TEN YEARS ON … HOW IS PART XIC OF THE TRADE PRACTICES ACT HOLDING UP TO THE INFRASTRUCTURE ONSLAUGHT?

MATTHEW NICHOLLS
Principal, Nicholls Legal *

Synopsis

After ten years on the statute books, Part XIC of the Trade Practices Act 1974 (*Cth) (the "**TPA**") is being called upon more – and is under greater pressure – than ever.*

Part XIC gives telecommunications carriers and carriage service providers a right of access to "declared services": essentially the bottleneck services which form the building blocks of telephony, data and video services that we seem to be craving with an insatiable appetite.

*Some of the declared services with which most of us are familiar include access to the public switched telephone network ("**PSTN**"), mobile termination access, some transmission routes and, of course, the unconditioned local loop service ("**ULLS**").*

In the early days of "telecommunications deregulation", the race was on for access to Telstra's PSTN, so that the likes of Optus, Primus Telecom and AAPT could provide competitively priced long-distance and international telephone services.

However, whilst it may not have been apparent in 1997, ULLS has turned out to become probably the greatest source of competitive tension in the telecommunications industry. One company (namely, Telstra) owns practically all of the underground copper-wire network which forms the basis of the ULLS and many of its competitors are now exercising their statutory right to obtain access to the ULLS, so that they may provide high-speed broadband services to their customers.

This has been described as a move to facilities-based competition. However, not wanting to stand still, commentators, industry players and regulators are already looking ahead to the next stage of infrastructure competition in the communications industry generally.

Somewhat fortunately, there have been a number of decisions on "appeal" to the Australian Competition Tribunal in the last several years, which have shed light on the proper application of Part XIC. These have mostly focussed on access to the "copper network" and mobile termination services, but the Tribunal's decisions apply across the various declared services (and other services for which it is anticipated that declaration will apply).

Themes

The intended role of Part XIC: facilitating timely and non-discriminatory access to telecommunications bottleneck facilities

In practical terms, the initial role of Part XIC of the TPA was (and still is) to facilitate timely and non-discriminatory access by *access seekers*, to telecommunications bottleneck facilities. This is generally regarded as being important, because it is uneconomic to duplicate such facilities (such as the "last mile" copper network from the access unit in the street to people's homes).

The Australian Competition & Consumer Commission (the "**Commission**") decides which services to declare and a service, once declared, must be made available to access seekers in accordance with *standard access obligations* ("**SAOs**") which are set out in section 152AR of the TPA.

Terms of access

Once a service has been declared, an access provider may give what is known as an *access undertaking* to the Commission; such an undertaking sets out the primary terms upon which the access provider proposes to supply the declared service to access seekers. The Commission must conduct an enquiry into whether the terms in the access undertaking are reasonable and must either accept or reject the undertaking. If accepted, the terms of the undertaking form the basis of the terms of supply of the declared service to access seekers. In determining whether the terms in the undertaking are reasonable, the Commission is required to have regard to a number of criteria, as set out in section 152AH of the TPA.

As a separate matter, an access seeker may request access to a declared service from an access provider. If the parties cannot agree on the terms of access, either party may bring the matter before the Commission by way of arbitration. In determining the matter, the Commission is required to have regard to a number of matters as set out in section 152CR of the TPA; the matters set out in sections 152AH and 152CR are essentially the same.

The Commission is required to have regard to a number of matters in assessing an access undertaking or in making a final arbitral determination. These are:

- whether the terms/determination will promote long-term interests of end-users (the "**LTIE**") of carriage services or of services supplied by means of carriage services. In determining this question, regard must be had to the extent to which the thing is likely to result in the achievement of the following objectives:
    - the objective of promoting competition in markets for listed services;
    - the objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users; and
    - the objective of encouraging the economically efficient use of, and the economically efficient investment in: (i) the infrastructure by which listed services are supplied; and (ii) any other infrastructure by which listed services are, or are likely to become, capable of being supplied;
- the legitimate business interests of the carrier or carriage service provider, and the carrier's or provider's investment in facilities used to supply the declared service;

- the interests of persons who have rights to use the declared service;
- the direct costs of providing access to the declared service;
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility; and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.

It is important to note that the person submitting an access undertaking bears the onus of proving that the terms of the undertaking are reasonable within the meaning of section 152AH.[1]

Access undertakings may be taken on review to the Tribunal;[2] however, arbitral determinations may not. A number of the above criteria have been the subject of consideration by the Tribunal upon review. The recent cases which have gone before the Tribunal have provided guidance as to the proper interpretation of key provisions of Part XIC of the TPA (including in particular sections 152AH and 152CR) and it is these matters on which this paper focuses.[3]

Quarantined investments

Whilst an access provider must comply with the SAOs in respect of a given declared service, it is also possible for an access provider to avoid having to comply with the SAOs in particular circumstances.

For example, an access provider may apply for an exemption in respect of existing declared services[4] or in respect of anticipated declared services (such as services which might be provided by means of a fibre to the node ("**FTTN**") network).[5]

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[1] See the Telstra LSS case at para 20.

[2] A review before the Tribunal is a re-hearing of the matter *de novo* and is limited to material information given, documents produced or evidence given to the Commission in connection with the making of the decision to which the review relates and any other information that was referred to in the Commission's reasons for making the decision to which the review relates.

