

## TelstraClear

### Impact of unbundling on entrant investment incentives

1. Telecom asserts that unbundling undermines investment incentives of entrants. Policy makers and entrants in Australia have stated that access regulation including unbundling has not undermined investment incentives.
2. Table 1 sets out the LLU time line in Australia:

Table 1:

<b>Aug 1999</b>	The ACCC Declares the Unconditioned Local Loop Service ( <b>ULLS</b> )
<b>Mar 2000</b>	Telstra gives the ACCC a written assurance that it will launch its ULLS and wholesale ADSL simultaneously
<b>Aug 2000</b>	ACCC Issues Pricing Principles for Telstra ULLS
<b>Aug 2000</b>	The ACCC requires Telstra to provide weekly details in regard to provision for access to its copper network
<b>Nov 2000</b>	The ACCC directs Telstra to provide extensive details concerning the scope and timeframes for delivery of services on its copper network to itself and its competitors
<b>Dec 2000</b>	The ACCC issues interim determinations in relation to ULLS disputes between Telstra and Optus/AAPT/One.Tel
<b>Jul – Oct 2001</b>	The Australian Communications Industry Forum completes various industry codes in relation to ULLS
<b>March 2002</b>	The ACCC issues its final report into the pricing of ULLS

### Ongoing Investment

3. In its 2001 report into telecommunications competition regulation, the Productivity Commission stated that there was little evidence that regulation was having an adverse effect on investment:

“... the information in table 3.9 [reproduced in Table 2 below] reveals that such a conclusion may not be justified. In the case of Cable & Wireless Optus, the major capital expenditure associated with its HFC cable network rollout was largely completed by 1997-98 and hence it is not surprising that the pre-1998 level of expenditure was not maintained. However, Cable & Wireless Optus’ capital expenditure picked up again appreciably in 1999-00. Indeed, over the period 1998–2000, its capital expenditure growth performance has been faster than that of Telstra. Because of the lumpiness of much investment

expenditure, arguments linking regulation and investment can either be supported or refuted depending on the selection of the particular start and end years. In any case, what is relevant is an appropriate ‘counterfactual’ — this is not readily discernible, if at all.”<sup>1</sup>

Table 2: Capital expenditure — largest 3 players 1996-2001<sup>2</sup>  
\$ million, year ended 30 June unless otherwise specified

	1996	1997	1998	1999	2000	2001
Telstra (a)	3904	4248	3741	4274	4705	4368
Cable & Wireless Optus (b)	1436	1627	786	898	1471	1604
AAPT (c)	na	na	111	204	215	na
Total largest 3 players	5340	5875	4638	5376	6391	5972

(a) Capital expenditure excluding capitalised interest.

(b) Data for 1999 and 2000 are year ended 31 March.

(c) Data for 1998 and 1999 are taken from AAPT 1999a. AAPT was expecting to invest in excess of \$500 million in the year to 30 June 2001.

4. More recent reports commissioned by the ACCC indicate that this level of investment is continuing:

“To facilitate the deployment of copper based xDSL technologies, Telstra announced in mid 1999 (Asia Pulse, 25 June 1999) that it will spend \$1.8bn over the period to 2002 on its copper wire network... Telstra has set aside \$600 million a year for capital expenditure on the copper network over a three-year period. About \$400 million will be allocated over three years to repair about a quarter of the network, which is badly degraded (AAPS News, 25 June 1999).”<sup>3</sup>

“Carriers invested \$1.765 billion in their local access networks over [2001-02], with carriers other than Telstra undertaking approximately one-third of this investment. In particular, significant investment occurred in relation to copper, optical fibre, HFC and satellite networks.”<sup>4</sup>

<sup>1</sup> Productivity Commission (Australia), Telecommunications Competition Regulation, September 2001 at pages 88-89.

<sup>2</sup> Productivity Commission (Australia), Telecommunications Competition Regulation, September 2001 at page 88.

