Submission in response to ACCC Draft Report

Inquiry into the Fixed Line Services Declarations

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Section 1. Overview

1.1 Optus welcomes the proposal to re-declare the Unbundled Local Loop Service (ULLS), Line Sharing Service (LSS), Wholesale Line Rental (WLR), Local Carriage Service (LCS) and the PSTN Origination and Termination Access Service (PSTN OTA) — the 'fixed line services' — for a further five year period to June 2019.

1.2 Competition in related fixed line markets is only possible with fair and equitable access to the ubiquitous Telstra copper customer access network (CAN). Notwithstanding the planned deployment of the NBN, the Telstra copper CAN will remain the network through which the majority of Australian households connect over the next five years.

1.3 Optus further welcomes the proposal to remove the WLR exemption in Central Business District (CBD) areas. Optus agrees that the removal of the exemption promotes the long term interest of end-users (LTIE) as it will assist to promote a more level playing field in related *national* fixed line markets — and particularly for Corporate and Government end-users.

1.4 This submission will show that:

(a) The level of competition — at the underlying network level and the retail level — has not sufficiently improved so as to warrant removal of any of the declared fixed line services;

(b) More needs to be done to ensure that the declaration of the fixed line services *actually* promotes competition in the related downstream fixed line markets;

(c) Removal of the WLR CBD exemptions will promote competition in related downstream retail markets and will help to limit Telstra from abusing its substantial market power; and

(d) Fixed termination should be treated in a consistent manner with mobile termination in order to remove the potential for regulatory arbitrage due to the use of different cost methodologies.

Level of competition has not changed to warrant removal of regulation

1.5 Optus acknowledges that services could be deregulated when the relevant infrastructure bottleneck is no longer present, and effective competition is no longer dependent upon efficient and effective access regulation. However, market data demonstrate that the level of competition in the related downstream markets has not altered sufficiently to warrant the removal of the fixed line services declarations.

1.6 With respect to network access services (ULLS and LSS), the dominance of Telstra's copper CAN has not altered since the start of the last declaration period (July 2009). In July 2009, Telstra's copper CAN represented around 95% of all fixed line communications connections in the national market. The remaining 5% represented Optus' HFC network. There has been no material investment in alternative communications networks since 2009. While the NBN has begun to be deployed, as at January 2014, 89,445[1] premises have active NBN fibre connections. This represents only 0.9% of the total fixed line market.[2]

1.7 Market evidence show that the level of investment in alternative fixed line networks has not been sufficient to change the conclusion that Telstra's copper CAN is the only ubiquitous national communications network. Subsequently, declaration of the network access services must remain to promote competition in related downstream retail markets. Absent re-declaration of network access services, Telstra has the ability and incentive to exclude access seekers from efficient access to the dominant copper CAN.

1.8 The alternative to network access services are resale services (WLR and LCS), which enable access seekers to provide services without the need to invest in competitive infrastructure. Market evidence shows that DSLAM competition is focused within Telstra's metropolitan Band 1 and Band 2 Exchange Services Areas (ESAs) — covering around 8.06 million premises. The remaining 2.38[3] million premises rely upon the resale access services for alternative services.

1.9 The economics of investing in alternative DSLAM infrastructure remains challenging, reflecting both the above-cost ULLS and LSS rates and the deployment of the NBN. It remains unlikely that access providers will invest in DSLAMs to expand network footprints over the next five years while at the same time Telstra's copper CAN is being progressively transitioned to NBN. Optus expects that access seekers will rely upon resale services more over the next regulatory period in order to build national market presence during the transition to the NBN environment.

1.10 Optus therefore agrees with the ACCC's assessment that re-declaration of the network access and resale services promote the LTIE.

More needs to be done to further promote LTIE

1.11 However, Optus believes more needs to be done to further promote the LTIE. The competitive impact of the 2009 fixed line services declaration and FAD has been negligible, as demonstrated by a lack of material improvement in competition in the relevant market and thus the LTIE has not been promoted.

1.12 The purpose of the declaration combined with efficient and effective access pricing is to *promote* competition in relevant markets. Market data show that over the last regulatory period the status quo has been maintained —Telstra remains the dominant player in the provision of retail fixed voice with a market share of 74 per cent in June 2013.[4] The latest ACMA report cements this fact and indicates Telstra's dominance extends to the retail market for fixed broadband. Telstra has increased its dominant share over the last declaration period from 41 per cent in June 2010 to 42 per cent market in June 2013.[5]

1.13 It is unsurprising that competition has not advanced over the last regulatory period as access prices were held artificially high to promote 'price stability'. Optus reiterates its view that

[1] NBN Co Weekly Progress Report for the week ending 2 February 2014: http://www.nbnco.com.au/content/dam/nbnco/documents/nbnco-rollout-metrics-19012014.pdf
[2] Estimated based in the figure presented in Telstra annual report 2012-13.
[3] ACCC, 2013, Draft Decision, p.32
[4] ACMA, 2013, Communications Report 2012-13, p.18
[5] ACCC, 2013, Draft Decision, p.35

there is no justification for including an additional $911m in costs to Telstra on top of its actual costs. The only impact is to limit competition and undermine the LTIE.

