Chapter 3

Competition

> Competition is not really working because of the structure of the industry—not because the ACCC or the ACA or ACIF are not working. They are all good people, but the structure of the industry is not correct… We have one big elephant and 12 mice playing on the soccer field and then we say, 'Okay, this is self-regulation.' Now, who wins? Obviously, if you have a self-regulatory regime linked to an industry or market structure where you have one big company dominating, then it is a furphy to believe that you can create competition in the market.[1]

3.1 During this inquiry the Committee has heard from telecommunications industry participants, commentators and consumer groups which claim that market structures give rise to a range of anti-competitive practices. This chapter discusses Parts IV and XIB of the *Trade Practices Act 1974* (TPA) and the regulatory mechanisms which deal with anti-competitive behaviour, and considers whether those mechanisms are effective. By way of illustration, the protracted recent ACCC case against Telstra in relation to the broadband competition notice is discussed. The chapter also highlights a variety of problems faced by industry participants who must compete with a powerful vertically integrated owner of monopoly infrastructure.

The current regulatory regime

3.2 The ACCC is the Commonwealth's statutory authority which administers the economic and competition aspects of telecommunications regulation, primarily under the TPA. Its functions include:

- administering the general restrictive trade practices regime in Part IV and the telecommunications-specific competitive safeguards regime in Part XIB, which addresses anti-competitive conduct by carriers and carriage service providers as well as allowing the ACCC to issue tariff filing directions and record-keeping rules;
- administering the telecommunications-specific regime in Part XIC for facilitating access to the networks of carriers. This includes declaring services for access, approving access codes, approving access undertakings, arbitrating disputes for declared services and registering access agreements; and
- administering other legislative provisions, including those relating to price control of Telstra's retail services, international conduct rules, number portability, electronic addressing, interconnection standards and arbitration of disputes about access to network information, access to

1 Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 45.

facilities, operator services, directory assistance services, provision of number portability, preselection and emergency call services.[2]

Part XIB - anti-competitive conduct

3.3 As noted above, the anti-competitive conduct and record-keeping rules in Part XIB apply specifically to telecommunications markets. Section 151AK states that a carrier or carriage service provider must not engage in anti-competitive conduct. A carrier is deemed to have engaged in anti-competitive conduct if it has a substantial degree of power in a telecommunications market and either:

- takes advantage of that power with the effect, or likely effect, of substantially lessening competition in that or any other telecommunications market;
- takes advantage of the power, and engages in other conduct on one or more occasions, with the combined effect, or likely combined effect, of substantially lessening competition in that or any other telecommunications market; or
- engages in conduct in contravention of sections 45, 45B, 46, 47, or 48 of the TPA where that conduct relates to a telecommunications market.[3]

3.4 On receipt of evidence of anti-competitive behaviour the ACCC initiates an investigation. If it determines that anti-competitive conduct has occurred or is occurring, the ACCC may issue a competition notice. There are two types of competition notices, Part A and Part B. Part A notices are issued when the ACCC has reason to believe that:

- a carrier or carriage service provider has or is engaged in an instance of anti-competitive conduct (under section 151AKA(1))
- a carrier or carriage service provider has or is engaged in at least one instance of anti-competitive conduct of a kind described in the notice (under section 151AKA(2)).

3.5 Part A competition notices are designed to fulfil a 'gatekeeper' role by acting as a precondition to private action under Part XIB. They are flexible instruments, which at the ACCC's discretion can be revoked or modified in minor ways without the need for a new investigation. Competition notices issued under subsection 151AKA(2) do not require the ACCC to specify a particular instance of anti-competitive conduct. This allows the ACCC to investigate where precise evidence has not yet come to light.[4] Part A notices were introduced in 1999 in response to criticisms that detailed particulars of the contravention were required under the existing notice regime.

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2 ACCC, website at 29 April 2005, http://www.accc.gov.au/content/index.phtml/itemId/269239.

3 TPA, subsections 151AJ(2) and (3).

4 David Stewart, 'Anti-competitive Conduct', *Australian Telecommunications Regulation (3ed.)* Alasdair Grant (ed.), UNSW Press, 2004, p. 173.

3.6 The ACCC may also issue a Part B notice under section 151AL, stating that a carrier or carriage service provider has contravened or is contravening the competition rule. Unlike a Part A notice, a Part B notice must set out particulars of the alleged contravention.

> A Part B competition notice could therefore be used to consolidate the results of an ACCC investigation into a single document for use by litigants alleging loss or damage resulting from the anti-competitive conduct.
>
> Section 151AN provides that a Part B competition notice is prima facie evidence of the matters set out in that notice….The avowed purpose of the Part B competition notice is to facilitate parties taking private legal action to enforce the competition rule or to recover loss or damage arising from anti-competitive conduct.[5]

3.7 While the notices are separate, in practice a Part B notice is unlikely to be issued unless the alleged conduct has been the subject of a Part A notice.[6]

3.8 Telstra's submission noted that the arrangements in Part XIB are the legacy of a compromise that was struck at the end of the duopoly period. Telstra argued that as with most forms of regulation, these provisions had beneficiaries with vested interests (in this case mainly Telstra's competitors), and that this has resulted in strong opposition to repeal. Telstra argued that Part XIB was a policy compromise which was 'never intended to be permanent':

> Rather, Part XIB was only ever intended as a transitional measure to assist the telecommunications sector during the early years of deregulation. The intent was always that Part XIB would be repealed, followed by greater reliance on the generic economy-wide competition laws.[7]

3.9 In 2001, the Productivity Commission's report on Telecommunications Competition Regulation expressed several concerns about Part XIB and considered whether Part XIB should be repealed or amended to modify its undesirable features. The Productivity Commission initially recommended in its Draft Report[8] that Part XIB should be repealed.

3.10 The Draft Report noted that the following concerns supported the repeal of Part XIB:

- enhanced opportunity for regulatory error and overreach;

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5 David Stewart, 'Anti-competitive Conduct', *Australian Telecommunications Regulation (3ed.)* Alasdair Grant (ed.), UNSW Press, 2004, p. 174.

6 Productivity Commission, *Telecommunications Competition Regulation,* Report No. 16, 2001, p. 159.

7 Telstra, *Submission* 25, p. 21.

8 Recommendation 5.1.

- many of the cases considered under Part XIB have been minor - not usually involving circumstances where lack of speedy regulatory action could lead to market foreclosure;
- relevant action can be pursued under Part IV (including the seeking of injunctions by firms that consider themselves adversely affected by the anti-competitive conduct of others), Part XIC or in a number of other ways;
- progress under Part XIC, together with further improvements to the access provisions reduce the need for specific anti-competitive conduct regulation in telecommunications markets;
- a strong case exists that the issues under Part XIB for which competition notices have been issued would more appropriately have been dealt with under other provisions of the Trade Practices Act, particularly Part IV;
- telecommunications competition has increased substantially since 1997 and should be more self-sustaining in the longer term, even with less regulation;
- given the other remedies available, removal of the anti-competitive conduct provisions of Part XIB is likely to have no significant effect on competition; and
- in the Productivity Commission's view, repeal of the anti-competitive conduct provisions of Part XIB would not be inconsistent with Australia's international obligations.

3.11 However, in its final report in 2001, the Productivity Commission altered its position, noting that its recommendation for repeal had attracted widespread industry criticism and strong opposition from the ACCC. The Commission instead adopted its second option of proposing amendments to Part XIB, with various reservations and conditions.[9] The Commission summarised its conclusion on Part XIB as follows:

> On balance, the Commission supports retention of Part XIB pending the development of more sustainable competition in telecommunications. This support is conditional on the introduction of an appeal mechanism intended to enhance procedural fairness. As Part XIB should only be a transitional measure, it should be further reviewed in three to five years.[10]

Part IV – anti-competitive conduct

3.12 Part IV of the TPA sets out general provisions relating to anti-competitive conduct. Section 46 relating to general misuse of market power prevents a corporation with a substantial degree of market power from taking advantage of that power for the purpose of eliminating or substantially damaging a competitor, preventing the entry of a person into any market, or deterring or preventing competitive conduct in a market.

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9 Telstra, *Submission* 25, p. 22.

10 Productivity Commission, *Telecommunications Competition Regulation*, Report No. 16, September 2001, p. 151.

The Productivity Commission described the 'purpose' test in section 46 and compared it with Part XIB:

> In section 46, purpose stands alone — there is no requirement for any effect or likely effect before regulatory/legal action can be taken against the alleged anticompetitive conduct. Nevertheless … purpose can be inferred from a firm's conduct or other relevant circumstances — this means that purpose can possibly be established from effect.[11]

3.13 The Committee heard during this inquiry that the 'purpose test' is 'notoriously difficult to establish'.[12]

Comparison of Part IV and Part XIB

3.14 As the Productivity Commission noted in its report on *Telecommunications Competition Regulation*,[13] 'both Part XIB and Part IV are judicial enforcement models that prescribe general rules of conduct that are enforceable by the courts'. The Productivity Commission also noted:

> Many of the steps necessary under a Part IV investigation also apply under Part XIB: ie defining markets, assessing market power, and assessing whether advantage was taken of that power.[14]

3.15 However, there are several important differences:

- unlike Part IV, Part XIB prohibits a use of market power that has an anticompetitive effect or likely effect rather than purpose;
- proceedings (other than for an injunction) cannot be instituted under Part XIB unless the ACCC has issued a Part A competition notice and the alleged conduct is of a kind dealt with in the notice;
- the evidentiary burden is reversed (a Part B competition notice under Part XIB is prima facie evidence of the matters in the notice);
- a competition notice places greater public pressure on the recipient to modify its conduct; and
- the maximum pecuniary penalty in Part XIB ($10 million plus $1 million per day) is greater than in Part IV ($10 million).[15]

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11 Productivity Commission, *Telecommunications Competition Regulation,* Report No. 16, September 2001, p. 157.

12 Unwired Australia, *Submission* 48, p. 2.

13 Productivity Commission, *Telecommunications Competition Regulation,* Report No. 16, September 2001, p. 162.

14 Productivity Commission, *Telecommunications Competition Regulation,* Report No. 16, September 2001, p. 157.

15 Productivity Commission, *Telecommunications Competition Regulation,* Report No. 16, September 2001, p. 162, referring to the ACCC's submission to its inquiry.

3.16 In addition, the Commission noted that court action 'is more likely to be required under Part IV to stop alleged anti-competitive conduct than under Part XIB'. Action under one part does not necessarily prevent action under the other in relation to the same incident of anti-competitive conduct, but a person is not liable for more than one pecuniary penalty. While in Part IV penalties and damages can reflect the entire period of anti-competitive conduct, under Part XIB they can only relate to the period after the issue of a Part A competition notice.[16]

Accounting separation and record-keeping rules

3.17 Under Part XIB the ACCC has certain information gathering powers:

- tariff filing directions, which require a carrier or carriage service provider with a substantial degree of market power to file certain tariff (price list) information with the ACCC. Additional tariff filing arrangements are imposed on Telstra; and
- record keeping rules that require selected carriers (namely, Telstra, Optus and Vodafone) to report quarterly to the ACCC. Record keeping information is used to scrutinise anti-competitive cross-subsidisation by vertically and horizontally integrated companies.