<sup>3</sup> ACCC, Telecommunications Infrastructure in Australia 2001, December 2001 at page 31.

<sup>4</sup> ACCC, Telecommunications Infrastructure in Australia 2002, October 2003 at page 20.

5. Telecom New Zealand's operation, AAPT, also disputed the negative effect of regulation on investment in its submission to the Australian Productivity Commission:

“AAPT rejects the claim often made by incumbent carriers that the existence of an access regime may hinder investment. Overall, AAPT's experience is that it is in those markets where access services have promoted competition, investment opportunities are created. The most efficient way to secure facilities-based competition is to allow new entrants to first build a customer base using access services. This provides the incentive for investment, the means of securing funding and the experience to efficiently employ those funds in new networks.”<sup>7</sup>

6. Furthermore, AAPT has argued that there is a link between declaration and higher investments:

“These are some of the major new infrastructure projects which have either commenced or have been completed recently. In many cases, the investment has occurred where the services have been declared. “AAPT itself has not felt reluctance to invest, develop new services or otherwise act because of the existence of Part XIB – as the examples given above demonstrate. AAPT's preparedness to invest was influenced by the fact that there were specific provisions in Part XIB that protected carriers from a misuse of market power. For example, AAPT has recently committed a large amount of capital to developing its own mobile telephone network. AAPT would not have made this investment had it been concerned that anti-competitive conduct (such as predatory pricing, or anticompetitive exclusive dealing) by other carriers could go unchallenged.

7. AAPT also argued that access regulation does not prevent incumbent investing or if they did cease investing, that the “investment slack” would be taken up by entrants:

“Even if firms with market power refrain from investing as a result of mistaken views about the impact of Part XIB, any such shortfall has probably been made up by rivals, such as AAPT, investing in their own facilities. These investments made by new entrants are likely to be efficiency enhancing, because they are likely to rely on new technologies. Moreover, the data available for recent years supports the view that Part XIB has had a positive effect on investment. The past few years have been characterised by high levels of capital investment and it is likely that the competitive safeguards imposed by Part XIB, have encouraged new entrants (especially small firms) to

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<sup>5</sup> ACCC, Telecommunications Infrastructure in Australia 2002, October 2003 at page 9.

<sup>6</sup> Productivity Commission (Australia), Telecommunications Competition Regulation, September 2001 at page 109 and Chris Anderson (Chief Executive, Optus), Ownership and Regulation – A Telco Perspective, 24 April 2002 (note: at 2002, other carriers accounted for only around 1 percent of local access connections).

<sup>7</sup> Submission of AAPT Ltd To Telecommunications Inquiry (Productivity Commission), Aug 2000 at page 3.

invest in infrastructure. This is because new entrants have greater confidence that they will be protected from anti-competitive conduct.”<sup>8</sup>

8. Dr Milner of Telecom has acknowledged that both incumbents and new entrants share a common vision of an NGN. Applying AAPT’s reasoning, entrants utilising unbundled access would make the investment on their own NGN services if Telecom decided it would not proceed or proceed as fast with its NGN plans.
9. Telecom has referred to a number of alternative technology networks in Australia in support of its views that alternative technologies can be used to provide services instead of unbundled copper and bitstream. Telecom expresses concern that unbundling will undermine investments in these networks. However, as will be seen from comparing the launch dates of these networks in table 3 with the LLU time line in table 1, these alternative networks to which Telecom enters was deployed after LLU was mandated in Australia.

