

December 16, 2005

BY ELECTRONIC MAIL

Ms. Gloria Blue
Executive Secretary
Trade Policy Staff Committee
ATTN: Section 1377 Comments
Office of the United States Trade Representative
1724 F Street, N.W.
Washington, DC 20508

Re: AUSTRALIA: U.S.-Australia Free Trade Agreement

Dear Ms. Blue:

Pursuant to Section 1377 of the Omnibus Trade and Competitiveness Act of 1988, 19 U.S.C. 3106 ("Section 1377"), Primus Telecommunications Group, Incorporated ("Primus"), through its counsel, hereby responds to the request of the Office of the United States Trade Representative ("USTR") for comments concerning U.S. trading partners' compliance with U.S. telecommunications trade agreements.

Primus hereby would like to take this opportunity to raise with the USTR concerns with the Australian telecommunications market that implicate Australia's compliance with the U.S.-Australia Free Trade Agreement ("FTA"). As described in more detail below, the Australian Government is at a critical point in its review and implementation of changes to its telecommunications regulatory regime as it develops legislation in conjunction with the sale of its remaining 51.8% interest in Telstra. Telstra is the dominant incumbent local, long distance, and broadband telecommunications services provider throughout Australia. Telstra, with the apparent backing of the Finance Ministry, is pushing hard for changes to the regulatory structure that will substantially weaken the role of the Australian regulator, the Australian Competition and Consumer Commission ("ACCC"), and remove many competitive safeguards. If the Australian Government continues down the path Telstra is advocating, Australia will be in violation of the FTA that entered into force this year. Therefore, it is critical that the USTR take action now to exert pressure on the Australian Government to live up to its commitments made

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in the FTA, and regulate Telstra in a manner that keeps the Australian telecommunications market open to fair and effective competition from U.S. and other carriers.

Background. Primus is a U.S. based telecommunications company with subsidiaries operating throughout the world. In Australia, Primus' subsidiary, Primus Telecom, first began operating following its acquisition of Australian-based telecommunications reseller Axicorp. The acquisition of Axicorp allowed Primus to obtain its carrier's license and begin operating in Australia as a fully fledged carrier on July 1, 1997. Primus Telecom has since grown into the fourth largest fixed-line and ISP telecommunications carrier and the only global telecommunications company in Australia. Primus Telecom offers a comprehensive range of voice, data, Internet and web hosting products, servicing both residential and business sectors. The Primus Telecom network offers nationwide coverage through its own backbone and is in the process of building out its own DSLAM network with facilities in almost 200 sites across Australia. The network enables Primus Telecom to provide nationwide long distance services and local call Internet access. Primus Telecom operates its own fiber network in the five major capital cities, delivering a range of business direct-connect services including ISDN, frame relay, ATM, telephone line and Broadband DSL, as well as telephone line and broadband DSL services direct to residential customers. Global connectivity is provided through an extensive voice, IP, wireless and ATM network operated by its U.S. parent company.

Telstra is a highly vertically and horizontally integrated telecommunications carrier with not only control and ownership over the copper customer access network monopoly, but it also is the majority shareholder of the major pay TV network, Foxtel, through which it controls the majority of pay TV content. Hence in Australia, unlike all other countries, the incumbent carrier does not face competition from cable networks and is therefore unique in the manner in which it must be regulated. Further, Telstra is one of the most, if not the most profitable telecommunications companies in the world with a 49% EBITDA. Notwithstanding, it has stated publicly that it intends to increase this to over 52% within several years.

Telstra's Campaign for Deregulation. Companies like Primus have only been able to compete with Telstra thanks to legislation and the efforts of the ACCC to check Telstra's incredible market power as the monopolist incumbent of Australia's ubiquitous copper network and dominance in every market segment, and give access to Telstra's bottleneck facilities, especially at the local loop level. The USTR's successful negotiation of an FTA with Australia also has helped define what regulatory elements are necessary for competition to flourish in the telecommunications marketplace. As can be expected, however, Telstra is not happy with the regulatory conditions under which it operates, and has used the Australian Government's recent decision to go forward with the complete privatization of Telstra (stage "T3") as an opportunity to have many of the competitive safeguards lessened or removed entirely.