[3] Note some of these cases dealt with Part IIIA rather than Part XIC, although they all dealt with the various statutory concepts embodied in Part XIC. The recent salient cases are:

- *Re Application by Sydney International Airport* [2000] ACompT 7 (the "**Sydney Airport case**")
- *Re Application by GasNet Australia (Operations) Pty Ltd* [2003] ACompT 6 (the "**GasNet case**")
- *Re Application by Seven Network Limited* [2004] ACompT 11 (the "**Seven Network case**")
- *Re Application by Services Sydney Pty Ltd* [2005] ACompT 7 (the "**Services Sydney case**")
- *Re Application by Optus Mobile Pty Ltd and Optus Networks Pty Ltd* [2006] ACompT 8 (the "**Optus MTAS case**")
- *Re Application by Vodafone Network Pty Ltd and Vodafone Australia Limited* [2007] ACompT 1 (the "**Vodafone MTAS case**")
- *Re Application by Telstra Corporation Limited* [2006] ACompT 4 (the "**Telstra LSS case**")
- *Re Application by Telstra Corporation Limited* (No.3) [2007] ACompT 3 (the "**Telstra ULLS case**")

[4] Telstra currently has an exemption application before the Commission in respect of wholesale line rental services and local carriage services.

[5] See section 152ATA of the TPA.

Section 152ATA of the TPA provides:

> (1) A person who is, or expects to be, a carrier or a carriage service provider may apply to the Commission for a written order that, in the event that a specified service or proposed service becomes an active declared service, the person is exempt from any or all of the obligations referred to in section 152AR, to the extent to which the obligations relate to the active declared service.
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> …
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> (6) The Commission must not make an order under paragraph (3)(a) unless the Commission is satisfied that the making of the order will promote the long-term interests of end-users of carriage services or of services provided by means of carriage services.

The policy foundation for section 152ATA was explained in the Seven Network case as follows:

> The 2002 amendments, which, *inter alia*, made undertakings and exemptions available in cases where declaration had not occurred (and even when the service was not yet in existence), were implemented in response to the Productivity Commission's inquiry report on Telecommunications Competition Regulation (December 2001). The Explanatory Memorandum to the Telecommunications Competition Bill 2002, which introduced the amendments, noted that they were aimed "to increase the level of competition and investment in the telecommunications market to the benefit of consumers and business". This was to be achieved by, *inter alia,* facilitating timely access to basic telecommunications services, facilitating investment in new telecommunications infrastructure, encouraging a more transparent regulatory market, enhancing accountability and transparency of decision-making under Pt XIB of the Act.
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> The purpose of each of the new provisions relating to access undertakings and the ability to seek anticipatory exemption orders was stated in identical terms "to provide certainty for potential investors in telecommunications infrastructure and services in relation to access to that infrastructure or service in the future...".
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> Prior to the exemption created by s 152ATA, a potential investor was unable to receive an order exempting it from the obligation to provide access to a declared service or to lodge an access undertaking until it supplied an active declared service. The Explanatory Memorandum to the Bill stated:
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>> *"This can provide a disincentive for investment because it means potential access providers cannot obtain regulatory certainty as to whether or not their service will be declared, and if so, on what terms they will be required to provide access. In particular, where `risky investments' are subject to potential declaration, the investment may be rendered uneconomic as a result of this uncertainty."*
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> While it was noted that the costs were difficult to quantify, the potential for lost or delayed investment was highlighted in the Explanatory Memorandum.
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> In considering how s 152ATA was likely to be used, the Explanatory Memorandum stated:
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>> *"Longstanding exemptions may be appropriate in circumstances where a service is `ex-post' contestable, and therefore would not normally be declared, but an investor may wish to obtain a ruling that this is the case beforehand."*
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> Alternatively, exemptions for a limited period could be granted as "an incentive to invest and innovate in otherwise uncertain circumstances".
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> In considering the conditions which may attach to an anticipatory exemption order, the Explanatory Memorandum noted:

> *"[A]n order may contain a limitation that the exemption applies to a service that is supplied using a particular facility, or particular infrastructure and/or in a certain geographical area. This also provides flexibility for the ACCC to grant an exemption in relation to any combination of standard access obligations."*[6]

Also, it is possible for an access provider to lodge a *special access undertaking* with the Commission,[7] whereby it proffers access terms in respect of an anticipated declared service.

In the Seven Network case, the Tribunal drew the following distinction between sections 152CBA (in relation to special access undertakings) and 152ATA (in relation to anticipatory exemption from SAOs):

> …an issue arises as to the relationship between the provisions and scheme of s 152ATA and the provisions and scheme of s 152CBA and their associated sections. Is it in the long-term interests of end-users to have an exemption granted under s 152ATA or is it more in their interests for an access undertaking or scheme to be proffered pursuant to s 152CBA? Which statutory mechanism is more suited to a determination or order that sets out access conditions that are premised on an affirmative view that the conditions are in the long-term interests of end-users?
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> We consider that it is the statutory mechanism applying to an application under s 152CBA, rather than an application under s 152ATA, which is more suited to an application that requires consideration of the suitability or adequacy of conditions of access to a carriage service or a carriage service provider. An application under s 152CBA focuses directly on the core key issue, namely, the access conditions. By way of contrast, an application under s 152ATA focuses upon the extent to which an exemption from an obligation to comply with the standard access obligations will be in the long-term interests of end-users. In such a framework or context any consideration of the suitability, adequacy or reasonableness of the conditions of access to the service is derivative and not a primary consideration.
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> This is not to say that the Commission and the Tribunal should not consider applications pursuant to s 152ATA such as have been made by Foxtel and Telstra. They should do so, but they should be particularly vigilant in focusing on the key criterion - is the order exempting the applicants in the long-term interests of end-users? That is a different focus from one that considers the reasonableness of conditions of access.[8]

So, the policy objective of Part XIC is to strike a balance between critical investment in telecommunications (or, more broadly, communications) infrastructure on the one hand and ensuring on the other hand that where competition requires that competitors have access to bottleneck facilities, then access and interconnection are provided on reasonable terms and in a timely fashion.

