81.

<sup>39</sup> ACCC, *Emerging market structures report*, June 2003, p. 30.

<sup>40</sup> OECD data, *Broadband access in OECD countries per 100 inhabitants (underlying data)*, June 2003.

In June 2003, as required by new legislation, the ACCC released for comment draft price and non-price model terms and conditions for three core services: LCS, ULLS and domestic PSTN originating and terminating access services. Non-price conditions include faults and maintenance, service migration and creditworthiness. These were designed to aid competition by increasing information and certainty in the market place through providing benchmark terms and conditions for access negotiations. Final terms and conditions were issued by the ACCC in October 2003.

However, as stated earlier, Telstra's market power across a range of telecommunications markets and its degree of horizontal and vertical integration remains a concern of the ACCC. The ACCC regards the above regulatory developments as only going part of the way in addressing this concern.

In a development that could be expected to have a bearing on the extent of access and facilities-based competition in the future, the December 2002 amendments to the legislation also required the ACCC to set expiry dates of within five years for all existing declarations, and maximum five-year expiry dates for all new service declarations where previously they were open ended. Accordingly, in June 2003 the ACCC released the timetable of expiry dates for declared services.

The mobile services declaration is being reviewed as part of a broader mobile services review which started in April 2003.

This review is examining what form of regulation, if any, should be applied to the mobile terminating and originating access services, the domestic and international roaming services and third generation mobile services. A review of the domestic transmission capacity service commenced in September 2003 and was completed at the end of March 2004.

An internet interconnection declaration inquiry started in April 2003, seeking to establish whether internet interconnection should be regulated. The ACCC is concerned to ensure that the terms and conditions for interconnection between domestic internet service providers are competitive. Bundling has also been a particular competition issue over the last few years. The ACCC continues to monitor whether bundling conduct in telecommunications markets may have anti-competitive effects.

In taking action to promote competition through reducing Telstra's market power in traditional telecommunications services, one of the ACCC's aims is to ensure that Telstra is not able to use its position to improperly leverage into a position of dominance in new services. This should serve to create a more diverse and competitive marketplace for new services and deliver long-term benefits to consumers.

It is recognised that next generation network (NGN) services such as IP services may warrant less regulation than traditional services as they emerge as a major source of competition to traditional services. How much regulation is implemented will depend on whether incumbent carriers become major providers of these services, their extent of vertical integration and potential for leverage of market power between traditional and new services and whether bottlenecks to alternative supply arise. If new suppliers of NGN services became a major source of competition to traditional services, this could in turn lead to reduced regulation of traditional services.

One part of this regulatory strategy is to ensure that Telstra faces more effective facilities based competitors in a growing range of markets. As discussed earlier, this will in part involve ensuring that Telstra's competitors do not become overly dependent on access arrangements, particularly for end-to-end wholesale services.<sup>41</sup> It also requires targeted application of conduct or ex-post actions to protect the competitive process so that efficient competitors are able to thrive. In this regard the ACCC considers that persistent competition issues are likely to point to market failure associated with the existing market structure.

If regulation is successful in promoting competition and efficient investment to overcome Telstra's market power in traditional services, the amount of regulation could possibly reduce, as these services decline in importance, and new more competitively delivered services take their place. This will help to ensure that Australian households and businesses receive the full benefits of technological change in the communications sector.

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<sup>41</sup> As noted above, there is likely to be continued reliance on various unbundled network elements by even facilities-based competitors for a considerable time as well as the need for terminating access to overcome bottlenecks to competition. This should be distinguished from strategies which are based solely on the resale/wholesale and 're-badging' of existing retail services.

## 3 Anti-competitive conduct investigations

### 3.1 Anti-competitive conduct provisions

Part XIB of the Act contains telecommunications specific anti-competitive conduct provisions. These provisions prohibit a carrier or carriage service provider (CSP) from engaging in anti-competitive conduct—a prohibition known as the competition rule. Section 151AJ sets out the two circumstances under which a carrier or a CSP contravenes the competition rule.

The first circumstance is when a carrier or CSP takes advantage of a substantial degree of power in a telecommunications market with the effect, or likely effect, of substantially lessening competition in that, or any other, telecommunications market. An examination of the purpose of the conduct is not required under the competition rule—unlike the general s. 46 misuse of market power provisions.

The second circumstance is when a carrier or CSP engages in conduct relating to a telecommunications market that contravenes the anti-competitive conduct provisions in Part IV of the Act. In particular:

- s. 45—contracts, arrangements or understandings that restrict dealings or affect competition
- s. 45B—covenants affecting competition
- s. 46—misuse of market power
- s. 47—exclusive dealing
- s. 48—resale price maintenance.

#### 3.1.1 Competition and advisory notices

The ACCC may issue competition notices in response to alleged anti-competitive conduct. When exercising this discretion it must consider the guidelines it has issued under s. 151AP(2) and any other matters it considers relevant.

There are two different types of competition notice:

- Part A competition notice—which may be issued by the ACCC when it believes that a carrier or CSP has engaged, or is engaging, in anti-competitive conduct. It does not constitute prima facie evidence of the matters in the notice. If the carrier or CSP does not comply with the notice, the ACCC may choose to seek orders for pecuniary penalties in relation to the period during which the notice was in force of up to \$10 million and \$1 million per day that the conduct continues.



- Part B competition notice—which the ACCC can issue to help prove a contravention of the competition rule. The Part B competition notice states that a specified carrier or CSP has contravened, or is contravening, the competition rule and sets out particulars of the breach. Once issued, a Part B competition notice is prima facie evidence of the matters set out in the notice (i.e. the facts comprising the particulars of the contravention) in any proceedings under Part XIB. It does not conclusively establish that a carrier or CSP has engaged in anti-competitive conduct as this can only be determined by the court.

The ACCC may also issue an advisory notices advising a carrier or CSP of the action that it should take, or consider taking, in order to ensure that it does not engage, or continue to engage, in anti-competitive conduct.

### 3.1.2 Exemption orders

A carrier or CSP proposing to engage in conduct which may normally breach the competition rule can apply to the ACCC for an exemption order. The ACCC may grant an exemption order if it is satisfied that:

- the resultant public benefit outweighs any public detriment of lessened competition or
- the conduct will not breach the competition rule.

Conduct subject to an exemption order will not be anti-competitive for the purpose of the competition rule.

The ACCC has never received an application for an exemption from the competition rule.

## 3.2 Investigations conducted in 2002–03

During 2002–03 the ACCC conducted anti-competitive conduct investigations regarding the following issues:

- possible resale price maintenance by a supplier of pre-paid mobile phone cards
- possible anti-competitive conduct by a supplier in relation to ports of local numbers
- possible price squeeze conduct in relation to wholesale broadband services in regional areas
- possible predatory pricing conduct for hardware and service in relation to two-way satellite internet offerings in regional areas
- possible refusal to deal in relation to data and voice terminating access services
- possible anti-competitive conduct in relation to 1900-providers offering value added services.

The ACCC did not find evidence of a breach of the Act in any of the above investigations and they were therefore closed.