In particular, Telstra has employed massive resources in a variety of fora in both the press and in meetings with legislators and other government officials to push a policy of nearly complete deregulation. Telstra bases its arguments on the false supposition that it is no longer a

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monopoly, there is strong competition in Australia, and that Telstra's ability to compete has been unfairly hurt by regulation.¹ Despite the fact that Telstra continues to be one of the most vertically and horizontally integrated and profitable telecommunications companies in the world, Telstra has argued that its regulatory burden is disproportionate to other carriers, and unless that gap is closed, Australia will not get the jobs and growth that comes with modern telecommunications.² Telstra ignores the fact, however, that Telstra's competition is mainly in the form of resellers and rebillers, and so long as Telstra maintains control of the last mile, there is absolutely no merit in the claim that competitors are eroding Telstra's fixed line revenue. So far, though, Telstra has received support from the Finance Ministry because of its arguments that the government will not be able to maximize its profits from the sale of Telstra unless regulatory restrictions are removed.

Telstra's campaign for deregulation has focused on the following: 1) restructuring and restricting the number of wholesale services available; 2) removing the oversight of the ACCC on pricing and offerings of unconditioned local loops (ULL) with a goal towards enacting a nationwide average price on ULL's that would seriously impact the business cases of all competitors; 3) removing the ACCC from oversight of operational separation requirements with a goal towards eliminating or lessening these requirements; 4) restructuring the universal service obligation; 5) removing regulation of local facilities by upgrading its existing copper wire network monopoly to fiber, and recasting network as "new facilities" not subject to regulation; and 6) having major institutional investors exert pressure on the government by claiming regulation will damage the privatization and sale of Telstra.³ There are growing signs that Telstra's campaign is gaining traction with the Prime Minister's office as well as key legislators. The Prime Minister is passionate about going through with the privatization, and is under considerable pressure by Telstra to carry out the privatization in a manner favorable to Telstra, that will keep up the value of Telstra's stock. So far though, the Minister for Information and Communications Technology has been listening to the arguments of the competitors, and not acquiescing to all of Telstra's demands. Telstra itself is starting to unilaterally change the terms of the wholesale services contracts and other contracts for essential facilities that it is currently negotiating in order to shorten their length from five years to six months. This gives Telstra the ability to not renew the contracts if it succeeds in having the government remove its obligations to provide wholesale services and make available essential facilities. Telstra's lobbying has already succeeded in some areas, resulting in Australian violations of the FTA as noted below. Further, if the Australian Government enacts the additional changes Telstra seeks, Australia will be in violation of several more commitments made under the FTA, as outlined below. Therefore,

¹ "Getting the Regulatory Settings Right for the Modern Telecommunications Market," speech by Kate McKenzie, Managing Director Telstra Regulatory, July 27, 2005, at http://www.telstra.com.au/abouttelstra/media/speeches_article.cfm?ObjectID=201.

² "Yesterday, Today, and Tomorrow: Telstra's Commitment to Regional, Rural and Remote Australia," speech by Sol Trujillo, Chief Executive Officer, Telstra, August 2, 2005, at http://www.telstra.com.au/abouttelstra/media/speeches_article.cfm?ObjectID=221

³ Australian Financial Review, "PM told to ease up on Telstra," December 13, 2005.

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we urge the USTR to enforce the FTA with Australia, and urge the Australian Government to not succumb to any further pressure by Telstra that will result in additional violations of their trade commitments.

Violations of the U.S.-Australia Free Trade Agreement

Article 12.7 : Treatment By Major Suppliers

Each Party shall ensure that major suppliers in its territory accord suppliers of public telecommunications services of the other Party treatment no less favorable than such major suppliers accord in like circumstances to their subsidiaries, their affiliates, or non-affiliated service suppliers, regarding:

(a) the availability, provisioning, rates, or quality of like public telecommunications services; and

(b) the availability of technical interfaces necessary for interconnection.