1.14 Optus submits more needs to be done to address the imbalances that continue to favour Telstra. Optus is concerned about the competitive impact arising from payments from NBN Co to Telstra for leasing certain fixed line assets. Many of these assets are included within the regulated RAB in the current FAD. Failure to adequately take the NBN Co payments into account risks Telstra making a windfall gain. That is, the combined revenue from regulated revenue and NBN Co payments may be higher than the annual revenue requirement as determined in the fixed line building block model.

1.15 Optus submits that this should cause the ACCC to reconsider the efficiency and efficacy of the approach taken in the last suite of decisions. The priority for the ACCC during this declaration period — most likely the last period where the CAN will be the dominant fixed network — is to ensure that access seekers are able to acquire new subscribers at the same cost as Telstra. Should the prices set during this declaration period continue to be set at levels in excess of the actual depreciated cost incurred by Telstra, competition will be irrevocably damaged and will undermine the purpose of the NBN.

Removal of WLR CBD exemption is welcomed

1.16 Optus welcomes the decision to remove the WLR exemption for CBD areas. The exemption has failed to promote the LTIE and has hampered competition in related downstream markets — including the national Corporate and Government market.

1.17 As acknowledged in the draft decision, Telstra is charging prices for the WLR service in the exempt CBD areas that are significantly higher than the regulated WLR price. There is no justification for the excessive WLR charges in the exempted CBD areas which are as much as 39% above the regulated rate for business end-users and 17% for residential home end-users[6] — this demonstrates Telstra's market power in exempted areas.

1.18 The WLR charges in CBD areas should be below the national average if it reflected the underlying cost of delivery. Optus notes if effective competition was present in CBD areas the competitive WLR charge would be reflective of the underlying cost, would decrease over time in line with other telecommunications charges, and would be sufficiently below retail rates so as to allow competition.

1.19 All three measures are not present. The reality is that the integrated dominant supplier of services in CBD areas has:

(a) Failed to decrease WLR charges over time;

(b) Imposed WLR charges significantly above the underlying cost of service; and

(c) Imposed WLR charges some 24% above its own retail line rental charges.

1.20 Actual evidence shows that Telstra is exploiting its significant market power in CBD areas by charging above cost WLR charges to prevent effective competition. Such outcomes would not be possible if competition was effective.

[6] ACCC, 2013, Draft Decision, p. 59

Fixed and mobile termination should be treated consistently

1.21 Optus agrees with the draft view that the relevant markets for PSTN TA and OA are the retail and wholesale supply of fixed voice services and the retail supply of bundled fixed voice services and fixed broadband services.[7] Optus also agrees that the re-declaration of the PSTN TA and OA services would promote competition in these related downstream retail markets

1.22 But the ACCC has not identified the full suite of related downstream retail markets that are impacted by the service. In addition to these markets, PSTN TA directly impacts upon the downstream retail market for mobile-to-fixed voice services. That is, the reciprocal market to the fixed-to-mobile market which the ACCC has identified for the purposes of assessing competition effects for the Mobile Termination Access Service (MTAS).

1.23 Optus supports the view that absent declaration of PSTN TA, end-users are likely to face increased prices and a reduction in competition in the supply of retail voice services.[8] This conclusion applies to both fixed and mobile originating calls within the retail fixed voice markets and the mobile-to-fixed calling market. Further, given the dominance of Telstra in both retail mobile (around 50% subscriber share) and retail fixed (around 75% market share) voice markets, Telstra will benefit the most from above-cost fixed termination charges in both mobile[9] and fixed retail markets.

1.24 Optus believes that the ACCC should consider the need for a common cost methodology across both fixed and mobile termination services. Optus is concerned that if fixed and mobile termination services utilise different cost methodologies, end-users' calling decisions would be influenced by arbitrary regulatory decisions rather than efficient costs of the services. This is not to say that fixed and mobile termination rates should equal. Indeed, network reality is that the fixed rate should always be less than mobile rate when using the same cost methodology.[10] Adoption of a common methodology would be consistent with the approach adopted by the European Commission.[11]

1.25 Such an approach would promote efficient investment in, and use of, infrastructure as build/buy decisions will be made on the basis of the relative cost differences between the two networks; and not by arbitrary regulatory decisions on cost methodologies.