The ACCC also conducted an investigation into allegations that Telstra was imposing commercially unreasonable conditions on customers who opted to use service providers other than Telstra as their whole-of-business service provider. This followed a complaint from Optus in late 2002 that Telstra was refusing to consent to requests from corporate and government customers to appoint an agent or third party to manage its telecommunication services.

In mid-April 2003 the ACCC was informed that Telstra and Optus had signed an Agency Recognition Agreement under which each would acknowledge the other's role in assisting businesses that decided to change whole-of-business service providers.

The ACCC's concerns resulting from its investigations extended to provisions contained in Telstra's standard form of agreement (SFOA). The provisions purported to give Telstra the right to:

- withhold its consent to a customer's request to appoint an agent or third party to manage its telecommunications services
- withdraw that consent at any time and in its absolute discretion
- deal with either the customer or the agent, or both, in relation to any matters arising under the agency agreement.

Telstra took steps to alleviate the ACCC's competition concerns by amending its SFOA to remove obstacles for any competitors wishing to provide whole-of-business services in the market.

## 4 Consumer safeguard provisions

This section details major ACCC investigations involving potential telecommunications breaches of the consumer protection provisions in Part V of the Act. The Act does not have consumer protection provisions specific to the telecommunications market.

To assist businesses and consumers in understanding their respective responsibilities and rights under the Act the ACCC launched *Fair call*, an advertising guide for telecommunications businesses in March 2003. The guide applies to telecommunications services including internet, mobile and fixed line services.

A total of 4247 consumer protection complaints regarding the telecommunications industry were registered with the ACCC in 2002–03. This compared to 6842 in the previous financial year.

Of the complaints received, 34 per cent did not fall within the ACCC's jurisdiction, that is, they were not issues covered by the Act. Additionally, each complaint does not represent a single issue. Usually there are a number of key issues per year that generate the majority of complaints. Thus several hundred complaints may relate to one issue.

Initial investigations conducted, and initial contact by the ACCC with relevant parties, resolved many of the issues.

The ACCC conducted substantive further investigation into seven telecommunications issues in 2002–03. The investigations concluded during this time frame are outlined below.

### 4.1 Telstra 'Say G'day' calling card product

In November 2002, the Federal Court declared that Telstra engaged in misleading and deceptive conduct when advertising its pre-paid long distance 'Say G'day' calling card product.

The ACCC action followed an investigation into complaints of hidden call charges and fees incurred by consumers using the Say G'day card's 'FREECALL 1800 099 032' phone number to make long distance calls.

The ACCC investigation showed that, contrary to Telstra's representations that the 1800 number was 'free' and the impression that the costs would not be a significant part of the overall charges, the 1800 number had a cost of 53 cents per minute, plus the advertised long distance call rates.

The court made orders restraining Telstra from continuing to make misleading claims in relation to the costs associated with the calling cards. Telstra also offered undertakings to the ACCC, including a commitment to review its trade practices compliance procedures and to waive the 53 cents per minute charge until corrected cards, vouchers and promotional materials were distributed to retailers.

## 4.2 National Telecoms Group

In February 2003 the ACCC commenced legal proceedings in the Federal Court against National Telecoms Group Pty Ltd (NTG). NTG, and several of its subsidiaries, had supplied telephony packages to small to medium enterprises consisting of a lease on a new telephone system and involving the transfer of the customer's fixed line telephony services to Direct Telecoms, a wholly owned subsidiary of NTG. The ACCC alleged that, in the course of marketing these telephony packages, NTG made false and misleading representations with respect to the price of the telephony packages in breach of ss. 52 and 53 of the *Trade Practices Act 1974*.

In December 2003 the Federal Court declared that National Telecoms Group engaged in misleading and deceptive conduct when offering its Synergy telephony package. The court also declared that NTG made false and misleading representations with respect to the price of its telephony services. The court granted injunctions restraining NTG from making the same or similar representations to consumers in the future. In addition, NTG has provided court enforceable undertakings to the ACCC agreeing to contact customers who have complained in order to resolve their complaints and review its trade practices compliance program.

## 4.3 Global Pre Paid Communications and In Touch Networks

In March 2003 the ACCC commenced legal proceedings in the Federal Court against Global Pre Paid Communications and In Touch Networks and associated individuals in relation to the sale of telephone card vending machine distributorships and the sale of Swisscom easyRoam SIM card distributorships. The ACCC alleged misrepresentations were made as to profitability, location support and maintenance of vending machines and misrepresentations as to the nature of the Swisscom business opportunity. The matter is currently in litigation.

## 4.4 Vodafone fastfone

In September 2002 Vodafone provided the ACCC with a s. 87B undertaking in relation to its change of terms and conditions for its prepaid fastfone mobile service. The ACCC received numerous complaints alleging customers were misled about reductions in the expiry period for their fastfone prepaid calls. Vodafone acknowledged that it did not inform all customers of the cut in the expiry period and that old advertising material at point of sale remained available after the change in terms and conditions. Vodafone agreed to offer refunds and full disclosure of contract conditions.

## 4.5 Alliance WA mobile telephone advertising

In January 2003 Alliance WA Pty Ltd provided the ACCC with court enforceable undertakings regarding its mobile phone and call plan advertising, including an undertaking to provide misled consumers with refunds.

Alliance admitted that its advertising may have misled consumers to believe that its advertised mobile phone(s) and call plan, including all calls, would cost no more than the amount shown in its advertisements. In fact, the amount shown in the advertisements as the 'Total Cost' was the cost of the mobile phone only and any calls made by consumers are subject to an additional per second charge.

Once the matter was drawn to Alliance's attention the company immediately ceased promoting the relevant advertisements and cooperated fully with the ACCC in offering undertakings, admitting that its conduct may have contravened ss. 52 and 53(e) of the Act.

Alliance offered refunds to affected consumers and has also undertaken:

- not to engage in similar conduct in the future
- to contact all customers who purchased the mobile phone and signed up to the call plan, explaining that they may have been misled by the advertisements, what the actual call charges are and that if they believe they have been misled, they can claim a refund
- to implement a trade practices compliance program.

## 5 Tariff filing, record keeping, monitoring and reporting

In addition to its general powers to obtain information under s. 155, the ACCC has telecommunications specific information-gathering powers under Parts XIB. These powers, including tariff filing provisions and the power to make record keeping rules, allow it to monitor the pricing conduct of carriers and CSPs when there are concerns about anti-competitive conduct, or when determining appropriate access prices.

They also enable the ACCC to monitor market behaviour in the telecommunications industry and to develop appropriate regulatory responses. The minister can also require that the ACCC monitor and report on various aspects of competition within the industry.

## 5.1 Tariff filing

The ACCC's tariff filing powers can be divided into two distinct parts:

- general telecommunications tariff filing (Division 4 of Part XIB)
- Telstra-specific tariff filing (Division 5 of Part XIB)

### 5.1.1 Tariff filing directions under Division 4 of Part XIB

If the ACCC is satisfied that a carrier or CSP has a substantial degree of market power in a telecommunications market, it may direct them under Division 4 of Part XIB to provide information on charges for specified carriage services and/or ancillary goods and services (including those for use in connection with a carriage service) or information on its intentions regarding those goods or services.