Having effective operational separation of Telstra is important to ensure that it treats other carriers fairly with regard to services and interconnection. Safeguards must be in place to ensure that dominant carriers like Telstra cannot unfairly discriminate in favor of affiliates. As part of their plan to privatize Telstra, the Australian government recently passed legislation that introduced an operational separation plan for Telstra. Unfortunately, due to Telstra's intense lobbying, Australia's plan is woefully inadequate, and sets the stage for unmitigated abuse by Telstra of its market position to provide anti-competitive favorable terms to its affiliates in the various markets in which they compete.

Schedule 11 of the *Telecommunications Legislation Amendment (Competition and Consumer Issues) Bill 2005* (Cth), which was recently adopted by Parliament, establishes an operational separation regime which effectively delegates to Telstra the responsibility for designing its own operational separation plan and, incredibly, delegates to Telstra the responsibility for determining what rectification measures (if any) ought to be imposed if it contravenes that plan. At the behest of Telstra, the Bill also removed the ACCC from any role in reviewing the plan, or overseeing its implementation. Instead, the review function lies with the Minister. If at some point in the future the Minister determines that Telstra has contravened its separation plan, Telstra would be required to prepare a "draft rectification plan", setting out the action to be taken by Telstra to ensure that the contravention eases. The Minister then approves that plan. The entire process is full of delays, and the legislation in effect creates an 18 month *at a minimum* window of time before a final rectification plan could come into force. The bottom line is that operational separation is called for in the new legislation, and at some point will become a reality, but ultimately it will be completely ineffectual in terms of imposing any real constraints on Telstra's conduct with respect to its competitors.

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Therefore, Primus urges the USTR to monitor closely the Australian Government's review and implementation of the operational separation plan to be developed by Telstra, and encourage the government to accelerate all timeframes to ensure a speedy resolution of any issues. Also, in order to comply with Australia's commitments to maintain a strong independent regulator, it is important that the Minister refer primary consideration of the plan to the industry regulator, the ACCC, and that the Minister give deference to the ACCC's recommendations following its consideration.

Article 12.8 : Competitive Safeguards

Each Party shall maintain appropriate measures for the purpose of preventing suppliers who, alone or together, are a major supplier in its territory from engaging in or continuing anti-competitive practices, including in particular:

(a) engaging in anti-competitive cross-subsidization;

The Australian Government's actions to delegate to Telstra development of an operational separation plan may very well result in a violation of Australia's commitment to prevent major suppliers from engaging in anti-competitive practices such as cross-subsidization. Telstra already has a record of engaging in heavy cross-subsidization between its city and rural services.⁴ Now Telstra is putting intense pressure on the ACCC to allow it to continue heavily cross-subsidizing ULL prices.

In keeping with Australia's FTA commitments, the ACCC has proposed to set ULL prices on a cost-based geographic basis. Telstra has argued in a variety of public fora, as well as directly with the ACCC, that elimination of its ability to cross-subsidize ULL prices would: 1) reduce facilities-based competition in rural areas; 2) reduce Telstra's overall ability to cross-subsidize service provision in the rural country from profits made in the city; and 3) reduce the ability of Telstra to invest in the network because it cannot receive a fair return on investment. One Telstra executive went so far as to threaten a couple of months ago that such regulatory reforms will result in higher prices and less services to the rural areas, and 16,000 lay-offs.⁵

In a recent document entitled "The Digital Compact & National Broadband Plan," Telstra outlined its vision for the future, and its strategies for working with the government to effectuate

⁴ See Morgan Stanley "Telecom Regulation for Investors' Conference", speech by Tony Warren, General Manager, Regulatory Affairs, September 20, 2005, at <http://www.asx.com.au/asx/statistics/announcementSearch.do?method=searchByCode&timeFrameSearchType=Y&year=2005&issuerCode=TLS>

⁵ See Telstra Country Wide GMD Doug Campbell speech at NSW Country Press Association, delivered October 14, 2005, at <http://www.asx.com.au/asx/statistics/announcementSearch.do?method=searchByCode&timeFrameSearchType=Y&year=2005&issuerCode=TLS>

