



**Submission by AAPT Limited & PowerTel Limited
to the Australian Competition and Consumer Commission
in response to**

Fixed Services Review: A Second Position Paper - April 2007

August 2007



Introduction

1. AAPT and PowerTel¹ welcome the opportunity to respond to the Australian Competition and Consumer Commission's (the **Commission**) *Fixed Services Review: A second position paper* released April 2007) (the **Position Paper**).
2. The Commission's Fixed Services Review is well timed. The environment in which telecommunications providers operate is fraught with uncertainty and risks undermining the competitive gains made to date:
 - (a) the incumbent remains without any real operational or structural restraints to the exercise of its market power and is vigorously pursuing a legal and public relations strategy aimed at destabilising the telecommunications access regime;
 - (b) political intervention in next generation technology debates risks rendering non incumbent assets stranded, together with the competitive gains those assets have driven to date;
 - (c) the Universal Service Obligation is under review; and
 - (d) the market is yet to decide which of the new technologies should form the platform of a 'next generation' network.
3. The Australian telecommunications market requires real operational or structural separation of last mile infrastructure assets if there are to be long lasting competitive gains. Until that happens, any competitive progress made in the Australian telecommunications market is destined to be superficial and readily eroded and the Commission and the telecommunications access regime will continue to play a crucial role in ensuring end users continue to benefit from technological developments and choice of carrier.
4. The Fixed Services Review presents an opportunity for the Commission to assess the way in which it utilises the regulatory tools available to it to solidify the competitive gains of the past and support the industry through the current environment of uncertainty. To the extent that those tools have been under utilised, the current environment demands they are sharpened. To the extent that those tools may be blunted or rendered unworkable by proposed calls for deregulation, the current environment demands that those calls be dismissed.
5. In this context, and for the reasons set out in this submission, AAPT responds to the two questions raised in the Position Paper as follows:

How should the commission balance its obligation to provide regulatory certainty against the changing dynamics of the telecommunications industry, and the need to maintain flexibility to respond to these changes?

6. AAPT submits that the Commission's proposal to define telecommunications markets by reference to exchange areas would *decrease* regulatory certainty and flexibility, especially in the context of the current next generation access network debate. Reasons for this include:
 - (a) exchange based markets are unlikely to be economically significant trade areas;
 - (b) exchange boundaries are not applicable across all fixed services technology platforms;
 - (c) there is no guarantee that a FTTN would continue to use the exchange as the point of handover for services;
 - (d) it ignores the fact that much of the need for regulatory intervention arises as a result of last mile infrastructure monopolisation;
 - (e) services available in the upstream market vary within individual exchanges;

1 Throughout this submission, references to AAPT should be taken to be references to both AAPT and PowerTel.

- (f) exchange based market definitions could result in anomalous findings of “market power” and may therefore have the effect of preventing what is generally acknowledged as needed industry consolidation;
 - (g) exchange based market definitions are incapable of offering certain market boundaries; and
 - (h) the potential number of markets would be administratively unworkable, both for the Commission (resulting in less effective regulatory enforcement and monitoring) and for industry participants whose regulatory resources are already strained.
7. The purpose of the telecommunications regime is the promotion of the long term interests of end users. End users will not benefit from exchange based markets as this will result in differentiated pricing outcomes across consumer groups and artificially targeted investment decisions. In these circumstances, AAPT submits that the Commission’s traditional approach to defining markets nationally continues to remain the most appropriate regulatory approach.
8. AAPT submits that if the purpose of the fixed services review is to identify opportunities for the Commission to increase the certainty and flexibility of the regulatory regime, the Commission should include as part of that review an internal audit of the current utilisation and effectiveness of regulatory safeguards. If the audit suggests the current regime is being under utilised, steps should be taken to ensure this is addressed. Only when the regulatory regime is being properly utilised and delivering real behavioural changes should calls for deregulation be considered.
9. The Commission is now in a position to start solidifying the competitive gains made to date by using its regulatory powers to reinforce and further promote needed behavioural change. AAPT considers that any internal audit of the way in which the Commission currently makes use of its regulatory toolkit should at least raise the following questions:
- (a) Why is the Commission yet to finalise Procedural Rules under s152ELB in circumstances where the power to make Procedural Rules was conferred on it to help combat regulatory gaming and delay?
 - (b) Whether the Commission should rely on clause 29A of Schedule 1 to the *Telecommunications Act 1997* to develop and release a Network Modernisation Code;
 - (c) Whether current model terms should be reviewed?; and
 - (d) Whether the Commission might make more use of its powers under s.152BBA of the Trade Practices Act) to intervene in commercial negotiations between access seekers and providers (including by means of releasing guidelines (see s152BBA(8)) as to when the Commission would be likely to respond to requests for intervention)?

