



# **CommsWorld Telecoms Regulation Forum**

*Deregulating telecommunications in the digital era*

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## Introduction

A conference of Telecommunications Regulation is very timely given the number of complex and interconnected issues that are around at the moment. The Draft Report of the Productivity Commission has given everyone in the industry food for thought and the Minister's decision to move ahead with legislative change in regards to arbitrations will no doubt have an impact on the way we operate.

Regulation of telecommunications in a digital environment involves three key challenges:

- Technological change;
- Market change; and
- Expectation change.

There is no doubt that technological change in the telecommunications sector is a fact of life. The change from a voice focussed telecommunications sector to a data focussed telecommunications sector has contributed to the migration to an IP world and with it the decreasing reliance on circuit switched communications. This has a number of implications for both industry and the Commission which I will discuss in more detail later.

Changes in the telecommunications market are also fast and furious - the figures speak for themselves. More than \$60 billion has been wiped off the value of Australian listed telecommunications companies since March last year. Consolidation of the market internationally and domestically means that the regulator must be ever vigilant in ensuring fairness in the market for both consumers and other players.

The expectations of the community and its political leaders are ever increasing in terms of price, availability and functionality of telecommunications services. Both the Government and the Opposition have announced policies that demonstrate their desire to promote the roll-out of

broadband services. The recently announced Government action in relation to the USO (Universal Service Obligation) and the CSG (Customer Service Guarantee) is another demonstration of the Government's increasing expectation of what the telecommunications industry should deliver.

This trifecta of change leaves the Commission with a work agenda that is full, challenging and rarely dull.

## ACCC Response To Productivity Commission Report

In addressing regulatory change, the ACCC welcomes the release of the Productivity Commission's Draft Report on *Telecommunications Competition Regulation*. The Draft Report contains the first independent assessment of the rationale and operation of the current regulatory regime and possible alternatives since the commencement of the regime in 1997.

As most of you would be aware of the key finding of the PC's Draft Report, I will restrict my comments today to the ACCC's views in relation to a few specific matters.

In regards to **pricing principles**, the ACCC has some concerns about the theoretical and practical validity of incorporating the Productivity Commission's pricing principles into legislation. They may not be appropriate for emerging interconnection issues such as high speed data (I'll discuss more about that later).

Regarding **arbitration arrangements**, the ACCC remains committed to the process of compulsory undertakings as the most workable and transparent way to achieve commercial negotiation and circumvent the costly and time-rich arbitration process.

Finally, the ACCC believes there would be serious implementation difficulties in operating an access holiday or establishing "safe harbours", particularly

where this relates to greenfields investment which is commercially sensitive and where the possibility of public scrutiny is a concern.

Regarding any potential declaration of a digital platform for the Foxtel/Telstra and Optus HCF cable network, the Commission has placed on the public record the following sentiments:

*Digital platform providers have a choice. They can take the early initiative in opening up their networks for digital services, thereby creating significant opportunities and benefits for both themselves and their customers or they can take the regressive step of maintaining closed shops - and then facing the diversity of demands from service providers, governments and customers for regulatory intervention.*

*In the Commission's view, regulation of other digital platforms will only need to be considered where commercial forces are being deliberately undermined and where the objective of an open access environment is being stifled. Legitimate market drivers should be given the opportunity to do their job.*

**Source: Commission speeches to both CISCO and the Internet Industry Association**

Unfortunately, the Commission's position has been misrepresented by in the media by Telstra on a number of occasions. For example, in Telstra's May 2001 presentation to the Productivity Commission's inquiry into telecommunications competition regulation, it said it would not make the upgrade until it knew if access charges would be regulated.

This campaign of misinformation and misrepresentation of the Commission has continued. Just last week, an article in *The Australian* detailed the following material, and I quote:

***Telstra, in an unrelated submission to the Productivity Commission, accused the watchdog yesterday of "inconsistency and substantive***

*unpredictability; of clear errors in calculations; of analysis that does not withstand close scrutiny".*

*"The ACCC does not feel obliged to maintain even the most elementary level of consistency between its decisions," it said.*

**(source: The Australian, 'Telstra and Fels at War', 6/7/01)**

To add insult to injury, Telstra has not yet publicly released a copy of its supplementary submission to the Productivity Commission. Telstra has released its submission to the media but is not prepared to let the Commission or the general public, scrutinise its contents.

On the whole, the Productivity Commission's Draft Report has provided no compelling evidence that the existing regimes lead to inefficient pricing outcomes, or that the particular amendments suggested are all necessarily better to meet the objects sought. Some of the amendments would be likely to introduce further uncertainty that is only now being removed from the existing provisions as outcomes become more apparent and a body of precedent begins to emerge.