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that vision.⁶ Among Telstra's proposals was a plea for "pricing parity," that allows Telstra to engage in nationwide price averaging for all services between metro and non-metro areas, on both the wholesale and retail level.⁷ This would be particularly troubling because it would raise wholesale rates in the metro areas far above cost, resulting in an anti-competitive cross-subsidization for no reason other than to prop up declining PSTN revenues. For instance, if Telstra were allowed to raise its ULL prices, it would seriously undermine the business operations of all its competitors, particularly where those competitors have based their investment decisions on previous well-established regulatory decisions which advocated cost-based geographic pricing. In fact, in an undertaking to the ACCC in 2004, Telstra itself proposed ULLS pricing based on geographic bands. But now that Telstra has taken a contradictory public position, it has yet to approach the ACCC to amend its argument, demonstrating again Telstra's contemptuous disregard for the role of the regulator. ULL is the very foundation of infrastructure based competition to date in Australia, and price restructuring of the nature proposed by Telstra would make unworkable the business plans of competitors presently utilizing them. Telstra's proposed structure would not support an alternative business plan.

Therefore, the USTR should monitor closely whether the Australian Government allows the ACCC to go forward with deaveraging ULL prices to bring them more in line with cost-based prices and does not override the ACCC's expert consideration of ULLS prices. If the Australian Government does not follow this course, it will be in violation of Australia's commitments to prevent anti-competitive cross-subsidization. In addition, as detailed below, if failure to take such action results in a price averaging regime for ULLs, the Australian Government would also be in violation of its commitments to have cost-based unbundled network elements.

Article 12.9 : Resale

Each Party shall ensure that major suppliers in its territory:

- (a) offer for resale, at reasonable rates, to suppliers of public telecommunications services of the other Party, public telecommunications services that such major supplier provides at retail to end users that are not suppliers of public telecommunications services; and*
- (b) do not impose unreasonable or discriminatory conditions or limitations on the resale of such services.*

Telstra has indicated that it plans to significantly restructure and restrict the number of services that it makes available as wholesale services. Telstra's management has repeatedly said

⁶ The Digital Compact & National Broadband Plan, August 11, 2005, at http://www.telstra.com.au/abouttelstra/investor/docs/tls339_briefingpaper.pdf ("Telstra Digital Compact").

⁷ *Id.*

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that it does not want to have to offer wholesale equivalents of its retail products, yet many of these retail products are built on Telstra's monopoly access network and can not be replicated.

For instance, Telstra has for some time been under pressure from the ACCC to make available a business grade DSL wholesale service in regional areas. It has been offering a retail version for about two years. It has, in typical fashion, moved very slowly to develop and offer the service, moving just fast enough to forestall regulatory intervention for anti-competitive conduct. In the past few months, it has had draft contracts under discussion with a handful of competitors, who had agreed to sign on to buy the service subject to final negotiations on a price being resolved between themselves, Telstra and the ACCC. However, in mid-September, Telstra unilaterally changed the draft contracts so that they expire after six months, not five years as originally drafted. Telstra said it made this change "given the current uncertain regulatory and commercial environment." After six months, Telstra can give notice at any time that it will terminate the service. The implications are that Telstra can withdraw from the wholesale business once such requirements are lifted, and it believes such regulatory relief is imminent.

Similarly, it has long been the case that Telstra charges its wholesale resale customers of the basic line access monopoly network the same amount for basic residential line access as it charges each individual residential service customer without any allowance for scale or costs borne by the wholesale competitor. At the same time, Telstra has provided less functionality to the wholesale competitors than it provides to each individual for an identical charge. Recently Telstra introduced an increase for less than 5% of its retail residential line access service customers, but the same increase was applied to 100% of its wholesale residential service customers, thereby raising the cost to its wholesale competitors to a higher than retail rate. In addition, Telstra provides to those few residential line access customers that saw a rate increase a range of discounts which it does not make available to its wholesale customers. This has the characteristics of a price squeeze and constitutes a breach of Article 12.9 of the FTA.

Therefore, Australia is in violation of its obligations to provide access to leased lines on reasonable terms, including price. In addition, Telstra's excessive pricing violates Australia's commitments under Sections 12.2 and 12.12 of the FTA. Accordingly, the USTR should closely monitor this situation, and encourage the ACCC and the government to enforce the FTA commitments and have Telstra provide its services on a wholesale basis and at reasonable rates.