Would the proposed timetable provide regulatory certainty to the industry? If not, why not and what alternatives are there?

10. AAPT applauds the Commission’s proposal to conduct a holistic review of declared services as a proposal which has the potential to both:
- (a) increase investment certainty; and
 - (b) reduce the opportunity for regulatory gaming,
11. AAPT submits, however, that the Commission’s proposed timetable must accommodate and allow for finalisation of concurrently running enquiries, including the FTTN enquiry and the review of the Universal Service Obligation.

Approach to regulation

It is time for a new approach

12. In the Discussion Paper, the Commission notes that there are three broad ways that competition in the provision of fixed line services occurs:
- Full facilities based competition;
 - Quasi-facilities based competition; or
 - Resale based competition.
13. In 2006, the Commission expressed the view that, of these three forms of competition, “full facilities based competition is the end goal in all circumstances”².
14. The rationale for what has been a historic preference on the part of the Commission for full facilities based competition is explained in the Position Paper as follows:
- “Facilities based competition is more likely to lead to sustainable competition, spur dynamic innovation and encourage the diffusion of new technologies over time; ultimately providing greater prospects for the relaxation or removal of access regulation.”³*
- ...
- “Efficient, facilities based competition is more likely to be ‘effective competition’ (and therefore promote the LTIE) because rivals are able to differentiate their services and compete more vigorously across greater elements of the network (and supply chain). It is also more likely to produce enduring benefits because competitors that have invested in their own infrastructure are more likely to remain in the market (because of high sunk costs).”⁴*
15. In pursuit of facilities-based competition, the Commission has to date supported an approach to regulation intended to favour entrants willing to climb the “ladder of investment” and become facilities-based (i.e., more vertically integrated) competitors.
16. Yet, ten years after the introduction of “open competition” in the telecommunications market, it remains the case that there are only two fixed services facilities based competitors, one of whom, Telstra, operates the only ubiquitous network.
17. AAPT submits that in these circumstances, and in the face of the Commission’s own acknowledgements that:
- (a) *“there are enduring features of telecommunications markets, in particular fixed-line networks, which suggest that full-facilities based competition across all elements of this infrastructure is not likely to be realistic, or even a technically feasible goal in the foreseeable future”⁵*; and
- (b) *“it increasingly appears that the seamless continuum that is implied under the stepping stone hypothesis – between resale-based competition and full-facilities based competition – is unlikely to be a realistic outcome for the regulation of fixed-line services.”⁶*

²Australian Competition & Consumer Commission, Fixed Services Review position paper, June 2006, at 13.

³Australian Competition & Consumer Commission, Fixed Services Review: A second position paper, April 2007, at 21.

⁴Ibid. at 31.

⁵Ibid. at 21.

⁶Ibid, at 22.

the Commission must now reassess its underlying approach toward the regulation of, and promotion of competition within the telecommunications industry.

18. This is especially the case in circumstances where political intervention in next generation technology debates may well have the consequence of leaving non incumbent investment assets stranded.