[7] ACCC, 2013, Draft Decision, p. 79

[8] ACCC, 2013, Draft Decision, p.80

[9] Telstra can internalise the fixed termination costs associated with calls originating from Telstra mobiles to Telstra fixed lines. Other MNOs cannot and will incur above cost charges, thus damaging competition in the retail mobile market. Telstra has the ability and the incentive to abuse its market power over the termination of calls on its PSTN by setting above cost fixed termination rates.

[10] This is further explained in section 4.

[11] See EC, Recommendation of 7.5.2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, C(2009) 3359 FINAL.

Section 2. Competition in relevant markets

2.1 Optus welcomes the findings in the Draft Report that competition in related downstream retail markets depends upon efficient and effective access regulation to the ubiquitous Telstra copper CAN.

2.2 The Draft Decision identifies the following relevant markets:

(a) Fixed voice services;

(b) Fixed broadband services; and

(c) Bundled voice and fixed services.

2.3 Optus submits that the ACCC should also refer to the downstream retail mobile-to-fixed voice market. This market is directly impacted by the PSTN TA service. This market is discussed in more detail in Section 4.

2.4 The provision of fixed line communications services occurs primarily through Telstra's ubiquitous copper CAN. Telstra controls around 95% of all connections nationally. The ability to compete in the fixed line market in *wholly* dependent upon efficient and effective access regulation. Indeed, the case for continued regulation of the fixed line services is stronger now than in 2009 due to Telstra's market dominance in the downstream fixed line markets, dominance in the market for double and triple play product bundling, and the implications of the transition to the National Broadband Network (NBN).

2.5 But while access regulation is a necessary condition for the development of effective competition, it may not by itself be enough to promote competition and the LTIE. Optus therefore recommends that the ACCC assesses whether its current approach to regulation and pricing is sufficient with regards to changes in the level of competition during the last regulatory period. Where competition is not developing in related downstream retail markets (including key segments like the Corporate and Government market), the ACCC should review its approach to the declared service and the applicable pricing.

2.6 This section looks at the level of competition in the downstream markets identified in the Draft Decision. Namely, the markets for:

(a) Fixed voice services;

(b) Fixed broadband services; and

(c) Bundled voice and fixed services.

2.7 Section 4 examines the level of competition in the downstream mobile-to-fixed voice market.

Defining the relevant voice market

2.8 The ACCC proposes to define a national fixed voice market. The ACCC concludes that:

(a) the level of substitution from mobile voice services is not sufficient to warrant its inclusion within the economic market; and

(b) POTS-emulation VoIP and some carrier grade VoIP should be included within the fixed voice market.[12]

2.9 Optus agrees with the ACCC's draft conclusion that the level of substitutability between fixed and mobile services is not sufficient to warrant inclusion within the same economic market. Optus agrees that mobile and fixed services are compliments rather than substitutes. While there are segments of the market that view mobile and fixed telephony services as direct substitutes; as a whole, the Australian communications market typically view the products as compliments. That is, fixed networks are used as the primary communications device at a fixed location (e.g. work or home) and mobile networks are used while on the move. The majority of end-users acquire both services.

2.10 Optus also agrees that POTS-emulation VoIP is a substitute for fixed voice services for the main reason that the end-user does not notice a significant difference between the two technical solutions. The quality is not significantly different and the end-user does not require specialised equipment. However, Optus reiterates its view that carrier grade VoIP is not a significant substitute for fixed voice services due to the difference in call quality and the requirement for dedicated customer equipment. There may be a segment of the market (i.e tech-savvy and early adopters) that is happy to trade price for quality and to adopt dedicated equipment, but this does not apply to the market as a whole.

2.11 The ACCC also concludes that the ULLS and LSS products are not substitutable at a wholesale level to the Telstra PSTN wholesale products. The ACCC concludes that while it is technically possible to supply comparable services using ULLS and LSS it is not commercially viable. This is due to the extra costs involved in investing in DSLAM and the lack of scale due to the limited scope of DSLAM roll-out compared to the national copper CAN (with its largely sunk costs). This limits the ability of access seekers to compete in a national wholesale market.

2.12 Optus agrees with this assessment and the conclusion that the use of ULLS to provide wholesale services is not directly substitutable to the wholesale national declared resale services provided over the Telstra copper CAN (WLR, LCS and PSTN OA).

Defining the relevant broadband and bundled markets

2.13 The ACCC propose to define a national fixed broadband market. The ACCC are of the view that:

(a) Broadband provided over alternative networks are substitutable for retail broadband services over the copper CAN but due to their limited coverage are not substitutable in the national market; and

(b) Mobile broadband services are a compliment for fixed broadband retail products.

2.14 Optus agrees with both of these conclusions. While alternative networks, such as HFC, offer superior fixed broadband experiences[13] for the same retail price point, on a national basis the HFC networks do not provide a substitutable alternative to copper broadband. As explained above, the mass market currently utilises mobile broadband services as a compliment to fixed broadband services. While mobile *devices* are fast becoming the first preference to access broadband services, the majority of internet usage is still through fixed

[12] ACCC, 2013, Draft Report, p.12.