Issues to which the Tribunal has given consideration

The LTIE

So, what does the "long-term interests of end-users" mean?

The Tribunal in the Seven Network case said:

> Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary, in our view, to take the following matters into account when applying the touchstone - the long-term interests of end-users:
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> * End-users: in this matter, "end-users" include actual and potential subscribers to subscription television services and other viewers in their households. The term is also likely to include

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6 Seven Network case, paras 36-40.
7 See section 152CBA of the TPA.
8 Seven Network case, paras 100-102.

> businesses, such as hotels and other places where people congregate, that subscribe or may potentially subscribe to subscription television services;
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> * Interests: the interests of end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings. In our view, this would include access to innovations such as interactivity in a quicker timeframe than would otherwise be the case; and
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> * Long-term: the long-term will be the period over which the full effects of the Tribunal's decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the subscription television industry) to adjust to the outcome, make investment decisions and implement growth - as well as entry and/or exit - strategies.
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> In considering how these elements may combine, it may be the case, for example, that very low prices are in the short-term interests of end-users. Over the long-term, however, sustainably low prices (which may be higher than the "very low prices" referred to above) are more likely to enhance their interests, as the long-term interests of end-users are likely to suffer in an environment characterised by short-lived operators who fall over soon after the customer signs with them, as distinct from one in which reliable service-providers offer competitive, but sustainable, services. Moves that enhance the quality and diversity of service may be subject to a similar analysis.
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> The use of the "long-term" may also assist in resolving the apparent tension between the criteria in s 152AB(2)(c) and (e). For example, action that promotes competition in the short-term may deter investment and hence, over the longer-term, competition may lessen (resulting in reduction to efficiency and innovation). Moreover, an action may promote competition at the retail level (resulting in more channels offered by more operators), but may deter facilities-based competition, with fewer service providers being prepared to establish delivery mechanisms of their own than would otherwise be the case. Assessed over the long-term, however, there is less likely to be any conflict between the promotion of competition and efficiency. Nonetheless, to the extent that there are mixed effects, we will have regard to the overall or net effect.[9]

And further from the Seven Network case:

> The LTIE test was introduced into the Act as part of the new telecommunications regime in 1997. The Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996 provides guidance as to the interpretation and application of the LTIE test. In particular, guidance is provided in relation to the term "end-user". In this respect, the Explanatory Memorandum (under the heading `Proposed section 152AB - Object of this Part') states:
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> > *"The term `end-users' recognises that telecommunications networks and services are used both by customers with a direct contractual relationship with a carrier or service provider and other end-users of carriage or content services (such as the members of a customer's household)."*[10]

However, the above statements only define the literal meanings of the words within the LTIE formulation: they do not define the concept of the LTIE (in terms of its inherently economic basis); nor do they shed light on the meaning of the statutory provisions in section 152AB of the TPA.

The Tribunal in the Seven Network case accepted the Commission's interpretation of the LTIE test in applying total-service long-run incremental cost ("**TSLRIC**") pricing principles and accordingly summarized the LTIE test as follows:

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[9] Seven Network case, paras 120-122.
[10] Seven Network case, para 47.

In our view, there are some basic pricing principles that should be observed in applying the LTIE test. In considering these principles, we are in general agreement with the approach established by the Commission in its guide to *Access Pricing Principles - Telecommunications* (as published in July 1997). In our view, key principles include:

* The price of a service should not exceed the minimum costs that an efficient firm will incur in the long-run in providing the service.
* The costs are the forward-looking costs, including a normal return on efficient investment (which takes into account the risk involved).
* Forward-looking means prospective costs using best-in-use technology. The access provider should only be compensated for the costs it would incur if it were using this technology, not what it actually incurs, for example in using out-of-date technology which is more costly. Of course, a firm may be using older technology because it was the best available at the time the investment was made and replacing it cannot be justified commercially. In a competitive market, however, that firm would only be able to charge on the basis of using the most up-to-date technology because, if it did not (in this hypothetical competitive market) access seekers would simply take the service from an alternative service provider.
* The cost of providing the service should be the cost that would be avoided in the long-run by not having to provide it. Thus, it is the additional or incremental costs necessarily incurred, assuming other production activities remain unchanged. In this matter, it assumes that Telstra and Foxtel would be providing subscription television services to subscribers.

