VIA ELECTRONIC MAIL

December 12, 2008

Ms. Gloria Blue
Executive Secretary
Trade Policy Staff Committee
Attn: Section 1377 Comments
Office of the United States Trade Representative
1724 F Street, NW
Washington, DC 20508

Re: AUSTRALIA: *U.S. - Australia Free Trade Agreement; WTO Violations -- Reference Paper and GATS Telecom Annex*

Dear Ms. Blue:

Primus Telecommunications Group, Incorporated ("Primus") takes this opportunity to make a submission in response to the request of the Office of the United States Trade Representative ("USTR") for comments pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C 3106, concerning U.S. trading partners' compliance with U.S. telecommunications trade agreements.

Background. Primus is a U.S. based telecommunications company with approximately $1 billion in annual revenues and has subsidiaries operating throughout the world. In Australia, Primus first began operating following its acquisition of Australian-based telecommunications reseller Axicorp. That acquisition allowed Primus to obtain its carrier's license and begin operating in Australia as a fully fledged carrier on July 1, 1997. Primus Telecom in Australia has since grown into one of the larger fixed-line and ISP telecommunications carriers in the country. In Australia, Primus offers a comprehensive range of voice, data, Internet and web hosting products, servicing both residential and business sectors. With annual revenue of $325 million (AUD), Primus is the 4th largest fixed line services carrier in Australia. The Primus network in Australia offers nationwide coverage through a fiber backbone and its own extensive DSLAM network with equipment installed in more than 250 key exchanges across Australia. The network enables Primus Telecom to provide nationwide long distance services and local call Internet access. Primus operates its own fiber network in the five major capital cities in Australia, delivering a range of business direct-connect services including ISDN, frame relay, ATM, telephone line and Broadband DSL, as well as telephone line and broadband DSL services direct to residential customers. Global connectivity is provided through an extensive voice, IP, wireless and ATM network operated by its U.S. parent company.

Telstra is a highly vertically and horizontally integrated telecommunications carrier with not only control and ownership over the copper customer access network monopoly, but it also is the majority shareholder of the major pay TV (cable) network, Foxtel, through which it controls the great majority of commercially valuable pay TV content. In Australia, unlike other countries, the incumbent carrier does not face competition from cable networks and is therefore unique in the manner in which it must be regulated. Further, Telstra remains

one of the most profitable telecommunications companies in the developed world. It dominates almost every communications market in which it operates in Australia and receives annual subsidies from its competitors through universal service levies, even those operating at a loss. It has also received significant governmental subsidies since 1997 and continues to demand more profit, more subsidies and less regulatory supervision. Through imposing excessive access charges for competitors to access essential monopoly services Telstra continues to extract above-economic revenue and significantly restrict the cash flow of its competitors. Telstra captures the bulk of the local industry profit share, with 79% of the share of EBITDA by carrier.[1] The rest of the industry, outside Optus and Vodafone, shares 1% of the local profit share.

Summary of concerns. Primus has serious concerns regarding the ability of competitive carriers like Primus to continue to operate in the Australian telecommunications market. Much of this unease stems from the Australian Government's current conduct of a tender process for the roll-out and operation of a national broadband network ("NBN"). In its 2008 Section 1377 Review, the USTR commented that the critical determinant of competitive opportunities in Australia's telecommunications market will be transparency in relation to Australia's selection of a winning bidder to operate a state-subsidized NBN. The USTR also noted the critical importance of associated open access obligations.

At this time it's not clear that the process will be truly open and transparent. On the face of the relevant tender documentation it seems the process to award the successful bidder the construction and operation of the NBN will be conducted "behind closed doors" without any industry visibility or consultation. It is also of concern that the principal regulator (ACCC) has been relegated to a minor commenting role in the process. This plays straight into Telstra's hands, and is particularly concerning given the NBN will dictate the ability of carriers like Primus to participate and compete in the communications industry for a generation to come. Any ill-considered, misinformed or arbitrary decisions in connection with the deployment of the NBN could clearly destroy any prospect for an open and competitive communications industry in Australia. It is alarming the outcome could be negotiated "behind closed doors" given that Telstra has been touted as having the inside running to win the tender and has run a long standing campaign to usurp competition, and has specifically requested the that if it constructs the NBN it requires the roll-back of regulation, a move away from cost-based pricing, an ability to discriminate in respect to services provided over the NBN, and increased flexibility over pricing.[2]

Primus also notes the construction of the NBN will lead to the stranding of network assets owned and operated by Primus and other participants in the industry. Primus has invested in these network assets over the course of the last 10 years in response to the Government's encouraging infrastructure investment as a means to deliver competition to Australian consumers. The stranding of these assets, and the associated detrimental impact on competition, was the motivation initially underlying Telstra's NBN proposals stemming

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[1] ACCC Telecommunications Market Indicator Report 2005-06, August 2007, p.4. http://www.accc.gov.au/content/item.phtml?itemId=794173&nodeId=10ddddaa662b4614c52f4f68236d8a51&fn=Telecommunications%20market%20indicator%20report%202005-06%20(released%20August%2007).pdf

[2] *See* Telstra summary of specific regulatory proposals: Telstra, *Public submission on the roll-out and operation of a National Broadband Network for Australia*, June 25, 2008, pp 20-21.

back to 2005.[3] That plan was intended to ensure the new network bypassed competitor's equipment (located in metro exchanges), essentially seeking to regain a monopoly hold on fixed line services in Australia. This remains Telstra's driving motivation.

Now that a publicly subsidized "replacement network" is contemplated, carriers that made investments should, at a minimum, be allowed to recover a reasonable rate of return on those investments. In the absence of that assurance, Primus submits that carriers should be financially compensated. Primus has not yet received any indication or assurance from the Government that it will even be consulted on the treatment of its assets that are likely to be rendered redundant. Primus would expect to be consulted in connection with the treatment of these assets and the transition path for the migration of Primus customers from the Primus network and equipment to the NBN. This lack of assurance around the consultation raises a real threat to the care, management and retention of Primus' customers. Consultation with industry participants is critical in order to ensure an agreeable and seamless transition that does not disrupt or compromise service to customers. Industry participants should also have an opportunity to inform decisions around redundancy of their equipment and associated compensation arrangements.

Apart from consideration of the NBN, and despite previous findings by the USTR, the Australian Government has yet to take any decisive action to address the recognized failure of the current regulatory regime. In its 2008 Section 1377 Review, the USTR identified concerns involving the lengthy access pricing process (which in respect to each contract period can take years to resolve) and also concerns involving co-location - in particular delays and denials by Telstra in relation to access seekers' installing equipment in public telephone exchanges. The current practices remain totally inconsistent with obligations to ensure industry participants such as Primus are provided with timely and reasonable access to the monopoly network components. In short, Primus submits that the telecommunications regulatory regime continues to fail to deliver on expectations of reasonable and non-discriminatory terms and conditions of access and interconnection.

Primus provides further details below in relation to these issues and requests the USTR to review these matters against Australia's obligations under the U.S.-Australia Free Trade Agreement ("FTA") and its WTO commitments made in the 1997 WTO Basic Telecommunications Agreement ("GATS Telecom Annex") and Reference Paper on Pro-Competitive Regulatory Principles ("Reference Paper").

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[3] Speech by Michael Egan, Chairman of TERRiA, July 24, 2008. http://www.terria.com.au/www/488/1001127/displayarticle/24th-july-2008-telstra-against-the-world--1001378.html ; See also *Minister must read between the lines of Telstra claims*, December 8, 2008, *The Australian*. http://www.theaustralian.news.com.au/business/story/0,28124,24764448-5014253,00.html

THE NBN AND THE POTENTIAL FOR VIOLATIONS OF THE U.S.-AUSTRALIA FREE TRADE AGREEMENT AND THE GATS TELECOM ANNEX AND REFERENCE PAPER

On April 11, 2008 the Australian Government issued a Request for Proposals to Roll-out and Operate a National Broadband Network (NBN) for Australia (the "RFP").[4] The RFP was issued with a view to inviting interested parties to tender for the establishment and operation of a NBN that delivered broadband speeds of 12 Mbps to 98 per cent of Australian homes and businesses. The Government also specified an objective that the NBN use fiber-to-the-premises (FTTP) or fiber-to-the-node (FTTN) architecture.

In its RFP the Australian Government specified 18 objectives for the NBN,[5] including objectives that the NBN continue to promote the long-term interest of end-users and facilitate competition through open access arrangements that ensure equivalence of price and non-price terms and conditions, and provide scope for access seekers to differentiate their product offerings. The RFP also set out the following six evaluation criteria:

1. the extent to which the Proposal meets the Commonwealth's objectives for the NBN project;

2. the capacity of the Proponent to roll-out, maintain, upgrade and operate the network;

3. the nature, scope and impact of any legislation and/or regulatory changes that are necessary to facilitate the Proposal;

4. the cost to the Commonwealth of the Proposal;

5. the acceptability to the Commonwealth of the contract terms and conditions proposed by the Proponent and the extent to which the Proposal departs from the Commonwealth's notified commercial terms (if any); and

6. the extent of the Proponent's compliance with the RFP.

The closing date for bids to establish the NBN was initially set as July 25, 2008. At the time of releasing the RFP the Government recognized that construction of an NBN for Australia would necessitate interconnection with current network infrastructure, and in particular the customer access network (CAN) which is under the control of Telstra. The Government sought relevant network information from the industry to assist proponents in the preparation of bids. This information was largely provided voluntarily, however due to

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[4] http://www.dbcde.gov.au/__data/assets/word_doc/0005/86072/Request_for_Proposals_-_DCON-08-18.doc

[5] See page 5, http://www.dbcde.gov.au/__data/assets/word_doc/0005/86072/Request_for_Proposals_-_DCON-08-18.doc

delays and complications in obtaining key network information from Telstra the deadline for lodgment of bids was subsequently revised to November 26, 2008.

Separately, the Government also invited industry submissions on the regulatory issues relevant to the NBN. Those submissions were requested by June 25, 2008. Primus made a submission and it is notable that most submissions identified competition concerns from the current industry structure and advocated a structurally separated ownership of the new NBN.[6] They largely proposed a structure where the owner/operator of the new network did not have any retail interests, therefore removing the incentives and ability to discriminate that currently exist and are routinely exercised by Telstra today. Most industry participants and commentators see the evolution of the NBN as a perfect opportunity to create a level playing field for competition in Australia. However, since filing of those submissions there has been no further engagement or interaction by the Government on the necessary and appropriate regulatory settings.

Primus understands five legitimate bids to establish the NBN were lodged by the appointed closing time on November 26, 2008. Three national bids, and two regional bids. The national bids were a TERRiA[7]-backed Optus bid, a bid by Acacia (a syndicate of largely former Telstra executives),[8] and a bid by AXIA (a Canadian based company with fiber deployments in Europe and Canada).[9]

Primus has publicly endorsed the TERRiA-backed Optus bid to establish and operate the NBN, and is a founding member of the TERRiA consortium of industry participants which sought to lodge its own bid. Ultimately TERRiA did not lodge a bid, but publicly supported the Optus bid on the basis that it offered a structurally separated outcome where the owner and operator of the NBN will not have incentives to favor one access seeker over any others.[10] Primus also has an option of acquiring a minority shareholding in the Optus bid vehicle, Optus Networks Pty Ltd.

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http://www.dbcde.gov.au/communications_for_business/funding_programs__and__support/request_for_submissions_on_regulatory_issues/submissions/Primus_Telecom.pdf. Access to other regulatory submissions is also available at this link.

