



AUSTRALIAN COMPETITION AND CONSUMER COMMISSION (*Commission*)

FIXED SERVICES REVIEW APRIL 2007

**IN RESPONSE TO LINE SHARING SERVICE (LSS)
DECLARATION INQUIRY**

Submission regarding the Commission's invitation for comment from industry participants in response to its LSS declaration inquiry

1. Introduction

This submission is provided by Network Technology (Aust.) Pty Ltd (*Network Technology*) in response to the Commission's *Fixed Services Review: a second position paper* dated April 2007 ("the LSS Discussion Paper").

Network Technology is responding to the Commission's invitation for industry participants to comment on a review of the current declaration of the LSS prior to the expiry of the service as a declared service in October 2007. Unfortunately, due to constrained resources and the limited time within which to respond to the invitation, Network Technology is unable to provide a comprehensive answer to each of the questions raised in the LSS Discussion Paper. However, Network Technology considers that re-declaration of the service is not only critical to the continued existence of an assured platform upon which to plan its day-to-day business operations, but to be equally important in the promotion of the long-term interests of end-users ("LTIE") of high-speed data services.

2. Promotion of Competition

When the service was originally declared in 2002, Telstra was the only service provider to offer LSS. Five years later, Telstra continues to be the sole supplier of a LSS to access seekers. In its August 2002 *Final Decision*¹, the Commission was of the belief that without declaration, Telstra would have the ability and incentive to set terms and conditions of access at uncompetitive levels². Given the fact that there are currently nine access disputes in relation to the price and non-price terms of the LSS³ which ultimately arose from a history of unsuccessful negotiation attempts with Telstra, it is reasonably indicative that expiry of the declaration would significantly foster the imbalance in bargaining power that the declaration serves to redress. Based on our experience in dealing with Telstra to date, we consider that in the absence of re-declaration, competitive rates for the LSS are unlikely to be achieved via commercial negotiation.

¹ Australian Competition and Consumer Commission, *LSS - Final Decision on whether or not a LSS should be declared under Part XIC of the Trade Practices Act 1974*, August 2002.

² *ibid*, p.ii.

³ Australian Competition and Consumer Commission website, 7 May 2007



Network Technology does not consider there to be effective substitutes to the LSS upon which access-seekers can offer retail data services to end-users at a level able to compete with Telstra. As at the time of the original declaration, the structure of the market has not yet proffered enough options to sustain a high level of competition without the existence of the LSS. Two of the three alternatives outlined in Table 5.2 of the LSS Discussion Paper (resale of xDSL or use of the ULLS) still require an access-seeker to rely on Telstra (in practice) to supply it with a wholesale data service. Of these, the only realistic alternative wholesale input to the LSS is the ULLS, as it would not be financially viable for Network Technology to revert to a pure resale business model. In relation to the use of ULL, Network Technology does not believe that the restructuring of its business operations towards the provision of all broadband services over ULL could be achieved in the short to medium term. Mass migration to ULL from LSS remains almost impossible as Telstra has no process for such migrations. The third alternative of installing end-to-end infrastructure is simply not a financially viable consideration for most participants in the broadband market. Further, the effective removal of the LSS by over-pricing may have the unwelcome side-effect of stalling the emergence of new methods for delivering telecommunications services, such as VoIP, which is a financially attractive alternative to the PSTN for a growing number of LSS end-users.

In its 2002 *Final Decision*, the Commission formed the view that of the alternatives on offer, only Telstra and Optus's Hybrid Fibre Coaxial ("HFC") networks were considered to be a potential constraint on the pricing of an LSS. However, the extent of substitutability is limited to select geographic areas.⁴ It is Network Technology's view that this remains the situation today despite some growth in wireless networks.

Further, Network Technology asks the Commission to have regard to the approach it took in 2002 in determining whether declaration would promote competition in telecommunications markets, where it said

In certain telecommunications markets, specific market characteristics may mean it is more efficient for there to be only one provider of a given service. In these circumstances, however, it may be that there is scope for competition to occur in downstream and/or vertically related markets. Without access to the vertically related service, however, carriers in vertically related markets will be unable to provide a final service to end-users.

Under the Act, declaration of a service can promote competition in listed services by mandating access to those services that are supplied in monopoly-provided vertically related markets. Further, under certain circumstances, the Act enables the Commission to set terms and conditions for access to these services. In turn, this can help ensure that a lack of competition in one market (the market in which the "eligible service" is supplied) does not prevent the development of competition in downstream, vertically related, markets.