This version of cost-based pricing is known as ‘total service long run incremental cost’ (“TSLRIC”). It includes operating and maintenance costs, a normal commercial return (moderated by the risk involved) and a contribution to common costs. In our view, in the general case where access prices need to be regulated, unless pricing is on a TSLRIC basis, efficient investment is unlikely to be encouraged. This, in turn, would fail to promote competition in the long-term, as end-users would not be able to benefit from new investment (thereby also missing out on more efficient and diverse product offerings). It is always the case that once an investment is made and sunk (it cannot be undone and the money recovered by selling the infrastructure as `parts’ or scrap), it is unnecessary - strictly speaking - to charge anything more than marginal cost to ensure the investor stays in business. After all, the investor is better off receiving its marginal costs rather than closing down. Such an approach, however, disregards the signals sent to other prospective investors who, if observing enforced marginal-cost pricing, are less likely to invest in the future.

This discussion should not be taken to suggest that TSLRIC pricing should be imposed at every opportunity. It will often be the case that regulation, including regulated pricing, is not appropriate in given circumstances. It does mean, however, that, in our view, it would generally not be in the LTIE to depart from TSLRIC pricing where access is regulated. Accordingly, where an access regime requires, or creates an unacceptable risk, of non-TSLRIC pricing, the Tribunal considers that such a regime is unlikely to encourage the efficient use of, and investment in, infrastructure.[11]

Promotion of competition

The exposition of the notion of competition in the case of *Re Queensland Co-operative Milling Association Ltd and Defiance Holding Ltd* has consistently been applied in Part XIC matters. In that case, the Federal Court said:

> “In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.
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> Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate...”.[12]

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[11] Seven Network case, paras 135-137.

[12] Re Queensland Co-operative Milling Association Ltd and Defiance Holding Ltd (1976) 25 FLR 169, at 188-189.

The Explanatory Memorandum to Part XIC of the Act expands on the promotion of competition criterion:

> ...it is intended that particular regard be had to the extent to which the particular thing would enable end-users to gain access to an increased range or choice of services.[13]

As a practical example of the application of the promotion of competition criterion, the Commission's ULLS Pricing Principles arrive at the unequivocal conclusion that, in the context of the ULLS, the reduction in the ULLS charge would clearly enable end-users to gain access to an increased range or choice of services, including in particular the opportunity for ULLS providers to offer different and varied service options to end-users, in addition to competitively priced broadband services and improved service quality in relation to such services. It would also give end-users more choice of service providers.

Further, the Commission said in its LSS Pricing Principles (in the context of whether to declare the line sharing service):

> In certain telecommunications markets, specific market characteristics may mean it is more efficient for there to be only one provider of a given service. In these circumstances, however, it may be that there is scope for competition to occur in downstream and/or vertically related markets. Without access to the vertically related service, however, carriers in vertically related markets will be unable to provide a final service to end-users.
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> Under the Act, declaration of a service can promote competition in listed services by mandating access to those services that are supplied in monopoly-provided vertically related markets. Further, under certain circumstances, the Act enables the Commission to set terms and conditions for access to these services. In turn, this can help ensure that a lack of competition in one market (the market in which the "eligible service" is supplied) does not prevent the development of competition in downstream, vertically related, markets.
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> In general, therefore, the Commission believes that declaration of an eligible service is likely to promote competition where the following conditions are present:
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> - the eligible service is an input that is used, or that could be used, to supply carriage services or services provided by means of carriage services (often referred to as 'downstream services'); and
> - competition in the market for the supply of the eligible service is unlikely to be effective in the future and this is likely to have a detrimental impact on competition in markets for downstream services.
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> In most cases the markets most likely to be affected by declaration are the market(s) for downstream services rather than the market in which the eligible service is supplied (where these markets are separate). This reflects the key rationale for access to essential infrastructure – that of promoting more competitive downstream markets by achieving a supply of inputs upstream at terms and conditions more reflective of competitive outcomes. Further, the aim of promoting the LTIE guides the Commission to be particularly mindful of the impact of declaration on the supply of services at the retail level.[14]

When the question of interpreting the meaning of the "promotion of competition", the Tribunal has made the following pronouncements.

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[13] *Trade Practices Amendment (Telecommunications) Act 1997* (Cth) Explanatory Memorandum.

[14] ACCC, Final Decision on whether or not a Line Sharing Service should be declared under Part XIC of the Trade Practices Act 1974, August 2002 ("**LSS Pricing Principles**"), section 4.1.

In the Sydney Airport case:

> The Tribunal does not consider that the notion of "promoting" competition in s 44H(4)(a) requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of "promoting" competition in s 44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.
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> …
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> The before and after tender competitive position is not, however, the appropriate focus of the Tribunal's concern in relation the s 44H(4)(a) test. In reaching a view as to whether increased access "would promote competition", the Tribunal must look to the future on a similar basis to the way it looks at the authorisation provisions, namely the future with or without declaration. Clearly, the Tribunal must have regard to the factual position as it now stands, with the tender process completed and Jardine and Ogden selected. But it must also determine what impact, if any, declaration would have on competitive conditions over and above the post-tender outcomes.[15]

In the Telstra ULLS case:

> We consider, with one qualification, that that observation applies to the meaning of "promoting competition" in s 152AB(2)(c) of the Act: *Seven Network Limited* (No 4) [2004] ACompT 11 at [124]. The qualification is that pursuant to s 44H(4)(a) (before its amendment) the Minister (and the Tribunal on review) had to be satisfied that access or increased access "would promote competition" in a market, whereas pursuant to s 152AB(2) we must have regard to "the extent to which" the term or condition is likely to result in the achievement of the objective of promoting competition in relevant markets. The difference in language recognised the different legislative regimes in Pt IIIA and Pt XIC. Section 44H(4)(a) (before its amendment) did not require a consideration of the extent to which access or increased access would promote competition in a market. Now s 44H(4)(a) requires the Minister (and the Tribunal on review) to be satisfied that access or increased access would promote a material increase in competition in a market. When, for example, s 152AB(2)(c) directs the Commission (and the Tribunal on review) to have regard to the extent to which averaging is likely to result in the achievement of promoting competition in rural areas, the Commission (and the Tribunal on review) must consider the extent of the competitive impact of averaging in rural areas and the likelihood of that extent, not only the improvement of the environment for competition.
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> Competition is a process, rather than a situation: *Re Queensland Co-Operative Milling Association and Defiance Holdings* (1976) 8 ALR 481 at 514-515. It is the way in which firms interact, and respond to each other, to ensure they best achieve their individual objectives. Under traditional economic theories of the firm, firms are normally considered to operate with the objective of maximising profits. In general, it is assumed that firms with this objective will compete to win market share from each other. In turn, competition between firms in this way is desirable from a consumer perspective because it creates incentives for firms:
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> - to lower their prices towards their costs of production in order to attract more consumers to their business so that they can expand their market share; and
> - to seek greater productive efficiencies (now and over time) so that they may lower their costs of production. In turn, this enables them profitably to lower prices for consumers in ways that will attract more consumers to their business in order to increase their share of the market.
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> It is in the interests of consumers that efficient producers of services survive the process of competition as they ensure that a given service can be profitably produced at the lowest possible cost. In turn, efficient producers are able profitably to provide services to consumers at lower prices. The process of competition allows efficient suppliers to survive and displace less efficient suppliers in well functioning markets. Inefficient suppliers will produce their services at a higher cost than their rivals. They will be unable profitably to lower the prices they set for consumers to the same level as

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[15] Sydney Airport case, paras 106 and 111.

> more efficient producers, with the consequence that they will be unable to win consumers and will therefore be forced out of the market. If, however, efficient suppliers are unable for other reasons to remain in the market, prices will not reduce to levels consistent with the costs of the efficient suppliers.
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> Accordingly, we believe it is important not to confuse the objective of promoting competition with the outcome of ensuring the greatest number of competitors. That is, the Act aims to promote competition because of the benefits that result from the process of competition, such as lower prices for consumers and the displacement of inefficient suppliers by efficient suppliers of services. As the Tribunal observed in *Sydney International Airport* (supra) at par [108]:
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> > "The Tribunal is concerned with furthering competition in a forward looking way, not furthering a particular type or number of competitors."[16]

And in the Services Sydney case:

> Whether averaging will promote competition in the relevant markets for listed services depends upon whether averaging will enable efficient suppliers to operate in dependent markets. The aim is not to ensure that the greatest number of competitors – irrespective of their level of efficiency – can enter and successfully remain in relevant markets. Rather, it is to ensure the existence of the conditions necessary to promote effective competition.[17]

Efficient investment in infrastructure

In order to satisfy the LTIE test, the prices claimed by an access provider should be based on the forward-looking efficient cost of providing the service.

For example, costs which are based on actual costs, rather than the forward-looking costs of an efficient operator, are likely to lead to over-investing in the relevant network (*i.e.* "gold plating" the network).

The Commission made the following observations in the LSS Pricing Principles (again, in the context of declaration of the service):

> Many of the submissions argued that a LSS would promote the more efficient use of infrastructure, and is thereby in the LTIE. The Commission agrees that the key advantage of a LSS is that it promotes optimal use of copper loops. For example, the simultaneous provision of services on one line by two separate providers will obviate the need to install a separate line for consumers wishing to be supplied data services by one service provider and voice services from a different service provider.
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> …it is not clear that the terms and conditions, including price, upon which Telstra currently intends to supply a LSS, are reasonable. Further, in the absence of declaration (or the threat thereof) it is also unclear whether Telstra would have an incentive to agree to terms and conditions consistent with the LTIE into the future. To the extent that Telstra might have an incentive to set terms and conditions in a fashion different to that which one might expect in a competitive markets for this service, declaration can serve to provide a means to remedy this form of market failure. This is particularly important as the Commission believes any moves by an access provider to set terms and conditions differently to those that would arise in competitive markets would be likely to prevent participants in downstream markets from competing with Telstra effectively in those markets. This would be likely to reduce allocative and dynamic efficiency in these markets since it will impact on competitors' ability to offer innovative and higher quality products to consumers and limit the extent to which the prices of final services consumed by end-users reflect the efficient costs of their production.[18]

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[16] Telstra ULLS case, paras 96-100.
[17] Services Sydney case, para 136.
[18] LSS Pricing Principles, section 6.1.

In the Telstra LSS case, the Tribunal stressed the pivotal requirement that an access provider establish that the charges in its access undertaking are based on *efficient* costs:

> …we would point out that whenever an access provider seeks approval of an access undertaking from the Commission which involves a consideration of a price term by comparing it with costs, it would be necessary, in order to satisfy the statutory framework, that the access provider establish that its costs are efficient costs.[19]

In the Seven Network case, the Tribunal noted that encouraging investment by access providers may be at the expense of investment by access seekers that would otherwise occur.