[7] TERRiA is a consortium of major infrastructure-based telecommunications companies that currently provide independent and competitive National Broadband Network (NBN) services in Australia. The companies initially represented were AAPT, Soul, Transact, iinet, Internode, Macquarie Telecom, Optus and Primus Telecom. They share a common belief that all Australian's deserve fair and affordable access to high-speed broadband services. This necessitates the building of an open network that offers equal access to all companies using this infrastructure. This will ensure that no one company has an unfair advantage over its competitors and that there is a genuinely level playing field. *See* http://www.terria.com.au/

[8] http://www.australianit.news.com.au/story/0,24897,24710253-15306,00.html
Australian IT article: Acacia confirms national NBN bid- Fran Foo, November 26, 2008.

[9] http://www.australianit.news.com.au/story/0,24897,24780196-5013041,00.html
Australian IT article: Axia shows its NBN hand- Mitchell Bingemann, December 11, 2008.

[10] Speech by Michael Egan, Chairman of TERRiA, July 24, 2008.
http://www.terria.com.au/www/488/1001127/displayarticle/24th-july-2008-telstra-against-the-world--1001378.html *See also* Optus /TERRiA press release dated November 26, 2008.

The two regional bids were by the Tasmanian Government addressing the island of Tasmania, and a bid from TransACT, a network and retail services provider based in Canberra that has bid to address the Australian Combined Territory.

Telstra did not lodge a bid to establish the NBN but rather submitted a statement it referred to as a proposal of what would be achieved by a fully detailed bid that Telstra had prepared but *did not* submit.[11] The Government has subsequently interpreted Telstra's proposal as a conforming bid.[12] This has caused some confusion and outrage amongst commentators and industry leaders in Australia, with the position expressed by the Government seeming to be quite contrary to the views held by many in Australia that Telstra's proposal falls well short of a genuine and credible bid for establishing the NBN and that Telstra should be removed as a participant from the tender process.[13]

The bids are to be examined by an independent Expert Panel, which was appointed earlier in the year by the Government.[14] The role of the Australian Competition and Consumer Commission (ACCC), Australia's federal economic regulatory body, has been relegated merely to provide a report to the Expert Panel to assist with its consideration of the bids. The Expert Panel will make recommendations to the Government in respect to the bid(s) it considers offer the best value for the money, with expectations that these should be the bids further examined by the Government. It is expected the Government would then seek to negotiate with the recommended bidders and to agree to terms and conditions for the establishment and operation of the NBN.

Telstra has sought to unsettle the NBN process from its inception, engaging in conduct including:

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[11] *See* Press release from Telstra dated November 26, 2008.
http://www.telstra.com.au/abouttelstra/media/announcements_article.cfm?ObjectID=44024

[12] http://www.zdnet.com.au/news/communications/soa/Govt-will-consider-Telstra-s-bid/0,130061791,339293515,00.htm
ZDNet.com.au article: Govt will consider Telstra's bid- Suzanne Tindall, November 27, 2008.

[13] http://www.zdnet.com.au/news/communications/soa/Telstra-submits-non-compliant-NBN-bid/0,130061791,339293491,00.htm
ZDNet.com.au article: Telstra submits non-compliant NBN bid- Suzanne Tindall November 26, 2008.
http://www.zdnet.com.au/blogs/fullduplex/soa/Dear-Telstra-pack-up-your-toys-go-home/0,139033349,339293507,00.htm?feed=pt_donald_mcgauchie
ZDNet.com.au article: Dear Telstra: pack up your toys, go home, November 26, 2008.
http://service.ecast.net.au/view/?ecast=10fd04aeeff9c5afec9bfecf98fdebd6fa925010
Communications Day article: Telstra fails to lodge full NBN RFP bid, offers non-compliant proposal instead.

[14] http://www.minister.dbcde.gov.au/media/media_releases/2008/016
Speech by Minister for Broadband, Communications and the Digital Economy, Senator the Hon Stephen Conroy.

- delays in providing network information (which compromised the ability of bidders to prepare a detailed bid);[15]
- threatening the Government that it would not participate in the process unless the Government ruled out the possibility of more stringent open access obligations;[16]
- repeatedly threatening legal action against the Government and industry participants in the event the Government was to award the construction of the NBN to someone other than Telstra;[17] and
- a national PR campaign designed to belittle the ability of alternative bidders and unsettle confidence in those other bidders.[18]

Even the Telstra Chairman, Donald McGauchie, has engaged in spreading misinformation and innuendo in an attempt to undermine other bidders and mislead the public and commentators into believing that Telstra is the only company capable of building and operating an NBN.[19]

Some significant concerns have since emerged in relation to the NBN process. Chief among these is the real prospect that the eventual outcome will be negotiated and agreed "behind closed doors" without any industry visibility or consultation. This is alarming given the potential consequences that the NBN decision could have for the industry in Australia, and indeed the national interest. The RFP permits the Government to overrule the recommendations of the independent Expert Panel and the Federal regulatory body, the ACCC, and reach its own "deal" in awarding the NBN. This plays into the hands of Telstra, which has a reputation for "horse trading" and unfairly imposing itself in such "back room dealings." This raises the risk of a "political outcome," where objectives are traded-off without reference to the Expert Panel or the ACCC, and where the substantive assessment and decision-making takes place completely "behind closed doors." At this time it appears the NBN process will not accommodate any transparency or provide for any industry consultation in relation to the bids. Nor is it clear the Government intends providing any consultation in respect to the migration of services to the NBN, and the impending redundancy of network equipment currently owned and operated by industry participants including Primus. These are critical decisions impacting Primus' customers, network

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[15] http://www.itnews.com.au/News/76617,conroy-delays-deadline-for-national-broadband-network.aspx
iT News article: Conroy delays deadline for national broadband network- Mitchell Bingemann, May 22, 2008.

[16] http://www.theaustralian.news.com.au/story/0,25197,24614456-5013404,00.html
The Australian article: Telstra warns of network pullout- Jennifer Hewett and Michael Sainsbury November 7, 2008.

[17] http://www.australianit.news.com.au/story/0,24897,21349152-15320,00.html Australian IT article: Telstra broadband lawsuit threat- Glenda Korporaal, March 9, 2008.

[18] http://www.telstra.com.au/abouttelstra/media/announcements_article.cfm?ObjectID=44042
http://www.telstra.com.au/abouttelstra/media/announcements_article.cfm?ObjectID=43664

[19] http://www.atug.com.au/NBNUpdates/p080625219.pdf
Response from Michael Egan, Chairman, TERRiA to Telstra Chairman Donald McGauchie's presentation, *"It's time to get serious about Australia's Next Generation Network"*
http://www.australianit.news.com.au/story/0,24897,24736146-5013641,00.html

operations and economic viability, and in our view Primus and other similarly situated market participants should be entitled to inform the process and decisions.

Another major concern is that it's not clear yet what the Government seeks to achieve in terms of "open access" for the NBN. Telstra has made clear that its view of "open access" does not provide for the "genuine" open access that the rest of the industry requires in order to compete on a fair and level footing with Telstra's retail business. It is telling to note the response from Mr. David Quilty, Telstra's Group Managing Director, Public Policy and Communications, at a Senate Committee hearing held recently in Canberra. Mr. Quilty was asked why so many industry participants favored structural separation. Mr. Quilty immediately quipped, "Because it is in their interests."[20] That goes to the heart of the industry's concern. It is in the interests of the competitive communications industry – and ultimately to all consumers in Australia - that the Government put in place a regulatory regime that removes the incentive and ability for Telstra to discriminate in favor of its own retail operations. It is the view of Primus that only genuine no-conflict "open access" can deliver the competition and innovation benefits that consumers value. The essential feature of that network must be "independence" - independent ownership and independent operation, through an ownership structure that truly drives competition, and delivers the real benefits of competition to consumers. Telstra has proved a reluctant and begrudging wholesaler, lacking inclination or incentive to deliver open access. Consumers and the national interest have suffered because of this, with consumers paying inflated prices for telecommunications services compared to the rest of the world.[21]

We urge the USTR to consider and to monitor developments in relation to the NBN to ensure that the Australian Government complies with its FTA obligations. In this regard, we note some particular concerns regarding FTA obligations.

FTA ARTICLE 12.2: ACCESS AND USE

1. *Each Party shall ensure that enterprises of the other Party have access to and use of any public telecommunications service, including leased circuits, offered in its territory or across its borders, on terms and conditions that are reasonable and non-discriminatory (including with respect to timeliness), such as those set out in paragraphs 2 through 5.*

2. *Each Party shall ensure that such enterprises are permitted to:*

   (a) purchase or lease, and attach terminal or other equipment that interfaces with a public telecommunications network;

   (b) provide services to individual or multiple end-users over leased or owned circuits;

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[20] *See* page 12, http://www.aph.gov.au/Senate/committee/broadband_ctte/hearings/111108_hansard.pdf Proof Committee Hansard, Select Committee on National Broadband Network, November 11, 2008.

[21] http://www.abc.net.au/worldtoday/content/2007/s2103534.htm
Transcript from ABC Radio – Telstra Lobby Group Pushes for Reform, November 28, 2007.

(c) connect owned or leased circuits with public telecommunications networks and services in the territory, or across the borders, of that Party, or with circuits leased or owned by another enterprise;

(d) perform switching, signaling, processing, and conversion functions.

FTA ARTICLE 12.3: INTERCONNECTION

1. *Each Party shall ensure suppliers of public telecommunications services in its territory provide, directly or indirectly, interconnection with the suppliers of public telecommunications services of the other Party.*

... ...

FTA ARTICLE 12.11: INTERCONNECTION

1. Each Party shall ensure that major suppliers in its territory provide interconnection for the facilities and equipment of suppliers of public telecommunications services of the other Party:

(a) at any technically feasible point in the major supplier's network;

(b) under non-discriminatory terms, conditions (including technical standards and specifications), and rates;

(c) of a quality no less favorable than that provided by such major suppliers for their own like services, for like services of non-affiliated service suppliers, or for their subsidiaries or other affiliates;

(d) in a timely fashion, on terms, conditions (including technical standards and specifications), and cost-oriented rates, that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that suppliers seeking interconnection need not pay for network components or facilities that they do not require for the service to be provided; and

(e) on request, at points in addition to the network termination points offered to the majority of users, subject to charges that reflect the cost of construction of necessary additional facilities.

In conducting the NBN tender process, the Australian Government should be required to comply with its obligations under Article 12.2, Article 12.3, and Article 12.11 of the FTA. The Government has stipulated as an objective that the NBN use FTTN or FTTP architecture. In deploying an FTTN network, the successful bidder will require access to the customer access network (CAN), which is controlled by Telstra. This access will be needed for the purposes of interconnection (the cutover of active services at the nodes to the new fiber

network), and lease of the last mile of copper (from nodes to customer premises) in order to provision services to consumers.

Telstra has made clear that it will object to providing interconnection. In this respect Telstra has threatened that it will use legal action to delay and frustrate access to "sub-loops" if the NBN were awarded to someone other than Telstra.[22] This raises the prospect that the successful bidder could be tied up in court for many years, and have to expend considerable sums, before they are in a position to initiate roll-out and operation of the NBN.