Article 12.10 : Unbundling Of Network Elements

Each Party shall provide its telecommunications regulatory body with the authority to require that major suppliers in its territory provide suppliers of public telecommunications services of the other Party access to network elements for the provision of public telecommunications services on an unbundled basis, and on terms and conditions, and at cost-oriented rates that are reasonable, non-discriminatory, and transparent.

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As described above, Telstra has made a concerted effort to have the ACCC overruled by the Government in order to force a restructuring of the price of unconditioned local loops. If Telstra is successful, and the ACCC loses the power to require cost-based ULLs, Australia would be in clear violation of its commitment under Article 12.10 to empower the ACCC to make network elements available on an unbundled, and cost-oriented basis. This is different than in the United States where the FCC has the power to require cost-based ULLs, but has found that it does need to exercise such power due to a variety of reasons such as the presence of intermodal competition. Therefore, the USTR should again monitor closely the Australian Government's actions in this area to ensure that the ACCC continues to have all the authority it needs to mandate Telstra provide cost-based ULLs.

Article 12.11 : Interconnection

Each Party shall ensure that major suppliers in its territory provide interconnection for the facilities and equipment of suppliers of public telecommunications services of the other Party:

- (a) at any technically feasible point in the major supplier's network;*
- (b) under non-discriminatory terms, conditions (including technical standards and specifications), and rates;*
- (c) of a quality no less favorable than that provided by such major suppliers for their own like services, for like services of non-affiliated service suppliers, or for their subsidiaries or other affiliates;*
- (d) in a timely fashion, on terms, conditions (including technical standards and specifications), and cost-oriented rates, that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that suppliers seeking interconnection need not pay for network components or facilities that they do not require for the service to be provided; . . .*

In Telstra's document, "The Digital Compact & National Broadband Plan," Telstra describes plans to upgrade its infrastructure, but argues that the Government must exempt these new facilities from regulation, or it will not build them.⁸ Telstra has approached the Government for a package of assistance in order to build "fiber to the home" which would be rolled out as fiber to the RIM located between the home and the exchange. Telstra has proposed to push out fiber beyond the exchange to about two-thirds of its capital city lines. Telstra loops currently connect to exchanges where competitors are able to collocate DSLAMs. But under Telstra's proposal, once completed, Telstra plans to remove the existing copper connections from the RIM to its central offices, or more likely cease to maintain it. As a result, its competitors would no longer have access from their DSLAM's to the copper local loops. In fact, Telstra has argued that as an incentive to build this "fiber" network, it should not have to give access to its competitors.

⁸ See Telstra Digital Compact.

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Although Telstra's proposed changes will make access to ULLs infeasible, Telstra has yet to engage with competitors to discuss the architecture of these network changes, or how competitive access will be preserved. On the contrary, Telstra has attempted to disguise this upgrade as a "new" network investment, and has argued that it should be able to avoid existing access obligations. This is the most serious challenge to sustainable competition in the Australian telecommunications market and requires immediate intervention by the USTR, the Australian Government and the ACCC to ensure the integrity and preservation of Australia's policy promoting infrastructure-based investment, and to guarantee that Australia keeps its commitments to ensure reasonable interconnection at any technically feasible point on its major supplier's network.

These actions underway in Australia can be differentiated from what is occurring in the United States because the FCC has specifically found that ULLs are not necessary in cases where due to both intramodal and intermodal competition, there are multiple pathways for competitors to reach businesses and residences. In Australia, competition has just begun, and Telstra still commands control of local loops, and is the gatekeeper of the last mile. For all practical purposes, any new entrant wishing to compete must have access to Telstra's ULLs. If the Australian Government allows Telstra to deny access to these ULLs under the guise of new network build out, it will be a crippling blow to competition, and Australia will be in violation of several of its FTA commitments.

