However, there are still some key policy issues arising from the application of the Act to networks that may need to be addressed.

How should pro-competitive issues be assessed?

Under the current legislative framework, pro-competitive elements of networks may be relevant in assessing whether conduct is likely to substantially harm competition. However, for wider public benefits such as employment opportunities and industry growth to be considered, parties may need to submit their conduct for authorisation by the Commission.

When conduct includes a per se offence (for example price fixing, as for credit card interchange fees), pro-competitive arguments may not be taken into account unless the parties seek authorisation.

In assessing efficiency benefits and pro-competitive elements under either an authorisation or competition test, difficult issues will still arise in assessing the potential strength —efficiency gains with new technology markets. For example, it may be argued that allowing participant-ownership in a B2B is important to guarantee throughput — otherwise a B2B may be too risky to launch. However, it will be difficult to test this proposition in an immature market environment.

Treatment of intellectual property rights and s. 51(3) exemption

Intellectual property rights will be highly valuable in e-commerce, and as seen in the Microsoft case, how they are used may affect the competitiveness of markets. However, currently the application of the Trade Practices Act to the use of intellectual property rights is uncertain, and may be limited to s. 46 cases. This may not be adequate to address all issues, as this would only cover issues that constitute a misuse of market power and fall under a purpose test. Other provisions of the Trade Practices Act also include an effects test for the wider competitive implications of the conduct in question.

Duration of market power

This paper suggests we should be cautious in assuming that, in new technology industries, market power associated with network effects will be fleeting as new technology overtakes old. However, regulators will still need to consider carefully what constitutes a significant period to identify whether they need to intervene to prevent the use of market power. This may need to take account of not only the absolute period that an incumbent may be expected to be in a position to exert substantial market power, but how much consumer detriment may be caused, even over a relatively short period.

Section 46 — purpose vs effects test

Conduct of a network operator may be assessed under s. 46 of the Act. Because s. 46 relates to the purpose of the conduct, rather than the effect on competition, it may be difficult to apply, particularly when the motivation behind the conduct appears to be ambiguous. For example, when a network operator decides to offer low connection prices to its network, this may imply either a pro or anti-competitive purpose, depending on the facts. In fact, it may be more appropriate to apply an effects test that goes to the heart of assessing the competitive implications of particular conduct, and is more suited to balancing pro and anti-competitive elements.

Administrative issues — when to assess B2Bs

As discussed above, B2B issues may arise during the formation stage and then continue. While a B2B may seek Commission clearance for the start-up service, it may be that over time the membership and operating rules change, the nature of the service may alter as new business opportunities emerge and the B2B's market position changes. This raises the issue of whether a B2B collaboration that has initial clearance will need to continue to seek informal clearance from the Commission when its rules change. In fact, when a particular venture has been authorised, parties will need to consider whether a particular rule change will in fact invalidate the terms of authorisation and require further or separate authorisation.

Deregulating telecommunications in the digital era

Following is an edited version of a presentation by Michael Cosgrave, the Commission's general manager, Telecommunications, to the CommsWorld Telecoms Regulation Forum in Sydney on 18 July.

Introduction

A conference of telecommunications regulation is timely given the number of complex and interconnected issues that are around at the moment. The draft report of the Productivity Commission has given everyone in the industry food for thought and the Minister's decision to move ahead with legislative change on arbitrations will no doubt affect how we operate.

Regulating telecommunications in a digital environment means facing the three challenges of:

- technological change;
- market change; and
- expectation change.

Technological change in the telecommunications sector is a fact of life. The move from a voice-focussed telecommunications sector to a data-focused one has contributed to the migration to an Internet protocol (IP) world and with it the decreasing reliance on circuit-switched communications. I will discuss in more detail later how this affects both the industry and the ACCC.

Changes in the telecommunications market are also fast and furious — the figures speak for themselves. More than $60 billion has been wiped off the value of Australian-listed telecommunications companies since March 2000. Consolidation of the market internationally and domestically means that the regulator must be ever vigilant in ensuring fairness in the market for both consumers and other players.

Community and political leaders continue to expect better prices, availability and functionality of telecommunications services. Both the Government and the Opposition have announced policies that demonstrate their desire to promote the roll-out of broadband services. The recently announced Government action on the USO (universal service obligation) and the CSG (customer service guarantee) further demonstrates the Government's increasing expectation of what the telecommunications industry should deliver.