As noted above, Primus has an option to acquire a minority shareholding in the Optus bid vehicle. However, Telstra has engaged in conduct specifically designed to unsettle the prospects for success of that and other bids. Primus is concerned that Telstra will use this tactic to jeopardize the Government's NBN tender process. The various competing FTTN bids are reliant on access and interconnection to the CAN, which was vested by the Government to the control of Telstra.

Primus has contributed in capital and kind to the TERRiA-backed Optus bid, has membership on the Optus bid Advisory board, and has an option to acquire a minority shareholding. Primus remains concerned however that Telstra will not honor its access obligations in the event that bid was successful, essentially compromising the bid. The Australian Government has an obligation to ensure that enterprises (such as Primus or other prospective bidders) have access to, and use of, the CAN. This obligation extends to ensuring Telstra provides necessary interconnection. If there is any doubt about these access and interconnection rights, as currently argued by Telstra, then in our view they are best addressed by the Australian Government passing legislation that ensures the necessary interconnection and access rights are going to be made available to the successful bidder.

Primus is particularly concerned that a lack of assurance to date about these access rights undermines the credibility of the TERRiA-backed Optus bid. Some of Telstra's arguments are gaining traction in the media and among the public, and there is a risk that Telstra's threat to block others from building the NBN may be seen by relevant advisers and decision-makers as an unnecessary complexity associated with any bids not supported by Telstra.

Irrespective of who owns and operates the NBN, industry participants, including Primus, will seek access to that network. As noted below, in establishing those access rules it is critical to ensure Telstra does not seek to negate its access and interconnection obligations. In the view of Primus these access obligations naturally extend to sub-loop access (ie. at nodes), and it remains incumbent on the Government to confirm that those rights of access exist, and to place these obligations beyond doubt and beyond the reach of any vexatious legal actions that Telstra may be considering. These obligations apply irrespective whether Primus wishes to access or interconnect with the current network or the new NBN. Telstra should not be permitted to muddy these obligations.

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[22] http://www.australianit.news.com.au/story/0,24897,21349152-15320,00.html
Australian IT article- Telstra Broadband Lawsuit Threat, Glenda Korpooral, March 9, 2007.

We urge the USTR to bring this concern to the attention of the Australian Government. Primus requests that this issue be addressed through confirmation by the Government that it will support competitive access and interconnection to the CAN, be that as Primus in its capacity as an access seeker and competitor in the retail market, or in its capacity as a potential NBN bidder. Primus submits the Government should introduce legislation to clarify any doubts or risks in relation to this access

FTA ARTICLE 12.9: RESALE

1. *Each Party shall ensure that major suppliers in its territory:*

   (a) offer for resale, at reasonable rates, to suppliers of public telecommunications services of the other Party, public telecommunications services that such major supplier provides at retail to end users that are not suppliers of public telecommunications services; and

   (b) do not impose unreasonable or discriminatory conditions or limitations on the resale of such services.

FTA ARTICLE 12.7 : TREATMENT BY MAJOR SUPPLIERS

Each Party shall ensure that major suppliers in its territory accord suppliers of public telecommunications services of the other Party treatment no less favorable than such major suppliers accord in like circumstances to their subsidiaries, their affiliates, or non-affiliated service suppliers, regarding:

(a) the availability, provisioning, rates, or quality of like public telecommunications services; and
(b) the availability of technical interfaces necessary for interconnection.

.....

Each Party shall maintain appropriate measures for the purpose of preventing suppliers who, alone or together, are a major supplier in its territory from engaging in or continuing anti-competitive practices, including in particular:

(a) engaging in anti-competitive cross-subsidization;

FTA ARTICLE 12.8 : COMPETITIVE SAFEGUARDS

Each Party shall maintain appropriate measures for the purpose of preventing suppliers who, alone or together, are a major supplier in its territory from engaging in or continuing anti-competitive practices, including in particular:

(a) engaging in anti-competitive cross-subsidization;

(b) using information obtained from competitors with anti-competitive results; and

> *(c) not making available, on a timely basis, to suppliers of public telecommunications services, technical information about essential facilities and commercially relevant information that are necessary for them to provide services.*

FTA ARTICLE 12.17 : INDEPENDENT REGULATORY BODIES AND DIVESTMENT

> *Each Party shall ensure that any telecommunications regulatory body that it establishes or maintains is independent and separate from, and not accountable to, any supplier of public telecommunications service.*

Primus also urges the USTR to monitor and ensure the Australian Government is cognizant of its obligations under Article 12.9, Article 12.7, Article 12.8 and Article 12.17. In particular Primus notes Telstra's intention to construct an NBN that undermines competition, and the lack of transparency surrounding the conduct of the process in relation to the terms on which access to the NBN will be made available to industry participants.

As noted above, it appears at this time that industry participants will not be given visibility of the conditions Telstra or other bidders would attach to the NBN roll-out if they were the successful bidder. This lack of transparency would apply to matters such as the points of interconnection, the nature of services that will be made available over the NBN, and the prices (and non-price terms) that will attach to the NBN access services. These are matters that significantly affect the business operations of industry competitors, to the extent that any misinformed decisions can destroy the business plans and the competitive potential for participants in the industry. This is particularly alarming given that in its 2008 Section 1377 Review, the USTR suggested that the critical determinant of competitive opportunities in Australia's telecommunications market will be transparency in relation to Australia's selection of a winning bidder to operate a state-subsidized national broadband network. The USTR also noted the critical importance of the associated open access obligations.

Telstra has made it clear that if it were to establish the NBN it would require the following pre-conditions:

(a) a specific guarantee that services on the NBN will be excluded from the current regulations.
(b) that it would only be obligated to provide access to a limited set of "anchor products." These are the legacy services it provides today – it would have no obligation to provide new services;
(c) that it should have freedom to set wholesale prices based on "value" not "cost"; and
(d) there would be no restrictions on Telstra discriminating between the prices and delivery of both wholesale and retail services.[23]

Telstra has been touted often as most likely to be awarded the right to construct and operate the NBN. This misconception is grounded in an orchestrated and misleading public relations campaign by Telstra that sought to position it as the only contender capable of

[23] As reported by the Select Committee, NBN, Interim Report, December 2008 at page 24.

constructing the NBN.[24] If however, Telstra were successful and managed to negotiate any of the conditions above that it seeks, it would clearly have disastrous ramifications for competition and competitors such as Primus. Indeed, if the Government succumbed to Telstra on these conditions it would totally decimate the ability of Primus and others to remain in the industry.

Telstra has repeatedly made it very clear that its view of "open access" will not deliver the level playing field and non-discriminatory access that would be achieved under a structurally separated outcome. It is therefore alarming that the Government could ultimately engage in "closed door" negotiations with Telstra (or for that matter any bidder) and agree to conditions attached to the establishment and operation of the NBN without any consultation with the wider industry, or without any independent oversight by the ACCC, the expert regulatory body that was created to make decisions and advise on these matters. The neutralization of the ACCC in the NBN process is in many ways a violation of the Australian Government's commitment in Article 12.17 to have an independent regulator that oversees telecommunications issues.

As previously advised to the USTR, in 2005 Telstra sought to roll-out a FTTN network and circumvent the regulatory body responsible for oversight of these matters by lobbying the then Minister for Communications, Helen Coonan "behind closed doors." Telstra sought a compact in connection with the roll-out of a FTTN network that would dispense with the regulatory regime (and was intended to destroy facilities-based competition which at that stage was taking a foothold in the market). Despite substantial protest from industry participants and commentators, Telstra very nearly succeeded. Ultimately, under considerable pressure, at the last minute Telstra was denied its request to circumvent the ACCC. It is therefore particularly troubling that some years later the new Government of the day has now issued an RFP that has again created an opportunity for Telstra to conduct those "behind closed door" negotiations. The rest of the industry will potentially have no visibility of the "deal" reached until the terms of the successful tender are publicly announced.

In the view of Primus, any decisions around the NBN should be conducted on a transparent basis and determined in consultation with industry participants and appropriate regulatory oversight, who are uniquely placed to inform the decision making process. These matters should not be determined "behind closed doors," as the associated decisions in relation to network architecture and access services will significantly impact the ability of carriers such as Primus to compete in the future, and have the potential to completely decimate competition. This closed process, and Telstra's clear and intended abuse of the process,[25] would violate the Australian Government's FTA obligations regarding competitive safeguards and the provision of resale in a reasonable and non-discriminatory basis. We urge the USTR to bring these matters to the attention of the Australian Government. We believe the process needs to be open and transparent. We also seek to ensure that the

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[24] *Minister must read between the lines of Telstra claims*, December 8, 2008, *The Australian.* http://www.theaustralian.news.com.au/business/story/0,28124,24764448-5014253,00.html *See also, Same old Song from Don and his broad band,* Australian IT, December 2, 2008, http://www.australianit.news.com.au/story/0,24897,24736146-5013641,00.html

[25] *See, e.g., Telstra execs are Labour MPs in disguise*, ZDnet, September 20, 2007. http://www.zdnet.com.au/news/communications/soa/Telstra-execs-are-Labor-MPs-in-disguise-Coonan/0,130061791,339282245,00.htm

protection of competition and the provision of access on a reasonable and non-discriminatory basis remain paramount considerations. In our view, based on 10 years of experience in the Australian telecommunications industry, only a structurally separated ownership model for the NBN is capable of protecting and enhancing competition in the retail telecommunications market.

ACTS, POLICY OR PRACTICE CITED IN A PREVIOUS SECTION 1377 REPORT

The USTR has previously noted shortcomings of the Australian regulatory regime. For example, in its 2008 Section 1377 Review the USTR identified concerns around the lengthy access pricing process (which in respect to each contract period can take years to resolve) and co-location - in particular delays and denials by Telstra in relation to access seekers' installing equipment in public telephone exchanges.

Those complained of practices remain unaltered and are totally inconsistent with treaty obligations to ensure industry participants such as Primus are provided with timely and reasonable access and access pricing in respect to monopoly infrastructure and services. The Australian Government has yet to take any decisive action to address the recognized failure of the current telecommunications regulatory regime. This is despite previous clear evidence of that failure, repeated requests from industry participants and commentators, and the previous findings by the USTR. Some of the issues that have been raised previously, and that remain key impediments to fair and reasonable access and competition in the Australian industry concern:

- **The failure of the negotiate-arbitrate model.** FTA requirements of Article 12.10, Section 5 of the GATS Telecom Annex specifically mandate governments ensure local leased lines and unbundled network elements be available on reasonable and non-discriminatory terms and conditions. The negotiate-arbitrate model in Australia has proved a clear failure, with genuine negotiation totally absent from the process, and the conduct of the arbitrations themselves subject to considerable delay and expense. Final Determinations can take many years to obtain, and in the experience of Primus, due to these lengthy delays determinations largely apply retrospectively. Even the retroactive economic relief is not fully compensatory as Telstra only "reimburses" the access seeker the unreasonable costs it had "confiscated" in the interim with a base interest component. In effect, the current regime forces access seekers to, in effect, make Telstra an involuntary "loan" at interest levels materially below Telstra's average weighted cost of capital (and substantially below that of the access seekers). The regulatory regime does not provide the certainty that industry participants need for planning and marketing purposes. Primus currently has three arbitrations before the ACCC. This includes a line sharing service (LSS) pricing dispute tabled in January 2008, and an unconditioned local loop service (ULLS) pricing dispute tabled in May 2008. These disputes had been lodged to obtain pricing to apply from January 2008 (LSS) and June 2008 (ULLS). At this time the arbitrations have not progressed to a stage where the ACCC has yet to request submissions on the appropriate pricing. Primus is not hopeful of a timely resolution. This lack of certainty about pricing, and the need for each industry

participant to file an individual dispute against Telstra in respect to each service it acquires leads to an unduly lengthy and expensive process. The arbitrations are also very legalistic in nature. The regime has failed dismally and Primus petitions the USTR to raise with the Australian Government - again - the importance of reasonable and timely access to network infrastructure and services. In our view the current regime should be replaced with a process of industry inquiry that establishes forward looking prices. This is the type of process that occurs with the energy industry in Australia, as applied by the Australian Energy Regulator, a constituent body of the ACCC. It's unclear why the Australian Government has not already revised the telecommunications regime in light of its clear failings to date.