3.18 Under measures in the *Telecommunications Competition Act 2002* and in conjunction with the ACCC's Regulatory Accounting Framework (RAF), Telstra is required to provide accounting separation of its wholesale and retail operations.[17]

3.19 Accounting separation aims to address competition concerns arising from the level of vertical integration between Telstra's wholesale and retail services and to improve the provision of costing and price information to the ACCC, access seekers and the public. The framework ensures that:

- Telstra prepares current (replacement) cost accounts (as well as existing historic cost accounts) to provide more transparency to the ACCC about Telstra's ongoing and sustainable wholesale and retail costs;
- Telstra publishes current cost and historic cost key financial statements in respect of 'core' interconnect services but not underlying detailed financial and traffic data which is regarded as commercially sensitive;
- the ACCC prepares and publishes an 'imputation' analysis (based on Telstra purchasing the 'core' interconnect services at the price that it charges external access seekers) which will demonstrate whether there is any systemic price squeeze behaviour;

16 Sections 151BY and 151CC.

17 Grahame O'Leary, *Enhancing Competition in Telecommunications: Accounting Separation of Telstra's Operations*, Research Note No. 39, Parliamentary Library, March 2004.

- Telstra publishes information comparing its performance in supplying 'core' services to itself and to external access seekers in relation to key non-price terms and conditions. (These will include faults/maintenance, ordering, provisioning, availability/performance, billing and notifications); and
- the ACCC prepares and publishes a six monthly report on competition in the corporate segment of the market.[18]

3.20 Accounting separation was implemented through the *Telecommunications Competition Act 2002* which gave the Minister power to direct the ACCC to prepare or publish reports using its existing broad record-keeping rule powers under Part XIB. In June 2003 the Minister directed the ACCC to implement an enhanced form of accounting separation of Telstra's wholesale and retail accounts. The ministerial direction introduced:

- current cost accounting as well as the historical costs used in the RAF;
- key performance indicators on non-price terms and conditions that compare service performance between retail and wholesale supplied services; and
- imputation analysis (imputation testing) of core telecommunications services supplied to access seekers.[19]

3.21 Telstra's submission outlined the requirements of the Accounting Separation Direction:

> - One requirement of the direction is for Telstra to update its regulatory accounting records from historic to current cost. Regulatory accounts for the core PSTN services of PSTN interconnection, local call resale and unconditioned local loop will provide a basis for comparison in relation to any existing regulated prices for these products.
> - An additional requirement under the accounting separation rules is for Telstra to publish imputation test results for various PSTN services including basic access, local calls, national long distance, international long distance and fixed to mobile services. An imputation tests measures whether an efficient competitor of Telstra can compete against Telstra's retail product offering, based on Telstra's retail price and an assessment of the efficient wholesale and retail costs to the competitor of providing the service. In the context of the accounting separation obligations, these costs are determined by the information in Telstra's regulatory accounts.
> - A further requirement relating to the accounting separation obligations is for the ACCC to publish a series of metrics that

18 DCITA, *Accounting Separation*, http://www.dcita.gov.au/tel/competition_policy_and_framework/accounting_separation (accessed 2 June 2005).

19 ACCC, website, accessed on 8 April 2004, URL: http://www.accc.gov.au/content/index.phtml/itemId/333799.

> compare Telstra's performance in terms of new service connections and fault rectification for both wholesale and retail customers.[20]

3.22 Telstra argued that the accounting separation requirements are extensive and significant resources have been dedicated to updating regulatory accounts and undertaking the specified tests. Mr Paul Budde also criticised the cost and effectiveness of accounting separation:

> We are wasting millions of dollars of the ACA's and the ACCC's by asking all sorts of questions. It takes an enormous bureaucratic effort to actually create these accounting separation reports and all sorts of other reports, but what is that actually going to add to the regulatory environment we are in? Absolutely nothing. So we have to make the resources of the regulators available for more sensible things to do rather than having them writing these bureaucratic reports.[21]

3.23 Mr David Forman on behalf of the Competitive Carriers Coalition (CCC) argued that the telecommunications industry had limited faith in the benefits of accounting separation given the time and resources spent on compliance:

> In terms of outcomes in the marketplace, it has resulted in no benefit that I am aware of. It has absorbed an enormous amount of time and energy and the resources of not only the competitors but the regulator, who has repeatedly said that it is a waste of time. This is by Telstra's own account also.[22]

3.24 Telstra also criticised the ACCC's limited confidence in the results of accounting separation, which Telstra argues is only because the ACCC cannot find evidence of anti-competitive behaviour:

> However, this does not mean that all the results published so far should be discredited. To date, the information published under the accounting separation rules has failed to demonstrate any systemic discrimination by Telstra in relation to its service connections and fault rectifications for wholesale and retail customers, a fact regularly confirmed by the ACCC. Nor have the accounting separation reports revealed any margin squeeze by Telstra concerning Telstra's wholesale and retail prices. Rather than being taken to be evidence of Telstra's competitive (or benign) behaviour, the ACCC has regularly downplayed the value of the information published under the accounting separation rules, largely disregarding it in their calls for further evidence of the need for greater regulation and transparency.[23]

3.25 Telstra argued that the fact that the accounting separation rules have not provided evidence to substantiate allegations of anti-competitive behaviour is not

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20 Telstra, *Submission* 25, p. 32.

21 Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 45.

22 Mr David Forman, *Committee Hansard*, 11 April 2005, p. 19.

23 Telstra, *Submission* 25, p. 33.

because accounting separation has failed, but rather because Telstra has not engaged in such behaviour.

3.26 However, this view is not shared by many of Telstra's competitors (as discussed later in this chapter), or on occasion by the ACCC which has issued several competition notices against Telstra. On 28 May 1998 a competition notice was issued to Telstra in relation to the terms and conditions on which Telstra provided wholesale internet services to other internet access providers. Another competition notice was issued to Telstra on 10 August 1998 in regard to the churn of customers from one carriage service provider to another. More recently, in 2004, the ACCC issued Telstra with a competition notice in regard to its ADSL services, as discussed in more detail below.

Anti-competitive behaviour: a case study

3.27 The use of market power to engage in alleged anti-competitive behaviour is illustrated in the 2004 broadband pricing matter. The Committee's report on *Competition in broadband services*, tabled in August 2004, included a detailed case study of the ACCC's actions against Telstra in regard to its pricing of ADSL broadband services. Resolution of this matter was protracted, taking nearly twelve months. As this incident is relevant to the analysis of the effectiveness of the regulatory regime, a revised case study is set out below. Many witnesses to this inquiry cited this incident as an indication of flaws in the regulatory regime.

3.28 On 15 February 2004, Telstra Bigpond announced it would offer an ADSL 256Kbps retail service for $29.95 per month. This price was claimed to be lower than the wholesale price that Telstra was offering to some of its competitors. Telstra defended its action by claiming that the reduction in price was to stimulate the retail broadband market - which had been declining - and competition more generally. In response to Telstra's new ADSL retail prices, Optus and a number of smaller ISPs announced cuts to their broadband plans to bring them into line with Telstra. However, smaller operators claimed that these prices were unsustainable and Telstra's 'pricing squeeze' was an attempt to manipulate the market.

3.29 In a submission to the Committee's previous inquiry, the CCC argued:

> The CCC members believe that these price changes represent a wilful and calculated attack on the integrity of the wholesale ADSL market. It is clear that Telstra is engaged in manipulating the development of the ADSL market by forcing too-high wholesale prices on independent service providers and by favouring its own retail arm to the detriment of other providers.[24]

3.30 Telstra's competitors went to the ACCC claiming that Telstra was engaged in anti-competitive behaviour. On 5 March 2004 the ACCC issued Telstra with a

24 CCC, *Submission* 50, p.3, to the Committee's inquiry into competition in broadband services.

consultation notice. On 9 March 2004 the consultation notice was extended by two days when Telstra requested more time to respond.

3.31 In line with requests from the ACCC to reduce its wholesale prices to competitive levels, Telstra lowered its wholesale price. However, as Mr Simon Hackett, the Managing Director of Internode, argued:

> It's a myth that $29.75 is the wholesale access price compared to the Telstra $29.95 retail price…. The $29.75 charge is EX GST. When you remove the GST from $29.95, it becomes $27.23 – or $2.52 BELOW the tail circuit charge. Also, that tail circuit charge is only one component of the full cost to mount a working ADSL service. When you add the other necessary costs in, you are up at more like $35 as a minimum underlying cost.[25]

3.32 On 19 March 2004 the ACCC issued a Part A Competition Notice to Telstra in relation to the pricing of Telstra's broadband internet services. The ACCC noted that it had reason to believe that Telstra had engaged and was engaging in at least one instance of anti-competitive conduct and was using its substantial market power to lessen and hinder competition.

3.33 The ACCC noted that since at least 15 February 2004:

> Telstra has supplied, and continues to supply, wholesale Broadband Services to its Wholesale Customers at wholesale prices set at a level whereby there was and is only a small positive or negative difference between those wholesale prices and the retail prices; and
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> Telstra has refused, and continues to refuse, to supply wholesale Broadband Services to its Wholesale Customers at prices other than wholesale prices set at a level whereby there was and is only a small positive or negative difference between those wholesale prices and the Retail Prices.[26]

3.34 The Part A Competition Notice against Telstra opened the way for a Part B Competition Notice to be issued with a possible fine of $10 million - rising by $1 million a day - and legal action from Telstra's competitors.

3.35 On 23 March 2004 Telstra's strategy was commented on in the following terms:

> At this stage it appears Telstra's strategy is to defuse the threat of the competition notice by commercially agreeing on deals on wholesale prices. Presumably it believes the potential volume gains, and the potential to

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25 Simon Hackett, Managing Director Internode, Opinion from Australian IT.com.au readers, Broadband price squeeze, 22 March 2004, URL: http://australianit.news.com.au/common/print/0,7208,897342361542566nbv6,00.html.

26 Australian Competition and Consumer Commission, ACCC issues competition notice to Telstra over broadband internet pricing, 19 March 2004, URL: http://www.accc.gov.au/content/item.phtml?itemId=490779&nodeId=file405a5f8237919&fn=Competition%20notice.pdf.

> migrate entry-level customers to higher-capacity, higher-margins plans, will still offset the loss of wholesale margins.[27]

3.36 On 31 March 2004 Telstra announced two new wholesale access packages aimed primarily at addressing the competition notice and the concerns of Telstra's wholesale customers:

> 'Protected Rates' Option.
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> This option provides wholesale prices at a 40 per cent discount to retail access and connection prices across all plans. Wholesale prices will be tied directly to BigPond's pricing plans by taking BigPond's effective starting retail prices and deducting a 40 per cent discount for retail costs and further deductions to cover other wholesaling costs. This will suit customers who want certainty over wholesale/retail pricing relativity.
>
> 'Growth' Option.
>
> This package will assist broadband ISPs to drive profitable growth across the spectrum of retail pricing. It will offer attractive price reductions for higher speed plans, on the basis that sustainable industry outcomes can be achieved via migration of retail end-users from lower value plans. It will suit those ISPs who see the commercial opportunity to upgrade their customers to higher-speed plans; and who want full flexibility over their retail pricing options.[28]

3.37 It was reported that Telstra's price reductions appeased the ACCC's concerns with ACCC Chairman, Mr Graeme Samuel, stating that Telstra's new offer 'appears to be a victory for commonsense'.[29] However, many of Telstra's competitors were critical. Some of Telstra's largest wholesale customers claimed that Telstra had not consulted with them on the new pricing arrangements and that they had heard of the new pricing arrangements via the media. Additionally, it was claimed that the options available to Telstra's wholesale customers tied them into Telstra's retail structure. It was argued that the 'Protected Rates' Option introduced a third variable cost for ISPs and the 'Growth' Option had not dropped the cost of 256k port pricing despite the fact that this was the area in which the current price squeeze existed.[30]

3.38 Some argued that the new pricing structure was largely an attempt to deflect ACCC intervention:

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27 Stephen Bartholomeusz, 'Telstra strung up by its broadband plan', *The Sydney Morning Herald*, URL: http://www.smh.com.au/articles/2004/03/22/1079939582767.html.