In 2002–03 the ACCC did not find it necessary to use these powers.

### 5.1.2 Tariff filing by Telstra under Division 5 of Part XIB

Division 5 of Part XIB requires Telstra to give the ACCC a written statement setting out any proposed pricing changes for basic carriage services (BCSs) seven days before the change occurs. These are services that allow for communication between two or more distinct places, supplied by fixed line or satellite-based facilities, but not including supply of customer equipment.

A strict interpretation of Division 5 would require Telstra to provide complete details of all offerings, both standard and individualised (non-standard), along with all variations made to them. To reduce the administrative burden of this requirement, both on the ACCC and Telstra, in June 1998 the ACCC and Telstra agreed that relevant information would be provided for certain BCSs, those identified by the ACCC as assisting it in detecting potential anti-competitive behaviour. The agreement consists of the following four elements:

- Telstra is to provide its standard form of agreement on a weekly basis, along with a list of all amendments (additions, variations and withdrawals) that have taken place during that week
- Telstra is to provide a monthly summary report of any non-standard form of agreements that it entered into for that calendar month
- Telstra is to brief the ACCC if it has introduced, varied or withdrawn an offering for a BCS and considers that change to be significant
- The ACCC may also request a briefing to obtain information about any amendments to Telstra's standard form of agreement or about a non-standard form of agreement

Exemptions exist for particular BCSs when:

- there is a limited likelihood for anti-competitive conduct
- information is already available to the ACCC through the access regime
- information is otherwise available from the previous tariff filing agreement between Telstra and Austel.

During 2002–03 Telstra complied with the requirements to give the ACCC tariff filing information.

## 5.2 Record keeping rules (RKR)

Under s. 151BU of Part XIB of the Act, the ACCC has the power to make an RKR by written instrument and require that carriers and CSPs comply with it. The rules may specify what records are kept, how reports are prepared and when these reports are to be provided. The ACCC cannot require the keeping of records unless they contain information relevant to its responsibilities.

### 5.2.1 Accounting separation

In December 2002 the government made provision for an enhanced accounting separation of Telstra's wholesale and retail operations with the passage of the *Telecommunications Competition Act 2002*. In accordance with this Act, the Minister for Communications, Information Technology and the Arts issued a direction on 19 June 2003, instructing the ACCC to issue record keeping rules (RKRs) under its powers under the *Trade Practices Act 1974*, requiring Telstra to provide the ACCC with reports on:

- current costs in addition to historical costs under the telecommunications industry accounting framework (CCA reports)
- imputation analysis comparing Telstra's retail prices and the costs faced by access seekers in purchasing core telecommunications services (fixed network originating and terminating access, wholesale local calls and the unconditioned local loop service) from Telstra (imputation reports)
- key performance indicators on non-price terms and conditions that compare Telstra's customer service performance between specified retail and wholesale supplied services (NPTC reports).

It is a requirement of the direction that the reports be made available to the public.

The ACCC issued three 'initial' RKRs during 2003 in consultation with Telstra and the industry more broadly. As the first reports were required to be published by late 2003, it was necessary to put in place initial or interim rules which were framed to accommodate what could be readily achieved using existing Telstra data and information systems. This meant that the first set of reports, and particularly the CCA report, could not meet all of the objectives assigned to the enhanced accounting framework by the government.

Accordingly, it is the ACCC's intention to replace the initial RKRs with more comprehensive or 'subsequent' RKRs at a later stage. This is expected to occur by mid 2004.

The first report to the minister was provided in the post-reporting period in December 2003.

The direction also requires the ACCC to provide the with a six-monthly report on competition in the corporate customer segment of the telecommunications market. This report is subject to a separate process (see 5.3.3).

## **5.2.2 Regulatory accounting framework**

In 2001 the ACCC introduced the Telecommunications Industry regulatory accounting framework (RAF), a vertical and horizontal accounting separation model that required revenue and cost information for wholesale and retail services to be reported to the ACCC. The RAF also required that service usage information, such as the number of local calls and the number of national long distance minutes, be reported.

As noted above, the ACCC amended the RAF in 2003, to take account of the new accounting separation regime and to make general improvements.

## **5.2.3 ULLS record keeping rules**

In December 2001 the ACCC issued two non-financial RKR to Telstra regarding the unbundled local loop service (ULLS). The first requires Telstra to give detailed information on how it provides its competitors with access to its copper network and the second requires information about deployment and fault handling of ADSL services. During 2002–03 the ACCC continued to monitor Telstra's conduct in providing service to ULLS access seekers.

## **5.2.4 Bundling record keeping rule**

In March 2003 the ACCC issued a RKR to Telstra seeking information to assess the effects of bundling on competition in telecommunications markets and requires Telstra to provide detailed information about its Rewards and HomeLine residential packages.

Bundling refers to the combined supply of two or more telecommunications services. The RKR requires Telstra to provide quarterly reports in relation to its 'bundled' service products, including information on matters such as the discounts given on a bundle of services, the number of customers receiving bundled services and whether customers currently receiving a bundle of services previously received individual services from Telstra or another provider.

## **5.2.5 Public disclosure of market indicator data**

Under the RAF the ACCC collects a range of financial and service usage data from the major telecommunication carriers operating in the Australian market.

The ACCC made a decision to publish extracts of this data in a market indicator report to be released bi-annually. The information to be published includes revenues, usage and market share information in relation to a range of retail and wholesale telecommunications services. This information is being released in accordance with the approach detailed in the ACCC's disclosure report for record keeping rule information issued in January 2003.

Disclosure notices regarding the publication of this information were sent to carriers in early July 2003 and the first market indicator report was released in September 2003.



## 5.3 Monitoring and reporting

### 5.3.1 Monitoring of fault handling and rectification

In late 2001 the ACCC received a number of complaints alleging discriminatory behaviour towards Telstra's wholesale service customers by Telstra, including provisioning practices and possible non-compliance by Telstra with its statutory obligations in the provision of fault detection, handling and rectification services to other providers.

After preliminary investigation the ACCC determined that while no case of discriminatory behaviour had been established, there was a lack of transparency and communication with wholesale customers of the status of orders during the provisioning process. The investigation also suggested that Telstra's wholesale customers may not be receiving the same standard of service as Telstra's retail customers, particularly in terms of the time taken to repair faults.

In August 2002 the ACCC commenced a monitoring program of Telstra's provisioning and faults management operations to ensure that Telstra's wholesale customers are getting the required standards of service.

The ACCC also assisted Telstra in developing an industry-based information and training program for service providers to get the best results out of Telstra's provisioning and faults management system.

### 5.3.2 Broadband competition monitoring

Division 12A of Part XIB of the Act enables the Minister for Communications, Information Technology and the Arts to require the ACCC to provide him with reports about competition within the telecommunications industry.