- **Telstra's denial of access to exchanges** to deploy DSLAM equipment – in breach of FTA Article 12.11, which mandates interconnection. While the ACCC has examined the practice and taken some steps to improve transparency, through introducing what is referred to as record keeping rules, anticompetitive delays and misinformation still burden the process. Following on from the review conducted last year by the USTR and consequent closer attention by the ACCC, Telstra revisited its list of "capped exchanges."[26] These are exchanges where Telstra had purportedly advised there was no room for access seeker equipment to be installed. As a result of that review many more exchanges were reclassified as open for installation of the equipment. To date Telstra has not been required to compensate industry participants for the impact on their businesses. It is concerning that delays and inefficient build processes still govern the deployment and installation process.[27]

- **Telstra's use of speculative and vexatious legal challenges**. As previously described, the current regulatory framework allows Telstra to misuse the judicial system in pursuing speculative legal actions designed to jeopardize regulatory proceedings, delay regulatory outcomes, impose costs upon industry participants, and undermine investor and industry confidence. This conduct persists. Currently, Primus is awaiting judgment on two appeals by Telstra against ACCC arbitrations, and is awaiting costs to be repaid in relation to two matters decided earlier in the year where the court found against Telstra. Primus is also currently locked in three arbitrations with Telstra. Primus considers this symptomatic of Telstra's reluctance to provide wholesale services to access seekers. Telstra is fully aware that the easiest way to protect its current margins and meet its extraordinary EBITDA objectives is to impede and deter competition through abuse of the regulatory and judicial systems.

- **Addressing Telstra's market power.** Telstra is a highly vertically and horizontally integrated telecommunications carrier with not only control and

[26] Letter from Telstra to Ravi Bhatia, dated April 11, 2008.
[27] By way of example, in May 2008 Primus sought permission to deploy equipment in the Richmond exchange. At this time Primus has no indication as to whether, and when, that request will be accepted. Similarly with the Ashfield exchange, where Primus submitted a request to deploy equipment in June 2008 and still awaits a decision on that request.

ownership over the copper customer access network monopoly, but it also is the majority shareholder of the major pay TV network, Foxtel, through which it controls the majority of pay TV content. In Australia, unlike other countries, the incumbent carrier does not face competition from cable networks and is therefore unique in the manner in which it must be regulated. Further, Telstra is one of the most - if not the most - profitable telecommunications companies in the world. This market power – and its concomitant abuse - has not been addressed in any way. Telstra has 80% of the Australian broadband market share, which puts it well above the market share held by any other incumbent around the world.[28] It also captures the bulk of the local industry profit share, with 79% of the share of EBITDA by carrier. Based on its market power and control over bottleneck infrastructure Telstra continues to thrive in the wholly ineffective regulatory approach adopted in Australia. Primus submits that for the benefit of competition and long-term consumer interest the regulatory regime must be reformed to address Telstra's market power.

- **The failure of operational separation.** Due to Telstra's intense lobbying, Australia's current so-called "operational separation plan" is woefully inadequate, and allows unmitigated abuse by Telstra of its market position to provide anti-competitive favorable terms to its affiliates in the various markets in which they compete. The outcomes have now been proven and the regime has proved completely ineffective and unenforceable. Despite regular allegations of Telstra misconduct, the competitive industry has now completely dismissed the operational separation plan as being wholly ineffective. The ACCC has also criticized the regime as ineffective over the course of 2008.[29] Senator Conroy, the Minister responsible for telecommunications has himself been critical of the regime, calling it flawed.[30] Yet despite this criticism, the Department responsible for the administration of the operational separation plan remains unwilling to rectify those failings. Primus considers this an unacceptable state of affairs and petitions the USTR to request the matter be given immediate attention by the Government of Australia.

The structure of the telecommunications industry in Australia, with the overwhelming dominance of Telstra, serves as an impediment and clear disincentive to open and fair competition. Telstra has no incentive to promote non-discriminatory access to access seekers. Firm and fair regulatory intervention is required.

As previously communicated, the USTR is encouraged to advocate that the Australian Government give serious consideration to its WTO and FTA obligations to ensure local leased lines and unbundled network elements are available on reasonable and non-discriminatory terms and conditions, and consider better alternatives to the current negotiate-arbitrate model. The current negotiate-arbitrate model has only served to expose US-owned

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[28] http://www.fairgobroadband.com.au/NBN-viewpoint.htm

[29] ACCC admits to failure of anti competitive Telstra measures, June 12 2008, Computerworld, Report on Senate Standing Committee, http://www.computerworld.com.au/index.php/id;1414952256

[30] Australian IT, *Labour plans a telecoms revolution*, November 13, 2007.

competitors and access seekers like Primus to unnecessary expense, uncertainty and unwarranted vulnerability.

Furthermore, recognizing the experience and expertise the ACCC has with regard to access pricing for monopoly infrastructure, the USTR should encourage the government to give consideration to empowering that specialist, and independent body, to establish access charges unchallenged, which would lead to a more efficient, timely, and reasonable outcome.

Conclusion. The regulatory regime set out in the *Trade Practices Act 1974* has clearly proven ineffective. This has been clearly demonstrated over the years. The Australian Government should take some immediate steps to improve the competitive environment through better policing and regulation of Telstra's market power. The regulatory environment has not aided competition, and Telstra has thrived, and will continue to unduly thrive, for as long as the Government persists with the inefficient and ineffective regulatory regime currently imposed in Australia.

Further, the Australian Government is now embarking on a new course which also provides a clear opportunity to address those past failings. Critical to the competitive future of the Australian telecommunications industry are the key decisions concerning network architecture, the NBN access services that will be made available, pricing for those services, interconnection points and the associated regulatory regime. In its 2008 Section 1377 Review, the USTR noted that the critical determinant of competitive opportunities in Australia's telecommunications market will be transparency in relation to Australia's selection of a winning bidder to operate a state-subsidized national broadband network. The USTR also noted the importance of associated access obligations. Primus agrees that these decisions must be conducted in an open and transparent manner, by a properly informed and accountable independent body. The future of the broadband industry in Australia and the awarding of a network monopoly should not be determined by private negotiations and "horse-trading" with the Government-of-the-day conducted behind closed doors. Only fully considered and properly informed decisions will protect the competitive environment and deliver the benefits of the broadband age to consumers and the national economy.

In our view it is critical that the USTR exercise the Section 1377 process strongly to encourage the Australian Government to take actions necessary to address the present imbalance and safeguard a future competitive environment for those foreign companies that have committed substantial investments to conducting business in Australia. Primus urges the USTR to review closely the Government's actions in relation to the NBN to ensure that it

honors its FTA obligations appropriately to protect competition and to address the current industry structural and regulatory failings, which presently place businesses like Primus in a disadvantageous position.

Yours sincerely,

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Results of the 2008 Section 1377 Review of Telecommunications Trade Agreements

Introduction

USTR annually reviews the operation and effectiveness of U.S. telecommunications trade agreements and the presence or absence of other mutually advantageous market opportunities, pursuant to Section 1377 of the *Omnibus Trade and Competitiveness Act of 1988*. The Section 1377 Review ("Review") is based on public comments filed by interested parties and information developed in ongoing contacts with industry, private sector, and foreign government representatives in various countries. This year USTR received comments from twelve companies and trade associations and reply comments from six companies, trade associations, and foreign governments. All public comments are posted on the USTR website at http://www.ustr.gov/Trade_Sectors/Telecom-E-commerce/Section_1377/Section_Index.html

Summary of Findings

The 2008 Section 1377 Review focuses on ***specific issues*** in Australia, China, El Salvador, Germany, Guatemala, Jamaica, Mexico, Oman and Singapore and on ***general issues*** of concern with respect to several countries, such as: concerns with regulatory independence and transparency; excessively high mobile termination rates; barriers to the use of Voice over Internet Protocol (VoIP) technology; and concerns with conformity assessment requirements that may create barriers to market entry. The 2008 Review also highlights ***progress*** on two issues cited in previous reviews.

Though several of the issues in the Review have been discussed in past reviews, we have found sufficient evidence to warrant highlighting them again. As some of these issues continue to raise general concerns regarding trading partners' compliance with their trade obligations, the 2008 Review helps to establish a set of issues that USTR will actively monitor throughout the year and on which, if warranted, USTR may take further action.

Discussion of Key Issues

1. Specific Country Issues

Australia – Competitive Access to Major Supplier's Network

For competitive suppliers that are dependent on the network of Telstra (Australia's major supplier) to serve their own customers, Telstra's longstanding efforts to resist network access obligations through legal challenges to the regulator and political pressure on the government continues to create an environment of legal and financial

uncertainty. One current problem is the competitors' inability to install (*i.e.*, "co-locate") their equipment in individual switching centers operated by Telstra exchanges. Other challenges include broader issues, such as the pricing of leased network elements (unbundled copper lines), and Telstra's broad-based constitutional challenge to the regulator's ability to impose almost any access obligation.

With respect to co-location, Australia's regulator, the Australian Competition and Consumer Commission (ACCC), has responded to competitors' complaints by recently initiating an investigation of Telstra's practices. Without access to certain strategically located exchanges, competitors' ability to expand their networks is constrained. Although incumbents throughout the world often assert (as does Telstra) that in many cases they simply do not have additional space for physical co-location, the ACCC should verify such claims and should consider whether Telstra has made a good-faith effort to create space for the co-location of competitors' equipment (*e.g.*, by removing obsolete equipment or restructuring space, etc.) to ensure that such access is not being unreasonably denied.

With respect to the pricing of unbundled copper lines, a key factor for competitive broadband offerings, the ACCC is expected to challenge the tariff Telstra proposed on March 3, 2008, since this tariff simply replicates rates Telstra proposed in 2005 which the ACCC subsequently rejected as too high (a rejection upheld on appeal by an Australian court). This type of lengthy ratemaking, involving submission, rejection, and appeal and possibly arbitration (which often takes years to complete) has come under criticism from competitors as preventing rational investment planning and supporting Telstra's interest in fomenting delay and uncertainty. USTR believes that, as an alternative, the ACCC should consider a price-regulation process that better balances the needs of consumers, incumbent and new providers, including a process advocated by competitors, under which the ACCC would initially impose indicative pricing, to be adjusted as appropriate once ACCC has completed a formal ratemaking.

Regarding Telstra's broad-based constitutional challenge to the regulator's powers to impose access obligations, the ACCC won a ruling before Australia's High Court in March 2007, affirming the ACCC's broad right to regulate. Since this challenge by Telstra threatened Australia's ability to fulfill its telecommunications obligations under the United States – Australia FTA (*e.g.*, it could have denied the regulator the authority to require unbundling of the network), USTR welcomes this decision.