28 Telstra, 'Low broadband prices preserved', *Media Release*, 1 April 2004, URL: http http://www.telstra.com.au/communications/media/mediareleases_article.cfm?ObjectID=31526.

29 Kate Mackenzie, 'Telstra BigPond Backflip', *The Australian*, 1 April 2004, URL: http://australianit. news.com.au/common/print/0,7208,9146732^15318^^nbv^15306,00.html.

30 Phil Sweeney, *Whirlpool News*, 6 April 2004, URL: http://whirlpool.net.au/article.cfm/1257.

> Telstra appears to have attempted to move focus away from that by introducing bizarre wholesale offerings on the side, which appear to be ultimately unattractive to their customers.[31]

3.39 On 9 June 2004 it was reported that the Competition Notice was still alive and as of that date Telstra had accumulated $91 million in possible fines. An article in *The Australian* referred to a seeming hesitancy by Mr Samuel to act and Telstra's propensity to:

> Fight the case in court, but the fabulously paranoid telco never ever makes it past the courthouse steps, preferring always to let a large sack of shareholders' cash do the talking.[32]

3.40 Mr Bruce Akhurst, Telstra's group managing director for wholesale, defended Telstra's action as merely stimulating the market and providing broadband at affordable prices. The discounting had led, over a five-month period, to a 46% increase in broadband subscriptions. The action led Telstra to forecast that it would sign up its millionth broadband customer by July 2004, six months ahead of earlier forecasts.[33]

3.41 On 25 June 2004 the ACCC warned that the Competition Notice still remained in force and that a number of potential options were open to the Commission in relation to the notice.[34] On 19 July 2004 the ACCC issued another media release stating that it still had reason to believe that Telstra was engaged in anti-competitive conduct of a kind described in the Competition Notice. Consequently, the ACCC had decided to keep the notice in force.[35]

3.42 On 21 February 2005 the ACCC revoked the Competition Notice, ending the long-running dispute. As part of the settlement Telstra agreed to rebate $6.5 million to its affected wholesale customers. While many of Telstra's competitors had urged the ACCC throughout the period that the Competition Notice was in force to pursue legal redress, and despite the ACCC's continued claim the Telstra was 'likely to have been in breach of section 151AK of the TPA', no action was taken against Telstra by the ACCC. While the ACCC issued a statement saying they were pleased with the outcome, many of Telstra's competitors were not.

3.43 Some submissions argued that the application of Part XIB required improvement, both in terms of transparency of the process and the size of the penalties

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31 Phil Sweeney, *Whirlpool News*, 6 April 2004, URL: http://whirlpool.net.au/article.cfm/1257.

32 Michael Sainsbury, 'Telstra taunts the watchdog', *The Australian*, 9 June, 2004.

33 Blair Speedy, 'Broadband cuts "altruistic"', *Weekend Australian,* 12 June 2004, p. 35.

34 ACCC, *Challenges in Telecommunications Competition and Regulation*, p. 3. Accessed on 30 June 2004, URL: http://www.accc.gov.au/content /item.phtml?itemId=518743&nodeId =file40dbc06cdfb57&fn=20040625%20SPAN.pdf.

35 ACCC, *'ACCC leaves competition notice in force'*, 19 July 2004, URL: http://www.accc.gov.au/content/index.phtml/itemId/524972/fromItemId/ 2332.

that the ACCC could impose. Additionally, it was noted that Part XIB was a reactive tool for the regulator and as such its use involved greater uncertainty and risk for market participants.[36]

Part XIB: lessons learnt

3.44 The 2004 ADSL competition notice against Telstra offers an opportunity to examine the anti-competitive mechanisms of the current regulatory regime and asses whether such mechanisms are successful in addressing anti-competitive behaviour. During this inquiry the Committee has received substantial evidence from industry participants, commentators and consumer groups which argued that the 2004 ADSL competition notice clearly illustrates the inadequacy of the current regulatory tools in dealing with anti-competitive behaviour. Several weaknesses identified with the Part XIB process are discussed below.

Defining abuse of market power

3.45 Several participants in the inquiry considered that the lack of clarity in the definition of anti-competitive conduct in Part XIB made it difficult for the ACCC to contest the 2004 broadband issue. AAPT argued that the number of complaints made versus the number of actions brought showed 'a great deal of confusion':

> There is no doubt that there is a lack of clarity of what constitutes anti-competitive conduct. This is complicated by the fact that existing case law in the area is related to markets that are initially competitive being preserved, whereas the telecommunications market is initially uncompetitive and we are trying to promote competition.[37]

3.46 Mr Paul Budde stated:

> Telstra can undercut the wholesale price with their retail price. What more evidence do we need that this is anticompetitive? It is obvious. Why does it take a year to say, 'Yes, perhaps it was anticompetitive,' because of some technicalities that lawyers can always find if you throw enough money at them.[38]

3.47 Mr David Spence representing Unwired Australia stated that they considered there was 'a lack of clarity on what constitutes abusive market power':

> We are concerned that companies practising tactics that could be seen as an abuse of market power are not being penalised enough or quickly enough. We believe the government needs to clearly and specifically define what constitutes an abuse of market power under the *Trade Practices Act*.[39]

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36 Optus, *Submission* 12, p. 22.

37 AAPT, *Submission* 13, p. 5.

38 Mr Paul Budde, *Committee Hansard*, 13 April 2005, p. 54.

39 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 109.

3.48 Mrs Dianne O'Hara from TransACT told the Committee:

> I think part of Telstra's conduct is anticompetitive, but it does not fit neatly within the anticompetitive components of the Trade Practices Act.[40]

Proving decreased competition – the effectiveness of accounting separation

3.49 Central to concerns about Part XIB is the requirement to demonstrate that competition has been lessened. The Committee heard arguments that Telstra was able to act in such a way as to make it difficult to prove instances of the lessening of competition.[41] Dr Walter Green from the Communications Experts Group stated:

> The one thing that comes out in all the submissions is that the ACCC have one hand tied behind their back. Not only do they have to prove that the action that is taken by a carrier is unethical or against competition but they then have to prove that what they did is of such significance that it would damage the community.[42]

3.50 The Communications Experts Group also pointed to the lack of clear methodology in establishing a case:

> There is no clear methodology or process for proving abuse of market power. In many cases the ACCC have asked for evidence to support a claim, however there is no outline or description as to what evidence is acceptable or what evidence will assist the ACCC in preparing a sound legal case. This makes it both expensive and difficult for all concerned in collecting and analysing evidence.[43]

3.51 Optus argued that often lessening of competition was very subtle and difficult to prove, especially with respect to non-price terms:

> In many cases Telstra can get away with giving resellers like Optus poorer connection times and repair times, and higher prices, than to its own retail operations because it judges that we would not be able to show to a court that the particular instance involved a substantial lessening of competition.[44]

3.52 The practices outlined by Optus and other wholesale customers, also discussed later in this chapter, cannot be captured by accounting separation and record-keeping rules. As the Committee heard:

> It is not only Telstra's wholesale rates that are hindering competitors from obtaining sustainable margins. Perhaps equally important are the numerous 'conditions' Telstra can use to make life miserable – from access to local

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40 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, p. 9.

41 For example, Optus, *Submission* 12, p. 22.

42 Dr Walter Green, *Committee Hansard*, 29 April 2005, p. 17.

43 Communications Experts Group, *Submission* 26, p. 2.

44 Optus, *Submission* 12, p. 22.

> exchanges (the key is lost) to uncertainty regarding investment from the competitors. Telstra can change the rules as it wishes – for example, in relation to its future network upgrades (wholesale conditions only apply to copper networks, not to HFC or FttH networks).[45]

3.53 This weakness of the analytical tools used to provide transparency of pricing was raised by Dr Walter Green:

> If you now start trying to put an econometric model together which will model those total costs, you suddenly find that there are sufficient vagaries and inconsistencies that you cannot create a sound legal argument. Even if you had all the information, the econometric modelling tools that you have today cannot deliver the ACCC with the tools to defend or propose adequate pricing.[46]

3.54 The ACCC also argued that Part XIB and accounting separation did not provide the appropriate mechanism to act more decisively:

> In the case of the recent Part XIB broadband pricing matter, the lack of genuine internal pricing by Telstra created substantial difficulties for the ACCC in establishing anti-competitive conduct by Telstra. As such, the ACCC was forced to rely on imputation testing, a much more limited analytical tool to infer an implicit price at which Telstra is supplying wholesale services to itself.[47]

3.55 Some submissions were concerned that the regulator itself had little faith in accounting separation and in its ability to deal with anti-competitive behaviour. Mr Ian Slattery from Primus, referring to the 2004 anti-competition notice, told the Committee:

> I am fairly confident in saying that the ACCC itself admitted that the accounting separation regime was of little, if any, use with regard to its investigation into that allegation of anticompetitive conduct. There is an absolutely critical issue of alleged anticompetitive conduct in which the accounting separation regime was of no assistance. If it cannot deal with the most fundamental of issues, then it is obviously a failure.[48]

3.56 Similarly, the Australian Consumers' Association noted that:

> The Accounting Separation framework devised by the Government accepts that Telstra vertical integration is an issue. However it is disturbing, if not entirely unexpected, to hear from the ACCC as custodian of the regulatory operation and analysis of that framework say:

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45 Mr Paul Budde, *Submission* 1, p. 1.

46 Dr Walter Green, *Committee Hansard*, 29 April 2005, p. 19.

47 ACCC, *Submission* 17, p. 6.

48 Mr Ian Slattery, *Committee Hansard*, 11 April 2005, p. 20.

> We have repeatedly made clear our view that the current accounting separation regime has not been successful in giving us the kind of transparency we need in order to develop a satisfactory understanding of the way Telstra operates its businesses.

The ACCC further states in submission to the PC:

> The ACCC's experience in administering the accounting separation arrangements suggests that the extent to which they facilitate the identification of anti-competitive behaviour is marginal at best. In most cases, investigations into allegedly anticompetitive conduct require the ACCC to collect very detailed, specific data which cannot be captured through periodic accounts reporting.[49]

3.57 In its submission to this inquiry the ACCC argued:

> The ACCC has previously noted some specific concerns regarding the effectiveness of the current enhanced accounting separation arrangements. Specifically, the current accounting separation is nominal in that it only requires Telstra to collect and report information. It does not require the carrier to reorganise its internal affairs and operate as if it were running two or more discrete businesses.[50]

3.58 The ACCC went on to argue that:

> The accounting separation regime was originally intended to provide greater transparency in the way Telstra conducts its retail and wholesale operations, thereby enabling the ACCC to easily identify any discriminatory behaviour towards rivals seeking access to its network.
>
> However, information provided by Telstra under these arrangements is highly aggregated, which can hide specific instances of anti-competitive behaviour requiring more detailed analysis. It is significant that the ACCC has relied on the existing accounting separation arrangements to only a very limited extent in relation to its imputation testing analysis of specific cases.
>
> More importantly, the primary limitation of the accounting separation arrangements is that they require only a notional allocation of costs across the wholesale and retail businesses.
>
> As noted above, the arrangements do not require the carrier to reorganise its internal affairs and operate as if it were running two or more separate discrete businesses.[51]

3.59 Further, the reliance of the ACCC upon Telstra to provide only notional allocation of costs across the wholesale and retail businesses ensures that it is difficult

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49 Australian Consumers' Association, *Submission* 16, p. 5.

