"Private networks – common interest" – Telecommunications regulation under review

Peter Leonard examines AUSTEL's first major review of telecommunications regulation

AUSTEL's report "Private Networks: Common Interest - A Review of "the Present Arrangements for Allowing Joint Use of Private Networks" is an interesting amalgam of legal and economic reasoning and is AUSTEL 's first major foray into the dark and mysterious world of Telecom pricing policy. As economics underlie AUSTEL's conclusions, it is necessary to first consider pricing issues before examining AUSTEL's conclusions.

The economic imperatives

Private networks may be broadly defined as telecommunications facilities for internal communications within individual or groups of companies and organisations. As the Telecommunications Act 1989 reserves to the public carriers (Telecom, OTC and AUSSAT) the exclusive right to lease communications channels crossing property boundaries (other than limited exceptions such as links provided solely by means of radiocommunications) such companies and organisations usually use carrier provided links for point-to-point voice, data and video communication. These links generally bypass the expensive centralised switching equipment of the telephone exchanges used by the carriers for public traffic and are therefore offered at a cheap rate by carrier.

Cost saving is only one of a number of reasons that companies and organisations establish private networks. However, the potential cost savings to users represent revenue lost to the carrier in provision of public network services. Accordingly, previous Telecom regulatory policy, and the provisions of the Telecommunications Act 1989 and the current AUSTEL private networks class licence, artificially limited the classes of person entitled to establish and operate private networks, using the so called " common interest" criteria. In broad terms, the current criteria limit the use of private networks to persons having a common business or other interest, where their primary business or other interest is not the operation of a telecommunications network or service, and where the operation of the telecommunications network of service is ancillary to their primary business or other interest.

The significance of any loss of revenue by Telecom through so-called "bypass" is a matter of considerable debate. The conventional wisdom has been that diversion of traffic from the public network to private networks has the potential to jeopardise Telecom's ability to fund its statutory community service obligations to provide universal telephone service and further network development. This view led to the inclusion as Section 72 (a) of the Telecommunications Act 1989 of "the private network licencing principle" that " private networks are not to be supplied in a way that would permit a person (other than a carrier) to sell, or otherwise dispose of, capacity of private networks to third parties". Of course, differences in gross revenue earnt from public and private services only tell part of the story: of greater significance is the difference (if any) in the rate of return from provision of public and private network services.

Tariff imbalance - differences in the relationship of prices to costs for various public and private network services - will be the prime determinant of the impact on Telecom profitability resulting from a particular common interest policy. In short, restrictions on the use of private networks (imposed through common interest policy) can only be justified on economic grounds to the extent that the pricing for leased private network capacity does not properly reflect the cost of provision of that capacity as against the pricing for the public network. The restrictions placed upon the person who can use private networks should therefore been seen as a transitional step pending establishment of rational cost based pricing for leased capacity. AUSTEL ' s conclusions are based upon a legal premise - that it could not permit "resale" of leased capacity because of the restriction in Section 72 (a) of the Act - and the results of AUSTEL economic analysis. AUSTEL concluded that Telecom's rate of return on narrowband leased circuits (such as tie-lines, frequently used for joining PABX's, and costing around $12,000 per annum) is at least comparable to that which it secures from its public trunk service. By contrast, wideband capacity (such as Telecom Megalinks, used for high volume traffic such as bank data transfer, and costing $205,000 per annum) costs considerably less than the equivalent public trunk services. AUSTEL therefore concludes that:

"in the case of wideband private networks, the magnitude of both the economic incentive for bypass and the potential monetary loss to Telecom may be significant. To safeguard against substantial bypass in this way, AUSTEL has recommended conditions on capacity sharing".

In short, AUSTEL determined that until Telecom rebalanced tarrifs, restrictions on capacity sharing should remain. AUSTEL's report also makes it clear that it would welcome a reference from the Minister to consider whether resale should continue to be prohibited by the Act.

Proposed new common interest criteria

AUSTEL recommends the substitution of three mutually exclusive categories of common interest in lieu of the current criteria. "Category A" would be "persons who need to communicate with each other and interchange traffic on a regular basis but whose sharing of capacity is incidental only to that interchange", provided that the primary use of the service is the interchange of traffic, and the use of the service for an individual parties own communications is secondary and not its principal feature.

This recommendation finally disposes of the previous Telecom policy that users of a private network could not use that network for individual communications purposes (i.e. branch office to branch office of the same company) as distinct from interchange between users (branch office of A to branch office of B, and so on). Aside from that change, category A essentially embraces the current arrangements, although assisting interpretation by more precise framing of the criteria. It is convenient to next deal with AUSTEL's category C : Commonwealth, State and Territory government agencies may jointly establish a private network jointly, "except where there is a demonstrable unfair commercial advantage to an agency resulting from its automatic inclusion in the Government category". Two clear exceptions would be the State banks and insurance companies. There is no reason why governments should occupy a special position - except that AUSTEL was seeking to remove "current inconsistencies and uncertainty" created by inexplicable differences in

Telecom regulatory decisions in relation to the various government networks. The government agencies category and the " unfair commercial advantage" exception to the category may not be important in practice, as government agencies are perhaps uniquely placed to fully exploit AUSTEL's "capacity sharing" category B.