## Legislative Change

The Commission welcomes recent initiatives by the Minister for Communications, Information Technology and the Arts to explore ways of improving the speed and certainty of telecommunications arbitrations. Senator Alston has proposed a number of amendments to the current arrangements. Several of these pick up recommendations made by the Commission itself in submissions to the current Productivity Commission review of the telecommunications competition regulation.

The Commission particularly welcomes the Minister's recognition that the legislative amendments will be an important component of any reforms. The problems are not simply procedural ones. I note that many industry participants have already expressed strong support for the proposals.

## Interconnection In A Digital Data World

The issue of Interconnection for Internet and dial-up data services demonstrates the trifecta of change very well. It involves technological change (in the migration to an IP environment), changes in the market (with more players entering the data market) and changes in community expectations (with increasing expectations of lower prices and more availability of broadband services by businesses, consumers and our political leaders).

## Data On The PSTN

The ACCC has increasingly become involved in the consideration of alternative ways in which interconnection arrangements for the provision of dial-up Internet and high-speed data services can be provided, and the appropriate pricing principles that should apply for determining access prices under these alternative arrangements.

Until recently, Telstra has been seeking PSTN terminating access from other carriers providing backbone PSTN infrastructure to Internet service providers (ISPs). In these instances, a data call originating from a customer directly connected to Telstra's PSTN network may be intended for an ISP directly connected to a competitor's PSTN network. In this instance, Telstra - the originating carrier - must purchase terminating access from a competitive carrier in order to terminate the call with the ISP connected to that network.

An issue that arises with interconnection is whether the timed interconnection arrangements (for terminating access) and pricing principles developed and applied for voice calls using the PSTN are still appropriate in the context of providing data services. For example, currently Telstra faces a price cap on local calls of 22 cents per call (GST inclusive and untimed). It has been argued that the price for terminating access on a non-dominant network for data calls should be calculated on a per-minute basis, as is currently determined for voice calls using the PSTN. It has also been argued that this

cost arrangement for carriage would not be in the economical or commercial interest of the party carrying the traffic of networks with vastly different and often extended call holding times.

In considering this issue, the ACCC has looked at a number of alternative “interconnection models” and pricing principles to apply for determining interconnection arrangements for high-speed data services. While the ACCC has adjusted the PSTN access charges and applied a capped interconnect charge for such calls to minimise any losses emanating from the retail price controls, this is only seen as a transitional arrangement until more appropriate interconnection and payment arrangements are developed.

In addition, in a world in transition between a circuit based and packet based environment, there are a number of competition issues which potentially arise for consideration when some carriers and CSPs are unable to extend their networks due to an inability to reach an interconnect agreement with the dominant supplier of PSTN services.

To date, neither the industry nor the ACCC is convinced that any particular interconnection approach is appropriate to deal with new data services in the longer term, and is continuing to develop its thinking on this matter, including with the assistance of industry. What is clear, however, is that there is a high degree of uncertainty as to whether the interconnection models and pricing principles that have been applied to pricing access to the PSTN for voice services are necessarily appropriate for pricing PSTN access for data services.

It is likely that the PSTN will become an increasingly inefficient vehicle for widespread carriage of high-speed data. The interconnection debate in the near future will, in all likelihood, turn to a consideration of a complex web of the carriage of calls across and between circuit switched networks, wireless networks, dedicated IP networks and the Internet.

## Pieces In The Pie

The Commission recognises that there are a whole host of inter-related issues which require a broader approach than simply addressing individual matters with individual action.

Acknowledging the complexity of pricing principles for existing telecommunications services such as ULLS, PSTN and wholesale local calls, the question of whether pricing principles are relevant at all for data interconnection warrants consideration. Should legislated pricing principles be attempted for data interconnection, the ACCC believes they would need to provide a sufficient degree of flexibility and generality such that they can be applied to a broad range of services using different interconnection arrangements.

The ACCC's 1998 Competition Notice to Telstra regarding peering with 3 other Internet Access Providers (IAPs – in this case Ozemail, connect.com & Optus) served to address the concerns of the largest players in the Australian market at that time. However even upon issue of the competition notice, the ACCC remained concerned about the ability of new entrants and smaller IAPs to reach agreements with Telstra and other competitors.

As the technology and market has evolved, the Commission has received representations from both new entrants and smaller IAPs seeking a mechanism to resolve their settlement issues. I have some doubts about the continued relevance of an enforcement approach which is, as I'm sure you would all agree a rather blunt tool in addressing these complex issues.