[13] DOCIS 3.0 over HFC offer download speed around 100Mbps compared to maximum ADSL2+ speed of 24Mbps. HFC speeds are also not dependent on the copper distance from the exchange.

connections (i.e. utilising WiFi). Optus does not expect this to change in the medium term even though the difference between fixed and mobile network download speeds are diminishing. Optus expects that the greater download capacities offered over fixed networks will continue to limit the level of full substitution between fixed and mobile broadband networks.

Assessing competition in the markets

2.15 The level of competition in the relevant downstream markets have not materially improved over the period of the last Declaration and FAD. Telstra remains the dominant retail provider for the fixed voice, fixed broadband and the fixed bundled markets. Relevant competition data included in the Draft Report shows that:

(a) Telstra's market share in the retail voice market has slightly declined from 84% in 2009 to 76% in 2012.[14] Representing a 3.3% compound annual average decline.

(b) Telstra's market share in the wholesale voice market has not materially changed from 86% in 2009 to 83% in 2012.[15] Representing a 1.2% compound annual average decline.

(c) Telstra's market share in the retail fixed broadband market increased from 41% to in June 2010 to 42% in June 2013.[16] Representing a 0.8% compound annual average increase.

2.16 The data show that the only improvement in competitive outcomes, in terms of the ability of access seekers to acquire subscriber growth, has been in the declining fixed voice market. Optus notes that this improvement has been marginal at best. The data show that there has been no improvement in competitive outcomes in the national fixed data market — the growing market that transitions into an NBN world.

2.17 Similarly, the share of competitive DSL SIOs has only marginally increased over the last regulatory period. The IAD for the last declaration period commenced in January 2011. Telstra's market share of DSL SIOs across bands 1-3 (which are subject to the same access price) was 62%.[17] At the end of September 2013, this market share had declined slightly to 59.4%.[18] Telstra's market share of band 4 DSL SIOs remains entrenched at over 99%, with only a 0.2 percentage point decline since December 2010.[19]

2.18 This data show that the last regulatory period has not impacted upon Telstra's monopoly power in the supply of DSLAM infrastructure across the various bands of ESAs.[20] Notwithstanding the adoption of the building-block model (BBM) approach in the FAD, Telstra's share of DSL SIOs remains entrenched above 99% in band 4 and around 60% in the 'competitive' bands 1-3.

[14] ACCC, 2013, Draft Report, Table 3.2
[15] ACCC, 2013, Draft Report, Table 3.2
[16] ACCC, 2013, Draft Report, Figure 3.8
[17] ACCC, 2011, Snapshot of Telstra's customer access network as at 31 December 2010
[18] ACCC, 2013, Snapshot of Telstra's customer access network as at September 2013
[19] ACCC, 2011, Snapshot of Telstra's customer access network as at 31 December 2010 & ACCC, 2013, Snapshot of Telstra's customer access network as at September 2013
[20] ACCC, 2013, Draft Report, Figure 3.9

2.19 Optus therefore agrees with the statement that "*the supply of DSL services over Telstra's CAN remained highly concentrated in 2012-13*."[21]

2.20 Optus further notes that this statement recognises that the prices set in the last fixed line services FAD have failed to adequately promote competition and the LTIE. While adoption of the BBM was a significant step forward, the new FAD should focus on promoting efficiency during the transition to NBN (i.e. static efficiency) rather than other issues not required to be considered under the legislative criteria.

2.21 In addition to the historic data, the ACCC should also recognise the impact of declaration of the fixed line services on the development of the market for NBN services. Over the period of the next regulatory period, to June 2019, it is expected that the majority of end-users will be transferred to NBN. As the dominant provider of fixed voice and broadband services, Telstra has the ability and incentive to limit competition. Should Telstra obtain a first mover advantage it will likely entrench its current dominant position across to the new 'competitive' fixed line platform. The current NBN Co pricing model (obtaining significant revenue from the flat rated CVC charge) means that there will be significant scale cost advantages for service providers (RSPs) using the NBN. RSPs that can obtain a large customer base will have a significant cost advantage which cannot be replicated by smaller RSPs.

2.22 Optus submits that this should cause the ACCC to revisit the efficiency and efficacy of the approach outlined in the last suite of decisions. The priority for the ACCC during this declaration period — most likely the last period where the CAN will be the dominant fixed network — is to ensure that access seekers are able to acquire new subscribers on the same price and non-price terms as Telstra supplies itself. Should the prices set during this declaration period continue to focus on price stability, and be set at levels in excess of the actual depreciated cost incurred by Telstra, competition will be irrevocably damaged and this may undermine a key objective of the NBN.