Capacity sharing is joint leasing of carrier capacity for carriage of communications other than interchange traffic: A to A, B to B, and so on. Capacity sharing will be subject to a number of proposed conditions. Firstly, each person whose traffic is carried on the private network service, together with the person directly connected to the service, must be jointly and severally liable for all charges payable to the carrier. Secondly, a person sharing capacity on the service must not enter into joint insurance or other joint risk avoidance measures that would have the effect of negating the person's joint and several liability. Thirdly, a person sharing capacity on the service must be connected to the service by a fixed link (that is, not via the public network). Fourthly, except where persons sharing the service are co-tenants in a building, exchange lines connected to the service must not be shared.

The joint and several liability requirement is no doubt primarily intended to discourage larger scale bypass of the public network by smaller entities jointly leasinguide band capacity: the cost of a Megalink ($205,000 p.a.) may well make the risk of liability unattractive to the average business man. The requirement is, of course, entirely artificial and devised solely as a means to deter growth of capacity sharing arrangements. The scheme can be criticized for working to the advantage of larger users and corporate groups but providing no real benefit to small and medium sized businesses.

AUSTEL' s report is refreshingly devoid of the obfuscation which has characterised private networks policy to date. The proposals are, on the whole, a balanced and constructive new initiative in Australian telecommunications regulation. Its recommendations may be seen as a holding operation pending further Telecom tariff rebalancing and a more complete examination of whether full resale of leased capacity should be permitted. It is unfortunate that AUSTEL did not choose to substantiate its conclusion that unrestricted capacity sharing (and resale) of wideband private network services would lead to a significant monetary loss to Telecom. No doubt telecommunications economists will now seek to demolish this conclusion as the pressure for unrestricted resale continues to mount.

Peter Leonard is a partner in the Sydney firm of Gilbert & Tobin, Lawyers

The politics of pay

George Frame, General Manager of Independent Television Newcastle, argues that the Saunderson Report should have endorsed satellite delivery

Having attended several pay TV Hearings, given evidence and presented seven submissions on behalf of our company, it has become evident to me that the issue of what benefits pay TV could bring Australia has been eclipsed by the politics being played in the arena. But, as in all electronic media in this country, politics are the axle which governs motion and direction according to the amount of friction applied, rather than being the spokes that should support the medium and its direction. Pay TV has been affected for over a decade by lack of movement due to various frictions of internal and external forces.

On November 30 1988 the House of Representatives Committee Report To Pay or Not to Pay (known as the Saunderson Report after its Chairman, John Saunderson) made one small adventurous turn, by favouring the introduction of pay TV. Of course the Report is just that, a Report. The Minister can accept or reject all or part of the Committee's recommendations. But once again, this will be determined by the hand of politics.

Australia lags

The Saunderson Report made 16 major recommendations on pay TV in Australia, however there were may other issues raised in the Saunderson Report and space will allow, at this stage, only one major issue to be put under the microscope.

Australia already lags behind much of the world in pay TV services and is the largest English speaking country not provided with this service. The Committee Report could be better titled "Pay TV in Australia, A Lost Continent."

Australia was foremost in the introduction of radio in the 20's and followed closely the international trend by introducing television in the mid 50's.

However pay TV is only now gaining any motion after a decade of debate. In fact if the Federation of Australian Commercial Television Stations submissions are adopted, the turn of the next century would be too early to introduce Pay TV.

Why are we out of step with the rest of the world? Is our current television industry that fragile? Corporately the television industry has been on a self destruct track, however, the core of the industry (high corporate flyers aside) is very strong and capable of making solid profits. An evaluation of industry balance sheets prior to 1988 testifies to this.

Pay TV, if it has any effect on current free-to-air operators, would take 5 to 6 years to make any appreciable penetration of the Australian television viewing market.

The lack of a decision to introduce pay TV has afforded the existing free-to-air television industry one of the greatest shields to competition ever enjoyed in this country. Other Australian industries would welcome the kind of protection that this pseudo import tariff awarded the broadcast industry represents.

The Saunderson Report proposed a cable/MDS delivery system for pay TV in Australia.

Cable (or fibre optics) can carry up to 40 channels, while multipoint distribution system (MDS), a microwave delivery system, can provide up to six channels in selected areas for "localised" services. MDS is a line-of-sight technology with 30 to 50 kilometres transmission coverage.

Satellite vs cable

Aussat's national direct broadcast service (DBS) was not only not recommended, but completely dismissed as a pay TV service. One only has to look at a map of Australia to realise the immensity of the technological task in providing a service to potential viewers on a national basis in the next 10 years.

Only satellite DBS can provide an immediate service when the scheduled Series B satellites are launched and commissioned in early 1992 with MDS providing re-transmission of the national six channels with localised programs inserted into local windows of the national service. The Saunderson Report recommends 40 national local franchises (e.g. for instance four franchises for Sydney).

Cable will commence to have penetration in major metropolitan markets by 1994/95 and eventually over the years cable will have the greater penetration, but only a DBS pay TV service can provide initially a co-ordinated national service associated with cable and MDS.

The moratorium on pay TV ends in September of this year and following the Federal election will rise again as a decision for the government of the day.

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