Article 11.7 : Expropriation and Compensation

1. *Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization, except:*
 - (a) *for a public purpose;*
 - (b) *in a non-discriminatory manner;*
 - (c) *on payment of prompt, adequate, and effective compensation; and*
 - (d) *in accordance with due process of law.*

Article 11.7 is another FTA commitment in danger of being violated if the Australian Government proceeds to allow Telstra to block access to local loops. In Annex 11-B to Article 11.7 of the FTA, an indirect expropriation is defined as an action or series of actions by a Party that has an effect equivalent to direct expropriation, including a "government action [that] interferes with distinct, reasonable investment-backed expectations." If the Australian Government allows Telstra to proceed with its plans to build fiber to the RIM as described above, the government would also be in violation of its commitments to not allow indirect expropriation of covered assets. This is because the Government's actions would result in millions of dollars of competitive carrier stranded assets, in particular all of those competitive carriers' lines built to Telstra's exchanges that would no longer be able to be used since the DSLAMs would not have access to the local loops. The competitive carriers spent millions of

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dollars building these facilities with the reasonable expectation that they would have access to Telstra's local loops as guaranteed under Australian law. A change in regulation of Telstra that allows Telstra to block access to these loops would therefore be an indirect expropriation of the competitive carriers' investments, and a violation of the FTA. Therefore, the USTR should ensure that the Australian Government does not violate these FTA commitments.

Article 12.17 : Independent Regulatory Bodies And Divestment

- 1. Each Party shall ensure that any telecommunications regulatory body that it establishes or maintains is independent and separate from, and not accountable to, any supplier of public telecommunications service.*
- 2. Each Party shall ensure that the decisions and procedures of its telecommunications regulatory body are impartial with respect to all interested persons. To this end, each Party shall ensure that its regulatory body does not hold a financial interest in any supplier of public telecommunications services, and that any financial interest that the Party holds in a supplier of a public telecommunications services does not influence the decisions and procedures of its telecommunications regulatory body.*

Telstra is making a concerted effort to have the Government strip many of the powers of the ACCC and Competition Tribunal to oversee Telstra's business.⁹ Telstra has argued that these changes are necessary for it to be able to promote national development. For instance, Telstra has appealed to the Government to invoke a never-used regulatory power to take the unprecedented step of overriding the ACCC on pricing for access to its copper wire network, by means of exploiting the Government's interest as a shareholder stating that bad decisions of the ACCC will further harm the company's share price, and hurt the Government's chances of getting top dollar when it sells off its remaining 51.8 per cent shareholding. Instead, Telstra is trying to get the Government to use a discretionary ministerial power to set an averaged deleterious price for its copper ULLs.¹⁰

If the ACCC backs down from its position to avoid Government intervention, Australia will be in violation of its commitments to both ensure that the ACCC is independent and not accountable to Telstra, and even more importantly, that the Government's controlling interest in Telstra does not influence the decisions and actions of the ACCC. Therefore, the USTR should encourage the Government to not exert pressure on the ACCC to succumb to Telstra's demands, nor attempt to take away the powers of the ACCC to regulate Telstra.

⁹ *Id.*

¹⁰ Telstra plea to sideline ACCC, by Michael Sainsbury and Steve Lewis, October 5, 2005, at <http://australianit.news.com.au/articles/0,7204,16819142%5E15347%5E%5Enbv%5E15306%2D15320,00.html>

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Conclusion. It has been several years since Australia agreed to open its telecommunications market to competition. Since then Australia has made good strides in living up to the commitments made to its WTO trading partners. On January 1, 2005, Australia and the U.S. entered into an FTA which imposes additional obligations on Australia to take further action to ensure that its telecommunications regulatory environment is supportive of competition. As noted above, due to an aggressive campaign from Telstra for deregulation, Australia has not lived up to some of its FTA commitments, and is in serious jeopardy of failing to meet many more. These actions have materially harmed competitive telecommunications carriers, including Primus and several other carriers with substantial sunk and on-going U.S. investment, and have seriously impeded their ability to compete in the Australian market. We therefore request the USTR to engage in discussions with the Australian Government directed at bringing Australia into compliance with its FTA commitments and ensuring fair and effective competition in the Australian telecommunications market.

Please feel free to contact the undersigned if you have any questions.

Sincerely yours,

/s/

Andrew D. Lipman
Catherine Wang
Troy F. Tanner

*Counsel to Primus Telecommunications Group,
Incorporated*