Looking ahead, a critical determinant of competitive opportunities in Australia's telecommunications market will be transparency in Australia's selection of a winning bidder to operate a state-subsidized national broadband network. The access

obligations the government imposes with respect to this network, as well the extent to which the winning bidder can deploy technology of its choice will be important. These decisions are expected this year, and USTR will continue to closely monitor this and the other issues noted above.

China – Impediments to Market Access

High on the list of commenters' concerns in this year's Review are China's capitalization requirements which appear excessive by almost any measure. Though the Chinese government has given numerous assurances from April 2005 to December 2007 that it would significantly reduce these requirements, it has confirmed neither the level of proposed reductions, nor the date on which such reductions would become effective. USTR urges China to expeditiously resolve this issue.

Commenters assert that another barrier to entry is an apparent but unwritten policy that only existing telecommunications licensees in China are eligible to serve as joint venture partners for foreign companies. Given the *de facto* duopoly China currently maintains in each of the fixed, mobile and satellite services sectors (*i.e.*, six basic operators in total), and the reported restructuring of the industry that may further limit the number of facilities-based telecom companies, such a policy would seem to limit joint venture partners to a commercially untenable number. In accordance with China's commitments in its Protocol of Accession to the World Trade Organization, any legally established Chinese company should be eligible to be a joint venture partner with a foreign operator in the telecommunications sector.

Commenters continue to raise concerns about the rules governing the provision of satellite capacity in China. Foreign satellite operators are generally prohibited from signing contracts directly with Chinese telecommunications companies, based on regulations promulgated by the regulator, the Ministry of Information Industries (MII). Instead, foreign satellite operators must first sell the satellite capacity to a domestic satellite operator (SinoSat or ChinaSat, which have recently been merged), who then resells it to telecommunications or broadcast companies in China. In addition to raising costs to foreign operators, this policy relegates foreign operators to the status of backup or secondary source of supply, and prevents them from developing their own customer base. At the same time, it appears that China's State Council has granted at least two foreign satellite operators (in which Chinese operators have minority investments) a "special allowance", which permits the foreign satellite operators to directly offer satellite capacity for domestic services in China. China does not appear to have accorded similar treatment to other foreign satellite operators whose capacity coverage can include China. USTR will monitor this issue to ensure that China is meeting its

IN THE AUSTRALIAN COMPETITION TRIBUNAL

File No 2 of 2008

RE: **APPLICATIONS UNDER SECTION 152AV OF THE TRADE PRACTICES ACT 1974 (THE ACT) FOR A REVIEW OF AN EXEMPTION ORDER DECISION (INDIVIDUAL EXEMPTION ORDER NOS. 1 – 4 OF 2008) MADE BY THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION (COMMISSION) IN RELATION TO TELSTRA CORPORATION LIMITED PURSUANT TO SECTION 152AT(3)(a) OF THE ACT**

BY: **CHIME COMMUNICATIONS PTY LTD**
Applicant

JUDGE: **JUSTICE FINKELSTEIN (PRESIDENT)**
R DAVEY
PROFESSOR D ROUND

DATE OF DETERMINATION: **22 DECEMBER 2008**

WHERE MADE: **MELBOURNE**

THE TRIBUNAL DETERMINES THAT:

The decision of the Australian Competition and Consumer Commission made on or about 22 August 2008 to grant Telstra Corporation Limited the exemption orders set out in appendixes E to H and the class exemption orders set out in appendixes I and J in its decision be set aside.

IN THE AUSTRALIAN COMPETITION TRIBUNAL

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DATE: **22 DECEMBER 2008**

PLACE: **MELBOURNE**

REASONS FOR DETERMINATION

Introduction

1 The provision of telecommunications services in Australia is heavily regulated. Part of that regulation, the establishment of a telecommunications access regime, is contained in Part XIC of the *Trade Practices Act 1974* (Cth). Particular services may be declared and once declared are subject to what are referred to as standard access obligations (SAOs). Two services, the local call service (LCS) and the wholesale line rental service (WLR), were declared in July 2006 (with effect from 1 August 2006). The LCS had previously been declared by the Australian Competition and Consumer Commission (ACCC) in July 1999. These declarations require Telstra Corporation Limited (Telstra) to supply those services over

its ubiquitous copper wire transmission network. By four applications (two in July 2007 and two in October 2007) Telstra sought an order from the ACCC that its provision of those services be exempt from the declarations in 387 exchanges. The applications were, in part, successful. Chime Communications Pty Ltd (Chime) has applied to the Tribunal to review the decision to grant the exemptions. APPT Limited, PowerTel Limited, Agile Pty Ltd, Macquarie Telecom Pty Limited and Primus Telecommunications Pty Limited were given leave to intervene in the review subject to control being maintained over the extent of their participation, and made submissions through Chime. The ACCC appeared to assist the Tribunal.

Background and the Legislation

2 In many key sectors of the economy the privileged position of former State-owned vertically integrated monopolies (the monopoly usually being statute-based) has resulted in market failure. The markets failed because competition was either non-existent or deficient. Firms holding a monopoly position are able to restrict output, reduce the quality of the goods and services they supply, and set prices above marginal cost. Competition laws have been developed to create a competitive environment. But competition laws by themselves do not produce efficiencies where a natural monopoly exists. By a natural monopoly we mean a situation where the entire market demand for a particular service can, due to economies of scale, be served at the least cost by a single supplier and where it is not economically efficient to replicate the facility. Typical examples are railways, ports, airports and telecommunication networks. Each is a so-called essential facility or bottleneck. Competition in natural monopoly markets is, by its very nature, unsustainable. One solution is to impose ex-ante regulation mandating access to essential facilities in order to deliver static and dynamic benefits to consumers.

3 The object of the Part XIC mandatory access regime is to promote the long-term interests of end-users: s 152AB(1). This object is to be achieved by: (a) promoting competition; (b) achieving any-to-any connectivity; and (c) encouraging the economically efficient use of, and investment in, infrastructure by which telecommunications services are, or are likely to become, capable of being supplied: s 152AB(2). Broadly speaking, the access regime operates in the following way. The ACCC may declare a listed carriage service (eg the LCS or WLR) to be a declared service: s 152AL. At the same time, the ACCC must also determine "pricing principles" relating to the price of access to the declared service: s 152AQA. The declaration must be for a period not exceeding five years, but may be extended for a further period of five years: s 152ALA. Once a service is declared the declaration requires the incumbent to supply it in accordance with the SAOs on terms and conditions agreed between it and a firm seeking access to the service. In the absence of an agreement between the incumbent and an access seeker: (a) where the ACCC has accepted an access undertaking from the incumbent, the service must be supplied on the terms and conditions in the undertaking; or (b) where no undertaking has been so accepted, on terms and conditions consistent with the relevant SAOs and pricing principles as arbitrated by the ACCC.

4 The aim of the access regime is to create conditions for improved competition by removing a barrier to entry in an upstream or downstream market that inhibits competition in that market or other markets. Access to the declared services has the capacity to promote either service-based or facility-based competition. Facility-based competition is presumed to be a necessary condition for long-term efficiency because that is when innovation is more likely to occur. Service-based competition is, over the long-term, regarded as merely a stepping stone to facility-based competition.

5 Part XIC accepts that mandated access to the telecommunications network which increases competition in the short term may harm competition in the long term and thus be harmful to end-users. Accordingly, s 152AT allows the provider of a declared service to apply for an exemption from the SAOs. In the first instance that application is made to the ACCC: s 152AT(1). The ACCC must either: (a) grant an exemption from one or more of the SAOs; or (b) refuse the application: s 152AT(3). An exemption may be unconditional or subject to conditions or limitations: s 152AT(5). However, before an exemption order is made the ACCC must be "satisfied that the making of the order will promote the long-term interests of end-users": s 152AT(4).

6 There is a controversy concerning the nature of the power conferred by s 152AT. The issue is whether the ACCC (or the Tribunal when reviewing a decision of the ACCC) is required to make an exemption order upon being satisfied that the order will promote the long-term interests of end-users. The proponent of this view (Telstra) submits, in effect, that the condition described in s 152AT(4) defines the circumstances in which the head of power in s 152AT(3) must be exercised. The alternative position is that the state of satisfaction that is required by s 152AT(4) is simply a condition that must be satisfied before an exemption order is made and the decision-maker is still required to take all relevant considerations into account in deciding whether or not to make an order .

7 The Tribunal is of opinion that s 152AT(4) does not define the manner in which the power in s 152AT(3) is to be exercised. This is clear from the structure of the section, which to some extent is worth repeating. First, a provider of a declared service may apply for an exemption. Second, the ACCC (or the Tribunal) must consider that application. Third, after considering the application the ACCC (or the Tribunal) must: (a) make an exemption order; or (b) refuse the application. To this point no limitation is imposed on the decision-making

power. Nor is there any requirement to take particular considerations into account. Then there is s 152AT(4), which in terms imposes a prohibition upon the making of an exemption order unless the criterion is satisfied. The section is silent on when the order should be made. This structure shows that there is no duty to make an exemption order if the s 152AT(4) criterion is satisfied. First, that is not what s 152AT(3) provides. It would be necessary to rewrite the section to produce that result. Second, the imposition of the supposed obligation would be inconsistent with Parliament's intention to confer a broad power on the ACCC (and the Tribunal) such that each application must be considered on a case by case basis. The Explanatory Memorandum to the Trade Practices Amendment (Telecommunications) Bill 1996 states that "[t]he provision [s 152AT] is drafted in broad terms because ACCC judgments about the giving of an exemption and the precise nature of exemptions given need to be made on a case-by-case basis".

8 Nor can it be accepted, as was put by the ACCC, that the range of factors that it (or the Tribunal) is able to take into account in reaching a decision is "extremely limited". This submission was based on *Re Sydney Airports Corporation Ltd* (2000) 156 FLR 10. There the Tribunal considered the ambit of the Minister's power under s 44H to declare a particular service (in that case an airport) for the purpose of enabling third parties to obtain access to that service. Section 44H(4) sets out six matters which the Minister must satisfy himself of before making a declaration. The Tribunal observed (at [223]) that s 44H(4) "cover[s] such a range of considerations that the Tribunal considers there is little room left for an exercise of discretion if it be satisfied of all the matters set out [therein]". This is especially so when a prescribed matter includes the "public interest". On this aspect, the contrast between s 44H and s 152AT could not be greater. Section 152AT does not specify any matters (save for the s 152AT(4) criterion) which the ACCC (or the Tribunal) must satisfy itself of before making

or refusing to make an exemption order. The matter is otherwise left at large. The matters to be taken into account must be determined by implication from the subject matter, scope and purpose of Part XIC. It follows that it is for the ACCC (or the Tribunal) to determine the appropriate weight to be given to any relevant matter.

The Technology and Services

9 It is helpful to provide a brief overview of the telecommunications technology and the services with which the application is concerned. The traditional telecommunications network (and the one owned by Telstra) is a fixed network to which end-users are connected. It is usually referred to as the public switched telephone network (PSTN). The PSTN is a circuit-switched network which involves an end-to-end physical circuit between the calling party and the called party. It consists of a transmission system (copper or aluminium wires) and switching systems by means of which connections are established between the calling party and the called party. The PSTN is comprised of: (a) the customer access network (CAN) connecting end-users to local exchanges (a local loop); and (b) the inter-exchange network which enables calls to be routed between local exchanges through other exchanges.