[21] ACCC, 2013, Draft Report, p.36

Section 3. Network access and resale services

3.1 Optus agrees with the draft proposal to re-declare the full suite of network access and resale services. Competition for fixed line services remains dependent upon access to Telstra's copper CAN. Competition is primarily delivered through the ULLS and LSS network access services but the scope of this is limited to metropolitan areas. Resale services (WLR and LCS) remain a necessary input for access seekers to provide services within their DSLAM footprints (where there is not sufficient capacity or the use of pair gain systems). Resale services are also needed for access seekers to expand their presence beyond the current DSLAM footprint. Further investment in DSLAMs beyond the existing areas does not represent an efficient investment in infrastructure given the sparse premise density and the transition to NBN.

3.2 This section examines the draft proposal to re-declare the:

(a) Network access services; and

(b) Resale services.

Network access services

3.3 Optus supports the findings of the Draft Report that the re-declaration of the network access services for a further five years would promote the LTIE. Optus agrees with the conclusion that Telstra's CAN remains an enduring bottleneck and that declaration will promote competition in several related downstream retail markets.[22]

3.4 Re-declaration of the network access services for a further five year period to 2019 would promote the LTIE as it will:

(a) Promote competition in related downstream markets;

(b) Encourage efficient use of and investment in infrastructure; and is

(c) Consistent with the legitimate commercial interests of the access provider.

3.5 While Optus supports the draft conclusion that the re-declaration of the ULLS and LSS would promote the LTIE, the ability of the ULLS and LSS products to promote the LTIE will depend upon the cost of access, especially as the transition to NBN makes the economics of investing in DSLAM infrastructure more challenging.

<u>Declaration will promote competition</u>

3.6 Optus agrees with the ACCC's draft conclusion that the affected downstream retail markets include:

(a) Retail and wholesale supply of fixed voice services;

(b) Retail and wholesale supply of fixed broadband services; and

[22] ACCC, 2013, Draft Report, p.41

(c) Retail supply of bundled fixed services.

3.7 Optus also agrees that access to ULLS and LSS are important inputs to the provision of competitive supply of fixed line services. Optus also recognises the observation that "*access to the ULLS and LSS on reasonable terms and conditions is likely to support retail competition by access seekers*".[23]

3.8 This hypothesis can be tested over the period of the expiring regulatory period. It is true that reasonable pricing of ULLS and LSS is likely to support retail competition. The relevant question is whether retail competition using ULLS and LSS has increased over the last three years.

3.9 ULLS and LSS SIOs represent only around 20% of SIOs on Telstra's copper network.[24] While the number of competitive SIOs has increased over time, a question remains whether competition has been adequately promoted if only 20% of SIOs are supplied by competitive providers. For example, in the UK DSL services provided over ULLS represent around 54% of all DSL services, with the number of non-ULLS DSL connections falling by 6% since 2009.[25] The Australian market is yet to see a similar level of competition.

3.10 Australian market evidence demonstrates that the level of competition has remained largely static and that the development of competition has occurred primarily in the metro areas within bands 1 and 2. Evidence shows that Telstra's share of DSL SIOs remains entrenched above 99% in band 4 and around 60% in the 'competitive' bands 1-3.

3.11 Optus submits that re-declaration of the ULLS and LSS is the first step to promote competition. Without adequate and accurate cost based pricing, the declaration will not achieve its objective of increasing competition.

Encouraging efficient investment in and use of infrastructure

3.12 Optus agrees with the view of the ACCC that declaration of ULLS and LSS will promote greater competition in related downstream markets. The ULLS and LSS will enable access seekers greater flexibility to develop products in a manner required by their end-users and thus will promote allocative and productive efficiency.

3.13 Optus further notes however, that the ability of ULLS and LSS to promote efficient investment in and use of infrastructure is limited by the impending transition to NBN and the shut-down of the copper network. Access seekers require investment in DSLAM infrastructure to provide fixed line services through the ULLS and LSS products. Optus notes that as the switch over for specific areas to the NBN approaches, the incentive to invest in DSLAMs in reduced. Absent a commensurate reduction in the price of ULLS and LSS to reflect the declining value of the copper network and DSLAM investments, Optus expects that resale services will become a more important form of access regulation during the declaration period.

3.14 Assessing efficiency requires an assessment of static and dynamic efficiency factors. In previous declarations, concepts of dynamic efficiency — ensuring incentives for re-investment in long lived sunk assets — were of central importance. However, the current declaration period is most likely going to be the last period in which the Telstra copper CAN

[23] ACCC, 2013, Draft Report, p.41
[24] ACCC, 2013, Draft Report, p.41
[25] Ofcom, 2013, Communications Market Report 2013, p.339

remains the dominant fixed line network. Over the period of the next declaration, Telstra will migrate customers off and shut down the copper CAN. There is no need for regulatory determinations to provide re-investment incentives for Telstra — there will be no competitive re-investment in fixed line infrastructure. Efficiency, therefore, demands that static considerations be at the forefront for this declaration.