Rebalancing the focus

19. The object of Australia's telecommunications access regime, as espoused under section 152AB of the *Trade Practices Act 1974*, is **not** the promotion of infrastructure investment.
20. Rather, the goal of the regime is the promotion of the long term interests of end users (**LTIE**) of carriage services and services supplied by means of carriage services.
21. While promotion of efficient investment in infrastructure is one of the factors the Commission must consider under s.152AB(2) as to whether a "thing" promotes the LTIE (see s152AB(2)(e)), it is not the only criterion of relevance.
22. Pursuant to s152AB(2) of the Act, in determining whether a particular thing promotes the LTIE, the Commission must have regard to the extent to which the thing is likely to result in the achievement of:
 - (a) the objective of promoting competition in markets for listed services: s152AB(2)(c);
 - (b) the objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users: s152AB(2)(d); and
 - (c) the objective of encouraging the economically efficient use of, and the economically efficient investment in:
 - (i) the infrastructure by which listed services are supplied; and
 - (ii) any other infrastructure by which listed services are, or are likely to become, capable of being supplied: s152AB(2)(e).
23. To date, however, the Commission appears to have in practice treated the objectives espoused in s.152AB(2)(c) (promotion of competition) and 152AB(2)(e) (promotion of efficient investment in and use of infrastructure) as one and the same – on the basis that promotion of efficient investment in infrastructure is a means of promoting competition.
24. The result of this "short cut" approach to the LTIE test has meant the following considerations have not been given sufficient attention, despite being of critical relevance to the question of whether a particular thing will achieve the objective of promoting competition (as per s152AB(2)(c)):
 - (a) the extent to which the Commission's general regulatory toolbox is and can be utilised to minimise and promptly address potentially anti-competitive conduct;
 - (b) the extent to which the Commission's general regulatory toolbox is and can be utilised to promote the effective operation of the telecommunications access regime by, for example:
 - incenting access providers to enter into genuine commercial negotiations;
 - protecting access seeker's legislative rights to raise access disputes;
 - minimising the effects of a vertically integrated incumbent; and
 - limiting gaming opportunities.
 - (c) the extent to which asymmetric information flows will likely be exacerbated or eased;
 - (d) implications of network modernisation initiatives; and

- (e) consumption trends and forward looking (long term) estimates of end-user demand (based on the rationale that something cannot be in the LTIE if it facilitates a product or service that end users do not want or need). AAPT submits that this consideration should also be paramount in any considerations as to whether a thing promotes the efficient use of and investment in infrastructure, on the basis that if current infrastructure assets could meet long term estimates of end user demand and are not subject to capacity constraints, the efficiency of any additional investment must be subject to serious question.

Solidifying the achievements of regulation to date

25. Despite the competitive successes the telecommunications regime has delivered to date, the Australian telecommunications market has **not undergone the necessary structural change** to ensure deregulation would not result in an erosion of those gains.
26. While end users have benefited from an increase in the number of service providers, **competition remains fragile**, with entrants to the market remaining wholly dependant on 'last mile' infrastructure owned and controlled by a vertically integrated incumbent operating with no meaningful market transparency.
27. As such, **unless and until there is real operational or structural separation** of last mile infrastructure assets, **any competitive gains in the Australian telecommunications market are destined to be superficial and readily eroded**.
28. AAPT acknowledges that, despite being the key toward less regulation, decisions as to whether and/or how best to operationally and/or structurally separate Telstra are not within the jurisdiction of the Commission.
29. To the extent there are calls for less regulation, such calls have a political response: namely a more robust operational separation model for Telstra or a move toward structural separation of last mile infrastructure (both in the context of the current customer access network and any next generation access network).
30. Failing such a response, the Commission has no choice but to be diligent and unapologetic in its exercise of the powers available to it to monitor, investigate and enforce the provisions of Parts IV, XIB and XIC of the Trade Practices Act. By doing so the Commission serves the LTIE by solidifying, to the extent it can, the competitive gains achieved to date.
31. AAPT therefore calls on the Commission to audit, as part of its fixed services review, how effective the Commission is in utilising the regulatory tools available to it to create a robust competitive framework.
32. Such an review should consider and redress, for example, why Procedural Rules pursuant to s. 152ELA are yet to be finalised, despite the Commission being conferred with the power to release such rules in 2005 on the basis that:

"Despite the amendments made to the access regime in 2002, the operation of the access regime continues to be detrimentally affected by the problems of delay and "gaming" of the regulatory arrangements in relation to the procedures and processes of the ACCC, as well as substantive issues.

....