In May 2002 the minister issued *Monitoring and reporting on competition in the telecommunications industry determination 2003 (No. 1)*, which requires the ACCC to provide a quarterly report to the minister on matters relating to competition in broadband services. Specifically, the determination requires that the ACCC report to the minister on:

- the availability of retail broadband services classified by technology type and transmission speeds
- the take-up of retail broadband services classified by technology type, transmission speed, geographic location of services, average data usage by end-users, usage by business type (small, medium or large) and the specific take-up by the education and health sectors
- the availability of wholesale broadband services classified by geographic location, technology type and transmission speeds
- the take-up of wholesale broadband services classified by geographic area, technology type and transmission speed.

The first report was due to the minister outside the reporting period in November 2003 (six months from the date of gazettal of the determination).

The ACCC wrote to the minister in November 2003 indicating that due to difficulties encountered in implementation of the determination, it would be unable to meet this deadline.

### **5.3.3 Corporate competition report**

As noted above (in section 5.2.1), the ministerial direction on accounting separation, released in June 2003, requires the ACCC to monitor and prepare six monthly reports on competition in the telecommunications industry in the corporate segment of the business customer group.

The first report is due to the minister as soon as practicable after the end of each six-month period (1 July 2003 and ending on 31 December 2003).

In November 2003, in the post-reporting period, the ACCC released a discussion paper seeking comment from industry on various definitional issues and seeking input regarding the development of the first report.

The first report is expected to be provided to the minister in the first half of 2004.

## 6 Access to telecommunications network services

This section outlines how the ACCC regulates access to telecommunications networks, including the declaration of telecommunication services, arbitration of access disputes, and the development of pricing principles for particular services, which the ACCC is likely to use to settle access disputes.

Part XIC of the Act establishes the industry-specific access regime for the telecommunications industry. The primary objective of Part XIC is to promote the long-term interests of end-users (LTIE), which is determined by assessing whether an action is likely to achieve the objectives of:

- promoting competition in telecommunications markets
- achieving any-to-any connectivity (i.e. ensuring communication between users of different networks)
- encouraging the economically efficient use of, and investment in, infrastructure.

The Part XIC access regime only applies to services that are declared. Declaration is the process of determining whether a service should be brought within the regulatory net. Services are declared after the ACCC holds a public inquiry.

A number of services supplied under pre-existing access agreements before deregulation were deemed to be declared upon commencement of Part XIC on 1 July 1997. The ACCC had previously assessed that declaration of these services was in the LTIE.

Once a service is declared the access provider is subject to standard access obligations, which require them to provide the service, on request, to the access seeker. In doing so, the access provider must take all reasonable steps to ensure that the technical and operational quality of the service is equivalent to the service it provides to itself.

While the terms and conditions of access are not specified in the Act, it does provide three ways in which they can be determined:

- by commercial negotiation between the access provider and access seeker
- if commercial negotiations cannot reach an agreed outcome the ACCC, following notification of an access dispute, can determine the access terms and conditions in an arbitration between the access seeker and provider of the declared service
- the ACCC can accept an undertaking by the access provider, which will determine the terms and conditions of access.

The ACCC has previously encouraged industry participants to negotiate and settle their own disputes and will continue to do so.

The December 2002 amendments to the Act did see a shift in the regulatory parameters towards greater transparency, removal of information asymmetries and a focus on ex-ante guidance. For example: the ACCC was required to develop model terms and conditions; merits review on final arbitration decisions was removed; an accounting separation regime for Telstra was introduced; the ACCC is required to implement pricing principles as soon as possible after declaration; and the access providers can now seek exemptions from the stand access obligations for services not yet in operation and/or not yet declared.

If intractable disagreements arise or anti-competitive conduct occurs the ACCC can use its regulatory powers to settle them.

## 6.1 Public inquiries into the declaration of telecommunications services

The ACCC's guide, *Telecommunications services—declaration provisions*, explains its approach to particular declaration issues, including the matters that it must consider and how it will consider them. The guide also contains a section dealing with procedural issues, such as the public inquiry process.

### 6.1.1 Line sharing service declaration inquiry

On 30 August 2002 the ACCC declared a line sharing service (LSS). This followed an extensive inquiry that commenced on 21 September 2001.

Line sharing refers to a situation where two separate carriers provide separate services over a single metallic pair (or 'line'). A metallic pair is capable of providing a broad range of services by utilising the full spectrum of the line. Traditionally, only 3.1 kHz, which is a relatively small part of the useable spectrum of a metallic pair of several MHz over a distance of up to 3.5 km, is used to provide voice services. Until recently, the rest of the spectrum remained unused. With the development of xDSL technology,<sup>42</sup> however, the remaining part of the spectrum can be used to provide a variety of broadband services. This allows a combination of low-speed and high-speed services to be provided on a single line at the same time.

Under line sharing, the metallic line is normally split (or shared) in a spectral sense so that one carrier or service provider provides the voice services over the line in question, while another carrier provides high-speed data services through the use of its own xDSL technology. This is the concept of line sharing and is also sometimes referred to as spectral unbundling or spectrum sharing.

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<sup>42</sup> xDSL refers to the 'family' of digital subscriber line services (e.g. ADSL = Asymmetric DSL, HDSL = High bit rate (or high-speed) DSL etc). For instance, ADSL uses a dedicated line from the customer premises to a network exchange to provide an 'always on' data service with downstream access speeds over 1.5 Mbits per second and upstream speeds typically one quarter of the downstream rate, while supporting an independent public switched telecommunications network (PSTN) dial-up voice service over the same line.

The declared service requires the access provider to provide a voiceband PSTN service to an end-user, whilst providing access to another carrier (the access seeker) to simultaneously provide services to the same end-user over the high-frequency portion of the unconditioned local loop. For example, if Telstra is the access provider, it could deliver voice services to end-users, while a second carrier could simultaneously provide high-speed data services (such as ADSL) over the same line.

For the purposes of conducting its public inquiry, the ACCC issued a discussion paper on 25 October 2001, and a draft decision to declare an LSS on 19 April 2002.

The ACCC's final decision to declare a LSS reflected concerns regarding the basic structure of the market within which the LSS is provided. In this regard, the ACCC found that Telstra is the sole provider of a LSS with no other services able to exert a sufficient competitive constraint on Telstra's pricing behaviour in the market in which the LSS is supplied. Accordingly, the ACCC was concerned that Telstra would not, in the absence of declaration, have an incentive to negotiate with a large range of carriers on competitive terms and conditions. The ACCC concluded that, in this event, the ability and incentive for Telstra to either deny access or set unreasonable terms and conditions would exist. Accordingly, it found that declaration would be likely to be in the LTIE.

The ACCC considered that declaring a LSS would involve the ACCC potentially having a role in setting the terms and conditions of access. The declaration route, therefore, represents a way of redressing the uneven balance of power in commercial negotiations.

### **6.1.2 Internet interconnection declaration inquiry**

In April 2003 the ACCC commenced an inquiry into whether or not an internet interconnection service should be declared and released a discussion paper.

Internet interconnection is the manner in which internet service providers (ISPs) connect to each other's backbone networks and transfer internet traffic between each other.