50 ACCC, *Submission* 17, p. 4.

51 ACCC, *Submission* 17, p. 4.

if not impossible to establish a true indication of wholesale and retail costs. Mr Ian Slattery from Primus told the Committee:

> We talk about transparency and all the rest of it, but it is really all about ensuring, to the fullest possible extent, in the absence of structural separation, which removes all incentives to behave inappropriately, that Telstra Wholesale treats its retail and competitive arm in the same way as it treats competitors. This is where accounting separation dramatically falls down in terms of wholesale pricing to retail arms. It is not reflective of an internal transfer pricing regime within Telstra. It is just a notional allocation of costs. It does not identify what Telstra retail is purchasing wholesale upstream inputs for.[52]

Difficulty in mounting a legal case

3.60 During Additional Estimates hearings in February 2005, Mr Graeme Samuel noted the complexity of the imputation and margin testing modelling and the difficulty in establishing a case for prosecution based upon these tests:

> … the real issues in relation to the matters that we have had to deal with on this competition notice have been in two areas. The first area is the complex imputation and margin testing modelling that we have had to do. That is always not only complex but also uncertain because it relies upon assumptions as to future conduct and future behaviour in the marketplace which can be the subject of much debate and that will lead to uncertainties in outcomes.[53]

3.61 ATUG argued that the lack of information transparency and the reliance of wholesale customers upon Telstra services were detrimental in resolving the competition notice:

> Information asymmetry, resource asymmetry and input dependence mean the real effectiveness of protective tools such as s46 or Part XIB is in practice doubtful – as we saw with the 2004/2005 Broadband Competition Notice. The inability of the ACCC to obtain court robust evidence from competitors who depend on Telstra services for their business is not surprising.[54]

3.62 Similarly, the fact that the ACCC requires material held by Telstra and upon Telstra's wholesale customers to provide evidence against the carrier is of concern. Dr Walter Green from the Communications Experts Group noted:

> A key failure in the current regulatory regime is the assumption that it is possible to construct a sound legal case based on econometric modelling to prove abuse of market power. This assumption is flawed because all the key

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52 Mr Ian Slattery, *Committee Hansard*, 11 April 2005, p. 22.

53 Mr Graeme Samuel, ACCC, Senate Economics Legislation Committee, *Additional Estimates Hansard*, 17 February 2005, p. 15.

54 ATUG, *Submission* 20, p. 10.

> data to prepare a legal argument is held by the carrier, and it is impossible to remove the effects of other transactions to enable a clear and unambiguous case to be presented.[55]

3.63 AAPT pointed out that the ACCC had difficulty in obtaining witness statements to support the process:

> The ACCC spent considerable resources in continually reviewing each new wholesale price offer made by Telstra and whether to lift the notice instead of dedicating them to construct the full case. As a consequence the ACCC found it hard to get quality witness statements as they came to it very late in the whole process.[56]

3.64 During Additional Estimates hearings in February 2005, ACCC Chairman, Mr Graeme Samuel, outlined the difficulty in obtaining evidence from wholesale customers alleging anticompetitive conduct:

> The second area is the gathering of evidence from those who might be affected by the alleged anticompetitive conduct. While there are many wholesale customers of Telstra that are quick to make very broad statements as to the impact of anticompetitive conduct, when one has to proceed through a process of obtaining detailed evidence that would be satisfactory for admission in a court of law that can take a lot more time and on some occasions there can be some reticence on the part of those wholesale customers to say anything more than they might have otherwise said, either anonymously or even on the record through the media.[57]

3.65 The Committee was told that some of Telstra's wholesale customers were reluctant to go to the ACCC for fear of possible retribution:

> In many cases the persons who can assist the ACCC are dependent on Telstra for revenue and connections to customers, so there is a reluctance to antagonise Telstra by lodging a complaint to the ACCC.[58]

3.66 The reluctance to antagonise Telstra was clearly felt by a number of ISPs who rely on Telstra for wholesale services. One witness likened it to 'standing on the dragon's tail':

> We do not take it to the ACCC; we take it to our account manager at Telstra and we jump up and down… I do not want to go to the ACCC about it, for the exact same reason I talked about before—that I want to focus on building my business rather than get involved in legal issues and ACCC issues and all the rest of it. The second reason is I feel it is like standing on

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55 Communications Experts Group, *Submission* 26, p. 2.

56 AAPT, *Submission* 13, p. 6.

57 Mr Graeme Samuel, ACCC, Senate Economics Legislation Committee, *Additional Estimates Hansard*, 17 February 2005, p. 15.

58 Communications Experts Group, *Submission* 26, p. 2.

> a dragon's tail: step on the dragon's tail and it turns around and bites you. It is just not worth it.[59]

3.67 However, the Committee also heard from representatives of the CCC who argued that their members did provide witness statements to the ACCC.[60] Similarly, Mr David Havyatt from AAPT told the Committee:

> We volunteered a witness statement to them in April 2004, long before they even asked for one, so we are still confused by this suggestion that there was a lack of support from the affected parties. What you did not notice, though, was anybody bringing an action for their own damages claims under the competition notice provisions, which, I think, is one of the issues that the ACCC were surprised by.[61]

3.68 While the Part A Competition Notice opened the way for affected parties to take legal action against Telstra, this did not occur. The Committee was told that Telstra's wholesale customers did not have the necessary resources to pursue an issue against Telstra:

> The issue as far as we are concerned is that, by definition, when you are dealing with anticompetitive conduct against someone with market power you are in a very asymmetric situation to begin with—the ability of the other party to commit resources to the legal matter is significantly greater than yours. When you are undertaking consideration of a claim you look at the potential outcomes; one of the outcomes could be that you wind up having to pay the other party's costs.[62]

3.69 Similarly, Mr Stephen Dalby from iiNet argued that smaller ISPs did not have the necessary financial resources to take civil action against Telstra and therefore looked to the larger international corporations like Optus, Primus and AAPT to do so:

> It would be a question of the finance and resources rather than necessarily the number of names on the roster … What tends to happen is a lot of the smaller players will sit back and look to see how Primus or AAPT or iiNET or somebody else goes and then ride on the shirt tails of that decision. I know there was a call from a Sydneysider or someone from Brisbane saying, 'Let's put a class action together,' following the announcement on the competition notes, but I do not know whether it ever got off the ground. In Western Australia the internet community here talked about getting a class action together right at the beginning of that competition notice. We declined at that stage and I do not think it got any further. In theory it is quite a possibility but I have not seen it happen.[63]

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59 Mr Damian Kay, Telcoinabox, *Committee Hansard*, 21 April 2005, p. 29.

60 Mr David Forman, *Committee Hansard*, 11 April 2005, p. 25.

61 Mr David Havyatt, *Committee Hansard*, 11 April 2005, p. 31.

62 Mr David Havyatt, *Committee Hansard*, 11 April 2005, p. 31.

63 Mr Stephen Dalby, *Committee Hansard*, 29 April 205, p. 48.

3.70 However, industry participants considered that it was the ACCC who should have pursued legal action and were critical of its decision not to do so. Mr Forman stated:

> We wanted the ACCC to go to court if it believed that there had been a breach of the law, to establish that it was willing to take that step against Telstra; that the law, when breached, was taken all the way to the court; and that it was willing to go through the processes of establishing the breach before the courts. I think the ACCC made judgements by taking what it considered was a pragmatic view that a settlement was a more cost-effective way of bringing the matter to a close. That goes to how you perceive this competition notice mechanism. Is the mechanism a lever to drive Telstra to settle with its customers or to settle with the ACCC, in which case the judgments that you make about it are dynamic—they continue to change, based on Telstra's behaviour? We did not take the attitude that it was that kind of mechanism. We thought: you break the law, you pay a fine. We thought that needed to be established.[64]

Flaws in the process

3.71 Some submissions raised concerns that the ACCC had resolved the ADSL competition notice behind closed doors with little or no industry involvement:

> There is little transparency into the details of the arrangement reached between the ACCC and Telstra in dealing with the matter. Further, there has been little consultation with industry about the new measures the ACCC has agreed with Telstra.[65]

3.72 Due to the lack of details of the settlement, some submissions sought more clarity from the ACCC on its position. Mr Paul Budde told the Committee:

> I think that it would assist everybody involved if this Inquiry clarifies the regulator's position on issues like this. Either the Regulator made a mistake and Telstra was attacked by malicious competitors who wanted a free ride on Telstra's network, or Telstra is 'gaming' the regulatory system and utilising the weaknesses in that system that prevent the ACCC from acting effectively.[66]

3.73 The length of time that the ACCC takes to issue a competition notice was also of concern to many, as outlined above. During recent Budget Estimates hearings, Mr Graeme Samuel acknowledged that the ACCC should act more quickly in future:

> [I]n the event that there was an apparent engaging in of anticompetitive conduct by a party that fell within the specific provisions of the telecommunications act in the future, we would probably find ourselves acting a little faster than we did this time around. This was done very

64 Mr David Forman, *Committee Hansard*, 11 April 2005, p. 24.

65 Optus, *Submission* 12, p. 22.

66 Mr Paul Budde, *Submission* 1, p. 6.

> quickly, but we would find ourselves acting somewhat faster. We might cut out some of the processes that we adopted this time around, other than those that are compulsory processes under the [A]ct.[67]

3.74 Mrs Dianne O'Hara from TransACT noted that engaging with the ACCC is not, at times, a viable path to take:

> As a small organisation, though, we do find it difficult to use the ACCC in order to achieve outcomes. TransACT's view is that with a lot of the ACCC processes you need time and resources to achieve an outcome, and those are things that TransACT generally does not have a lot of. … One example of that is the heat loading issue. Looking at the practicalities of it, we wanted to get to Gungahlin as quickly as possible, part of that is you settle and a practical outcome of that settlement is that you just get the extra rack space and you wear that additional cost. If we had gone through some sort of ACCC process we would not be as far down the track with the Gungahlin exchange as we are now.[68]

3.75 During recent Senate Estimates hearings the Committee also became aware that Telstra had lodged a 'Freedom of Information' request with the ACCC in regard to statements made by ACCC Chairman, Mr Graeme Samuel, on the frequency of complaints from some of Telstra's competitors about getting access to Telstra exchanges for installing new broadband equipment. The Committee is concerned that this action may act as a deterrent to competitors from using the ACCC regulatory process and 'stepping on the dragon's tail'.[69]

Financial penalties

3.76 Industry participants were particularly critical about the compensation agreement between Telstra and the ACCC. They argued that the $6.5 million payment to Telstra's wholesale customers would not act as a deterrent for future anti-competitive behaviour. As Mr David Spence from Unwired Australia stated:

> … it is also clear to the industry that the ACCC has been ineffective when it comes to ensuring companies do not abuse market power. To take a recent example, the $6½ million fine issued to Telstra this year in response to its retail price drop almost a year previously was seen by the industry as a slap on the wrist—certainly not something that would prevent Telstra from doing the same again.[70]

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67 Mr Graeme Samuel, Senate Economics Legislation Committee, *Estimates Hansard*, 31 May 2005, p. 57.

68 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, p. 9. The Gungahlin example is discussed in more detail below.