> Efficient investment, however, implies the right mix. That is, efficient outcomes mean that optimal buy/build decisions are being made, as assessed from the perspective of end-users. By 'optimal' is meant providing the best outcome in terms of prices, quality and diversity.
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> …
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> Furthermore, caution must be exercised to ensure that the access price attaching to infrastructure is not excessive, as this would be unlikely to encourage efficient use of investments. Where certain infrastructure has excess capacity but is overpriced, further investment in infrastructure (designed to avoid the excessive access price) may not - from an end-user's perspective - be efficient. Accordingly, a balance must be reached between allowing a reasonable, but not excessive, return to access providers. Reaching this balance will assist in encouraging both the efficient use of, and investment in, infrastructure. Such balance, in turn, is likely to promote competition in the long-term.[20]

The Tribunal's treatment of Optus' "efficient cost" claim in the Optus MTAS case demonstrates the difficulties faced by access providers in overcoming this crucial hurdle. Optus in that matter went to great pains to demonstrate that its costs were efficient, diverging from Telstra's standard "historical/actual" cost approach (which the Commission and Tribunal have consistently rejected) and instead advancing a "deemed efficient" cost approach:

> CRA [Optus' consultant] noted that its model was not entirely based on actual network costs as asset values had been adjusted to reflect modern equipment prices. For this purpose Optus provided CRA with information on changes in its mobile network equipment prices over time. CRA's modelling approach was said to be forward-looking in the sense that it measured the costs that would be incurred by a new entrant supplying the GSM services rather than the historical costs of Optus' past equipment purchases.[21]

However, the Tribunal rejected this approach, notwithstanding its freshness and ingenuity, as once again it lacked the underlying evidentiary support and analytical rigour to satisfy the Tribunal that Optus' costs represented the true, forward-looking, efficient costs of providing the service:

> However, there was no evidence before the Commission, or before us, that the cost inputs provided by Optus to CRA were efficient costs. Optus had identified costs relating to its GSM mobile business for 2003/2004 but there was no evidence before us that the costs so identified were "efficient".[22]

This approach was reinforced by the Tribunal in the Vodafone MTAS case:

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[19] Telstra LSS case, para 46.
[20] Seven Network case, paras 130 and 134.
[21] Optus MTAS case, para 115.
[22] Optus MTAS case, para. 114.

> Vodafone submitted that there was no material capable of casting sufficient doubt on the efficiency of its inputs into the PwC models to affect any conclusion that the prices and terms in the undertaking were reasonable. In support of this submission, Vodafone relied upon the following matters:
>
> - neither the Commission nor any of the intervenors had nominated any specific cost, item or aspect of Vodafone's business or network which was said to be inefficient;
> - the preparation of the PwC models involved a revaluation of network assets to current day values and this would remove any suggestion that Vodafone's network assets were overpriced;
> - Vodafone's network was developed, and its non-network costs incurred, in a highly competitive environment. It followed that Vodafone's costs were efficient because of the competitive market in which Vodafone operated; and
> - the consultant Analysys considered that for the purposes of producing top-down fully allocated cost results, the use of Vodafone's actual costs was reasonable.
>
> We do not consider that Vodafone's submission poses the correct question. As we observed in *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* (supra) at par [118]:
>
> > "Although there is merit in the proposition that a firm in a competitive market has an incentive to be efficient and to incur its costs efficiently, there is still a need for the Commission (and, on review the Tribunal), to be satisfied, having regard to the matters set out in s 152AH and the objectives in s 152AB of the Act, that the firm's costs are efficiently incurred."
>
> …
>
> It is not to the point that there is no material before us capable of casting sufficient doubt on the efficiency of Vodafone's inputs into the PwC models. Rather the point is whether we are satisfied, having regard to all the material placed before us, that Vodafone's costs are efficiently incurred.[23]

And further in the Vodafone MTAS case:

> We consider that Vodafone is obligated to adduce some evidence that its costs were efficiently incurred. In saying this, we have no wish to impose a requirement that the submitter of an undertaking to the Commission foresee every possible speculative criticism of its investment and other business decisions. There are limits to the second-guessing of an operator's basic strategic decisions regarding the size of its network, the geographical area it seeks to cover, the level of market demand it seeks to satisfy and the manner of its product development. Nevertheless, it cannot be sufficient simply to assert, without any supporting material, that costs were efficiently incurred.[24]

This underlines the contention that the ambit approach to pricing which has been observed in relation to access providers' access undertakings has been consistently and comprehensively rejected by the Commission and the Tribunal. It is submitted that, in future, access providers would have a greater chance of having their access undertakings accepted, were they to proffer undertakings which were based on plausible, realistic and defensible costings – supported by verifiable and credible evidence – rather than ambit claims which have no proper evidentiary basis, but rather appear to be founded on hyperbolical economic theory.

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[23] Vodafone MTAS case, paras 48-49.
[24] Vodafone MTAS case, para 60.