Table 3: Recent Australian Local Infrastructure

Network	Telecom Comment	Dates
TransAct	TransAct is rolling out a fibre-to-the-curb network throughout the Australia Capital Territory that utilises high speed VDSL technology. <sup>9</sup>	<ul style="list-style-type: none"> <li>• Built: 1998<sup>10</sup>-2000</li> <li>• Service: May 2000</li> </ul>
Personal Broadband Australia (PBBA)/iBurst	PBBA plans to eventually roll out a national network to 8 major cities in Australia by 2006—providing wholesale access to ISPs and other service providers... The iBurst technology involves a compelling combination of high speed (1Mbps per customer), mobility (automatic handover between base stations and even a moving car), wide area coverage (up to 600Kbps 12km away from a base station) and high base station capacity (thousands of customers, depending on usage patterns). <sup>11</sup>	<ul style="list-style-type: none"> <li>• Acquired spectrum in auctions in: Mar 2001</li> <li>• Network built: 2001 onwards</li> <li>• Proposed service launch: 2003</li> </ul>

<sup>8</sup> AAPT, Submission Of AAPT Ltd To Telecommunications Inquiry (Productivity Commission), Aug 2000 at page 23-24.

<sup>9</sup> Telecom’s Response To The Commerce Commission’s Draft Report 29 October 2003 at page 44.

<sup>10</sup> TransAct commenced building its network around the time the ACCC commenced its LLU Inquiry.

<sup>11</sup> Telecom’s Response To The Commerce Commission’s Draft Report 29 October 2003 at page 75.

Network	Telecom Comment	Dates
Unwired Australia	Unwired Australia... started deploying its Navini-based network in May 2002, when the ACA released the 3.4GHz band for commercial use. Unwired [is] the only operator capable of developing a national platform in this spectrum with a potential reach of 95 percent of the Australian population. By August 2003, the company had covered most of Sydney, utilising 70 base stations managed by Crown Castle. Initial trials in Paddington and Balmain have been highly successful. <sup>12</sup>	<ul style="list-style-type: none"> <li>● Acquired spectrum in auctions in: Dec 2000</li> <li>● Network built: 2000-2004</li> <li>● Proposed service launch: early 2004</li> </ul>

10. AAPT itself has continued to build bid network since the LLU designation. Telecom New Zealand's 2001 Annual Report states:

"AAPT's capital expenditure for [2001] was A\$484 million. This included expenditure for the LMDS and CBD fibre networks, payments for the Optus backbone and Southern Cross capacity, as well as expenditure on the rollout of CDMA in Australia prior to the close-down of this project... In Australia, Telecom currently expects to spend approximately A\$300 million on capital expenditure in the 12 months to 30 June 2002."<sup>13</sup>

"Today AAPT can service 220,000 businesses in 30 urban locations using fibre optics and other broadband technologies. It is a sound basis on which to deliver more of our own network services to customers and earn higher margins. In selected locations, we will build or lease new infrastructure, or partner with others to extend our access capabilities where they can best deliver value to AAPT. VicOne is a great example: AAPT provides a data network linking more than 3,500 sites – schools, hospitals and Victorian government agencies with secure access to information and communications. We have started a major upgrade of VicOne that adds value for network users and for AAPT."<sup>14</sup>

In its 2002 Annual Report, Telecom states that the AAPT local access network consisted of:

<sup>12</sup> Telecom's Response To The Commerce Commission's Draft Report 29 October 2003 at page 74.

<sup>13</sup> Telecom Annual Report 2001 at pages 35 –36.

<sup>14</sup> Telecom Annual Report 2001 at page 6.

“Local access links in central business districts—fibre optic networks in six state capitals (connection into 294 buildings) and LMDS wireless coverage for customer access at locations throughout Australia.”<sup>15</sup>

“With AAPT increasing the number of customers directly connected to its network, greater local service revenue is being generated.”<sup>16</sup>

11. TelstraClear acknowledges that, if the economic signals through pricing of unbundled services are not set correctly, the “build/buy” decision can be distorted. Further, once effective wholesale level competition emerges, and the incumbent shifts to a wholesaling mindset, continued regulation may be unwarranted and also could have a distorting effect. New Zealand is very far from that point. Safeguards built into the New Zealand legislation, which were absent from the Australian legislation (such as the limited connection test) allow the Commission to monitor any adverse investment impacts and adjust the regulatory settings.

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<sup>15</sup> Telecom Annual Report 2002 at page 15.

<sup>16</sup> Telecom Annual Report 2002 at page 39.