

# Resale of telecommunications capacity

Peter Waters argues that in developing its resale policy, the government must be careful in weighing up the competing interests of carriers and resellers

**A**s the Review of the Structural Arrangements Between the Carriers illustrates, whenever the Federal government pulls on a thread in the telecommunications industry, the whole sleeve of telecommunications policy is likely to fall off. The government's determination to rid itself of the AUSSAT embarrassment quickly unravelled the long established telephone monopoly. The treatment of the resale issue could just as easily unwind the new duopoly, even before the government has cut the fabric of that new regime.

## The problem of resale

**S**ome of the heat in the resale debate is generated by a confusion over what is meant by resale in the Australian context. Resale can mean one of three things:

- the construction and operation of network facilities by non-carriers, and the resale of capacity on those facilities to third parties;
- the purchase of capacity from the carriers to establish private networks and then resale of excess capacity by the user or by a commercial facilities manager;
- the provision of value added or information services are provided wholly over the public switched telephone network (PSTN), or using a combination of leased carrier capacity and the PSTN.

Resale of the first kind looms large in the collective minds of foreign telecommunications companies, particularly the US carriers. Resellers and their customers are able to bypass not only the public switched services provided by the carriers but also the network hardware into which the carriers have sunk large amounts of capital.

If this kind of resale was permitted public utilities could lay cable along their statutory easements, or a reseller could build private earth stations and purchase INTELSAT or INMARSAT satellite capacity, bypassing the privatised AUSSAT capacity. While the duopoly essentially is to be facilities-based, the government has not yet made clear the extent to which third parties will be able to build their own facilities or utilise existing facilities for limited resale (eg not interconnected with the PSTN).

Carriers are usually unconcerned with the third type of resale, since there is no bypass either of their public switched services or networks. The value added service (VAS)

provider's activities actually encourage the greater use of the carrier's basic voice telephony or data transmission services. However, the Government's declared intention to do away with the distinction between basic/VAS services draws VAS providers into the maelstrom surrounding resale.

In Australia, resale usually means the second kind of resale identified above, the on-sale of capacity leased from the carriers for private networks. Resale of leased carrier capacity, of course, does not result in bypass of the carriers' networks since the resellers can only lease capacity from the carriers. The more traffic which the reseller carries the more capacity it has to lease from the carriers, thus benefitting them and possibly assisting the second carrier in building its own network more quickly. However, the traffic which travels over leased capacity is not always "new" traffic to the network, but has been diverted from the PSTN.

Carriers have claimed that substantial bypass of their PSTN services through carrier leased capacity diminishes their ability to generate sufficient surplus from their highly profitable routes which is necessary to fund the capital intensive requirements of network construction and the provision of less profitable services on thinner routes.

## The case for extensive resale

**E**conomic, competitive and nationalistic arguments are mustered in favour of extensive resale of leased carrier capacity.

The main economic and competitive advantages of resale are said to be:

- Resale leads to better utilisation of network capacity by permitting use of redundant capacity on private networks;
- Resale encourages a wider diversity of telecommunications products and stimulates innovation;
- Resale provides greater price competition to the carriers, and encourages them to cut costs and improve efficiency. An unadulterated duopoly is a risky way of securing more competition as the duopolists may opt for the quiet life and co-ordinate their market behaviour.

Resale also permits entry into a wider telecommunications market of Australian companies which would not have had the financial capacity to participate in the larger picture of the second carrier. The reseller

market has low capital barriers to entry because the main capital expenditure falls to the duopoly carriers in providing the capacity used by the reseller.

## The case against extensive resale rights

**I**f the overseas experience is anything to go by, extensive resale rights are likely to be bitterly opposed by the carriers. Rumours are already circulating that a number of foreign telecommunications companies have taken fright over the government's resale rights, and forsaken Australia for more promising telecommunications opportunities elsewhere, such as in eastern Europe.

The carriers' position is likely to be that extensive resale rights are at odds with the basic concept of a duopoly, for the following reasons:

- Competition in the basic network will take root more effectively if a single competitor is first allowed to become established before the door is further opened to admit additional competitors. Abruptly opening the telecommunications industry to competition may simply produce small, weak competitors and reinforce the dominant position of the former monopoly.
- The overseas experience is that telecommunications customers, both business and residential, are fairly conservative and not readily dislodged from the former monopoly carrier. Immediate unrestricted entry which results in an array of separate offerings could confuse consumers, causing them to cling more firmly to their traditional carrier.
- If resold capacity could be used to provide carrier-like services, resellers would have a considerable advantage over carriers. In return for their privileged status, carriers are subject to significant obligations, including the requirement to provide or fund universal service, regulation of service standards, and prohibitions against discrimination in supply of services and facilities. Resellers would have many of the advantages of carrier status but without these obligations. The asymmetrical regulation of similar services undermines the efficacy and relevance of a regulatory

dividing line between the carriers and resellers.

- The building of a viable second network will involve a great commitment of capital in an inherently risky operation. If resold capacity can be used to provide carrier-like services, the second carrier might itself instead opt for a smaller commitment of capital and technology and limit itself to reselling leased capacity to certain large customers.