The ACCC's decision to commence this inquiry was motivated by three main factors.

First, the ACCC has already considered the domestic internet interconnection arrangements from a Part XIB perspective. This investigation concluded over four years ago. Nonetheless, the ACCC continues to receive complaints in relation to internet interconnection arrangements. This may indicate that whilst Part XIB can deal with issues on a case-by-case basis, the market for internet interconnection may contain structural features that are best dealt with in a long-term sense using Part XIC of the Act.

Second, on 22 January 2003 the independent Broadband Advisory Group released its report to government.<sup>43</sup> Recommendation 18(c) of this report states:

The Government should...request the ACCC to investigate and report on industry concerns regarding domestic Internet peering arrangements and provide the Minister for Communications, Information Technology and the Arts with recommendations on how this matter may be appropriately addressed.

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<sup>43</sup> Broadband Advisory Group, *Australia's broadband connectivity*, 22 January 2003, p. 39.

The minister subsequently wrote to the ACCC in relation to this recommendation on 5 February 2003. It is the ACCC's view that one way to respond to the minister's request is to commence a declaration inquiry under Part XIC and invite submissions from industry in relation to key issues of concern.

Finally, the ACCC has received requests from industry to consider the competition issues raised by the domestic internet interconnection arrangements in Australia under Part XIC of the Act.

The review is ongoing and expected to be finalised in mid-2004.

### **6.1.3 Transmission capacity service declaration review**

Transmission capacity is a generic service used for the carriage of voice, data or other communications. The ACCC regulates access to a range of non inter-capital transmission services. Formerly declared inter-capital transmission routes were removed from declaration in 2001. This followed an earlier variation in 1998 which had included the Melbourne–Adelaide, Adelaide–Perth and Sydney–Brisbane inter-capital routes in the declaration.

In September 2003 the ACCC commenced a review of the transmission capacity service declaration ahead of the expiry date of the declaration at the end of March 2004.

A final decision was made in March 2004 to exclude 14 capital-regional city routes where there is effective competition or evidence of sufficient contestability to promote the competitive supply/provision of these services and to end the existing monitoring program on all inter-capital routes.

### **6.1.4 Domestic GSM and CDMA originating and terminating access service declaration review**

The review of the domestic GSM and CDMA originating and terminating access declaration review was incorporated into the general mobile services review that commenced in April 2003 (see section 6.6.1).

### **6.1.5 Timetable for the review of existing declarations**

The December 2002 amendments to the Act required the ACCC to set expiry dates for each current declaration and conduct a public review of each declaration in the six months before the expiry date to determine whether it should be maintained, varied or revoked. All reviews must be completed by the end of 2007.

In accordance with this requirement the ACCC released a timetable in June 2003 which set the following expiry dates for current declarations:

- Transmission capacity—March 2004
- Domestic GSM and CDMA originating and terminating access—June 2004
- Digital data access—June 2005
- ISDN originating and terminating access—June 2005

- Domestic PSTN originating and terminating access—December 2006
- Local PSTN originating and terminating access—December 2006
- Conditioned local loop—July 2006
- Unconditioned local loop—July 2006
- Local carriage service—July 2006
- Analogue subscription television broadcasting carriage—July 2007
- Line sharing service—October 2007

## 6.2 Exemption from declaration

The SAOs require, among other things, that an access provider supply a declared service to an access seeker if requested. Under s. 152AT of the Act, a carrier or CSP may apply to the ACCC for a written order exempting it from the SAOs that apply to a declared service.

If the ACCC believes that an order made about an application for an individual exemption is likely to have a material effect on the interests of a person, the ACCC must publish the application and invite submissions on whether the application should be accepted.

The Act also enables an access provider (or a potential access provider) to apply for and receive an exemption from the standard access obligations prior to an investment in a telecommunications service being made or that service becoming an active declared service.

The ACCC must not grant an exemption order unless it is satisfied the making of the order will promote the LTIE.

### 6.2.1 Local carriage service exemption applications

Telstra applied to the ACCC in June 2000 for an exemption under s. 152AT of the Act from its obligations to supply the local carriage service (LCS) to its competitors in the CBD areas of Sydney, Melbourne, Brisbane, Adelaide and Perth. The ACCC also decided to consider a class exemption under s. 152AS in the areas covered by Telstra's application and sought public comment.

The ACCC made a final decision on this matter in July 2002. The final decision provided for two separate exemptions:

- One is an individual exemption that relates only to Telstra. This was held over for one year and took effect on 17 July 2003. It has a number of conditions attached that relate to provision of certain information to the ACCC for a period of two years from the date of effect.
- The other is a class exemption that applies to all carriers and carriage service providers other than Telstra. It took effect from the date of gazettal (31 July 2002) and is not subject to any conditions.

Telstra lodged a second application in November 2000 for an exemption from its obligation to supply the local carriage service to its competitors in the CBD areas of Hobart, Canberra and Darwin, metropolitan areas of all capital cities, and three regional centres, Newcastle, Wollongong and Geelong. The ACCC sought public comment in relation to this exemption application and a possible class exemption under s. 152AS in March 2001 and received a number of submissions in response. Telstra subsequently notified the ACCC that it intended to change the scope of its exemption application. On this basis consideration of the application was suspended. Telstra has not submitted any further applications for an exemption for the local carriage service to the ACCC.

## **6.2.2 Digital pay TV exemption**

In December 2002 Telstra and Foxtel made applications to the ACCC under s. 152ATA of the Act for anticipatory individual exemptions in relation to the proposed provision of digital pay TV services. The effect of an individual exemption order would be to exempt Foxtel and Telstra from future access regulation regarding digital pay TV services.

The application relates to the Foxtel content supply agreement. The ACCC accepted that this agreement did not contravene the Act after being offered acceptable court enforceable undertakings from Foxtel, Telstra, Optus and Austar in November 2002 (see section 6.3.1 for more detail).

In December 2003 the ACCC granted the exemption subject to a number of important limitations and conditions, including that Telstra and Foxtel further strengthen the terms and conditions of access outlined in the November 2002 access undertakings.

The exemptions provide up-front certainty about the terms of access to future digital pay TV services.

## **6.3 Access undertakings**

Part XIC includes a mechanism allowing access providers to give voluntary access undertakings on the supply of declared services. They must set out the terms and conditions upon which the access provider undertakes to comply with the particular standard access obligations.

Under Part XIC, the ACCC is required to accept or reject an undertaking. If accepted, the ACCC must apply a relevant undertaking in an access dispute. For that reason undertakings, if accepted by the ACCC, provide a degree of certainty to both access providers and access seekers.

In assessing these access undertakings the ACCC is required to satisfy itself that the:

- undertaking is consistent with the standard access obligations outlined in the Act
- terms and conditions of access are 'reasonable', as defined in the Act.



### 6.3.1 Telstra and Foxtel pay TV analogue access undertakings

In March 2002 Foxtel and Optus announced their intention to enter into a content supply arrangement. The ACCC concluded that if given effect, the arrangement would breach the competition provisions of the Act.