3.15 Declaration is the first step in ensuring the efficient investment in and use of infrastructure. However, the LTIE will only be promoted where the related FAD is set at a level that promotes usage and static efficiency. The previous FAD which focused on price stability has failed to promote the LTIE.

Legitimate commercial interests of access providers

3.16 Optus agrees with the draft conclusion that the declaration of ULLS and LSS are not detrimental to Telstra's legitimate commercial interests.

Resale services

3.17 Resale services (WLR, LCS and PSTN OA) remain an important suite of fixed line services for access seekers to offer services throughout the national market. Optus agrees with the view of the ACCC that resale services play an important role in promoting competition because of its lower barriers to entry compared to network access services. The advantage of resale services over network access services is likely to increase as the transition to NBN gets closer and the ability to recover DSLAM investment reduces.

3.18 Optus also supports the proposal to remove the WLR CBD exemption. Removal of the exemption will promote competition in downstream markets, including the Corporate and Government market where the ability to provide a seamless national product is important in acquiring end-users.

3.19 Optus agrees that the re-declaration of the resale services would promote competition in related downstream economic markets — especially beyond the existing DSLAM investment footprint. Greater reliance is likely to be placed on resale services as the period to NBN switch over comes closer and access seekers have less time to recover the costs of further DSLAM investment.

3.20 In the absence of resale services, it is possible that access seekers could utilise network access services to provide competitive fixed line services. However, the ability of access seekers to provide national services using ULLS and LSS is limited. As at September 2013, there were still 4,490 ESAs that had no ULLS access seeker present. This represents 88% of all ESAs. Optus agrees with the view of the ACCC that:

> *The availability of resale services will enable these access seekers to offer their customers voice services in areas where they have not installed their own exchange equipment.*[26]

3.21 It may also be argued that removal of the resale services declarations would encourage investment by access seekers in DSLAM infrastructure. However, the economics of such investment are challenging. The ESAs where the potential numbers of SIOs are sufficient s to warrant DSLAM investment already have several access seekers present. ESAs that do not

[26] ACCC, 2013, Draft Report, p.52

have DSLAMs present are unlikely to have sufficient end-users so as to justify the investment. Optus agrees with the ACCC's statement that:

> *… the marginal returns from further DSLAM investments have fallen because the most profitable investments have already been undertaken.*[27]

3.22 In addition, the ability of access seekers to recover the costs associated with DSLAM investment in the absence of regulated resale services is limited given the roll-out of the NBN. Optus agrees with the observation that:

> *The rollout of the NBN is expected to have further reduced the returns and increased the risks of new copper-based equipment investments which will become stranded when customers migrate off the copper network.*[28]

3.23 Optus agrees with the views of the ACCC that retail providers have an incentive to build scale during the deployment of the NBN.[29] As such, in the absence of declared resale services Telstra would have the incentive and ability to increase access charges in order to build its retail market share.

3.24 Such behaviour can be observed in the market already. The WLR charge for the CBD exempted areas is in excess of the regulated WLR charge. As highlighted in the Draft Report, Telstra charges $31.77 for business end-users in CBD areas and $27.60 for residential end-users — far in excess of the regulated national average WLR charge of $22.84.[30] Actual market evidence shows that where Telstra does not face regulatory oversight, it will not lower charges. The CBD WLR charge is more egregious when considering that the CBD areas are the least cost areas to serve and the regulated WLR rate is a national average. The cost-based CBD WLR charge is below the national average rate, but absent regulation Telstra imposes a rate between 20-39% above the regulated rate.

3.25 Optus also agrees with the observation that the *"high WLR prices paid by access seekers make it more difficult for them to undercut Telstra's retail prices and offer lower prices to end-users in the CBD area."*[31] Optus notes the current retail Telstra Voice Budget product charges $20.86 (excluding GST) — 9% below the regulated rate and 24% below the unregulated WLR CBD charge.[32] Furthermore, the terms and conditions of the product state clearly that it cannot be used with PSTN access override or combined with non-Telstra broadband. The Critical Information Summary states that the end-user agrees:

> *… not to take services from other telecommunications providers by dialling their access override code and you must not take up a broadband service with another provider where that provider uses line sharing technology*.[33]

3.26 Access seekers are not able to compete against Telstra's basic line rental offering. It seems counter intuitive that the dominant supplier of retail fixed voice services, with approximately 75% market shares is able to undercut the wholesale regulated rate by between 9% and 24% on the condition that the product not be used with other regulated services.