10 There are four relevant declared services which Telstra is required to supply over its fixed network. Only two are the subject of the exemption application, the LCS and the WLR. The LCS is a service for the carriage of voice telephone calls from customer equipment (typically a handset) at an end-user's premises to separately located customer equipment of an end-user in the same standard zone. In essence, the service involves the supply of an end-to-end voice grade local call. An access seeker who has access to the LCS is able to resell local calls without the deployment of its own telecommunications infrastructure.

11 The LCS, excluding the provision of it in the central business districts in Sydney, Melbourne, Adelaide, Brisbane and Perth, was declared in July 1999 following the ACCC's enquiry into local telecommunications services. In July 2006 the declaration was continued until 31 July 2009.

12 The WLR is a line rental telephone service which allows an end-user to connect to the service provider's PSTN and provides the end-user with (a) an ability to make an receive 3.1 khz bandwidth calls including local calls, national and international calls; and (b) a telephone number. The WLR is also a resale-based service. The access seeker has no need for its own infrastructure.

13 The WLR service, excluding the central business districts of Sydney, Melbourne, Adelaide, Brisbane and Perth, was declared in July 2006: ACCC, *Local Services Review – Final Decision*, July 2006. The service is declared until 31 July 2009.

14 With both the LCS and WLR, the access provider (the incumbent) provides its retail services on a wholesale basis to a service provider. The service provider places its brand name on the service and promotes the re-branded service to end-users. Competition takes place in the marketing, billing and customer support of the service. There is little, if any, real differentiation in the service itself. End-users will benefit to the extent that service providers compete between each other and against the incumbent to keep the overall price of supplying the service in line with the cost of supply.

15 The remaining two services are the unconditioned local loop service (ULLS) and the line sharing service (LSS). Both are used for the provision of broadband services. Access to broadband is available through a variety of technologies. The first and most commonly used

are digital subscriber lines (DSL) which can convert the standard copper wire network into a high speed digital line with the installation of infrastructure at the network operator's switches. At the switch a digital subscriber line access multiplexer (DSLAM) separates the high speed traffic. The most common form of digital subscriber line is asymmetric DSL (ADSL). Fibre optic cable technology offers speeds potentially in excess of DSL. Currently there is a proposal to roll out a fibre optic national broadband network (NBN). In April 2008 the Federal Government released a request for proposals to roll out the NBN. The request contemplates that the roll out will begin in January 2009 and be made progressively operational over five years. Nonetheless, the timeframe for the commencement and completion of the NBN roll-out is uncertain.

16 At the present time (new technology will no doubt bring about change) the widespread use of broadband is primarily available over Telstra's copper network Subject to the roll-out of the proposed NBN there is little prospect for the replication of the network.

17 The ULLS, which was first declared in August 1999, involves the use of an unconditioned communications wire between the boundary of a telecommunications network at the end-user's premises and a point on the telecommunications network that is a potential point for interconnection, generally an exchange. The "unconditioned communications wire" is part of the CAN. The service is described as "unconditioned" because it involves access to the raw wires that forms a local loop. The entrant is able to add its own infrastructure in order to supply high speed data carriage services to end-users or, alternatively, multiple telephony services or a combination of voice and data services.

18 The LSS, also known as the spectrum sharing service, was first declared in August 2002 and in October 2007 the declaration was extended to 31 July 2009. The LSS involves

the use of the non-voiceband frequency of an unconditioned communications wire over which an underlying voiceband PSTN service is operating. The LSS gives the entrant use of the high frequency (or broadband) portion of the line to supply data services such as high speed internet access. With LSS, a local loop is used by two service providers, one making use of the high frequency portion of the loop and the other (typically Telstra) using the low frequency (or voiceband) portion of the loop.

19 The ULLS gives the entrant exclusive use of a given loop. A service provider that supplies a broadband service through LSS and wishes to "bundle" a fixed voice service (as most do) has two options. One is to bundle LSS with LCS or WLR. The other is to invest in, or acquire access to, equipment that enables the supply of fixed voice services over ULLS.

20 As already mentioned, an entrant with access to ULLS or LSS requires equipment to provide services to end-users. With Telstra's network that equipment is usually located at, or near to an exchange, if there is space. The incumbent (Telstra) leases the space to the entrant if it physically uses the incumbent's space. The typical piece of equipment which the entrant will install is a DSLAM. (We use the term DSLAM to embrace multi-service access nodes and other equipment capable of providing voice and/or data services by way of the ULLS or LSS.) Typically, a DSLAM connected to the ULLS would be configured so that the entrant may provide a bundled voice and broadband data service while a DSLAM connected to the LSS would be configured so that the entrant may provide a broadband data service only (the underlying voice service being provided by Telstra). DSLAMs have a relatively short commercial life expectancy because the technology is changing rapidly. Further, as the nature of the services supplied by a DSLAM change, there is a corresponding need to change all or part of a DSLAM. By way of example, a DSLAM connected to ULLS which is

required to provide ADSL services must contain shelves with ADSL cards. If it is to provide voice and data services it must have shelves with ADSL cards, a splitter and voice cards.

Barriers to Entry and Expansion

21 Access to ULLS and LSS provides an opportunity for significant differentiation as the entrant can choose from a variety of DSL technologies. There is also an incentive to invest in innovative equipment. Moreover, access to ULLS and LSS fosters competition for high bandwidth services without requiring entrants to invest in a fully rolled-out network. This puts pressure on the incumbent to offer end-users a new range of competitive services. Still, use of ULLS and LSS at best creates an environment for quasi-facilities-based competition. The copper network will not be replicated until the NBN is established.

22 While entrants have been given access to ULLS and LSS to compete with the incumbent (Telstra), the roll out has been slow and Telstra's dominant position has not been materially reduced. As at June 2008 entrants have only taken 5% of the national market for ULLS-based services in operation (SIOs). The explanation is that there are barriers that stand in the way of entry. Some barriers are capable of empirical analysis, some are not. The barriers are both absolute and strategic. The most important barriers are as follows. First, the incumbent (Telstra) has the advantage of having a ubiquitous network, a well-known brand, knowledge of the customer base, and the benefit of customer inaction. Second, the incumbent (Telstra) may easily engage in behaviour that will strategically delay entry, which will increase the entrant's costs. For example, the entrant must install equipment in the incumbent's (Telstra's) exchange, and access for the installation works can easily be frustrated. Third, sometimes there is no space at a particular exchange: this is referred to as exchange capping. There are practical difficulties standing in the way of acquiring a building

near a capped exchange and connecting with the exchange. If work is required at an exchange to provide space for an entrant's equipment it will take time to complete the work. Even in exchanges where no work is required, it is not unusual for there to be delay in an entrant gaining access to a Telstra exchange to enable its equipment to be installed. If more than one entrant seeks access they are placed in a queue. The delay in carrying out the installation is commonly in the order of six months and sometimes can be up to 24 months.

23 An example of behaviour that causes delay in entry and expansion and increases an entrant's costs is the drawn-out process by which terms of access, including pricing, are agreed. Part XIC, Div 8 establishes a regime for resolving disputes about access. Section 152CLA(1) provides that those disputes should be "resolved in a timely manner (including through the use of ... mediation and conciliation)". But experience shows that there are many disputes that take considerable time to resolve and, when legal issues arise, the parties can end up in court.

24 It is common ground that the cost of DSLAM equipment is not a prohibitive barrier to competitively significant entry. The precise cost of purchasing and installing DSLAM equipment and carrying out associated works is a matter of debate. Dependent upon the configuration of the equipment (a reflection of the type – eg voice and broadband – and number of services to be provided), the cost estimates (eg equipment, installation and other associated costs) range from $11,500 to $51,000. Nonetheless there is material which suggests that an entrant could make a return on its investment within two years and recover its outlay within five years.

25 As regards scale economies, there is a range of estimates concerning the number of SIOs an entrant would need to attract in order to make entry worthwhile: the range is from 30

to 360 SIOs with one DSLAM. The most likely explanation for the different views is that the number of end-users required to produce a reasonable return is subject to a variety of factors including the magnitude of other fixed costs, the percentage of SIOs affected by pair gains, the percentage of SIOs on fixed term contracts, the number of competitors within an exchange and other factors which are referred to below.

26 A barrier that may not be so easily overcome is the difficulty of transferring (migrating) a customer supplied with LSS-based services (bundled with a fixed voice service using LCS or WLR) to ULLS which provides both broadband and voice services. There is material suggesting that the migration is both costly and time consuming: and users may be left without a broadband service for an average of twelve days, but on occasions for upwards of three weeks.

27 Despite these barriers there are a significant number of entrants who use DSLAMs in order to access ULLS and LSS. The information concerning these entrants is derived from two sources. The first is DSLAM tracker data which is gathered from websites of telecommunications service providers and reports of independent telecommunications market analysts. This data provides information about the provision of high speed broadband in exchanges. The second source is the data provided to the ACCC by industry participants pursuant to the record-keeping rules (RKR) that were implemented under Pt XIB, Div 6. The DSLAM tracker information provides data for the periods prior to September 2007 and the RKR data for periods including and following September 2007. The DSLAM tracker includes: (a) actual and planned competitor infrastructure build in all exchanges (grouped by competitors); and (b) the number of competitors in each exchange. The RKR data identifies the number of ULLS and LSS acquirers in each exchange. It does not include data pertaining

to: (a) the number of installed DSLAMs per exchange; or (b) the number of DSLAMs installed by each individual access seeker and their capacities.

28 As at June 2008 out of the 380 exchanges the subject of the application, the number of DSLAM competitors in each exchange are as follows: (a) there is at least one DSLAM competitor in every subject exchange; (b) there are two or more DSLAM competitors in 334 subject exchanges; (c) there are three or more DSLAMs competitors in 270 subject exchanges; and (d) there are more than four DSLAM competitors in 208 subject exchanges. It is to be noted that the number of DSLAM competitors in each exchange does not say anything about the number of installed DSLAMs per exchange or the number of DSLAMs per exchange installed by each individual entrant.

29 As at 14 January 2008, the DSLAM infrastructure installed in the 371 of the 380 exchanges by ULLS and/or LSS access seekers was capable of servicing 2,483,673 lines. Of those, 1,043,879 pairs were in use, leaving 1,439,794 lines available. This information does not allow the Tribunal to determine the spare capacity of the installed DSLAMs in total or in any of the exchanges. The reason is as follows. In order to provide voice functionality, voice port cards must be installed in the modular solution sub-racks in the DSLAM (in addition to DSL port cards which provide the broadband service). The number of cards that are needed is determined by the number of services being supplied using that DSLAM. Each card contains a specific number of ports. Each port in turn services one copper pair (or local loop). The number of ports serviced by a card varies. It follows that the number of spare lines alone says nothing about capacity. Capacity is also dependent on the: (a) capacity of the ports currently installed in the DSLAMs; and (b) physical space available on the DSLAMs for the installation of additional cards. There is no meaningful hard information on these matters.

30 In addition, not all DSLAMs are technologically capable of providing broadband services and standard voice services within the same device. The evidence did not identify the number of existing DSLAMs with DSL that are capable of being upgraded to deliver voice services. To ascertain the proportion of current voice service capable devices, a survey of all providers would need to be undertaken.

31 It is also impossible to reach any conclusion regarding the available space in each exchange for the installation of new DSLAMs (to accommodate service providers wishing to install additional equipment to provide voice services on ULLS).