In general, therefore, the Commission believes that declaration of an eligible service is likely to promote competition where the following conditions are present:

⁴ Australian Competition and Consumer Commission, *LSS - Final Decision on whether or not a LSS should be declared under Part XIC of the Trade Practices Act 1974*, August 2002, p.44.



- the eligible service is an input that is used, or that could be used, to supply carriage services or services provided by means of carriage services (often referred to as 'downstream services'); and
- competition in the market for the supply of the eligible service is unlikely to be effective in the future and this is likely to have a detrimental impact on competition in markets for downstream services.

In most cases the markets most likely to be affected by declaration are the market(s) for downstream services rather than the market in which the eligible service is supplied (where these markets are separate). This reflects the key rationale for access to essential infrastructure – that of promoting more competitive downstream markets by achieving a supply of inputs upstream at terms and conditions more reflective of competitive outcomes. Further, the aim of promoting the LTIE guides the Commission to be particularly mindful of the impact of declaration on the supply of services at the retail level⁵.

The Commission acknowledges in the LSS Discussion Paper that ADSL remains the dominant type of broadband product at retail level, and Telstra continues to be the dominant provider of these services in both markets.⁶ In light of this, the LSS is an element of the fixed-line network that continues to represent an enduring bottleneck and as such necessitates the need for a declaration under Part XIC of the *Trade Practices Act 1974* ("the Act") in order to promote the LTIE.

3. **Any-to-any connectivity**

Network Technology does not consider that re-declaration of the LSS will pose a threat to the objective of any-to-any connectivity.

4. **Efficient investment**

Declaration of the LSS in 2002 has significantly increased competition in the broadband market, which has led to lower prices, better quality and more innovative products on offer and thus more choice for end-users. It is only the protection afforded by declaration under Part XIC of the Act that has ensured the prices paid for access have been, or will be, reasonable enough to flow onto end-users, and in turn more closely reflect the underlying costs of providing these services.

The rise in faster and better-quality high bandwidth data services has only come about because of the increase in competition between service providers wanting to offer those services without initially providing a voice component. It is therefore in the LTIE to continue to declare a service that provides this option at the wholesale level.

This was recognised by the Commission in 2002, when it said:

...it is not clear that the terms and conditions, including price, upon which Telstra currently intends to supply a LSS, are reasonable. Further, in the absence of declaration (or the threat

⁵ *ibid*, p.31.

⁶ LSS Discussion Paper, p.60.



thereof) it is also unclear whether Telstra would have an incentive to agree to terms and conditions consistent with the LTIE into the future. To the extent that Telstra might have an incentive to set terms and conditions in a fashion different to that which one might expect in a competitive markets for this service, declaration can serve to provide a means to remedy this form of market failure. This is particularly important as the Commission believes any moves by an access provider to set terms and conditions differently to those that would arise in competitive markets would be likely to prevent participants in downstream markets from competing with Telstra effectively in those markets. This would be likely to reduce allocative and dynamic efficiency in these markets since it will impact on competitors' ability to offer innovative and higher quality products to consumers and limit the extent to which the prices of final services consumed by end-users reflect the efficient costs of their production.⁷

Network Technology does not consider that re-declaration would prevent efficient investment or encourage inefficient investment in infrastructure by which listed services are supplied. As in 2002, declaration of the LSS is particularly important for new entrants to use as a transitional step towards developing their own infrastructure for the use of the ULLS, and the supply of voice services to end-users. Many small players are currently in the process of migrating their first wholesale DSL to LSS transfers. For those access-seekers who only want to provide ADSL, without the guarantee of reasonable terms of access to the LSS they will be forced to try and negotiate directly with Telstra, or consider the prohibitive and additional costs involved in seeking access to the ULLS without providing a voice service at all (thereby not employing the full potential of the infrastructure under the ULLS), or attempting to off-load the voice component to a third party for a commercial return. These entry-barriers would likely slow the rate at which the quality of high bandwidth data services are being developed. This concept was expanded on by Optus in its submission to the 2002 *Final Decision*:

Optus also believes that line sharing will reduce network costs since it will result in long held data calls being taken off the PSTN network and will also overcome current problems created by a shortage of spare copper pairs. This will mean that network owners will be able to postpone, in the short term, capital expenditure required to increase capacity for data calls or to provide additional copper pairs. In turn, Optus argues this will free up capital for efficient investment in other projects.