The legitimate business interests of the carrier or provider

In considerting the legitimate business interests of the access provider, the focus is on what is *legitimate*. The Tribunal said in the Telstra LSS case:

> The expression "legitimate business interests" is a general expression and is somewhat open-textured. What is "legitimate" conduct or a "legitimate" interest in business may be open to a number of differing interpretations. We consider that a carrier's "legitimate business interests" is a reference to what is regarded as allowable and appropriate in commercial or business terms. In the context of s 152AH(1)(b), the expression connotes something which is allowable and appropriate when negotiating access to the carrier's infrastructure. When looked at through the prism of a charge term and condition of access and its relationship to a carrier's cost structure, it is a reference to the interest of a carrier in recovering the costs of its infrastructure and its operating costs and obtaining a normal return on its capital. Support for this view can be found in the Explanatory Memorandum to the *Trade Practices Amendment (Telecommunications) Bill 1996* which introduced Pt XIC into the Act. That Memorandum noted:
>
> > *"Consistent with Part IIIA of the TPA, the references here to the 'legitimate' business interests of the carrier or carriage service provider and to the 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market."*[25]

It is submitted that an access provider's legitimate business interests, including its ability to exploit economies of scale and scope, are satisfied by supplying the service to access seekers at a price which is consistent with a properly constructed, verifiable TSLRIC model (or the closest available approximation to TSLRIC).

The interests of all persons who have rights to use the declared service

In the Telstra LSS case, the Tribunal found that a cost allocation method which denied access seekers equality of opportunity in relation to the retail markets in respect of which they are in competition with Telstra was not in the interests of all persons who have rights to use the declared service (in that case, LSS). The Tribunal said that:

> …the interests of persons who have a right to use the LSS, access seekers, are served by an access price that enables them to compete on their merits (that is, on the basis of their own efficiency) in downstream markets.[26]

The direct costs of providing access to the declared service

The price for the declared service must be cost-based. As described by the Commission in its *Access Pricing Principles* paper,[27] the TSLRIC pricing methodology is generally accepted as being the best available way of determining cost-based (long-run) charges for declared services.

Again, the notion of "direct costs" is intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.[28]

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[25] Telstra LSS case, para 89.
[26] Telstra LSS case, para 138.
[27] Australian Competition & Consumer Commission, *Access Pricing Principles – Telecommunications*, July 1997.
[28] See fn 25, above.

However, the Tribunal has expressed the view that the reference to "direct costs" in paragraph 152AH(1)(d) of the TPA does not exclude consideration being given to *indirect* (fixed and common) costs.[29]

Other issues considered by the Tribunal

The role of market definition

The Tribunal has not placed tremendous weight on market definition analysis in Part XIC cases. In the Services Sydney case (which was a Part IIIA case, but which dealt with legal questions which have parallels in Part XIC), the Tribunal said:

> While product and geographic substitution will often be the focus of argument in Pt IV matters, this is less often so in Pt IIIA matters. The focus here tends to be not on the dimensions of the market, as defined by substitution, but on the existence of separate markets from the market for the service. In other words, at which functional levels in the supply chain do markets occur?
>
> Consistent with the QCMA case, a market exists where there are actual or potential transactions for goods or services. Actual transactions can be observed, but how do we determine whether there are potential transactions, which is generally the issue that arises for consideration under Pt IIIA, at least as regards the market(s) for the service(s)? This question arose first under s 46 in the High Court decision *Queensland Wire Industries Pty Ltd v Broken Hill Proprietary Co. Ltd* (the Star Picket Fence Post case) (1989) 167 CLR 177, which concerned a refusal to supply on reasonable terms a product known as 'Y-bar', which was needed to make star pickets for rural fencing. The question arose as to whether there could be a market for or including Y-bar, when there was no actual trade in the product. The High Court found that there was. Deane J said (at 196) that:
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> > '… a market can exist if there be the potential for close competition even though none in fact exists. A market will continue to exist even though dealings in it be temporarily dormant or suspended. Indeed, for the purposes of the Act, a market may exist for particular existing goods at a particular level if there exists a demand for (and a potential for competition between traders in) such goods at that level, notwithstanding that there is no supplier of, nor trade in, those goods at a given time – because, for example, one party is unwilling to enter any transaction at the price or on the conditions set by the other.'[30]

Numerous choices, one approach

The Tribunal has clarified an important question: that is, where there is a range of possible integers available to choose from, how does one decide which is appropriate?

In the GasNet case, the Tribunal said:

> It is clear…that there is no single correct figure involved in determining the values of the parameters to be applied in developing an applicable Reference Tariff. The application of the Reference Tariff Principles involves issues of judgment and degree. Different minds, acting reasonably, can be expected to make different choices within a range of possible choices which nonetheless remain consistent with the Reference Tariff Principles. Where the Reference Tariff Principles produce tension, the Relevant Regulator has an overriding discretion to resolve the tensions in a way which best reflects the statutory objectives of the Law. However, where there are no conflicts or tensions in the application of the Reference Tariff Principles, and where the AA proposed by the Service Provider falls within the range of choice reasonably open and consistent with Reference Tariff Principles, it is beyond the power of the Relevant Regulator not to approve the proposed AA simply because it prefers a different AA which it believes would better achieve the Relevant Regulator's understanding of the statutory objectives of the Law.[31]

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[29] See the Optus MTAS case, para 137.
[30] Services Sydney case, paras 109-110.
[31] GasNet case, para 29.