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

ACCC response to Productivity Commission report

In addressing regulatory change, the ACCC welcomes the release of the Productivity Commission's draft report, *Telecommunications competition regulation*. The draft report contains the first independent assessment of the rationale and operation of the current regulatory regime and possible alternatives since the regime began in 1997.

Pricing principles

The ACCC is concerned about the theoretical and practical validity of incorporating the Productivity Commission's pricing principles into legislation. They may not be appropriate for emerging interconnection issues such as high speed data (covered in greater detail further on).

Arbitration arrangements

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

Access holidays or safe harbours

Finally, the ACCC believes there would be serious implementation difficulties in operating an access holiday or establishing 'safe harbours', particularly for greenfields investment which is commercially sensitive and if the possibility of public scrutiny is a concern.

The ACCC has placed on the public record the following sentiments on any potential declaration of a digital platform for the Foxtel/Telstra and Optus HCF (hybrid fibre-optic/coaxial cable) network:

> Digital platform providers have a choice. They can take the early initiative in opening up their networks for digital services, thereby creating significant opportunities and benefits for both themselves and their customers or they can take the regressive step of maintaining closed shops — and then facing the diversity of demands from service providers, governments and customers for regulatory intervention.
>
> In the Commission's view, regulation of other digital platforms will only need to be considered where commercial forces are being deliberately undermined and where the objective of an open access environment is being stifled. Legitimate market drivers should be given the opportunity to do their job.
>
> Source: ACCC speeches to both CISCO and the Internet Industry Association.

Unfortunately, the ACCC's position has been misrepresented in the media by Telstra. For example, in Telstra's May 2001 presentation to the Productivity Commission's inquiry into telecommunications competition regulation, it said it would not make the

upgrade until it knew if access charges would be regulated.

This campaign of misinformation and misrepresentation of the ACCC has continued:

> Telstra, in an unrelated submission to the Productivity Commission, accused the watchdog yesterday of 'inconsistency and substantive unpredictability; of clear errors in calculations; of analysis that does not withstand close scrutiny'.
>
> 'The ACCC does not feel obliged to maintain even the most elementary level of consistency between its decisions,' it said.
>
> Source: 'Telstra and Fels at War', *The Australian*, 6 July 2001.

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

On the whole, the Productivity Commission's draft report has provided no compelling evidence that the existing regimes lead to inefficient pricing outcomes, or that the amendments suggested would all help meet the objectives. Some would probably increase the uncertainty which is only now being removed from the existing provisions as outcomes become more apparent and a body of precedent begins to emerge.

Legislative change

The ACCC welcomes recent initiatives by the Minister for Communications, Information Technology and the Arts to explore ways to make telecommunications arbitrations faster and more certain. Of the various amendments to the current arrangements proposed by Senator Alston several accord with ACCC submissions to the current Productivity Commission review of the telecommunications competition regulation.

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

Interconnection in a digital data world

The issue of interconnection for Internet and dial-up data services effectively demonstrates the trifecta of changes. Technological changes (in the migration to an IP environment), market changes (with more players entering the data market) and expectation changes (with increasing expectations of lower prices and more availability of broadband services by businesses, consumers and our political leaders) are all present.

Data on the PSTN

The ACCC is increasingly considering the alternative ways interconnection arrangements for the provision of dial-up Internet and high-speed data services can be provided, and the appropriate pricing principles that should apply for determining access prices.

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

An issue that arises with interconnection is whether the timed interconnection arrangements (for terminating access) and pricing principles developed and applied for voice calls using the PSTN are still appropriate for data services. For example, Telstra currently faces a price cap on local calls of 22 cents per call (GST inclusive and untimed). It has been argued that the price for terminating access on a non-dominant network for data calls should be calculated on a per-minute basis, as is currently determined for voice calls using the PSTN. It has also been argued that this cost arrangement for carriage would not be in the economical or commercial interest of the party carrying the traffic of networks with vastly different and often extended call holding times.

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

In addition, in a world in transition between a circuit-based and packet-based environment, competition issues can arise when some carriers and

CSPs are unable to extend their networks because they cannot agree on interconnections with the dominant supplier of PSTN services.

Neither the industry nor the ACCC is so far convinced that any particular interconnection approach is appropriate for new data services in the longer term, and is continuing to develop, with industry, its thinking on this matter. There is clearly much uncertainty as to whether the interconnection models and pricing principles that have been applied to pricing access to the PSTN for voice services are necessarily appropriate for pricing PSTN access for data services.