When examining the issue of data interconnection, the definition and role of the market in which the provider operates and the relationship it has with other providers or end-users may require examination. For example, backbone providers, Internet Access Providers, Internet Service Providers, carriers and vendors have complex relationships with each other and involve the use of a



variety of technologies. In addition to the type of provider under consideration, what the market is for each provider, ie, do they operate in a wholesale and or retail environment may also warrant consideration. In such a converging industry, the role of content providers may also be included in discussion.

Internationally there is currently a debate as to whether Internet services per se are a tradeable good or whether they constitute a value-added service.

There is a clear relationship between access to the local loop and the interconnection for data services. As many of you would be aware, the Commission is continuing to work through the complex matters of ULLS pricing principles – including the determination of what is an appropriate level of ULLS specific costs.

The Commission will soon be in a position to finalise its views and release a draft final determination.

The issues facing ULLS such as the future development of local loop architecture and its impact on new technologies will be apparent in any interconnection consideration for data. In particular, the development of more efficient interconnection arrangements appropriate to a broadband/IP network architecture with the aim of both facilitating technically efficient broadband service interconnection as well as consequential reform of inter-carrier payment and compensation approaches for an IP/broadband environment may also warrant some consideration.

There is no doubting that the world of data services is global in nature. Ensuring Australia is internationally competitive in its handling of data interconnect settlement is another consideration for both the regulator and industry.

There is no escaping the effect a legislated untimed local call obligation has on the economic fundamentals of the market. How to address such complex

issues as interconnection with an untimed and capped component doesn't make the challenge any easier for either industry or the regulator.

Any model that may or may not be developed will also have to be sufficiently flexible to withstand the test of time with technological change.

The Commission wants to make it abundantly clear that the solution to a more complex interconnection environment does not necessarily involve heavy-handed regulation. There is no pre-existing view in the Commission that a solution mandated by the regulator for interconnection arrangements for data will be necessary. The Commission is instead looking to industry to unwind some of these complex issues in relation to pricing, market structure and so on and sees its role as providing regulatory guidance or assistance where necessary.

## Mergers And Acquisitions

The One.Tel collapse is undoubtedly complex and the reasons behind the company's exit from the market are still emerging. What is clear is that the blame cannot be laid at the feet of competition.

International experiences have demonstrated that consolidation in the communications sector is a world-wide phenomenon, particularly follow-up the bursting of the "dot-com bubble" in the US. The job shedding in equipment vendors and the increase in broadband packages in the US is evidence that Australia's telecommunications future is not unique. In Australia's favour there was no over-spend on 3G spectrum and much of the broadband roll-out has kept pace with demand.

Consolidation may well be a sign of an efficient market – there is nothing new or wrong with the exit of an inefficient company from the marketplace.

## **Authorisation**

Where a merger proposal is likely to breach s50 of the Act (ie acquisitions that would or are likely to substantially lessen competition in a substantial market in Australia, in an Australian State or Territory.), the merger parties should consider authorisation. Authorisation is a process of granting immunity on public benefit grounds, for mergers and acquisitions, which would or might otherwise contravene s50 of the Act. It provides a mechanism by which various 'trade-offs' that arise out of mergers can be taken into consideration. For example, a merger may enable a firm to achieve a size sufficient to achieve economies of scale, but may also increase domestic market power and lead to decreases in consumer welfare. These trade-offs are considered on a case by case basis.

Authorisation is a public process in which any interested party may make a submission. Submissions are open for inspection on a public register and there may be provision for a public conference of interested parties. There is, of course, provision for maintaining confidentiality of commercially sensitive information at the Commission's discretion.

Parties proposing a merger should be aware that they cannot seek authorisation for a merger which has already occurred. Further, the Commission cannot initiate the authorisation process. The merger parties must apply for authorisation. Contrary to popular belief merger authorisation is not a particularly slow and complex process. The Commission has 30 days to consider an application. This may be extended to 45 days for complex matters. If the Commission has not made a determination in the relevant period the authorisation is deemed to have been granted.

The Commission grants authorisation if it is satisfied that the acquisition would result, or would be likely to result, in benefit to the public.

## Conclusion

There is no doubt that change will continue to play a strong role in the development of the telecommunications regime. The Government's response to the Productivity Commission's Final Report has the potential to fundamentally change the way in which the telecommunications regime operates in Australia.

The Commission looks forward to active industry participation in the development of a new framework to address the issue of data interconnection in the coming months.