### The range of possible boundary lines around resale

**F**inding an appropriate boundary line between functions which are reserved to carriers and those which are open to wider competition has been a continuing problem in the world's telecommunications regimes as they move towards deregulation. No single or readily apparent answer has emerged.

In the progressive liberalisation of resale, a point is reached where resellers should no longer be viewed merely as customers of the carriers but as carriers themselves. Where it is decided to go the way of a duopoly, then logic dictates that some boundary lines be drawn between carriers and resellers. Where those boundary lines should be drawn is essentially a political and commercial judgment about how big or small the duopoly domain needs to be in order to attract bidders for AUSSAT, and then to sustain the second carrier and the prompt roll-out of its network. The domain reserved to the duopoly should be sufficient to achieve those policy objectives while at the same time allowing enough ambit in the marketplace for the resellers.

Distinctions between basic and enhanced services, or "reserved services" and "value added services" in the Australian context are being overtaken by technology. Value is continually being added to telecommunications networks and services as a result of technological change, innovation in network design and the evolution of software. The concept of added value inevitably becomes a relative, not absolute, concept, and will be constantly shifting as the carrier upgrades its basic services. A function which would be regarded as "value added" today may become part of tomorrow's basic service offering by a carrier.

The European Commission has endeavoured to avoid the basic/enhanced difficulties by settling for a distinction between voice and non-voice services. This distinction is much clearer and more obvious than the basic/enhanced distinction. Voice services are also more traditionally associated with monopoly carriers, and there is more likely to be consensus on this boundary line. However, with the roll-out of digital networks, it will be technically difficult to distinguish between

voice and non-voice signals.

Current Australian facilities-based limitations essentially prohibit double ended interconnection of private networks and traffic may only be private-public, or public-private, but not public-private-public. Facilities-based limitations have also been criticised as a regulatory contrivance which artificially restricts the technological capacities of resellers and ignores consumer requirements.

Shared use of telecommunications capacity can be limited within a defined group of users, such as AUSTEL's pre-duopoly proposal that "common interest" groups for private networks be defined by joint and severable liability for each other's communications charges. However, user-based limitations can be ill-defined and difficult to police or can be pushed out to permit the assembly of disparate users into virtual "private telephone companies" within the wider public network. In Japan, a common interest group can cover a single industrial sector, including suppliers, manufacturers, distributors and competitors.

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### The government's proposal

**G**iven the difficulties discussed above, and its desire to maximise competition, the Government has apparently decided to abandon any endeavour to draw boundary lines around resale. Instead, the vertical relationship between the resellers and the second carrier will be constructed on the different price at which each buys capacity from Telecom/OTC.

The carrier-to-carrier prices, both for interconnection and lease of capacity, are to be set by negotiation between the carriers and, failing that, by AUSTEL. The required margin can only be achieved if not only the "bottom" of the margin bracket - carrier-to-carrier prices for leased capacity and interconnect - are set, but also the top of the bracket - Telecom-reseller prices for both - are fixed in some manner.

There may be competitive risks in leaving the determination of the Telecom/OTC-non-carrier prices entirely to "market forces", since Telecom/OTC's dominant position in the market could allow it to substantially influence or manipulate the market. If Telecom/OTC has an unrestricted ability to drive the carrier/non-carrier price towards the fixed carrier/carrier price, Telecom/OTC could

undermine the vertical structure of the duopoly. While Telecom/OTC would forgo revenue in the short term, the longer term advantage in pitting the second carrier against the non-carriers would be to undermine the challenge presented by the second carrier to Telecom/OTC's entrenched position. Telecom/OTC's unrestrained ability to narrow the pricing gap between the second carrier and non-carriers could undermine the government's objective to achieve vigorous facilities-based competition through the medium of a duopoly.

AUSTEL could be given authority to determine the Telecom/OTC-non-carrier price in rate setting proceedings, but this is likely to create a more intrusive, complex regulatory regime than the government wants. An alternative option which preserves pricing autonomy for Telecom/OTC would be to require Telecom/OTC to publish its schedule of charges and terms. The schedule could establish differential pricing based on cost differences in volume, transmission capacity, distance, performance characteristics or supply period. Essentially, the current grounds of defence to discrimination under section 98 of the *Telecommunications Act 1989* would be used as the criteria by which Telecom is to construct a tariff schedule.

As the above discussion demonstrates, the resale issue is not simple nor is the answer apparent. Having opted for a duopoly, the government must fashion a resale policy which comfortably fits within that framework, and does not undermine it. The duopoly is a creation of government policy, and cannot be abandoned at the moment of its birth, or put on a starvation diet. On the other hand, competitive service providers are an important fact of life in the Australian telecommunications market, and they can bring greater diversity and innovation in telecommunications services. The trick is to ensure that the second carrier and the resellers each have a sufficient market to survive and prosper.

*Peter Waters is a solicitor with the Sydney firm of Gilbert & Tobin. Shortly before publication, AUSTEL's Resale Report was released. The Report has been the subject of vigorous debate, and an update will be in the next CLB.*