69 Senate Economics Legislation Committee, *Budget Estimates Hansard*, 31 May 2005, p. 62.

70 Mr David Spence, *Committee Hansard,* 13 April 2005, p. 110.

3.77 Many others such as Mr Damian Kay considered the payment was inconsequential compared with the huge market gain Telstra had made while it was subject to the competition notice:

> Even if it was $1 million a day and they did it for 60 days—$60 million—with all those people coming on signing 12- to 24-month contracts, it is well worth it. Call it a cost of acquisition… They just build it into their marketing fund. Sixty million dollars is not a lot of money when you are signing 100,000 people up to a service because it is the cheapest in the market and you are not providing those tail circuits—whatever you want to call them—such as access to DSLAMs at a more expensive price than they are retailed.[71]

Impact on smaller players

3.78 During this inquiry the Committee became aware that many small ISPs were hit hard by both Telstra's actions and the Part XIB process itself. As one regional ISP explained to the Committee:

> Telstra clearly knew and understood that the ACCC would find them guilty. ... They also knew that in the time it took to drag them, kicking and screaming and shuffling feet, to the ACCC they would effectively destroy the market for people like us. The consumer would be driven over to their services, and the consumer is not likely to come back, whether it be a business consumer or an everyday consumer, because there is a lock-in effect. You have identities. When you set up business technology systems there are these things called internet protocol addresses and network addresses et cetera, so there is that lock-in effect. Telstra, quite cannibalistically, understood that very well. … I found that the ACCC was quite a toothless tiger.[72]

3.79 Consequently, it appears that small telecommunications businesses believe that Part XIB does little to protect them from anti-competitive behaviour and protects only large businesses with deep pockets and the ability to ride out the protracted process:

> … it protects large operators in the sense that it is a cumbersome and effective reactive arrangement, it has a long gestation period and it is subject to the court's determination on whatever remedy. From a small operator's viewpoint, part XIB…seems to be so far away and part XIC seems to have no teeth, so we believe that we are essentially unprotected.[73]

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71 Mr Damian Kay, *Committee Hansard*, 21 April 2005, p. 27.

72 Mr Arthur Hissey, *Committee Hansard*, 14 April 2005, p. 24.

73 Mr Thomas Amos, *Committee Hansard*, 13 April 2005, p. 88.

The ACCC's powers

3.80 Mr David Spence from Unwired Australia told the Committee he considered that the ACCC did not have adequate powers to gather evidence:

> … it takes a long time to collect evidence and get Telstra to respond to the collection of evidence in a way that can be utilised by the ACCC. It is not just Telstra; it is others too. [The ACCC] should have the power to go in and investigate inside telecommunications companies.[74]

3.81 However, Mr Bill Scales, Telstra's Group Managing Director, Corporate and Human Relations, told the Committee:

> The ACCC has the power to effectively subpoena every document inside Telstra and to subpoena every executive inside Telstra. In this particular case the ACCC took nearly 12 months trawling through a whole range of documents. We provided complete access to any document the ACCC wanted… Remember that literally thousands of documents were asked for and literally thousands of documents were provided. They were also, under the so-called 155 notices, able to in fact subpoena executives, and they did. They were able to question them at length, and they did. And they found no evidence of anti-competitive behaviour. The ACCC can say whatever they like. All I can say to you is: if they had that power available to them—and they did—and they could find no evidence—and they did not—why do they keep saying that?[75]

3.82 Evidence to this inquiry suggests that Part XIB did not provide the ACCC with adequate legislative mechanisms to gather the necessary information to support their claim of a section 151AK breach. Industry participants told the Committee that they felt the ACCC's power was more in their persuasive rather than litigious powers:

> We get the strong feeling from them that they have limited powers in what they can do. Their biggest strength perhaps is persuasive power rather than litigious power. Litigation is very expensive—we know that—and the large telecommunications companies are very large and have many lawyers working for them. Our understanding is that, if they did have more power and if they did have bigger funds, it is likely that there would be earlier settlements and faster settlements than what has happened in the past.[76]

3.83 Mr Doug Coates submitted that the effectiveness of Part XIB was as much in its potential threat as any real weapon:

> This is the 'big stick' of the regime and its effectiveness relies as much in being a potential threat as an actual regulatory weapon. As such it should generally be reserved for critical situations and not applied excessively to

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74 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 117.

75 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 71.

76 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 116.

> relatively trivial disputes. The ACCC seems to know how to wield this stick, as was demonstrated quite recently.[77]

3.84 ACCC Chairman, Mr Graeme Samuel, had this to say during the Senate estimate hearings in 2005:

> [W]e have a number of processes available to us to deal with what we believe is a breach. Those processes will range from reaching a negotiated administrative settlement to producing court enforceable undertakings, all of which are provided for under section 87B of the act, through to proceeding to court to obtain various remedies. They are a suite of processes that are part of what is known as the compliance or enforcement pyramid. They are a normal part of every regulator that enforces the law.[78]

3.85 He went on to argue:

> I think it is clear in every approach and every analysis that has been undertaken of enforcement processes that there is a pyramid. It is known as the enforcement or the compliance pyramid. The foundation stone of that pyramid, the very base of it, is preventing breaches of the law in the first place. Then it moves up through various levels, through administrative settlements and court enforceable undertakings and through to the sharp point of the pyramid, which is litigation. The sharp point, the litigation process, is the powerful weapon, the powerful tool.[79]

Telstra's response

3.86 While the many witnesses to this inquiry felt that the 2004 competition notice issued against Telstra was ineffective, Telstra had a different view. Mr Bill Scales criticised the ACCC's handling of the process and claimed that it had indeed affected Telstra's dealings with the market throughout the period the notice was in force:

> The way that [Part XIB] is currently administered gives us a significant amount of uncertainty about what might be the actions taken by a regulator—in this case the ACCC—when we take any action to operate what we would regard as relatively normal in the marketplace. The most recent Big Pond competition notice was a very good example of that. From our perspective, we saw ourselves operating simply to meet the competition. There is no doubt that throughout that whole period we became risk averse in making what would have been normal business investment decisions. While it will not show up in any statistic, I can tell you without doubt that that affected the way by which Telstra thought about some of its investments over that whole period. Simply the operation on a

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77 Mr Doug Coates, *Submission* 2, p. 1.

78 Mr Graeme Samuel, Senate Economics Legislation Committee, *Budget Estimates Hansard*, 31 May 2005, p. 64.

79 Mr Graeme Samuel, Senate Economics Legislation Committee, Budget *Estimates Hansard*, 31 May 2005, p. 64.

> day-to-day basis of that particular section of the act is an impediment to the way we think about ongoing investment and the level of investment.[80]

3.87 Mr Malcolm Moore, telecommunications consultant, told the Committee that Part XIB was punitive against Telstra and should be repealed as it was not necessary.[81] This view was shared by Dr Mitchell Landrigan from Telstra, who argued that:

> Our position quite consistently for a number of years has been that the measures within part IV of the Trade Practices Act are, and have been demonstrably shown to be, sufficient to regulate the telecommunications sector and that the powers within part XIB are not necessary.[82]

The Committee's view

3.88 The Committee does not share the view that Part XIB is redundant. The 2004 broadband pricing episode demonstrates the need for a mechanism to address the issue of the abuse of market power, and it also demonstrates that Part XIB, the current mechanism, has a number of flaws. As Mr Richard Thwaites representing ATUG told the Committee:

> We believe that the anticompetitive behaviour provisions in the Trade Practices Act in several places need strengthening.[83]

3.89 In the final chapter of this report, the Committee proposes various amendments that may address these weaknesses. The Committee notes the Minister's comments of 9 March 2005:

> It is only more recently that the effectiveness of the competition rules has been seriously tested. For example the recently settled Competition Notice on Telstra in relation to ADSL pricing. While the framework will continue to serve us well, there are increasing calls for changes to deal with future network investments and ongoing transparency issues.[84]

Telstra's relationship with its wholesale customers

> In my industry we all see ourselves not in competition with each other but in competition with Telstra. I have 20,000 customers. My collective businesses turn over $25 million a year, and I am not a big player. I would

80 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 58.

81 Mr Malcolm Moore, *Committee Hansard*, 13 April 2005, p. 95.

82 Dr Mitchell Landrigan, *Committee Hansard*, 4 May 2005, p. 57.

83 Mr Richard Thwaites, *Committee Hansard*, 11 April 2005, p. 40.

84 Senator the Hon Helen Coonan, Minister for Communications, Information Technology and the Arts *Address to the Australian Telecommunications Users Group Conference*, Sydney, 9 March 2005, accessed on 16 April 2005 at: http://www.minister.dcita.gov.au/media/speeches/address_to_the_australian_telecommunications_users_group_conference.

> not even rate. I am a drop in the ocean—and I am happy to stay under the radar.[85]

3.90 During this inquiry the Committee heard from several of Telstra's wholesale customers who claimed that Telstra engaged in a range of anti-competitive practices that undermine the long-term competitive aspects of the market. Mr Arthur Hissey from Computer and Research Technology in Dubbo told the Committee:

> Telstra's behaviour in the market place is sometimes duplicitous and misleading – it purports itself to be a flexible commercial provider of communications technologies. In fact, it exerts unfair market pressures by virtue of its size – position – and infrastructure ownership. Then unlike real world businesses that are forced to either live or die by their true performance in a market place - they then hide behind a curtain of bureaucracy and government protection as and when the need suits them.[86]

3.91 Mrs Dianne O'Hara from TransACT told the Committee that Telstra adopted a range of practices that stifled competition, in effect favouring Telstra's retail services:

> TransACT is very operationally centred. It is fairly small and it has defined resources that it commits to certain things. What we come up against most is the dominance of Telstra and the various processes—'tactics' is perhaps not the right word—that are employed to slow, delay or make difficult effective competition at that level. From TransACT's point of view what we and other carriers would like is to be treated equally by Telstra wholesale. We want Telstra retail to be treated in exactly the same fashion as Telstra wholesale treat us without giving them additional information … [T]here is a range of non-price issues … be it information sharing or decision-making processes, and quite often it is those sorts of things that impact more on us than just the straight-out pricing issues.[87]

3.92 The number of Telstra's wholesale customers who have come forward during the course of this inquiry with allegations of anti-competitive conduct is of concern to the Committee. While these cases are disturbing and the Committee is sympathetic towards the many individuals whose livelihoods depend on fair commercial dealings, it is the regulatory regime which allows such behaviour, and the inadequacies of the regulatory tools to deal with this behaviour, that are of most concern.

3.93 The Committee notes that while there has been significant criticism of some aspects of Telstra's conduct in the pursuit of business gains, many submissions and witnesses were at pains to distinguish their comments about local Telstra employees. For example, Mr Joe Knagge from KNet Technology stated:

> … I worked for Telecom for 18 years. I am not here to bag Telstra. They are a very good organisation. They have extremely dedicated staff. I think

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85 Mr Damian Kay, Telcoinabox, *Committee Hansard*, 21 April 2005, p. 19.

86 Computer Research and Technology, *Submission* 27, p. 3.

87 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, p. 7.

> they are somewhat under-resourced, especially in relation to the uniqueness of regional Australia. … At the moment, the Telstra staff that I know in regional Australia still have that same dedication. They will go out there and they will try to get the very best service for their customers.[88]

3.94 In Perth, Mr Stephen Dalby from iiNet told the Committee that their experience with Telstra was bipolar. At the commercial level, agreements are one-sided, delays are common, choice is limited and very little is negotiable. At the technical level, performance is usually excellent and staff make every effort to co-operate.[89]

> So commercially, Telstra suck. Technically, they are great. That is a thread that runs through all of our relationships with Telstra. At a commercial level we do have nightmares. … Every decision has to be approved by at least seven managing directors as far as we can figure out. The only thing that Telstra has more of than managing directors is lawyers. It is unbelievable. Every decision has to be made a dozen times. That is at the commercial level. Once you get through that and you have signed an agreement and that has been propagated throughout the organisation, which is a story of its own, often things happen really well. We have had some great experiences. We take their technical guys out for a drink because they do such a great job. But that is after the heartburn of getting to that point in the first place.[90]

3.95 The cases of alleged anti-competitive behaviour which were brought to the Committee's attention have been grouped into the following key areas:

- competitors' capacity to roll out infrastructure;
- Telstra's deployment of services into regions once a competitor has rolled out infrastructure;
- aggressive pricing practices;
- 'churning' customers from the Telstra network;
- the unrecoverable costs of dealing with Telstra;
- managing customer problems on the Telstra network; and
- ADSL on Telstra lines.