[27] ACCC, 2013, Draft Report, p.53
[28] ACCC, 2013, Draft Report, p.53
[29] ACCC, 2013, Draft Report, p.52
[30] ACCC, 2013, Draft Report, p.59
[31] ACCC, 2013, Draft Report, p.68
[32] https://www.telstra.com.au/home-phone/plans-rates/
[33] Telstra Voice Budget, Critical Information Summary, p.1

3.27 Optus submits that there is clear evidence that Telstra has, and continues to, exploit its dominance in the fixed line services markets to limit competition. For these reasons, re-declaration of the resale services for a further five year period would promote competitive in the related national fixed line services markets.

Section 4. Interconnection services

4.1 Optus supports the proposal to re-declare the PSTN Terminating Access (PSTN TA) and Originating Access (PSTN OA) services for a further five year period to 2019. Optus agrees that declaration of termination services is likely to promote competition in the wholesale and retail markets for fixed-voice services.

4.2 Optus further submits that consideration should be given to the impact PSTN TA has on the related retail mobile voice market — particularly the decision by end-users to make calls to a mobile (mobile-to-mobile calls) or fixed line SIO (mobile-to-fixed calls). Optus is concerned that if fixed and mobile termination services utilise different cost methodologies, end-users' calling decisions would be influenced by arbitrary regulatory decisions rather than efficient costs of the services.

4.3 The LTIE is best promoted by having a consistent cost methodology between PSTN and mobile termination services.

Declaration will promote competition

4.4 Optus agrees with the draft view that the relevant markets for PSTN TA and OA are the retail and wholesale supply of fixed voice services and the retail supply of bundled fixed voice services and fixed broadband services.[34] Optus also agrees that the re-declaration of the PSTN TA and OA services would promote competition in these related downstream retail markets.

4.5 However, the ACCC has not identified the full set of affected downstream retail markets. Optus submits that the ACCC consider the impact of PSTN TA on the related retail market for mobile-to-fixed voice services. That is, the reciprocal market to the fixed-to-mobile market which the ACCC has identified for the purposes of assessing competition effects for the Mobile Termination Access Service (MTAS). Termination services are a two-way reciprocal access service. The ACCC has recognised the fixed-to-mobile call market and declared MTAS to ensure that competition is promoted in the fixed-to-mobile calls market. The reciprocal market to the fixed-to-mobile market is the mobile-to-fixed market. PSTN TA is a mandatory component of this market. Absent access to the service, end-users cannot make mobile-to-fixed calls. Therefore the mobile-to-fixed call market is a related downstream retail market directly impacted by the declared service. Absent declaration, Telstra will have the ability and incentive to impose above cost fixed termination charges for mobile calls originating from non-Telstra mobiles — damaging the level of competition in the retail mobile market.

4.6 Optus supports the view that absent declaration of PSTN TA, end-users are likely to face increased prices and a reduction in competition in the supply of retail voice services.[35] This conclusion applies to both fixed and mobile originating calls from the retail fixed voice and the retail mobile-to-fixed voice markets. Given the dominance of Telstra in both retail mobile

[34] ACCC, 2013, Draft Decision, p.79

[35] ACCC, 2013, Draft Decision, p.80

and retail fixed voice markets, Telstra will benefit the most from above-cost fixed termination charges in both mobile[36] and fixed retail markets.

Any-to-any connectivity

4.7 Optus agrees that continual declaration of the PSTN TA and OA services is likely to achieve any-to-any connectivity. The ACCC is correct in stating that network operators have market power in respect of calls terminating on their networks. Absent declaration, there may be incentive to use this market power to deny interconnection or impose above cost charges for termination charges.[37] In addition, Telstra has a strong incentive to limit competition in the retail mobile market by imposing above cost fixed termination charges on mobile-to-fixed calls originating on non-Telstra MNOs.

4.8 With respect to fixed termination services, re-declaration will achieve connectivity to fixed line end-users for calls originating from all domestic networks — both fixed and mobile. Optus agrees with the conclusion of the ACCC that declaration will be enable end-users to call other fixed line end-users, regardless of the network they are calling from (including mobile originated calls).

Encouraging efficient investment in and use of infrastructure

4.9 Optus agrees that the re-declaration of the PSTN OA and TA services will encourage the efficient investment in and use of infrastructure.

4.10 Optus submits the ACCC should also consider the efficient use of infrastructure in both related downstream fixed (fixed-to-fixed) and mobile (mobile-to-fixed) call markets. Consequently, Optus believes that the ACCC should consider the need for equal treatment of fixed and mobile termination services so as to remove any potential bias towards one network other another. That is, both mobile and fixed should utilise the same cost methodology.