32 The increase in the number of entrants and the aggregate size of their market share raises the question whether regulation is still required. Of course regulation has a cost. In a competitive market service providers seek to reduce costs and prices and improve services to increase profit. Regulation constrains a service provider's flexibility. Inappropriate regulation may reduce the incentive for cost reductions, investment and innovation. For example, regulated low access prices discourage investment: an entrant will forego investment if its present returns are higher than the returns from new investment. From the incumbent's perspective, regulated wholesale access could result in an increase in overall costs when compared with the costs of operating a principally vertically integrated operation. Hence mandatory wholesale access can be inefficient in a network industry, especially one in which the incumbent continues to provide both wholesale and retail services. Nonetheless, regulated access does prevent the incumbent from abusing its position of power and may deliver benefits to end-users, at least in the short term.

33 A decision to remove regulated access requires a balance to be struck between competing factors. On the one hand there is the risk that continued regulation will result in

market distortions, high prices and fewer choices. On the other, there is the risk that premature deregulation will permit the still-dominant incumbent (and on any view Telstra still has significant market power with 89% of all fixed voice lines being supplied over Telstra's PSTN, of which approximately 80% are lines retailed by Telstra) to engage in anti-competitive conduct, which will distort the market in the long term. The choice to be made is between ex-ante regulation of access and prices and ex-post law enforcement to deter anti-competitive conduct. If there be any appreciable risk of harm to end-users, regulation will usually trump law enforcement: cf *Re Telstra Corporation Ltd (No 3)* (2007) 242 ALR 482, [316] and [326]. The decision should also balance the short-term benefits resulting from continued regulation, weighed against the potential for long term benefits that may flow from deregulation.

The Application for Exemption and the ACCC's decision

34 By its four applications Telstra seeks exemption from the obligation to observe the SAOs in its supply of LCS and WLR in a total of 387 exchanges selected on the basis that each exchange has, in addition to Telstra, at least one provider of ULLS (the so-called one plus rule). During the course of the hearing Telstra identified seven exchanges for which it no longer sought exemption because they did not meet the one plus rule. In only one of the 380 subject exchanges was the DSLAM entry based solely on LSS.

35 The ACCC and service providers in Australia have traditionally adopted a national geographic area when framing the geographic scope of telecommunications markets. Following the declaration of ULLS and LSS, the installation of DSLAMs in Telstra's exchanges has been uneven across exchanges. This seems to be the reason that the parties have examined the competitive dynamics at a more geographically disaggregated level, namely, in areas serviced by exchanges where entrants have installed DSLAMs.

36 The Tribunal neither accepts nor rejects that approach. It does, however, accept that an exchange-by-exchange analysis may provide information about the actual level of competition in the relevant market for the provision of the relevant service. There is, of course, a danger in drawing conclusions about the universal long-term effects of conduct when that conduct takes place in only a relatively small geographic market.

37 However that may be, on 22 August 2008 the ACCC made orders exempting Telstra from compliance with the SAOs in respect of 248 exchanges, with the exemption to take effect 12 months from the publication of its decision. These were exchanges that, as at 30 June 2008, had: (a) 14,000 or more addressable SIOs connected to a Telstra exchange via an uninterrupted wire through which an end-user might be provided with an ULLS-based service; or (b) 4 or more ULLS-based competitors (including Telstra) within the exchange (referred to by the parties as the three plus rule).

38 To maximise the prospect that the exemptions were in the long-term interests of end-users, the ACCC imposed several conditions and limitations. They were that the exemptions would not apply to: (a) the supply by Telstra of the LCS or WLR to an access seeker who immediately prior to the commencement of the order used the LSS, LCS and WLR to supply an end-user with a bundled fixed voice and broadband service until such time as Telstra developed and implemented an LSS to ULLS migration process that is satisfactory to the ACCC; (b) the supply of the LCS or WLR to a queued access seeker, that is, an access seeker who had, prior to the proposed commencement of the orders, applied to Telstra to install a DSLAM in an exchange the subject of the applications (the queuing condition); (c) a capped exchange, potentially capped exchange or a constructively capped exchange (that is, an exchange the subject of the applications in which there was a physical constraint on the installation of an access seeker's DSLAM or where Telstra might require an access seeker to

pay for improvements to the exchange to enable access); (d) an exchange where Telstra ceases to supply the ULLS; and (e) the supply of the LCS or WLR provided under an agreement in force at the commencement of the orders.

39 These are the orders that are the subject of the application to review. On the review the Tribunal may either affirm, set aside or vary the orders: s 152AW(1). The review is limited in this respect – the only information to which the Tribunal may have regard is that which was before the ACCC: s 152AW(4). This limitation has the potential of imposing significant limitations upon the Tribunal's capacity to adequately resolve a dispute in the most analytically-appropriate contemporaneous sense. There will be cases where important facts come into existence between the time of the ACCC's decision and the Tribunal hearing which, in ordinary circumstances, an administrative tribunal would take into account. Under the present regime the Tribunal must consider the application based only on the material before the ACCC. Moreover, the Tribunal does not investigate whether the ACCC fell into error - the review is a review de novo: *Re Seven Network Limited (No 1)* (2004) 187 FLR 351, [1], [40] and [41]. On the other hand, the Tribunal is entitled to give the ACCC's reasons due regard.

40 The thrust of Telstra's case for exemption can be summarised briefly. Broadly speaking, the markets in which to determine the effect of deregulation are: (a) the downstream (retail) markets for the supply of all fixed voice and broadband data services; and (b) the upstream (wholesale) markets for the supply of inputs, including WLR, LCS, ULLS and LSS for the supply of fixed voice services as well as, potentially, broadband services. Telstra would also include mobile services and voice-over-internet protocol in the upstream markets but, according to its submission, their inclusion "[is] not decisive". In exchanges where an entrant has installed a DSLAM ULLS is a substitute for other wholesale

inputs in the upstream markets (including WLR and LCS) for the provision of services in the downstream markets. With ULLS, a service provider who has installed a DSLAM (with appropriate functionality) with switching and transmission capacity is able to provide voice and broadband services to end-users. That is to say, ULLS is equivalent to, and economically substitutable for, the voice services that can be provided by way of WLR or LCS. It is economically equivalent because there are few barriers to commence using, or expanding the use of, ULLS, assuming space is available in the relevant exchange.

The Use of a Rule of Thumb

41 Telstra's argument for exemptions is largely founded on the opinions of Telstra's consultant, Dr Patterson, an economist who has considerable expertise in the telecommunications industry. In his principal report Dr Patterson put forward the following propositions. There are a variety of technically and commercially viable substitutes for LCS and WLR, including ULLS and, to a lesser extent, other competing fixed access network infrastructure. In view of the provision of these substitutable services, Dr Patterson says that there is no bottleneck. Because there is no bottleneck, downstream competition will not be compromised by the grant of the exemptions. Not only would competition be undiminished but efficient competition and efficient infrastructure investment and use would be promoted by an exemption order. Here Dr Patterson's proposition is that regulation is inefficient and that exemption best promotes efficiency. Hence, if regulation is terminated the resultant competition would stimulate efficient investment.

42 It was also through Dr Patterson's reports that Telstra proposed its one plus decision rule, a rule of thumb it claimed should be applied to determine which exchanges should be exempt from SAOs. Dr Patterson put it this way in his report: "[T]he presence of one in-place competitor having access to ULLS at cost-based prices, and having already

demonstrated a capacity to serve the market, demonstrates the inevitability of constraint on Telstra's retail pricing behaviour at least as well as the availability of LCS/WLR." He said he had arrived at this conclusion for two reasons: (a) "The existence of an ULLS-based competitor clearly demonstrates that there are no material barriers to competitive entry by ULLS-based operators"; and (b) Economic analysis leads to the conclusion that "there are no material barriers to ULLS-based entry or expansion", which is "consistent with the empirical observation that entry has actually occurred". As regards the effect of the grant of exemption on Telstra's perceived freedom of pricing, Dr Patterson said that the existence of competitors would act as a restraint.

43 The ACCC is also of the opinion that a rule of thumb should be adopted. It opted for a three plus approach on the basis that an addressable market that can support four competitors (including Telstra) is an appropriate benchmark. It also added, as an alternative, that an exemption should be granted for an exchange that has 14,000 or more addressable SIOs on the basis that there is a relationship between the number of entrants and the average number of SIOs in an exchange.

The Ladder of Investment Hypothesis

44 Telstra also relied upon a report from Professor Cave, of the University of Warwick, which considered whether deregulation would encourage efficient investment in alternative infrastructure. In his writings Professor Cave has developed an approach to the analysis of incentives to infrastructure investment known as the "stepping stones" or "ladder of investment" hypothesis. To use Professor Cave's description of this hypothesis: "[C]ompetitors challenge an incumbent by offering services which rely, as their market share rises, less and less on the incumbent's assets and more and more on their own. Thus, competitors progressively build out their networks closer and closer to their customers."

45 The ladder of investment hypothesis is based on the desirability of encouraging investment (though progressive acquisition of infrastructure assets) by entrants into a relevant regulated market. In this way, new technology will be introduced into the market and contestability will be achieved. Through such a market-driven process, socially desirable results will come about and there will be less need for the potentially distortionary effects of regulation.

46 Under this hypothesis, it is the task of regulators to signal that the terms and conditions of access will change. That is, those seeking access to the incumbent's infrastructure will be put on notice that over time they need to increase their own infrastructure investment, and rely less on that of the incumbent. If not, then entrants run the risk that the incumbent's services will no longer be regulated and accordingly may not be supplied, or may not be supplied under the same (regulated) prices and conditions as before. It is the regulator's task to make this path both feasible and commercially achievable.

47 For a typical telecommunications market, the first rung is entry via reselling of an incumbent's services, the second is the provision of some form of replicable or independent add-on capacity to the incumbent's network and, on the third rung, the firm is expected to invest in network facilities of its own.

48 According to adherents of this hypothesis, a regulator may accelerate this process by signalling that it will withdraw protection at progressive stages of the ladder, when it becomes convinced that no bottleneck elements remain at the relevant rung, thereby forcing entrants to climb the ladder of independent provision. Essential to this process is the need for the regulator to identify accurately the disappearance of the bottlenecks which were the cause

of regulation in the first place. This has, in fact, been signalled by the ACCC in its July 2006 ACCC's *Declaration Inquiry for the ULLS, PSTN OTA and CLLS – Final Determination.*

49 Inherent in the ladder of investment process is the need for the regulator to be on top of what is happening in the market in terms of firm numbers, their competitive options, changes in market shares, capacity in the market, the long term-interests of end-users and in developments in technology and its deployment.

50 In deciding to withdraw regulatory protection at a lower rung of the ladder, the regulator in effect leaves entrants at the mercy of the incumbent for access to the relevant service. It must be confident that, in trying to encourage a firm to begin its technological ascent, the firm will face an equality of opportunity to compete on the next rung of the ladder with the incumbent operator (and any other recent entrants who have progressed to this rung of their own volition).

51 There are clearly costs associated with the ladder of investment hypothesis when it is applied by a regulator – the costs of false positive decision errors (when it would have been socially advantageous to withdraw protection at the lower rung, but regulation was left in place) and false negative decision errors (when the timing was not right to withdraw regulated access but this was done, resulting in damage to the newer firms and to end-users). It would normally be easier to revisit a decision at a later stage and subsequently withdraw regulation, than it would be to re-regulate after the market had been divested of some or all of its regulatory constraints.

52 When a regulator decides to withdraw regulatory oversight at a certain rung of the ladder, it needs to be confident that those previously protected by the regulation will have an

equality of opportunity to compete in the market, either by: (a) retaining their old supply sources and conditions of supply; (b) by entering into contracts with alternative suppliers; (c) by investing in their own facilities; or (d) by using excess capacity of other providers operating on the next rung of the ladder.

