



Resolution of telecommunications access disputes: a draft guide

Comment on the draft guidelines issued by the
Australian Competition and Consumer Commission

June 2002

1. This document comments first, on the issue of whether agreements reached commercially ought to be capable of being re-opened for regulatory redetermination and second, on the ACCC's interpretation of the statutory criteria.

A Comments on the reconsideration of commercially accepted contracts

2. It is widely accepted that regulatory intervention ought only to occur where (1) the normal operations of market forces are inadequate to protect and promote the long term interests of end-users and (2) the benefits of the intervention will outweigh its costs. Caution in respect of regulatory intervention reflects the fact that regulation itself is costly, both in the call it makes on society's resources and more generally, in terms of the inefficiencies it creates.
3. Additionally, it is clear that the current regulatory arrangements are intended not to displace commercial forces but to complement and support their development. The telecommunications regime ought, in other words, to promote commercial dealings wherever these are reasonably workable and efficient, and the expectation should be that over time, issues related to access will be increasingly dealt with commercially, rather than requiring regulatory intervention.
4. To date, considerable progress has been achieved in moving towards reliance on commercial means to address issues associated with the provision of declared services, and of wholesale services more generally. Access services in Australian telecommunications are currently provided for on the basis of commercial agreements between parties, rather than through final regulatory determinations. Obviously, the commercial agreements have been heavily influenced by the existence and operation of the regulatory mechanisms, as well as by the recourse parties have at times had to those mechanisms; but it is bargaining 'in the shadow' of these mechanisms that shaped the final outcomes.

5. This is economically desirable for several reasons. First, it reduces the call implementing the regime makes on scarce public sector resources. Second, it allows outcomes to reflect more fully individual circumstances, and hence to secure better agreements than could be obtained through a purely regulatory process. Third, once these agreements are entered into, each of the parties to an agreement can make the investments required to best serve that agreement, confident in the terms and conditions that will determine the return on those investments.
6. These considerations are consistent with the legislation's emphasis on arbitration as a 'back-stop' to commercial negotiation and with the "negotiate-arbitrate" model that more generally underpins the Australian approach to access regulation.
7. They are also consistent with the emphasis economists place on the role of negotiation and contracting generally in achieving efficient outcomes and by extension, in securing the long term interest of end-users. This is not to claim that direct negotiation between parties is in and of itself sufficient to secure all efficient outcomes; there are market failures that can result in the parties not agreeing on efficient terms. However, by providing the parties with a means of resolving the issues that market failures might create, the telecommunications regime itself will weigh on the process of private contracting and hence guide that process to efficient outcomes.
8. Indeed, the more effective the regime is, and the more low cost and generally efficacious the alternative it provides, the less the parties will need to make use of it. Rather, it will come into play by influencing the bargains they reach, rather than by itself directly setting outcomes.
9. For this process to work efficiently, however, the parties must have confidence in the value of the agreements they reach. If these agreements are not in fact binding, but rather can be re-opened for regulatory determination whenever it suits one party or the other, then the efficiency objectives of the regime will be severely undermined. This is for two reasons.

10. First, if contractual arrangements can be re-opened for regulatory determination, the parties will have few incentives to enter into these arrangements in the first place. Since the arrangements will provide no certainty, while regulatory decisions can and will, the choice between commercial negotiation and reliance on the regulatory process will be skewed in favour of the latter. As a result, the community will forego the benefits set out above.
11. Second, even if commercial agreements are reached, the parties will place an inefficiently low level of reliance upon them. More specifically, even if the agreement would best be met by undertaking investments specific to the relationship at issue, those investments will be exposed to greater risk and hence are less likely to be undertaken. This is one of the main reasons economists have stressed the costs and risks involved in allowing parties to effectively walk away from contractually determined terms.¹
12. More generally, the impact of allowing settled contracts to be re-opened for regulatory re-determination is to place in each party a call option on seeking new terms. This will increase the risk contracting involves, and hence will reduce the level of contracting and increase the cost of achieving any given outcome by contractual means.
13. This does not imply that it is always inefficient for parties to renegotiate or alter the terms on which they contract. Many commercial contracts provide for renegotiation or more generally review, often relative to known factual triggers and redetermination