Experience with the access regimes has also demonstrated that provisions in Part XIC that provide for the ACCC's procedures can sometimes be used to frustrate the objective of timely decision making. Concerns have also been raised about a lack of

certainty in the procedures the ACCC follows in considering access undertakings and resolving access disputes.”⁷

33. Further, AAPT submits that such a review should also consider whether the Commission should rely on clause 29A of Schedule 1 to the *Telecommunications Act 1997* to develop and release a Network Modernisation Code to address issues such as:
- (a) What constitutes adequate notice for particular types of network upgrades?
 - (b) What type of detailed telecommunications network planning information is required by carriers to enable them to undertake planning for their own telecommunications network?
 - (c) How network transition is to be managed – e.g. will carriers have an obligation to continue to supply declared services through a transition period and, if so, how long should that transition period reasonably be?
 - (d) How will end to end connectivity be maintained as end users migrate from one network platform to another?
 - (e) What level of consultation should be required?
34. Other areas of consideration should include reviewing the currency of the model terms as well as benefits that may be gained as a result of the Commission releasing guidelines indicating when it would be prepared to respond to requests to intervene in commercial negotiations under s152BBA of the Trade Practices Act. It may be, for example, that the Commission might reduce the incidence of access disputes if it is able to address information asymmetries at the negotiation level by issuing procedural directions pursuant to s152BBA(3)(a) (procedural directions requiring a party to give relevant information to another party).
35. Unless and until the regulatory regime is operating as effectively as possible to both promote and maintain behavioural changes, AAPT submits that any calls for redefining markets for the purpose of identifying opportunities for deregulation are premature.

Proposed approach to market definitions

Use of the exchange as the relevant geographic unit

36. A key focus of the Position Paper is the question: “does the application of national market definitions remain appropriate?”⁸
37. As an alternative to its “typical” approach of defining telecommunications markets nationally, the Commission proposes in the Position Paper:

“that the most desirable and analytically meaningful approach in relation to the fixed-line sector would be to consider geographic units at the exchange level. This is particularly because a main driver for a shift in competitive dynamics across discrete geographic regions is likely to be the take-up (and potential for take-up) of ULLS and/or LSS services, and that the strategies of access seekers in terms of the areas they target is likely to be heavily influenced by the characteristics of an exchange (i.e. no. of customers connected etc).”⁹

⁷ Explanatory Memorandum to the Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2005, at 5.

⁸ Australian Competition & Consumer Commission, Fixed Services Review: A second position paper, April 2007, at 26.

⁹ *Ibid.* at 39.

38. In support of an exchange based approach, the Commission claims:

“The potential advantages of using the ‘exchange’ as the geographic unit is that it may closely reflect the extent to which there are different competitive conditions in different geographic regions, compared to arbitrary delineations between different geographic levels such as between CBD, metropolitan and rural & regional areas.”¹⁰

39. With respect, AAPT considers the proposal to geographically define markets by reference to exchange areas to be ill-conceived, including for the following reasons:

- (a) Exchange based markets are unlikely to be economically significant trade areas¹¹.
- (b) Exchange boundaries are not applicable across all technology platforms. By way of example, neither the footprint of Optus’s hybrid fibre coaxial (HFC) network nor the footprints of the various mobile networks follow Telstra’s exchange service boundaries;
- (c) Implicit in exchange based delineation appears to be the assumption that the exchange operates as the nucleus of competitive activity in the delivery of telecommunications services. There is no guarantee under a FTTN that the exchange would or should continue to be the point of handover for services. As such the concept of an exchange may become practically redundant from an access perspective in the context of next generation technologies;
- (d) As noted by the Competitive Carriers’ Coalition, *“on an exchange basis, end user access still depends on the regulated access to the last mile from the exchange, no matter how many independent DSLAM owners operate in that exchange.”¹²*
- (e) The services that are available in the upstream market vary within individual exchanges. For example, a customer more than 1.5km from the exchange will not be able to be supplied with a broadband service of 12mb/s other than via electronics located closer to the customer in a street side cabinet.
- (f) Exchange based market definitions could result in anomalous findings of “market power”, despite lack of control over key inputs. Conversely, exchange based market definitions could artificially dilute market power assessments in the case of Telstra and Optus;
- (g) As a result of (f), exchange based market definitions may have the effect of preventing what is generally acknowledged as needed industry consolidation;
- (h) Exchange based market definitions are incapable of offering certain market boundaries, increasing the regulatory risk to which entrants are exposed. AAPT notes in this regard that each of the possible indicators across which the Commission suggests exchange areas may be aggregated are subject to flux¹³.