53 When a regulator removes regulatory protection, in the hope of encouraging entrants to move up the ladder, it denies potential entrants the ability to enter the market on the same conditions as earlier entrants, for two reasons. First, the incumbent may decide not to provide the previously regulated service. This forces the entrant to enter the market at a higher rung, which in turn requires it to invest in its own capital equipment or to negotiate access to the equipment of other firms already operating on the higher rung, without having had the opportunity to learn about the market through a less complicated form of initial entry. Second, if the previously regulated service is provided, the entrant may face higher costs of entry if the incumbent chooses not to offer wholesale services at previously (regulated) prices. It follows that new entrants will face higher barriers to entry than those that came before them. This could have the effect of retarding new entrants that could have promoted competition in the market, and competition in the market will then depend on there being no barriers to the expansion of the market share of those entrants that have already entered the market.

Satisfaction of the s 152AT(4) criterion

54 The case put by Telstra, including its one plus rule, was directed to showing that the s 152AT(4) criterion (that deregulation would promote the long-term interests of end-users) had been satisfied. The ACCC's three plus rule or its alternative of an exchange with 14,000 addressable SIOs was directed to the same end. It is to be noted that Telstra did not address the Tribunal on how its discretion should be exercised if the s 152AT(4) criterion was met.

This is, no doubt, because the discretion issue was only raised late in the day by the Tribunal itself, all parties (and the ACCC) having proceeded on the false premise that there was no discretion.

55 Be that as it may, it must be said that the argument that s 152TA(4) is satisfied had little by way of empirical evidence to support it. In large measure the argument was founded simply on the view of many (if not most) industrial organisation economists that "competition is the best regulator" because regulation will inevitably produce lack of choice, inefficient investment and disincentives to innovate, whereas removing regulation will produce the opposite results.

56 The Tribunal is prepared to accept that, as a general proposition, long-term regulation may not be in the long-term interest of end-users. But whether or not regulation should end at any particular point depends, critically, upon trends in the state of actual and potential competition in the market at that time. Moreover, it is the Tribunal's view that determining the competitive state of the market should be largely an empirical exercise. This involves examining observable market behaviour. There are many indicators of a competitive market. Principally they are: (a) the number of new entrants; (b) the growth of the entrants' market share (either through attracting new business or taking share from the incumbent); (c) an increase in the range and quality of services provided; and (d) a reduction in the price of services. If these indicators are present they show not only rivalrous behaviour, but also socially-beneficial rivalrous behaviour.

57 It is unfortunate that each of Telstra and the ACCC avoided empirical market analysis by the adoption of a rule of thumb which they say should be applied to determine whether a particular exchange should be exempt from regulation.

58 The problem with a fixed rule of thumb in the area of deregulation is that it is just a shortcut. Simple numbers-based rules of thumb are not uncommonly used as a screening device to indicate thresholds beyond which markets might ordinarily be expected to work competitively. But a rule of thumb is a static indicator only and reveals nothing about market dynamics over time.

59 For example, Telstra's one plus rule and the ACCC's three plus rule identify the current number of rivals, but give no indication of: (a) how this number of firms eventuated; (b) whether their presence (market share) in the market is growing or declining; (c) whether there has been exit over time and, if so, for what reason; (d) whether end-users attracted to new entrants are increasing; (e) whether entry was for strategic or indirect purposes designed to influence behaviour elsewhere or to compete in the market (ie the particular exchange) in question. Nor can a rule of thumb reliably indicate anything about past, present, or importantly for regulatory purposes, likely future behaviour by either incumbents or potential entrants.

60 To be fair, both Telstra and the ACCC accept that ultimately the critical values used in their respective rules of thumb are a matter of judgment. While the Tribunal acknowledges that certain rules may be useful as screening devices, to be ultimately determinative of a regulatory process that seeks to minimise regulatory distortions and to promote productive, allocative and dynamic efficiencies, any rule must be carefully researched and justified (if it is capable of being justified) on grounds of sound economic knowledge.

61 The problem is that while the feasibility of entry may be demonstrated by actual entry, the fact of entry by one firm, or even by more than one firm, of itself does not establish that the incumbent is either presently restrained or is likely to be subject to the constraints of

the competitive process in the future, by either the entrant or by further new entrants. Notwithstanding relatively low costs of entry and few sunk costs, the competitive impact of entry depends upon what the entrant does after it has entered, and how the incumbent responds to it.

62 A few illustrations of the kind of problems that may arise from a simplistic application of Telstra's one plus, or the ACCC's three plus, rules of thumb will help make the point. The facts in this matter show that the capacity of a DSLAM can vary greatly, dependent upon its configuration. But there is no hard information about the minimum or maximum capacity of the DSLAMs installed by an entrant at any exchange. In the absence of hard information about the capacity of the installed DSLAMs, it is not possible to conclude whether an entrant with one or more DSLAMs is capable of providing: (a) any competitive constraint on the incumbent (Telstra); (b) accommodation to a further entrant who is unable for whatever reason to access the exchange with its own DSLAM; and (c) short-run accommodation to existing rivals who, faced with an unregulated LCS or WLR, may be forced to consider engaging in further infrastructure-based competition in lieu of resale-based competition.

63 There is also the possibility that entry has a limited purpose, aimed at serving only a small part of the market. It may have been entry designed to accommodate the firm's customers in other markets who seek some moderate level of service in the subject markets. It may have been a toe-hold entry designed solely to get into a queue of sorts, or to provide a signal to other potential entrants as to the firm's intentions.

64 Toe-hold limited entry is often relatively inexpensive. Incumbent firms may make no real effort to stop it, but rather wait to see what transpires. It may be easier to block

expansion than entry. If the entrant looks set to expand and threaten to take more than a few customers at the margin, the incumbent could take action to make that expansion competitively difficult by a variety of price and non-price strategies. We have the example of Telstra providing ADSL2+ only in exchanges where it is faced with an entrant providing that service. Mention has already been made of Telstra making access difficult by capping, queuing and forcing access requests to arbitration and litigation. Without characterising this conduct in pejorative terms (eg as 'sabotage' conduct) it has the effect of slowing down access and raising the cost of securing access.

65 There is also the possibility that the incumbent may encourage several small entrants to set up, as under these circumstances they could face great uncertainty about each other's expansion plans. Thus, no one firm may be prepared to invest enough to seriously threaten the incumbent's position.

66 These are just some of the factors that show that simple observation of new firms over time entering a market provides little more than an indication that those firms appear to believe that their entry will be commercially profitable within their wider set of corporate goals. It indicates either nothing, or very little, about the social usefulness of that entry in terms of constraining an incumbent to respond in ways that are likely to promote competition. In particular, in the absence of details of the type and extent of entry, and on what has happened in the market after entry, it is not possible to say anything with confidence about the impact of barriers to competitively significant new entry, barriers to expansion, or the impact of entry or competition in the subject exchanges.

67 It is also necessary to consider that the uncertainties faced by a new entrant will be greater, the greater the rate of entry, and the larger the pool of potential entrants. If minor

scale entry signals a lack of commitment, end-users (especially businesses and governmental end-users) may not be prepared to leave the incumbent (for fear of later reprisals if the entrant decides to exit) and so entry, while palpable in numbers, may be of no commercial or competitive significance whatsoever.

68 Moreover, to be competitively significant an entrant must at least be likely to have both the physical capacity and the willingness to confront the incumbent and take market share away from it, by offering end-users a better price–product–service package. Whether that is happening in each exchange depends upon knowing what has happened in that exchange. In the absence of information about capacity (actual and potential), the projected growth in capacity over time and details of market activity generally, it is not possible, with any confidence, to reach conclusions about the likely impact of entry. Put another way, it is vital to have reliable hard information on these matters as well as knowledge of the asset and management capacity of the entrants, their willingness and ability to be competitive in the market and the response of their rivals, before any authoritative statement can be made on whether entry has, or is likely to, promote competition in the market.

69 In these circumstances the Tribunal is of the opinion that the fact of entry into an exchange by a firm with one, two or more DSLAMs means very little. What is important to know for competition assessment purposes is the impact of entry on Telstra: has entry had or, more importantly in terms of the Act, is entry likely to have, a competitive impact on Telstra's behaviour?

70 Entry will have a competitive impact and is likely to achieve the objective of promoting competition if it attracts customers away from Telstra. The new entrant does this by offering a better price, better terms of sale or innovative product offerings. In addition,

there will be circumstances, for example, in the case of a business or government end-user, where the entrant must convince the end-user that it has the capacity to satisfy its demands in both the short run and the long run. Also, the entrant needs the financial strength and management ability to ride out Telstra's responses. These are the issues that require investigation. These are also the issues that the simplistic application of Telstra's one plus, and the ACCC's three plus, rules of thumb ignore.

71 There is simply no empirical evidence before the Tribunal from which it is possible to arrive at any, even any tentative, conclusion about market behaviour and whether entry is likely to produce a competitively significant long run impact in the relevant markets.

A Possible Framework

72 It is hard to deny that, if it were possible, it would be very useful to formulate a set of rules that provide a roadmap for deregulation. If a roadmap were to be developed based on today's technology and knowledge, it would include at least the following eight factors: (a) the total number of addressable SIOs in the market; (b) the number of exchanges in which there is at least one entrant; (c) the number of entrants; (d) the total number of addressable SIOs broken down on an exchange by exchange basis in the subject exchanges; (e) the share of SIOs that the entrants have taken from the incumbent; (f) the physical capacity and operational willingness of the entrants to take more market share; (g) the cost and ease of installing new infrastructure; and (h) the capacity and technology status of each DSLAM in each exchange. Such an inquiry would at least provide a basis for drawing inferences on whether deregulation is likely to result in the achievement of the objective of promoting competition.

73 Interestingly, the Office of Communications in the United Kingdom uses somewhat similar criteria to determine whether an incumbent has significant market power. The Canadian regulator, the Canadian Radio-Television Telecommunications Commission, has adopted similar rules of thumb to determine whether there should be deregulation. The view the Tribunal takes is that the adoption of a definitive prescriptive roadmap is an approach that is likely to lead to error. There is little scope for the development of a general fixed rule, although it is possible to identify market features the existence of which, and following careful analysis of them, may suggest that deregulation is appropriate.

Conclusion

74 The Tribunal is not satisfied that the making of the exemption orders sought by Telstra will promote the long-term interests of end-users of carriage services or of services provided by means of carriage services. It is not, therefore, necessary to consider matters that go to discretion. Nor is it necessary to consider whether it is legitimate, for the ACCC or the Tribunal, to reach the satisfaction required by s 152AT(4) by imposing conditions or limitations.

75 The analysis and reasoning applies *mutatis mutandis* to the class exemption orders set out in appendixes I and J of the ACCC's final decision. The class exemption orders were made as a consequence of the ACCC's proposed orders in respect of Telstra and, like those orders, would have exempted service providers other than Telstra from the SAOs in respect of the LCS and WLR in any one of the subject exchanges.

Decision

76 The decision of the ACCC to grant Telstra the exemption orders set out in appendixes E to H and the class exemption orders set out in appendixes I and J, in its final decision be set aside.

I certify that the preceding seventy six (76) numbered paragraphs are a true copy of the Reasons for Determination of the Australia Competition Tribunal.

Associate: 

Dated: 22 December 2008

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