¹ Holmstrom, for example, has formalised this argument as a “moral hazard in teams” problem, where the unobservable (and therefore non-contractable) investments of several parties contribute to the total surplus: Holmstrom B, 1982, “Moral hazard in teams”, *Bell Journal of Economics*, 13-2:324---340. See more generally Williamson O E, 1979, “Transaction Cost Economics: The Governance of Contractual Relations”, *Journal of Law and Economics*, 22:233-261.

criteria. However, there is a substantial difference between (1) parties voluntarily reviewing the manner in which they share the joint benefit of an agreement over time, in line with factors that can be and generally are specified *ex ante*, and (2) effectively giving a party the option of terminating at will. The first mainly alters the allocation of what economists refer to as the surplus from the contract, while the second will substantially affect whether there is any surplus to be realised at all.

14. The effects of allowing contracts to be re-opened to regulatory determination – in terms of a reduced incentive to contract, and the discouragement of efficient reliance in contracts – are only likely to increase costs, and hence to be inimical to the long term interests of end-users. Their overall impact will be to unnecessarily increase the scope of regulatory intervention, with the inefficiencies and distortions that brings.

B Comments on the interpretation of the statutory criteria

15. It is not the intention here to review or reconsider the statutory criteria in any depth here. There are however, some points that deserve special emphasis.

The long term interests of end-users

16. With respect to the overall criterion of the long term interests of end-users, the sustainability of any benefits end-users obtain needs to be given special weight. Gains which are merely transitory or short-term cannot properly be viewed as enhancing long term welfare.
17. This, in turn, leads to the important points made by the Productivity Commission in its recent review of the telecommunications regime. More specifically, the Commission emphasized that consumers gain far more from the assurance that required investments will be forthcoming than they do from temporary and ultimately unsustainable price reductions. Consistent with this analysis, proper consideration of the criterion should stress the consumer interest in providing continued incentives for efficient investment.

Legitimate business interests

18. Efficient investment and output, to be sustainable, require that investors be able to expect that prudent outlays will be recouped. This is no more than would occur in a competitive market.
19. The ACCC should therefore explicitly recognise that any decision, in the context of an arbitration, that prevented or unduly impeded all prudently incurred costs from being recouped, would be inconsistent with the statutory criteria.
20. In considering the scope of costs to be recouped, the ACCC should explicitly recognise the need to recoup the costs associated with regulatory constraints such as the access deficit.

Interests of persons who have rights to use the service

21. The interests of persons who have rights to use the service are promoted *inter alia* by ensuring that the service is available as and when required. This again implies that encouraging efficient investment in the service is an important consideration in respect of this criterion.
22. More generally, this criterion should **not** be seen primarily redistributive relative to the legitimate interests of the facility owner – that is, as implying or involving a distribution of a given amount of gain as between the facility owner and the users with rights to use the service. Rather, both facility owners and users have a joint interest in the sustainable and efficient supply of the service and hence in ensuring appropriate incentives for on-going investment. This in turn requires that the outcomes of access arbitrations be consistent with full recovery of prudent outlays.

Efficient operation

23. Consideration of efficient operation ought to be made subject to and within the framework of the overall goal of the legislation. More specifically, efficient operation

should be sought within the confines and constraints imposed by the need to promote welfare over the longer term.

24. As a result, outcomes which secured fuller utilisation of existing assets, but which compromised the longer term renewal of assets, ought to be recognised as being inconsistent with a proper reading of this criterion.

Operational and technical requirements

25. This criterion, in addition to the general considerations recalled by the ACCC, means that account must be taken of any regulatory requirements imposed on the asset owners and on operators that go to issues of safety and service reliability. These notably include Telstra's obligations under the CSG's.
26. A proper interpretation of the criterion therefore requires that the costs and other burdens associated with obligations such as the CSG's be taken into account in an access determination.