40. AAPT also questions the administrative workability of exchange based markets, especially in circumstances where, AAPT submits, there is no clear criterion for aggregation and in circumstances where not all services are available from all exchanges. AAPT questions how

¹⁰Ibid, at 38.

¹¹*In Re Australia Meat Holdings* (1989) ATPR 40-932 at 50,011: “Any geographic market must be one that corresponds to the commercial realities of the industry and represents an economically significant trade area”.

¹²Competitive Carriers’ Coalition, Submission to the Fixed Services Review; Second Position Paper, 31 July 2007, at 3.

¹³Australian Competition & Consumer Commission, Fixed Services Review: A second position paper, April 2007, at 40. Possible aggregators suggested by the Commission include: structural factors such as the number of facilities-based competitors that operate in a local exchange; population density thresholds; and evidence of price discrimination or price correlation between different geographic regions.

either the Commission or industry participants are to be expected to resource the process of monitoring, understanding and analysing hundreds, if not thousands, of discrete geographic markets.

Proposal to conduct a holistic review

41. AAPT supports the Commission's proposal to review service declarations as a whole.
42. AAPT perceives 3 key benefits to a holistic approach:
 - (a) Despite investment decisions being based on projected 3-5 year investment recovery periods, the staggered approach to services declarations has meant that the industry has been deprived corresponding regulatory certainty in terms of regulated inputs and pricing. A holistic review would address this disconnect between regulated input outcomes and investment planning.
 - (b) The process of responding to a revolving series of reviews means regulatory resources are constantly diverted from value creating activity. A holistic review process would alleviate this.
 - (c) AAPT expects that windows of opportunity for gaming, and the corresponding uncertainty that flows from that, would be diminished were there a single review cycle. Industry disruption and uncertainty arising from gaming could be further reduced were a holistic review undertaken and finalised at least 6 months prior to the expiry of any pre-existing declarations.

Timetable for review

43. AAPT notes that any certainty which would result from a holistic review would be greatly enhanced by ensuring that the review does not become derailed or rendered redundant as a result of concurrently running enquiries, such as the current Expert Panel FTTN review and the review of the Universal Service Obligation.
44. However, as set out above, AAPT submits that it would be appropriate and desirable, for the Commission to include as part of the review an audit of the extent to which the regulatory tools available to the Commission to monitor, investigate and enforce the provisions of Parts IV, XIB and XIC of the Trade Practices Act are being utilised. As a minimum, AAPT submits that such a review would justify the release by the Commission of Procedural Rules pursuant to s.152ELA of the Trade Practices Act, and the development and finalisation of a network modernisation code pursuant to s.29A of Schedule 1 to the Telecommunications Act 1997.
45. Given the above, AAPT proposes the following indicative timetable (marked up for the Commission's convenience):

Milestone	Indicative Timing
Infrastructure Audit Discussion Paper	March 2007
Commence current LSS Declaration Inquiry	End April 2007
Final decision in current LSS Declaration Inquiry	By 31 October 2007
Release draft Infrastructure Audit Record Keeping Rule	By October 2007
Commence review of internal Commission approach to telecommunications monitoring, investigation and	By October 2007

enforcement	
Release final Procedural Rules	By October 2007
Release draft network modernisation code	By December 2007 (but in any event by a date sufficient for such code to be considered as part of the Expert Panel's deliberations)
Commence review of declaration of all relevant fixed services (ULLS, LSS, PSTN OTA, LCS and WLR)	By mid-2008 but no earlier than the date on which the federal government announces final FTTN decision
Draft decision on declaration of all relevant fixed services	By December 2008
Final decision on declaration of all relevant fixed services (and timetable for next fixed services review)	By June 2009