The PSTN will probably become an increasingly inefficient vehicle for widespread carriage of high-speed data and the interconnection debate will soon turn to considering a complex web of the carriage of calls across and between circuit-switched networks, wireless networks, dedicated IP networks and the Internet.

Pieces of the pie

The ACCC recognises that there are a host of inter-related issues needing a broader approach than simply addressing individual matters with individual action.

In light of the complexity of pricing principles for existing telecommunications services such as ULLS (unconditioned local loops), PSTN and wholesale local calls, we need to ask if pricing principles are relevant at all for data interconnection. If legislated pricing principles are attempted for data interconnection, the ACCC believes they would need to be sufficiently flexible and general to be applied to a broad range of services using different interconnection arrangements.

The ACCC's 1998 Competition Notice to Telstra on peering (traffic exchange between Internet access providers (IAPs) with three other IAPs — in this case Ozemail, connect.com and Optus) served to address the concerns of the largest players in the Australian market at that time. However even upon issue of the competition notice, the ACCC remained concerned about the ability of new entrants and smaller IAPs to reach agreements with Telstra and other competitors.

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

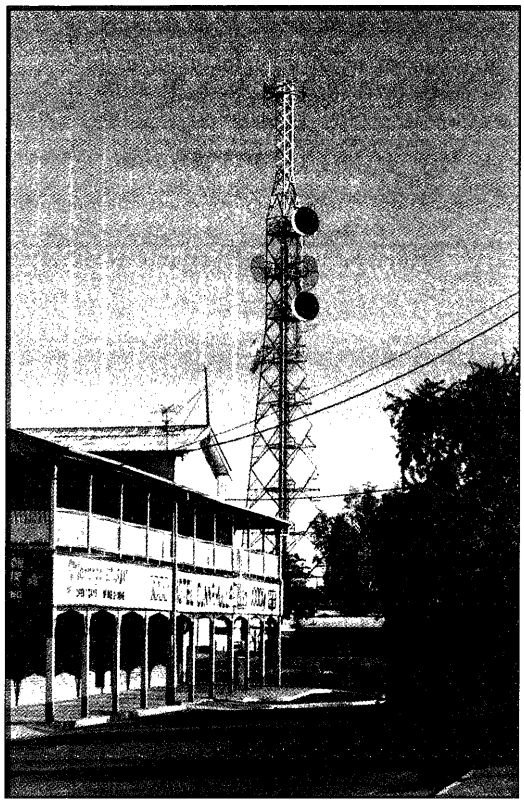
For data interconnection, the definition and role of the market in which the provider operates and the relationship it has with other providers or end-users may need to be examined. For example, backbone providers, Internet access providers, Internet service providers, carriers and vendors have complex relationships with each other and use a variety of technologies. As well as the type of provider, the market for each — that is, do they operate in a wholesale and/or retail environment — may also need to be considered. In such a converging industry, the role of content providers may also need to be discussed.

Internationally, there is currently a debate on whether Internet services per se are a tradable good or whether they constitute a value-added service.

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

The ACCC will soon be able to finalise its views and release a draft final determination.

The issues facing ULLS such as the future development of local loop architecture and its impact on



new technologies will be apparent in any interconnection consideration for data. In particular, there is the issue of the development of more efficient interconnection arrangements appropriate to a broadband/IP network architecture. These would aim to facilitate technically efficient broadband service interconnection as well as consequential reform of inter-carrier payment and compensation approaches for an IP/broadband environment.

There is no doubting that the data service business is a global one and the regulator and industry must ensure Australia is internationally competitive in its handling of data interconnect settlement.

There is no escaping the effect a legislated untimed local call obligation has on the economic fundamentals of the market. How to address such complex issues as interconnection with an untimed and capped component doesn't make the challenge any easier for either industry or the regulator.

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

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

Mergers and acquisitions

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

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

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

Authorisation

If a merger proposal is likely to breach s. 50 of the Act (i.e. acquisitions that would or are likely to substantially lessen competition in a substantial market in Australia, or in an Australian State or Territory), the merger parties should consider authorisation. Authorisation is a process of granting immunity on public benefit grounds, for mergers and acquisitions, which would or might otherwise contravene s. 50 of the Act. It provides a mechanism by which various 'trade-offs' that arise out of mergers can be considered. For example, a merger may enable a firm to become big enough to achieve economies of scale, but may also increase domestic market power and lead to decreases in consumer welfare. These trade-offs are considered on a case-by-case basis.

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

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

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

Conclusion

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

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