To address these competition concerns, various parties provided the ACCC with court enforceable undertakings. These undertakings included a commitment by Foxtel and Telstra:

- to provide service providers with access to the analogue pay TV carriage service and set top units (STUs) through the provision of Part XIC access undertakings
- to provide service providers with access to the pay TV network, once digital pay TV services are provided on that network.

The undertakings were accepted in November 2002.

These processes were outlined in detail in section 3.2.5 of the *2001–02 Telecommunications competitive safeguards report*.

Following acceptance of the s. 87B undertakings several processes needed to be completed. The ACCC needed to assess:

- Telstra and Foxtel's analogue access undertakings under s. 152BS of the Act that set out the price and non-price terms and conditions upon which access will be provided to analogue pay TV services
- exemption applications made under s. 1523ATA of the Act by Telstra and Foxtel seeking exemption from access obligations if their pay TV networks are digitised.

Acceptance of the content supply agreement by the ACCC did not imply that the further analogue and digital pay TV access undertakings would be approved.

In November 2002 Telstra Multimedia and Foxtel lodged the analogue access undertakings with the ACCC. The undertakings, if accepted, would provide third parties with the opportunity to deliver analogue pay TV services in competition with Foxtel and Optus using the Telstra/ Foxtel analogue pay TV networks.

The ACCC rejected the undertakings in December 2003 as it was concerned that:

- the cost of access to Foxtel's analogue STUs appears to overstate the relevant business risks, and should provide for a lower return on capital
- some of the non-price elements of the access undertakings should be further strengthened to promote effective and timely terms and conditions of access, including dispute resolution processes.

The exemption application is examined above in section 6.2.1.

## 6.3.2 Core service undertakings

In January 2003 Telstra lodged core service undertakings with the ACCC specifying the terms and conditions upon which it undertook to meet its standard access obligations to supply the domestic public switched telephone network (PSTN) originating and termination access services, the unbundled local loop service (ULLS) and the local carriage services (LCS) for 2002–03, 2003–04 and 2004–05.

The ACCC released a discussion paper relating to these undertakings in March 2003, seeking submissions from industry.

Telstra withdrew the undertakings in October 2003 with the ACCC's release of model price terms and conditions for these services (see section 6.5.2). It lodged new undertakings for these services in November 2003.

## 6.4 Access disputes

As part of the ACCC's role in regulating access in the telecommunications industry, it has arbitration powers enabling it to issue directions, conduct hearings and make determinations to resolve access disputes. The ACCC must undertake arbitrations if notified of an access dispute, but only after private negotiations, mediation and/or conciliation fail. When the ACCC accepts a relevant access undertaking, the terms of the undertaking must be applied in resolving the dispute. If there is no undertaking relevant to the dispute, then the ACCC may determine the appropriate terms and conditions within the arbitration process.

Before a dispute is referred to the ACCC for arbitration, the following criteria must be satisfied:

- a declared service is supplied, or will be supplied, by a carrier or a CSP
- one or more standard access obligations apply, or will apply, to the carrier or CSP in relation to the declared service
- an access seeker is unable to agree with the carrier or CSP about the terms and conditions on which the carrier or CSP is to comply with those obligations.

### 6.4.1 Dispute resolution guidelines

The ACCC released a final guide to the resolution of telecommunications access disputes in October 2002. The guide was developed after the ACCC commissioned Phillips Fox and Resolve Advisors to conduct an independent review of its dispute resolution processes.

The guide was revised in May 2003 to reflect the December 2002 amendments to the telecommunications specific provisions of the Act and comments were sought from interested parties regarding specific aspects of the guide.

## 6.4.2 Arbitrations

The ACCC has not received a new arbitration since March 2001. There are two current arbitrations, both relating to analogue pay TV services.

TARBS and C7 first notified access disputes to the ACCC in 1999 and 2000 regarding access to Telstra's cable to provide pay TV services. These arbitrations were delayed because of various proceedings before the Federal Court in 1999 and 2000 (completed in August 2001).

The ACCC issued interim determinations in these disputes in April 2001. It was asked to help resolve technical/implementation issues preventing the interim determinations taking effect. As a separate but parallel process, the parties were required to make submissions on terms and conditions of access, including pricing, for the ACCC's final determinations. The ACCC commissioned an independent report about these technical issues.

However, the technical difficulties led to a desire on the part of access seekers not to implement the determinations<sup>44</sup> and in April 2002 the interim determinations lapsed.

The focus of the arbitrations then shifted to resolving issues ahead of making the final determination. In June 2002, to minimise disputation over process issues and to encourage consideration of substantive issues, the ACCC instituted a case management approach to the arbitration, including employing professional mediators/case managers.

In a related process, Telstra lodged draft Part XIC undertakings with the ACCC in late 2001–02 relating to analogue pay TV services. This was part of the arrangements between Foxtel, Optus, Telstra and others regarding content, digital and analogue access and other matters (see section 3.2.5 for details). This resulted in the pay TV arbitrations being put on hold while the ACCC considered these arrangements.

Part of these arrangements included a proposal to resolve the access dispute namely that, should it approve the analogue pay TV undertakings, the ACCC should make arbitration determinations in line with those undertakings. Equally, however, if the ACCC rejected the undertakings the arbitration would once again need to be resolved.

## 6.5 Pricing principles and indicative pricing

Following the declaration of a service it has often been ACCC practice to develop and release pricing principles to inform the market of its likely decisions in arbitrations, thus providing greater certainty to access seekers and promoting the timely resolution of access disputes without having to refer to the ACCC.

Changes to the legislation in December 2002 now require that pricing principles are issued for each newly declared service.

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<sup>44</sup> This was also related to other developments, in particular the loss by Seven/C7 of the AFL broadcasting rights.

## 6.5.1 Pricing principles for PSTN, ULLS and LCS

In September 2002 the ACCC issued a discussion paper looking at how the ACCC can provide guidance to the market on the process for access to the following wholesale telecommunications services:

- the public switched telephone network (PSTN) originating and terminating access
- the unbundled local loop service (ULLS)
- the local carriage service (LCS).

The paper did not set or specify indicative prices for these services, but indicated that the ACCC would seek to do this in early 2003 and sought industry comment on how prices should be determined.

Following changes to the Act in December 2002 the ACCC was required to publish model price and non-price terms and conditions for three 'core' services—PSTN, ULLS and LCS. As a result this preliminary work fed into the development of these principles for these services (see 6.5.2).

## 6.5.2 Pricing principles for LSS

In August 2002 the ACCC released pricing principles for the LSS at the same time as it declared the LSS service. In this regard, the ACCC indicated it believes there are two types of cost that could be considered when determining an appropriate price for a LSS—incremental LSS-specific costs and some allocation of the costs of a line over which a LSS is provided.

The ACCC believes that it is reasonable for an access provider to recover incremental LSS-specific costs through the access charge for a LSS.

With regard to whether some allocation of the costs of a line used to provide a LSS should be included in the price of a LSS, the ACCC notes that in assessing an undertaking, or making an arbitral determination, with regard to the price of a LSS, it may take into account the prices charged by a carrier for its other services, either declared or retail. However, its powers are limited with regard to specifying the price of these other services.