4.11 Consistency of cost methodology between fixed and mobile termination services removes any regulatory distortions and enables end-users to make calling decisions based on the true consistent efficient costs of the termination services. For example, the European Commission (EC) has adopted a common cost methodology across both fixed and mobile termination services.[38] The EC states:

> ***Significant divergences in the regulatory treatment of fixed and mobile termination rates create fundamental competitive distortions****. Termination markets represent a situation of two-way access where both interconnecting operators are presumed to benefit from the arrangement but, as these operators are also in competition with each other for subscribers, termination rates can have important strategic and competitive implications. Where termination rates are set above efficient costs, this creates*

[36] Telstra can internalise the fixed termination costs associated with calls originating from Telstra mobiles to Telstra fixed lines. Other MNOs cannot and will incur above cost charges, thus damaging competition in the retail mobile market.

[37] ACCC, 2013, Draft Decision, p.81

[38] See EC, Recommendation of 7.5.2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, C(2009) 3359 FINAL

substantial transfers between fixed and mobile markets and consumers.[39] [emphasis added]

4.12 The EC concludes that the "*lack of harmonisation in the application of cost-accounting principles to termination markets to-date demonstrates a need for a common approach*".[40]

4.13 Optus notes the current approach to setting FTR and MTR in the European Union where a consistent cost methodology (BU-LRIC) is used to determine the costs. See, for example, the Dutch regulator which used one fixed and mobile cost model to set cost-based rates.[41] A further example if the Czech Republic with has applied the BU-LRIC method for both fixed and mobile termination. The EC has also rejected the German regulator's proposal to use LRIC+ rather than the harmonised BU-LRIC method for FTR.[42] Optus sees merit in investigating this approach in Australia.

4.14 The ACCC has consistently observed that fixed and mobile services are compliments to one another — the majority of end-users have both a fixed and mobile connection. The decision to call a mobile or fixed line number will in part be influenced by the price of the call. An important factor for the outbound call charge is the applicable termination charge. When different cost methodologies are applied inefficient call decisions may result. For instance, if the FTR uses a fully allocated cost method and the MTR uses an incremental cost approach, the fixed rate would be relatively higher imposing higher calls charges on mobile-to-fixed calls.[43]

4.15 This is not to say that FTR and MTR should equal. Indeed, network reality is that FTR should always be less than MTR when using the same cost methodology. Both MTR and FTR include core-related network costs. In both networks, core costs are relatively close as modern telecommunications networks are moving towards having common all-IP core networks. However, FTR do not include any access network components (i.e. last mile copper line) as these costs are not driven by the level of traffic. On the other hand, mobile access network components are allocated to MTRs (i.e. BTS costs, backhaul links, spectrum) as mobile access networks are dimensioned to provide suitable levels of busy hour capacity — which includes the level of termination traffic. An example how the same cost methodology results in different rates is the recent Dutch MTR and FTR decision, where using a common BU-LRIC cost method MTR (1.019 € cents) were set around 9.5 times the FTR (0.108 € cents).[44]

4.16 In addition, because both access and core networks contain costs common across all voice and data services, as the volume of data increases, the level of costs allocated to voice termination services decrease. Optus expects that the growth in both mobile and fixed data would lead to decreasing fixed and mobile termination rates. While MTRs have fallen significantly over the last regulatory period for this reason, there has been little movement in the FTR.

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[39] EC, Recommendation of 7.5.2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, C(2009) 3359 FINAL, p.3

[40] EC, Recommendation of 7.5.2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, C(2009) 3359 FINAL, p.3

[41] http://europa.eu/rapid/press-release_IP-13-760_en.htm

[42] http://europa.eu/rapid/press-release_IP-13-311_en.htm

[43] For the same cost base, fully allocated cost method includes a greater number of costs than included in incremental cost methods. For example, all costs are allocated to the relevant service rather than costs that are incremental to the provision of the service. The level of network optimisation may also differ between the cost approaches.

[44] http://europa.eu/rapid/press-release_IP-13-760_en.htm

4.17 Optus is concerned that using a fully distributed cost method to set FTR and adopting an incremental cost method for MTR would lead to a situation where FTR and MTR converge. This could only happen where the FTR cost method allows more costs (or different costs) than allowed under MTR. Such an outcome would lead to inefficient use of infrastructure and potentially damage competition in related retail mobile markets.[45]

4.18 Optus reiterates that the LTIE will be best promoted by declaration of the PSTN TA *combined* with a cost-based FAD that applies a consistent cost methodology with that used in the MTAS FAD. Failure to apply a consistent cost methodology will distort the calling patterns of end-users and impose above-cost charges to MNOs in the competitive mobile market. In addition, it has the potential to favour the dominant fixed-mobile converged operator Telstra to the detriment of other providers in the market. Such an outcome does not promote the LTIE.

[45] As noted above, above cost FTRs benefit Telstra as the dominant mobile and fixed network operators. Telstra could impose high FTRs on other MNOs (thereby increasing their call costs for mobile-to-fixed calls) while not incurring FTR charges for calls originating on its mobile network.