3.96 Each of these issues is discussed below. Due to time constraints the Committee was unable to talk with as many ISPs as it desired. However, the problems outlined below and the experiences of dealing with Telstra commercially appear indicative of the issues faced throughout the country. In fact, the Committee notes that

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88 Mr Joe Knagge, *Committee Hansard*, 14 April 2005, p. 11.

89 Mr Stephen Dalby, *Committee Hansard,* 29 April 2005, p. 46.

90 Mr Stephen Dalby, *Committee Hansard,* 29 April 2005, p. 46.

there was a striking similarity of the complaints made by ISPs throughout the country. As one ISP representative stated:

> I have had discussions with other ISPs. The difference between the ISP industry and the telco industry is that ISPs talk to each other and share information quite well even though they are in competition. Talking to other ISPs, they have similar issues.[91]

Competitors' capacity to roll out infrastructure

3.97 Representing TransACT, a company that provides wholesale and retail services in the Canberra-Queanbeyan region, Mrs Dianne O'Hara gave examples of the difficulties an infrastructure competitor of Telstra faced:

> When you start doing work throughout the TEBA [Telstra Exchange Building Access] processes, you apply online and get an access pass to these exchanges. That is what we did. They are issued to each individual person.
>
> In the case of the Gungahlin exchange, the access pass was acquired and used. Telstra then started constructing a fence around the exchange. At a certain point, they padlocked the gate, so when you went to use your pass at the exchange you could not get in because you could not get through the gate. Effectively, that meant that TransACT personnel who had been granted access passes using Telstra's processes could not get access to that exchange. In order to access the exchange, our staff member had to then call the Telstra area manager, who would then issue them with the key to the padlock so they could get through the fence to get into the exchange.
>
> They did that on every separate occasion. They did, I suppose, attempt to make some effort to allow you to get in. At the same time as that, we had to apply for a key to the padlock—which we did—but that took some months to arrive.[92]

3.98 Mrs O'Hara went further:

> We have rolled out currently to six Telstra exchanges throughout the ACT; we did that from late 2003 until the first half of 2004. We again applied for TEBA space at the Telstra exchange at Gungahlin, when it was constructed. At that time there was a new change in the process that had been followed quite uniformly with the previous six exchanges. At the preliminary design study stage, TransACT was informed that the heat loading within the TransACT racks that we proposed to put in at that exchange was too high. That same heat loading requirement had not been imposed previously. TransACT was informed that their study would not be approved, as the heat load in the racks exceeded Telstra's policy guidelines.
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> We asked about what the policy guidelines were because we were not able to reference them either in the facilities access agreement or in Telstra

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91 Mr Stephen Dalby, iiNet, *Committee Hansard,* 29 April 2005, p. 42.

92 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, p. 4.

> TEBA design documentation. TransACT was referred to a web site. We were unable to reference the web site so we went back to Telstra again and were given a password. The password did not work and ultimately, after a delay of some weeks, we were faxed a hard copy of a working draft—marked 1997—on heat load. That is what has been applied since. The practical result of that is that TransACT has to rent additional space at the exchange to meet the heat load requirements. The other thing is that at the same stage as the Gungahlin exchange preliminary study went in, the same preliminary study went in for the Mawson exchange and that was approved without reference to the same heat load study.[93]

3.99 Mrs O'Hara explained that while these delays might appear to be negligible, the effects on business could be very damaging in such a fast-paced market.[94] Retail customers typically commit to term contracts. As a result, time is of the essence in installing infrastructure in exchanges to enable the provision of services. Delays such as these would have led to many potential customers being signed up by Telstra during the period that these delays were happening.

3.100 The Committee is concerned that when perpetuated across the industry these practices have an accumulative and substantially negative impact.

Telstra's deployment of services into regions once a competitor has rolled out infrastructure

3.101 The Committee was told that Telstra often invests in infrastructure shortly after a competitor has rolled out its own infrastructure in a region. Optus, with its cable pay-TV roll-out; Yless4U, a wireless broadband company in Bungendore near Canberra; and GMTel, a broadband company in Shepparton[95] are all companies which are claimed to have been affected by Telstra's aggressive behaviour. The Committee heard a substantial amount of evidence suggesting that Telstra's decision to deploy services to a regional area was often only in response to a competitor moving into that market:

> The evidence in North Queensland suggests that Telstra has been reluctant to make significant changes in investment in regional network infrastructure, except in reaction to a third party market. From our perspective, the major contenders to move into the marketplace are IQ Connect, Macquarie and trtel. They are the predominant players. They are altering the climate in Townsville, which is forcing Telstra to make changes.[96]

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93 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, p. 3.

94 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, p. 4.

95 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 110.

96 Mr Anthony Wilson, Townsville City Council, *Committee Hansard*, 21 April 2005, p. 35.

3.102 Telstra's preparedness to make non-commercial investments to protect its markets acts as a deterrent for many smaller telecommunications companies. These investments, often made only after competitor investment, are difficult to see as being anything but anti-competitive. If a business case for infrastructure investment did not exist in a market prior to a competitor's infrastructure roll out, it is unlikely to be improved by the presence of a new entrant. However, there is almost an expectation in the industry that once a competitor deploys infrastructure and services into a region, it will be closely followed by Telstra, which will use significant resources to out-market any competition.

> The issue for us in going into any region is really what happens once you have deployed the network… Once you go into that region, [Telstra] roll out on a Saturday morning their tables and chairs and start promoting their service. They do a lot of advertising and outmarket you in that area for a while to make it unsustainable.[97]

3.103 Telstra's marketing may also pre-empt competitors' movements into particular new markets by rolling out excess capacity. Again it was claimed that Telstra was able to use its significant resources to undermine any possible competition. As Mr David Spence from Unwired Australia told the Committee:

> In the McDonald's at Lithgow Telstra are running out hotspots. They are doing that round the country at the moment, with big posters saying, 'Get unwired.' That is before we roll out our service to these places.'… What they are offering is not a service that is anything like ours. It is a WiFi service, which means you take your laptop in with your Centrino chip and you get a little WiFi access in the McDonald's in Lithgow. They get into areas before we can roll out our network, in order to confuse the marketplace. So when we come with our brand Unwired, the market is already thinking, 'Get unwired, get Telstra'.[98]

3.104 The Committee notes that any near monopoly organisation when threatened with competitive action would work in a similar way to protect its markets. Mr Stephen Dalby from iiNet argued:

> The clear message that we have from dealing with incumbents over regulatory matters is that it is very obvious to us that some of the behaviour is designed to protect their market. It is not because they do not understand or that they do not have enough people; it is deliberate, it is a protective tactic and we believe that in many case they are aware of where the endgame is. They are not stupid. They understand that at some point this change will be effected, but they want to manage typically a decline in their revenues and manage that at as slight a slope as they possibly can. They do not want a rapid drop-off in revenues. You do not need to be Einstein to figure that out.[99]

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97 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 113.

98 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 114.

99 Mr Stephen Dalby, *Committee Hansard*, 29 April 2005, p. 36.

3.105 Mr Bill Scales, from Telstra, argued that the corporation responded to demand in the same way that its competitor did. Thus it was unsurprising that Telstra went into an area at roughly the same time as its competitors:

> In some ways it is not surprising that companies like us will look for where there is likely to be increased demand and that we will all go into that area roughly at the same time. So there is nothing surprising about people trying to anticipate where demand is and accommodating it. … You could imagine, again, a sort of cause and effect. You could see a situation where people register on the broadband register at the same time other people in other sectors of the industry are saying, 'It looks like there's a demand.' Then they go in and we go in at roughly the same time. But certainly we are not influenced at all by whether a competitor is going in. What we are doing is chasing customers where we can observe them.[100]

Aggressive pricing practices

3.106 The goal of competition policy is to drive prices down as service providers compete for market share. The Committee heard evidence of aggressive pricing practices being a major obstacle for competitors in the retail broadband market. Such practices in themselves are positive in that they result in lower prices, and the Committee has no issue with them. It is the unethical practice of price squeezes which is of concern to the Committee. Consequently the Committee distinguishes between the situations where Telstra's competitors are seeking some competitive advantage for their services and where they are subjected to price squeezing, as in the ADSL wholesale issue of March 2004.

3.107 Mr David Spence from Unwired Australia told the Committee of Telstra's aggressive pricing practices:

> A few months before we launched, Telstra dropped their prices dramatically and quite substantially, and we had to change our business case and what we did about how to go to the market. Recently, a month ago, I brought in some fast internet speeds of 64K and 128K for the dial-up market, which is in broadband. It is always on at these speeds. My blow-in price was pitched directly at Telstra's dial-up blow-in price of $15.95. A week later they dropped their price to $2.95 for the first six months of any new customer coming on in dial-up.[101]

3.108 Telstra's competitors argued that Telstra's ability to lower its prices in response to moves in the market ultimate disadvantages long term competition, as it is difficult for competitors to raise capital and invest sufficient funds in new services and infrastructure. This issue is discussed in detail in the following chapter.

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100 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 61.

101 Mr David Spence, *Committee Hansard*, 13 April 2005, p. 112.

3.109 The 2004 ADSL competition notice discussed above indicates that Telstra has the motivation to provide some wholesale products at higher rates than the equivalent retail product. The Committee heard that Telstra prices certain retail products below their wholesale cost, for example, in wireless access in Townsville.[102] Mr Damian Kay, Telcoinabox, said:

> The AirCard is over the CDMA network. I went to a Telstra shop and bought an AirCard—the cards retail for around $560. We looked at all the plans then went back to the office and met with our Telstra account rep and said, 'Can you give us the pricing for wholesale to buy the per kilobit download or MEG—whatever you want to call it—for that?' And the retail pricing was cheaper than the wholesale. So I use the retail service—it is cheaper.[103]

3.110 Similarly, he told the Committee about retail versus wholesale prices of ADSL:

> When we were first putting together Telcoinabox we sat down with Telstra. We had an arrangement with them and we were looking at what provider or network we would use to provide ADSL services to the franchisees, to universals and directly to the customer. So we went and saw Telstra. They had a product called vISP in-a-box, funnily enough. We went through the whole thing and it was great; it was sensational. There were some really good systems that backed it. It is more than price, of course; it is system support and all the rest of it. So we went through that and we said, 'Great! Show us the pricing.' 'Bang!' I had all their retail pricing ready, because I had a gut feel. I said, 'Your wholesale is more expensive than your retail.' They said, 'That's our pricing.' I said, 'Well, how do I compete, again?' It was quite a bizarre situation.[104]

Churning customers from the Telstra network

3.111 Some small to medium ISPs expressed concern about the prices charged by Telstra for the provisioning of exchanges and for enabling the transfer of the service from Telstra to another customer network. The Committee was told that Telstra charges its wholesale customers $90 for a technician to transfer a single customer off the Telstra network onto their own network, and that there is no variation in the price for mass migrations from the Telstra network:

> To churn a DSL service from Telstra Wholesale onto your own DSLAM … is $90 per service. If you do the maths quickly, if you have 200 or 300 services in an exchange area and you want them migrated to your network, Telstra is charging up to $20,000 for you to migrate those customers onto your network. If you know the rate that is being charged retail for a DSL service—that is, $29.95—it takes a long while to get back that $20,000. In

102 Mr Damian Kay, *Committee Hansard*, 21 April 2005, p. 17.

103 Mr Damian Kay, *Committee Hansard*, 21 April 2005, p. 27.

104 Mr Damian Kay, *Committee Hansard*, 21 April 2005, pp 26-27.

> other words, the cost of actually putting your infrastructure in place is not the issue. It is the cost of migrating it from Telstra's network to your network that is the issue. It just stops it from happening.[105]

3.112 Representatives from some national carriers also raised the issue of transfer costs, arguing that Telstra offers no discounts for economies of scale for mass migrations onto non-Telstra networks. Mr Ian Slattery from Primus said:

> I will add a slightly different dimension to this issue of Telstra's connection charge, which is over and above all the other capital costs. As a 'back of the envelope', when we look at the mass migration that Primus is intending to undertake to move its customers off a Telstra resale service onto our own DSLAM network, the total cost that we will be up for, given this $90 connection charge, will come in at around the same amount as our total capital costs and infrastructure.[106]

3.113 Similarly, Mr Paul Broad from PowerTel Ltd told the Committee:

> The thing about that is that it costs you, say, 90 bucks for one and 20 bucks for a hundred. There is no economy. Blokes are out there changing them and the up-front costs of getting there are the same. In effect, he gets in his car, drives away and comes back 90 times to redo it. Give me a break! It is an exploitation of monopoly power.[107]

3.114 Mr Graeme Samuel recently reported that the ACCC has noted industry concern over the cost of churning, and is investigating the matter:

> And one of the areas of considerable dispute in the industry is the prices Telstra is charging to have competitors' DSLAMs connected to the local copper loop - $90 to have somebody go to the exchange and physically change the connection from a Telstra DSLAM to the competitor's. This is one of the matters the ACCC is currently considering in relation to Telstra's ULLS and LSS undertakings.[108]

3.115 Mr Bill Scales from Telstra argued that the calculation of the cost of 'provision services' is complex and does not simply involve moving a single cable in an exchange. The cost depends on a variety of factors:

> When our wholesale business looks at these issues and negotiates with our wholesale customers, there are a range of prices for the delivery of certain services. They range from the complete provisioning, which is the establishing of a DSLAM and doing all of the work associated with that, where we are virtually providing the whole service for a wholesale customer so that to all intents and purposes they become a reseller of our

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105 Mr Errol Shaw, PowerTel Ltd, *Committee Hansard*, 11 April 2005, pp 23-24.

106 Mr Ian Slattery, *Committee Hansard*, 11 April 2005, p. 24.

107 Mr Paul Broad, *Committee Hansard*, 11 April 2005, p. 24.

108 Mr Graeme Samuel, 'The Telecommunications and Media Revolution', speech at the National Press Club, 27 April 2005, p. 5.

> business. Then we go right the way through to where some of our wholesale customers buy their own DSLAMs and do their own work, and all we do is the sorts of things that you might be describing here—relatively simple services—and each of them has a different cost.[109]

3.116 Telstra representative Mr Denis Mullane, General Manager Integrated Network Planning, told the Committee during the 2005 Budget Estimate hearings that the process was extensive:

> So we lock in these resources 20 days from the cut-over point. We require the provider to provide Telstra with a list of all the telephone services or the customers that are going to be migrated, and their cable pair details. That has to come into Telstra. … Then the work is programmed; it is confirmed. ... From between day 15 and day 3, Telstra go on site at the exchanges and they pre-jumper the work. … But they leave the service in situ as it is. Then, on the day of cut-over, they go back on site, they pull out the existing jumpers and they connect the new jumpers, so there is only a minimal outage period for the customer. … Then the records have to be updated. That is a very critical part. It requires considerable time, effort and resources. … And on top of that there is a project management that Telstra needs to put around its side of all of this business. We do project manage every job that has more than 50 end users. … But we do not count those in the cost. For all of that, the cost is not $90.
>
> In summary, it is very complex. It requires lots of preparation, very tight coordination across a wide group of people. We cost that work in line with the ACCC guidelines. For these mass migrations we do not charge a standard price, we negotiate a price and so on, where we can do that.[110]

3.117 Similarly, Mr Christopher Hill, a telecommunications consultant representing the Western Australian Local Government Association, told the Committee:

> There are some other impediments to them rolling out their network. To actually move a copper wire from over here to six feet to the left, it needs to be ordered in batches of 100 or 500 copper wires to be moved at a time and the work can occur many weeks out, so, although they have access to the copper and they can send signals down that copper, they cannot move the customer across from Telstra's infrastructure to their own in practical terms at this point in time. Once again, that is probably due to the situation sneaking up on the incumbent, but right now we still have a little bit of progress to make before we have a workable, fair and equitable access to that existing copper infrastructure in the ground.[111]

3.118 Concerns were raised with the Committee about the time that provisioning and churning processes take. The facility or exchange is Telstra's, and while Telstra

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109 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 66.

110 Mr Denis Mullane, Senate Environment, Communications, Information Technology and the Arts Legislation Committee, *Budget Estimates Hansard*, 24 May 2005, p. 73.

111 Mr Christopher Hill, *Committee Hansard*, 29 April 2005, p. 12.

allows technicians from other companies to enter, only Telstra technicians are authorised to undertake this work, so as to ensure that it is done in a way that does not threaten Telstra's capability or the capability of its other wholesale customers.[112]

3.119 The Committee heard that it could take up to six weeks to transfer a customer from the Telstra network onto a competitor's network. As Mr Damian Kay from Telcoinabox told the Committee:

> On many occasions Universal Telecom and Telcoinabox service providers have had to phone Telstra because they are so frustrated with requests for orders—we call them 'orders' in the LOLO system, or linx online ordering system. Whether it be an ad move or change order, customers have been delayed, put on hold or cancelled—they just disappear out of the system. Appointment times have been moved and so forth, and the person on the other end of the phone says—I do not know whether this forms part of their training when they start customer service 101 at Telstra—'If you had been with Telstra we would have done it for you straightaway'.[113]

3.120 Delays were also reported by Mrs Dianne O'Hara from TransACT. Mrs O'Hara explained that there were several steps in churning a customer from the Telstra network to TransACT:

> You have to ask whether there is a vacant line there. If there is not, you have to make other arrangements. They come back. You then put in a request to use that line. You then book an appointment for a Telstra technician to go out there and do whatever they need to do, both at the customer's house and at the exchange. You need our own contractors to then follow up and hook up our equipment at the house.[114]

3.121 However, Mrs O'Hara noted that this already lengthy process was intermittently prolonged due to missed appointments by Telstra technicians. The problem recurred in spite of efforts to secure a more reliable service from Telstra:

> We have had issues before with appointments and missing appointments, and that is one of the ongoing issues that this working level committee is trying to address and at various times has addressed, and then it seems that something slips again.[115]

3.122 The Committee considers that Telstra's failure to provide provisioning and churn services in a prompt, reliable and cost-effective manner is a substantial inhibitor of competition, and that immediate action is required.

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112 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 68.

113 Mr Damian Kay, *Committee Hansard*, 21 April 2005, p. 19.

114 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, p. 12.

115 Mrs Dianne O'Hara, *Committee Hansard*, 20 June 2005, p. 12.

The unrecoverable costs of dealing with Telstra

3.123 Several small ISPs told the Committee of the enormous cost they incurred in securing services from Telstra for resale to retail customers. These costs are largely unrecoverable and have the effect of discouraging Telstra's wholesale competitors from taking on customers. As Mr Arthur Hissey stated in Dubbo:

> It probably cost our company tens of thousands of dollars and hundreds of lost man-hours that we cannot recover. We are squeezed into a no-win situation. We cannot engage with or do our job for our customers until Telstra have done theirs. We are often in the situation where we become the go-between. I know that many of our colleagues in the industry are forced to go to Telstra as a negotiator, a facilitator, someone who understands the language but are not in a position to charge the customer. It is ridiculous to say to a customer, 'Look, I'm going to charge you $50,000 up front just to argue with, fight with and knock down Telstra so that we can engage a business solution for your particular business.[116]

3.124 Similarly, in north Queensland the Committee heard about a woman whose service was temporarily disconnected for not paying her account. In attempting to have this service reconnected, the ISP incurred costs from the Telecommunications Industry Ombudsman (TIO):

> On payment of her account we put in a request to have her line reconnected, and that took seven days from the time of request. In the midst of that Samantha lodged a complaint with the Telecommunications Industry Ombudsman, which subsequently cost us $1,000 to the TIO for something we had no control over. Again, that line has now been churned away from our provider to Telstra.[117]

3.125 The problem of unrecoverable service costs for line rentals was also raised with the Committee. The Committee heard that there is practically no wholesale margin on the supply of local line rental to the end user. Therefore a service provider can only re-bill the local line rental to the end customer. The local line rental pricing from Telstra for a business line customer on their Business Line Complete plan, is $31.77, and $24.50 for a residential home line. Hence the cost of customer care for a Telstra line is not recoverable, as one ISP told the Committee:

> The biggest issue here is that we have to support that, and that is a huge cost. There is general customer care; ads, moves and changes; monthly billing of the local line rental; collection of the local line rental, so we have to hold the debt of the end customer; and logging of line faults and so forth.[118]

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116 Mr Arthur Hissey, *Committee Hansard*, 14 April 2005, p. 19.

117 Mr Jeremy Moffat, *Committee Hansard*, 21 April 2005, p. 21.

118 Mr Damian Kay, Telcoinabox, *Committee Hansard*, 21 April 2005, p. 18.

3.126 Mr Damian Kay told the Committee that as a Telstra wholesale customer the cost to him of servicing a Telstra business line is $4.70 per month.

> Keeping this in mind, in supporting a typical line—for instance, I have used a business line in my submission—the approximate cost of billing, including the bill processing, the bill printing, the billing system and the postage, is $2. Collection, which includes anything like Australia Post, BPay, credit cards and so forth, is 60c. Total customer support is around $1.50. I have made a bad debt provision of two per cent of roughly $30, which is 60c. So the approximate total cost of just servicing every line is $4.70 per line per month.[119]

Managing customer problems on the Telstra network

3.127 Several regional ISPs told the Committee that, in their experience, Telstra frequently denied out of hand that service and supply faults experienced by wholesale customers originated on the Telstra network. Mr Arthur Hissey of Computer Research and Technology in Dubbo argued that Telstra's approach was irrational:

> … whenever you go to Telstra with a problem, on your own behalf or on your customer's behalf, Telstra's response is almost inevitably the same: 'There is no problem.' If I could draw an analogy with your car: imagine you went to a motor mechanic and said, 'I have a problem with my brakes,' and he immediately said to you, 'No, you don't.' You would think that was pretty bizarre—you are suggesting that you are having trouble stopping and have an unsafe vehicle and you are being told that it is fine. After you argue for a while, he says, 'Prove to me that it is not something else to do with your car—the suspension, steering or driving—and that it is not the road conditions. In fact, exclude every other possible factor that might be affecting a braking situation.' You would say, 'This is an absolutely ludicrous situation.' It is so bizarre as to be a Monty Python sketch.[120]

3.128 Mr Hissey stated that his company spends huge amounts of time and money convincing Telstra that the source of the problem is on the Telstra network and not with the ISP's equipment:

> Inevitably, by way of excluding all the other factors that might affect things, we will change equipment, pull equipment down, dismantle it and test it. We exclude every event and we go to Telstra and say, 'There is a problem' and they say, 'It is your computer' and we say, 'No, it's not' and they say, 'It is your router' and we say, 'No, it's not; it is proved and tested.' In the end there is nothing else it can possibly be other than the Telstra link. We have spent months—three, four and five months in some situations—where our businesses cannot connect to the internet in a reliable fashion, and Telstra has absolutely and vehemently denied there was a problem. Then a new business will come in next door, Telstra will be forced to run some new lines and the problem dissolves and disappears.