When Telstra is recovering its line-related costs through other revenue sources, the ACCC believes it would be inappropriate to include any allocation of line costs in the price of a LSS. At the time of releasing its pricing principles, the ACCC indicated it believes that Telstra already fully recovers its line-related costs through a range of other revenue sources. These include line rental charges for end-users, higher than cost charges for some retail services provided over its PSTN network and through an access deficit contribution (ADC) in the interconnection access price paid by its competitors for certain PSTN access services. In this instance, therefore, the ACCC indicated it believed the appropriate price for a LSS should be set with reference only to the LSS-specific costs of providing a LSS.

However, were Telstra to alter its pricing structure so that it no longer recovered all of its line related costs through its various other revenue sources, the ACCC indicated it believed it may be appropriate to include an allocation of line related costs in the price of a LSS.

Since declaration the ACCC has received no notification of access disputes with regard to the provision of this service. However, in the post-reporting period it did receive an undertaking from Telstra (in September 2003) regarding price and certain non-price terms and conditions with regard to the LSS.

### **6.5.3 Model terms and conditions for ‘core services’**

Section 152 AQB of the Act required that the ACCC publish model terms and conditions relating to access to core services—defined as the PSTN, ULLS and LCS.

The PSTN origination and termination services are used as inputs by access seekers primarily to supply long distance, fixed-to-mobile and mobile-to-fixed calls to customers in Australia. They can also be used by other network operators to interconnect with Telstra’s fixed network.

The ULLS involves the use of unconditioned cable (typically copper) between customers and a telephone exchange, where the cable terminates. This service enables access seekers to supply advanced, high-speed data services, such as xDSL (digital subscriber line), to customers as well as local and long-distance voice services in competition with Telstra.

The LCS is a service for carriage of telephone calls from customer equipment at a customer’s premises to separately located customer equipment of a customer in the same standard zone. It allows access seekers to provide local calls on a resale or wholesale basis in competition with Telstra.

The ACCC released its final determination on price and non-price terms and conditions in October 2003. This specified lower access charges for use of Telstra’s fixed network over the next three years. This largely confirms the ACCC’s draft views released in June 2003.

The model terms and conditions are not binding, but provide guidance as to the ACCC’s views on fair terms and conditions of access to these core telecommunications services.

### **6.5.4 Pricing principles for GSM & CDMA**

In October 2002 the ACCC released pricing principles for GSM (global system for mobile) and CDMA (code division multiple access) mobile termination services. This followed the April 2002 variation of the domestic GSM originating and terminating access declaration to include CDMA services.

GSM and CDMA are the dominant international, second generation (2G), digital mobile transmission systems.

In June 2002 the ACCC issued its draft pricing principles for CDMA services (declared in April 2002). The ACCC principles reflect its view that there should be consistency between the pricing principles used for GSM and CDMA services.

Thus the pricing principles provided that wholesale mobile prices are linked to the price competition in the retail market for mobile services.

The principles are to be reviewed as part of the mobile services review (see section 6.6.1).

## 6.6 Other access work

### 6.6.1 Mobile services review

In March 2003 the ACCC announced a broad ranging review of mobile services that would examine what form of regulation, if any, should be applied to the mobile terminating and originating access services, the domestic and international roaming services and 3G mobile services.

The review fulfilled a commitment made by the ACCC in July 2001 to re-examine its pricing methodology (retail benchmarking) for GSM mobile termination service within two years.

Following the release of a discussion paper in April 2003, submissions were received from 20 different organisations.

The mobile terminating access service (MTAS) is a wholesale input, used by providers of calls from fixed-line and mobile networks, in order to complete calls to mobile subscribers connected to GSM and CDMA networks. The service was deemed to be declared in July 1997 and the declaration is set to expire at the end of June 2004. A key issue in this inquiry, therefore, is whether or not the ACCC should continue, vary or revoke its existing declaration of the MTAS (including whether declaration should be varied to include termination on 3G networks).

A number of parties to the review argued there are no effective substitutes to terminating a call to a particular mobile phone user on their particular network once they have chosen which network to subscribe to. For instance, if a mobile phone user chooses to subscribe to Vodafone's mobile phone network, other carriers whose consumers choose to call this mobile phone user will have no option but to seek interconnection with Vodafone's network. In essence, those in favour of continued declaration argue that mobile phone networks have control over access to all mobile phone users that are subscribed to their network. In turn, this gives them the ability and incentive to raise the price of mobile terminating access services above cost. Those in favour of continued declaration argue this is presently occurring with regard to the provision of the MTAS, and that this is raising the price of calls to mobile phone users above their underlying cost, and causing distortions to usage patterns and consumption decisions—especially with regard to fixed-to-mobile (FTM) calls.

Many submitters also argue that above cost termination charges are inhibiting the effectiveness of competition in the downstream market within which FTM calls are provided. This is because above-cost termination charges enable vertically-integrated providers of both fixed and mobile services to raise the input costs of their rival fixed-line only network operators, who must purchase the MTAS from them in order to provide FTM calls to their consumers.

Those arguing against continued declaration of the MTAS, however, argue that mobile network operators compete to provide a full suite of mobile services that includes retail mobile services—such as mobile access and outgoing calls—as well as the MTAS. Further, they argue that competition over the provision of all mobile services is highly effective so continued declaration of the MTAS is no longer needed.

Some mobile network operators have also expressed concerns in their submissions that if the ACCC continues to regulate the MTAS, any consequent reductions in the price of the MTAS may not be 'passed-through' to consumers in the form of lower prices for FTM calls. This is because they believe competition is not fully effective in the downstream market within which FTM services are provided such that there would be sufficient competitive pressure to pass-on reductions in input costs (such as reductions in the price of the MTAS) to consumers of FTM calls.

As well as considering whether continued declaration of a MTAS would be in the LTIE, the review has also asked interested parties to comment on what they believe would be appropriate pricing principles for the MTAS if it were to continue to be declared.

In July 2001 the ACCC released a report indicating its preference for a retail benchmarking pricing principle for the MTAS. Under this approach, the price of the MTAS is required to reduce in line with decreases in the price of a bundle of retail mobile services. In order to monitor the effectiveness of this pricing principle, the ACCC implemented a monitoring program to estimate price changes in the bundle of retail GSM mobile services. In August 2003, the ACCC released a retail benchmarking report that publicly disclosed the results of its monitoring of retail GSM price changes over the previous two years. Disclosure of this information was not in any way an initial view regarding the need for regulation of mobile termination services or the appropriate pricing principles that should apply for such services.

In July 1997 the ACCC also deemed a mobile originating access service (MOAS) to be declared. However, unlike the MTAS which declared mobile termination irrespective of the type of call made to mobile phone users, the MOAS is far more limited in its scope. In particular, the declared MOAS only applies to calls made from mobile phones when they are made to 13/1300 and 1800 special number services. As with the MTAS, the MOAS declaration is due to expire at the end of June 2004. Accordingly, the ACCC is reviewing whether this declaration should be continued, varied or revoked after this time.