In the Telstra LSS case, the Tribunal had to consider whether the price for monthly access in Telstra's access undertaking was reasonable. In applying the above principle from the GasNet case, the Tribunal found that the question is not what is the *most* reasonable figure, but whether the figure that is posited by the provider of the access undertaking is reasonable within the meaning of the relevant statutory criteria:

> In this area of analysis there is no one correct or appropriate figure in determining reasonable costs or a reasonable charge. Matters and issues of judgment and degree are involved at various levels of the analysis. In considering whether Telstra's estimates of its costs are reasonable we are not driven to considering whether the Commission's or other parties' views or assessment of those costs are more reasonable. Nor do we enquire whether Telstra's method or approach in estimating its costs is the correct or appropriate approach. If Telstra's method or approach in estimating its costs is reasonable having regard to the statutory matters set out in ss 152AH and 152AB then the matter rests and a comparison with the $9.00 monthly charge is then to be made: *Application by GasNet Australia (Operations) Pty Ltd* (2004) ATPR 41-978 at [29].[32]

Later in the Telstra LSS case, the Tribunal said:

> In a number of respects we are operating in areas where there is no one specific regulatory, economic, accounting or financial answer, and where there may be a number of approaches to the determination of relevant costs or their allocation which may be regarded as reasonable. Our inquiry is directed to whether Telstra's $9.00 monthly charge in its access undertaking is reasonable having regard to the statutory matters set out in of ss 152AH and 152AB of the Act.[33]

Material before the Tribunal

In the Telstra LSS case, an issue arose as to whether the parties were limited to submissions made before the Commission, or whether they could raise new submissions and contentions. In short, Telstra contented that to permit the Commission and interveners to raise new submissions (albeit based on material which was before the Commission below in accordance with sub-section 152CF(4)), would amount to a denial of procedural fairness. The Tribunal held that sub-section 152CF properly construed contains no such limitation and that it would severly curtail the function and power of the Tribunal if it was limited only to considering submissions and contentions which had been advanced before the Commission.[34]

Further, material which was before the Commission but which was erroneously omitted from the material to be put before the Tribunal, may subsequently be put before the Tribunal.[35]

International benchmarking

In attempting to have access undertakings accepted, various access providers have provided so-called international benchmarking reports which purport to demonstrate the reasonableness of their proposed access prices as compared with access prices for similar services overseas.

The Commission and the Tribunal have been somewhat sceptical about accepting such material. In the MTAS case, in rejecting such material, the Tribunal dealt with the question thus.

> However, a number of other additional factors relevant to cost differences between the countries were not taken into account by CRA [Optus' consultants]. These included spectrum allocations, network purchasing power, vertical/horizontal integration, network usage and scale, population density, land and labour costs, the use of different technology, retail prices, scope of services offered and the

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32 Telstra LSS case, para 63.
33 Telstra LSS case, para 67.
34 See Telstra LSS case, paras 17 *ff*.
35 See *Application by Re Telstra Corporation Limited* (No 1) [2006] ACompT 7.

> quality of services offered. The Commission submitted that the effect of CRA making only selective adjustments to its international cost benchmarks resulted in a distorted and unreliable analysis.
>
> …
>
> We do not consider that the international benchmarking analysis proffered by Optus is of any assistance to us in determining the issue as to the reasonableness of Optus' price. The range of prices derived by CRA is so broad as to be of little assistance. Further, the nature of the adjustments made by CRA and the adjustments to which it gave no consideration, render the figures derived an inadequate comparator for Australian conditions.
>
> In any event, the nature of the international benchmarking exercise was such that it teaches very little, or nothing at all, as to whether Optus' price terms are reasonable having regard to the matters set out in s 152AH and the objectives in s 152AB. In order to place any reliance upon the international benchmarking analysis it would be necessary to know much more about the regulatory environment within which they were determined, the state of the relevant markets and the socio-economic environment in which the mobile services were operative.[36]

Conclusion

Now that a number of decided cases have considered the meanings of various key provisions in Part XIC of the TPA, it seems the hurdle for having an access undertaking accepted is somewhat higher than access providers might originally have thought.

For a start, they must provide a credible evidentiary basis for their cost claims – not just economic posturing, however eminent their experts might be. Also, they must frame their cost claims in terms of the reasonableness test in Part XIC – not in terms of some putative proxy for reasonableness, such as their historic or actual costs, or some approximation to so-called international benchmarks – and they bear the onus of demonstrating that such claims are reasonable.

This failure by access providers to put credible access undertakings before the Commission means that often the only practical avenue by which access seekers may obtain reasonable access prices for declared services (in accordance with section 152CR of the TPA) is to submit themselves to arbitration – only to have to argue the same matters, albeit in a different forum. This begs the question as to the effectiveness of the access undertaking regime in general. Whilst there have been criticisms levelled at the time it takes to obtain an arbitral outcome, at least this avenue provides a mechanism which is capable of yielding definitive outcomes on access prices for declared services for both access providers and access seekers.

*** A note about the author**

Matthew Nicholls, principal of Nicholls Legal, has practised in telecommunications and trade practices law for over 13 years. Matthew has acted for multiple parties in each of the recent reviews by the Australian Competition Tribunal in relation to declared services under Part XIC of the TPA, is currently acting for several parties in Telstra's High Court challenge to Part XIC and recently assisted in advising the Department of Communications, Information Technology and the Arts on the policy and regulatory implications of next generation networks. Contact: matthew@nicholls-legal.com.au

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[36] Optus MTAS case, paras 293 and 296-7.