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119 Mr Damian Kay, *Committee Hansard*, 21 April 2005, p. 18.

120 Mr Arthur Hissey, *Committee Hansard*, 14 April 2005, p. 20.

> Months and months, hundreds of man-hours and tens of thousands of dollars are involved in trying to solve problems at an IT level and when one of our customers moves to Sydney the problem just disappears.[121]

3.129 Mr Hissey gave another example:

> That is your response when you go to Telstra: 'There is not a problem.' I think three or four days later we proved to some extent that there was a problem and they said they would check the lines. We were, for all intents and purposes, forcing them to check the lines. They said they had. I can only assume that that is a lie because one of my colleagues—one of our managers—accosted one of the Telstra field engineers and said, 'Please come in on a friendship basis and check our line.' When he did he said, 'Yes, of course it is not working; it is disconnected.' It is a death sentence to an ISP—an internet service provider—to have their service offline for one week, especially in a growing demand market. That random sampling shows events that are far from uncommon.[122]

3.130 In Perth, Mr Stephen Dalby from iiNet argued that regulation could not necessarily address the issues faced by wholesale customers who sought and were denied information from Telstra. Mr Dalby suggested that a paradigm shift within the organisation maybe more effective:

> They are very unresponsive to queries. These are all things that I do not think a regulatory regime is really going to do much about. It needs a paradigm change rather than regulation, but I bring it up in this context anyway. They are very unresponsive to queries, so that when you ask for more information or ask for an alternative, often you get no answer.[123]

ADSL on Telstra lines

3.131 During hearings in regional areas, some local ISPs claimed that Telstra would obstruct the reselling of wholesale ADSL services to non-Telstra customers. In Dubbo, Mr Jeffery Caldbeck from the Dubbo City Development Corporation told the Committee that Telstra were unwilling to provide ADSL availability information unless the customer signed on with Telstra:

> The problem was that he could not find out from Telstra whether there was a service delivery to his new house. So we took the matter on board for him. I personally rang Telstra and they asked for the street number and the telephone number, which I gave them. I asked whether a service delivery was available. I was told, 'We believe it is.' I said, 'Does that mean a yes or a no?' They replied, 'If you are willing to continue with this call and sign up, we will tell you whether it is available.'[124]

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121 Mr Arthur Hissey, *Committee Hansard*, 14 April 2005, p. 20.

122 Mr Arthur Hissey, *Committee Hansard*, 14 April 2005, p. 20.

123 Mr Stephen Dalby, *Committee Hansard,* 29 April 2005, p. 38.

124 Mr Jeffery Caldbeck, *Committee Hansard*, 14 April 2005, p. 3.

3.132 Similarly, in north Queensland the Committee heard accounts of customers being told that they would have to churn to Telstra in order to receive ADSL services. The Townville City Council were particularly concerned as they felt that local residents were being deceived by this practice:

> It is from our experience of trying to install broadband services that we were told by Telstra that customers who have non-current Telstra accounts will have to move their churn to Telstra Country Wide to get ADSL BigPond. Further, customers with Duet lines were also being bluffed into adding additional lines at a cost of $209. The council have successfully disputed this with Telstra Country Wide, but it is of concern to ordinary individual consumers who may be deceived by this process.[125]

3.133 The Committee heard from Mr Damian Kay from Telcoinabox who suggested that Telstra ability to offer ADSL services to retail customers, once they sign up with Telstra, amounts to corporate bullying:

> Telstra owns the exchanges. … a large majority of the connections are through the Telstra exchanges and via the Telstra DSLAMs. So when we buy what we might call a 'circuit' or 'tail'—or whatever term you want to use in the industry—which is the ability for us to be able to pump it down the copper wire, we use a system that Telstra gives us called LOLO. If you put a number into LOLO it tells you what services are available on it. It is a simple access to the system that Telstra gives you, and if it says no we believe the answer is no—it is either too far from the exchange to be able to provide that service or it is a bad line or the copper wire needs replacing—or whatever the reason is. But we have had examples where the customer then rings up Telstra and says, 'Can I get DSL?' and Telstra says yes and it is connected. It is corporate bullying; it is ridiculous.[126]

3.134 When questioned about this practice, Mr Bill Scales from Telstra argued:

> The general point that I would make about this, given that this is a review of the regulatory framework, is that there are remedies for this now. The ACCC could ring us at any time about any of these issues. It can investigate any of these issues at any time. It can determine at any time, under the existing regulatory framework, whether we are acting anti-competitively. None of this is new. There are remedies, and they are available to the ACCC and to people who make complaints right at this very moment.[127]

3.135 Witnesses also raised the issue of full line forcing where they were being forced to buy other Telstra products in order to purchase key ADSL Telstra services:

> I think the structure of the pricing for ADSL is still anticompetitive… When you buy a tail—that is, the service between the telephone exchange and the customer's premises—Telstra also obliges you to buy other

125 Mr Anthony Wilson, *Committee Hansard*, 21 April 2005, p. 35.

126 Mr Damian Kay, *Committee Hansard*, 21 April 2005, p. 20.

127 Mr Bill Scales, *Committee Hansard,* 4 May 2005, p. 70.

> products that you could buy elsewhere on the market but you are not free to. They refer to them as AGVCs—aggregated virtual circuits—and they aggregate all those tails from those customers from a single point back to us, as the ISP. That is just basic stuff. It does not have to be compatible with anything.[128]

3.136 In its defence, Telstra argues that the availability of ADSL services is not an exact science and the information that wholesale or retail customer receives depends on who answers the query:

> … when somebody rings up at front of house and asks whether they can get ADSL in their home or premises, the person on the line then has to go and look at our provisioning capability. They have to decide, on the basis of the information that may be available online, whether it is close enough to the exchange to say that we will be able to continually provide that service at the standard that is required.
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> … we have talked about the fact that roughly about 3½ kilometres from the exchange is where we begin to get a query about whether we can or cannot guarantee to a customer that they can get a high-quality broadband service on that line. In some circumstances, we have found that if, for example, a person rings you up, Senator Conroy, and you look at what is in front of you and say, 'I don't think you are going to be able to get it because you are not 3½ kilometres from the exchange; you are five,' and you might then ring up Senator Cherry, Senator Cherry would look at the same document and say, 'I just happen to know that I had somebody yesterday who rang me. While it's technically 3½ kilometres, I happen to know that it's actually not 3½ kilometres but it's flat…and so on and it might be four, and therefore I think we can provision you.'[129]

3.137 Mr Peter Lindsay MP also came to Telstra's defence, telling the Committee that he has received complaints from constituents about their inability to receive ADSL. However, on investigation he found that other ISPs had misled potential customers:

> I will get a complaint like, 'I cannot get ADSL connected.' …The customer will always tell you that it is a Telstra problem, but when you get to the bottom of it, it is not Telstra. What the customer has done is that they have gone to another ISP—there is a myriad of ISPs these days—and the ISP will say, 'No, you cannot get ADSL at your location.' As soon as I contact Telstra and say, 'Here is the phone number; here is the address; is ADSL available?' Telstra says, 'Of course it is.' You have to wonder why that happens.[130]

3.138 Speculating on the reasons for that result, Mr Lindsay said:

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128 Mr Stephen Dalby, *Committee Hansard*, 29 April 2005, p. 42.

129 Mr Bill Scales, *Committee Hansard*, 4 May 2005, p. 69.

130 Mr Peter Lindsay MP, *Committee Hansard*, 21 April 2005, p. 2.

> … I do not know whether some of the smaller ISPs have the capacity or the wherewithal to get the information and to get things connected. I do not know whether they have a shortage of capital and so, to allow their business to work within their capital limits, they tell the customer, 'Sorry, we can't connect you to ADSL' until whenever it is, while they wait till they get some more money in to buy the modems, do the installation, pay for the installation or whatever. I do not know what is going on there, but something is going on. When you come back to the customer and say, 'Look, I've checked with Telstra; your ADSL service is available now and you can connect now,' I can tell you it does not do the ISP that they contacted initially much good.
>
> Telstra is getting the blame for things that are not its problem.[131]

3.139 However, Mr Lindsay's views were not widely shared. Throughout this inquiry the Committee has been impressed by the high level of service and innovation provided by small and medium businesses in the telecommunications sector. Small regional businesses, as discussed in Chapter 2, depend for their survival on their ability to offer effective and efficient services. These small businesses also rely upon Telstra. It is this dependence which causes problems when Telstra does not share service and infrastructure information with wholesale customers. Mr Hissey, of Computer Research and Technology, described a recent example:

> … recently an organisation—I think it has about 230 banking branches in 75 different countries—wanted to come to Australia. It engaged us to set up its telecommunications and communications infrastructure. We went to Telstra and asked, 'What are the existing services that you provide to this company now, because they want to move and expand into Australia?' Eventually, after weeks and weeks of trying to access the right person, we were given the answer, 'We don't know; can you go and ask the customer for us?' We said, 'Hell, no, go and ask them yourself'—and they would not and they did not, and they did not care.
>
> But why would it bother Telstra? It is huge; it is monopolistic. It bothers us because we are engaged to provide a service that Telstra are key and critical in the delivery of—not the most expensive and not even the most technical. But, without Telstra linch-pinning it, the whole thing does not happen.[132]

3.140 The Committee acknowledges that Telstra takes every opportunity available to it to protect its market share. However, situations such as this which may potentially develop international business links present an opportunity for Telstra to work in partnership with its wholesale customers to the benefit of both. Mr Hissey argued:

> But, instead of Telstra being a proactive telecommunications organisation, one that comes to us and says, 'Let us assist you in setting up a rather

131 Mr Peter Lindsay MP, *Committee Hansard*, 21 April 2005, p. 2.

132 Mr Arthur Hissey, *Committee Hansard*, 14 April 2005, p. 23.

> important migration of companies into Australia,' it is obstacle driven the entire way.[133]

3.141 The Committee believes that the conduct referred to throughout this chapter reflects an apparent reluctance on Telstra's part to develop its wholesale business at the expense of its retail business. It also appears that post hoc regulatory intervention is unable to deal with these numerous smaller issues. As such the Committee suggests that the possible separation of these activities to allow Telstra to develop two independent businesses should be considered more closely.

Conclusion

3.142 In this chapter the Committee has canvassed various issues raised by telecommunications sector service providers who have claimed that Telstra uses its monopoly infrastructure to engage in a range of anti-competitive behaviour. The March 2004 ADSL episode illustrates that while there is currently specific regulatory provisions aimed at dealing with such behaviour, Part XIB of the TPA, appears inadequate.

3.143 The weaknesses of the current regulatory regime lie in the ability of Telstra to mask where the delineation between its wholesale and retail prices occur; the ACCC's limited capacity to prove anti-competitive conduct; the ACCC's limited ability to identify and respond to a myriad of non-price discriminations; and ultimately the fact that the ACCC's power to impose only financial penalties is not an adequate deterrent to anti-competitive behaviour. Consequently Part XIB of the TPA does not appear to provide the regulator, the industry or the wider community with confidence in the anti-competition regime.

133 Mr Arthur Hissey, *Committee Hansard*, 14 April 2005, p. 23.