Domestic inter-carrier roaming is a service that allows the consumers of one domestic mobile network to use their handsets to make and receive calls in Australia from another mobile network. An example of domestic inter-carrier roaming may be where a customer's provider has no network coverage in a particular geographic area. In this case, domestic roaming could enable the customer to consume a mobile telephony service by roaming onto another carrier's network. Domestic inter-carrier roaming is particularly useful for new entrants and niche market participants who initially roll out networks in limited geographic areas. Domestic inter-carrier roaming is not currently a declared service. During the review, however, the ACCC has asked interested parties to consider whether declaration of a domestic inter-carrier roaming service would be in the LTIE, and if so, what form any regulation under declaration should take.

International inter-carrier roaming is a service that enables mobile phone users to make and receive calls on their mobile phone when travelling in overseas jurisdictions. The service is enabled by arrangements at the wholesale level between the network operator or service provider in the mobile phone user's 'home' country and network operators in the countries where the mobile phone user is travelling. In essence, these arrangements allow the travelling mobile phone user to 'roam' onto (and therefore receive and make calls on) mobile networks in the countries they are travelling in.

Consideration of this issue has been prompted by a large number of complaints from consumers to the ACCC regarding what they consider to be high prices for calls they make and receive on their mobile phones when travelling overseas. During the review, the ACCC has asked interested parties to comment on whether some form of regulation regarding the provision of international roaming services would be appropriate, and if so, what form this regulation should take.

In the post-reporting period, the ACCC held public forums in Melbourne (29 August 2003) and Sydney (11 September 2003) to provide interested parties with further opportunities to raise and discuss issues in this review.

Decisions will be made by June 2004 regarding the declaration of a MTAS and MOAS. Later in the year final decisions will be made regarding domestic inter-carrier roaming and international inter-carrier roaming.

## **6.7 Telecommunications access code**

Under s. 152BJ of the Act, the ACCC is empowered to make a telecommunications access code. It considered making a code in 2002, but determined that as amendments to the Act in December 2002 required the ACCC to publish benchmark terms and conditions for access to core services, an access code was not required at that stage.



# 7 Number portability

This section outlines the ACCC's legislative responsibilities and associated activities under the Telecommunications Act regarding number portability for telecommunications services.

Number portability provides end-users with the ability to change their service provider within specified number ranges (e.g. the number range used to provide mobile services) and retain the same number.

Division 2 of Part 22 of the Telecommunications Act requires the ACA to develop a numbering plan outlining the allocation and use of numbers in connection with the supply of carriage services. Under s. 458 of the Telecommunications Act the ACCC has statutory powers to direct the ACA regarding number portability. The ACA cannot establish rules about number portability in the numbering plan unless the ACCC directs it to do so and any rules the ACA inserts into the plan must be consistent with ACCC directions.

In exercising its power, the ACCC must consider whether portability of particular number ranges is required to promote the LTIE of carriage services or services supplied using carriage services. The ACCC will assess whether the LTIE is promoted using the same criteria as detailed in section 6 of this report.

Under s. 462 of the Telecommunications Act the ACCC is also required to arbitrate any disputes that arise concerning number portability (if the parties fail to agree on an arbitrator).

## 7.1 ACCC directions to the ACA on number portability

### 7.1.1 National and premium rate services

The ACCC issued a direction to the ACA regarding national and premium rate services in June 2003. The decision was in two parts:

- Portability for premium rate numbers was mandated as it was likely to benefit end-users by promoting competition and that this benefit is likely to outweigh the cost to industry of implementing portability
- However, a decision on number portability for national rate numbers was delayed as these services are not currently available and the industry is yet to identify a business case for them.

### 7.1.2 Pricing principles for non-geographic portability

The pricing principles apply to all portable non-geographic numbers (i.e. freephone, local rate and premium rate numbers).

If the ACCC is required to arbitrate a dispute over the terms and conditions of the provision of non-geographic number portability (NGNP) it will usually allocate the costs of NGNP between the donor CSP and the recipient CSP as follows. Each CSP should be responsible for:

- all system set-up and maintenance costs
- any additional call conveyance costs and
- customer transfer costs

incurred in their own network to meet their obligations under the Numbering Plan to provide NGNP.

## 8 Other responsibilities under the Telecommunications Act

Following amendment to the *Telecommunications Act 1997* in December 2002 the ACCC, rather than the Australian Communications Authority, has the power to declare a service to be pre-selectable. The ACA must then make a determination in relation to the service that is declared. The ACCC did not undertake work in relation to this new responsibility during 2002–03.

### 8.1 Australian Communications Industry Forum (ACIF)

During 2002–03 ACCC staff participated as observers on several code committees organised by the ACIF, the industry body for telecommunications companies.

ACIF committees comprise representatives of the telecommunications industry, consumer groups and government regulators (such as, the ACCC, the ACA and the Telecommunications Industry Ombudsman). A number of codes were progressed within the ACIF during 2002–03 covering:

- mobile number portability (revision)
- local number portability (revision)
- rights of use—premium call services
- next generation networks
- customer and network fault management (revision).

The ACCC's involvement in ACIF committees includes consumer protection issues, as well as operational and network issues.

The ACIF's Code Administration and Compliance Scheme will continue to monitor compliance of industry participants who are signatories to these codes. If codes are registered with the ACA, it can take enforcement action against industry participants for failure to comply.

#### 8.1.1 Mobile number portability (MNP)

ACCC staff contributed to meetings to review the MNP industry code. As a result of experiences gained after the implementation of MNP in September 2001, the ACIF decided that it was necessary to review the industry code on MNP, IT specifications and operations manual. The revised industry code and associated documents were finalised in August 2003. ACIF intends to submit the code for registration by the ACA, thus making it enforceable.

### **8.1.2 Local number portability (LNP)**

Commission staff participated in meetings convened by the ACIF to review its industry code on LNP, including the IT specifications and operations manual. The revised industry code sets out the procedures that carriers and carriage service providers must follow to support the requirements associated with porting telephone numbers associated with many services. The revised industry code and associated documents were completed in August 2003. ACIF intends to submit the code for registration by the ACA, making it enforceable.

### **8.1.3 Rights of use—premium call services**

ACCC staff participated in meetings convened by the ACIF to develop an industry code on rights of use for premium call services. A draft industry code is expected to be released for public comment in April 2004. ACIF intends to submit the code for registration by the ACA, making it enforceable.

### **8.1.4 Next generation networks**

ACCC staff contributed to meetings of ACIF's Next Generation Network Framework Operations Group (NGN FOG), which was originally tasked with progressing interconnection issues associated with the emergence of NGNs and multimedia services they are intended to deliver. It is apparent that the emergence of NGNs has far reaching consequences for the technical, commercial and regulatory arrangements current in the industry. ACIF intends to submit a report on these consequences to the Department of Communications, Information Technology and the Arts in August 2004, and will continue to work towards resolution of these issues through a new NGN Facilitation Group.