According to Optus, the ability of new entrants to either resell the incumbent's network or to undertake partial facilities-based investment by gaining access to unbundled elements of the incumbent's network, can create the stepping stone for efficient investment and full facilities based competition for the LSS. In the absence of such possibilities, the large investments and sunk costs associated with facilities based entry can create significant barriers to entry⁸

⁷ *ibid*, p.72.

⁸ *ibid*, p.75.



It is Network Technology's view that this remains the situation today.

Network Technology considers that mandated access to the LSS can be provided while maintaining the legitimate commercial interests of Telstra, and should not impede any incentives for economically efficient investment in infrastructure.

5. Pricing Principles

It is Network Technology's submission that the current LSS pricing principles (as set in 2002 and followed by the Commission in subsequent determinations) continue to be applied should the LSS be re-declared.

A contribution to the costs of providing a telephone line should not be included in LSS annual charges as they continue to be fully recovered in other charges, as shown by increases in line rental charges by Telstra.⁹ To date, Telstra has not offered a satisfactory proposal that does not see it 'double-dipping' from revenues earned on their supply of both low bandwidth and high bandwidth fixed-line services.

Even if the Commission choose to consider that a contribution to line costs should be included in LSS annual charges, Network Technology considers that the time required by the Commission to properly assess the consequences of, and engage in public consultation regarding the balancing of LSS and WLR charges will be very significant. Not only would any rebalancing involve material changes to the current LSS pricing structure but the Commission would also have to consider the impact on a variety of other declared and non-declared services including the ULLS, PSTN, ADSL, LCS and national and international call charges. Network Technology considers that a reasonable public consultation period (no less than 3 months) is necessary to enable informed analysis, consideration and comment by the industry. The short response time for submissions to this LSS Discussion Paper has not afforded such an opportunity.

If, following detailed analysis and consultation, the Commission were to conclude that a rebalancing of LSS and WLR charges was appropriate, Network Technology considers that Telstra would then be required to make changes across all of its WLR access arrangements before any increase in LSS prices could be introduced.¹⁰ Otherwise, given that LSS and WLR may be supplied by different service providers, there would be potential for Telstra to over-recover its line-related costs. Network Technology expects that Telstra has a variety of contractual arrangements with WLR and LSS access seekers, each of which would have different end dates. Any rebalancing should not take effect until the last of those end-dates has expired. Accordingly, it would take Telstra a significant length of time to implement the requisite changes to its contractual arrangements.

Further, any material change to the LCS pricing principles or structure should have a phased application. Network Technology has made its investment and business decisions on the basis of the currently applying approach to LSS pricing, which has been in place since 2002.

⁹ LSS Discussion Paper, p.69.

¹⁰ Ibid, p. 16.



If a transaction path is not adopted for the introduction of any rebalancing, Network Technology and other access seekers would suffer severe financial hardship.

With their existing business structure, it will be extremely difficult for Network Technology and companies like it to compete against Telstra and other service providers which have a higher ratio of WLR to LSS customers. This will lead to an inevitable reduction in competition in the market for DSL services.

If a transition path is adopted over an adequate timeframe to enable access seekers to restructure their businesses to offset the effect of the rebalancing between WLR and LSS pricing, the logical move will be for access seekers to migrate services from LSS to ULLS. However, this will essentially force access seekers to become full service providers rather than specialist broadband providers.

In reality, access seekers will have little choice but to provide a bundled service as rebalancing between WLR and LSS will act as a disincentive to access seekers providing *just* ADSL or *just* voice services. Any rebalancing will therefore reduce competition in both markets.

In any event, Network Technology does not believe that the restructuring of its business operations towards the provision of services over the ULL could be achieved within the next few years. Mass migration to ULL from LSS remains almost impossible. Telstra has no process for such migrations and Telstra has not provided any indication of when this may be rectified.

6. Effect on Network Technology

Network Technology currently has around [c-i-c] line sharing services in operation. We forecast this number to rise to [c-i-c] by June 2008. Based on prior experience and Telstra's very public stance regarding LSS pricing, we consider Telstra would substantially increase LSS charges if the service is not re-declared. In such a situation it would be unlikely that the services in operation would rise but rather would be likely to drop as our costs and hence prices would rise. In the long-term re-declaration is good for the LTIE as it enhances competition by promoting diversity of carriage supply and service providers.

Robert Farago
Director – Strategy
Network Technology (Aust.) Pty. Ltd.
11/5/2007.