

# **“FUTURE SCOPE OF THE LOCAL CARRIAGE SERVICE DECLARATION”**

**Primus’ Submission**

**in response**

**to ACCC discussion paper**

15 October 2000

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## **1. Introduction**

This paper is in response to the Australian Competition and Consumer Commission discussion paper “FUTURE SCOPE OF THE LOCAL CARRIAGE SERVICE DECLARATION” dated Aug 2000.

The key issue is the consideration of Telstra’s application to the ACCC for an individual exemption from the standard access obligations in relation to the local carriage service under s. 152AT of the *Trade Practices Act 1974* (the Act). In particular, the exemption relates to the supply of the local carriage service within the central business district (CBD) areas of Melbourne, Sydney, Brisbane, Adelaide and Perth.

The Commission is currently arbitrating an access dispute in relation to the terms and conditions of supply of the local carriage service, by Telstra, separately notified by Primus Telecommunications and four other carriage service providers.

## **2. Materiality**

Awarding Telstra an exemption in the five capital city CBD areas will have material consequences.

Primus is a significant LCS reseller, supplying an estimated 5% of retail services (via LCS) in the five CBD areas under consideration. We strongly oppose Telstra’s request for an exemption to the declared service determination for LCS, as such a decision would have a major adverse impact upon Primus’ current revenues.

The local call resale service is the only means by which non dominant carriers, such as Primus can offer bundled services to customers – an accepted and well understood competitive service offering. The lack of LCS would mean Primus would only be able to offer long distance services. This would result in customers, almost by default, using Telstra for all services in order to obtain bundled service offerings and retain single billing. This would have an adverse impact on Primus’ long-distance business.

Primus experience suggests 16% of CBD customers purchase local services from service providers other than Telstra. The most significant service providers are AAPT, Primus, OneTel, Macquarie, and CWO.

At this time only minor infrastructure-based competition has taken place into major business premises. The largest supplier is Optus, with about 5% share of total CBD line services market.

Therefore LCS is the principal method used for competitive local service supply in CBD areas, particularly in regard to SME business.

### **3. The class exemption**

To grant an exemption to the incumbent dominant operator ie. Telstra, would render the declaration of LCS meaningless from a competition standpoint. If Telstra is granted an exemption then clearly all carriers should be exempted.

### **4. Future variations to the declaration of the local carriage service**

Primus agrees that when substantial infrastructure-based competition is available in the CBD's, for all levels of business subscribers, that is the time to review the declaration of LCS.

#### **Lack of Facilities Based Competition**

However, at this time there is negligible infrastructure-based competition.

Only Optus and RequestDSL appear to have signed ULL supply with Telstra (the predominant method to deploy PSTS line services to smaller businesses).

The time to build a network, gain ULL supply agreements, and obtain commercial terms permitting full competition to smaller users is expected to take several years, particularly as this exemption should not occur until an adequate number of competing operators exist across all areas under review.

Primus suggests that it is difficult to accurately estimate when this degree of infrastructure-based competition will exist, save to say it will be several years.

#### **Geographic Considerations**

The presence of infrastructure-based local service competition needs to be considered across the entire list of ESA's, and exemptions considered only in those ESA's where there is clear and demonstrable facilities-based competition.

An exemption to the LCS declaration in five CBD areas implies competitors must build a network to serve all Telstra Exchange Serving Areas (ESA's) in those CBDs. If a network is not built across all ESA's, then a service provider must buy local line services from a supplier other than Telstra, or simply exit the local line market.

#### **Level of Competition**

The provision of a CLASS-5 (local service) switch is necessary in order to provide full-service local lines.

A lower level of market entry should therefore be anticipated in Adelaide and Perth ESA's, due to the high barrier to entry in purchasing and operating a central "CLASS 5" (local-line) switch in these smaller markets.

Only Optus, Primus and AAPT currently have CLASS-5 switches in Adelaide and Perth, and as such are likely local service market entrants. Indeed Optus and Primus have already announced major network builds to take advantage of the ULL declaration in the five capital cities. AAPT is yet to announce any plans.

On the East Coast a greater number of local service carriers should be expected, due to the greater size of the cities, and the existing number of major switch operators already in existence.

PowerTel has a Nortel DMS100 switch (identical to those used by Primus and Optus) in Sydney, Melbourne and Brisbane, but have indicated they do not intend to use ULL services, or enter the ubiquitous local-service CBD market.

MCI-Worldcom and Global One have switches in both Sydney and Melbourne, however they are Nortel DMS-GSP switches designed only for “trunk” access. They are not CLASS-5 switches supporting fully-featured analog PSTS lines, and conversion to a DMS100 would be prohibitively expensive.

Even if there was adequate competitive supply of local switch networks, several critical industry processes would be needed before any local service could be commercially implemented. Support for LNP, ULL, IPND, Preselection/BNA and Call Intercept systems are all mandatory for local-service providers. The development of all these systems is not only costly but takes considerable time before a local service launch is possible. LNP, ULL, IPND, and Preselection/BNA systems must be formally tested and approved in conjunction with Telstra.

Therefore, realistically, the only operators equipped today to rollout local services anywhere are Primus, Optus and AAPT and then only Optus and Primus have signalled intent to actually do so. Therefore it is premature to act on an LCS exemption at least until these networks are operational and customers have been migrated away from LCS.

Even then, it is unknown if a fully competitive local service market will exist with just three players. Optus has indicated that it is opposed to the LCS declaration in regard to alternate carriers, which clearly suggests Optus will not offer local wholesale services.

### **Timeframe for Review**

The timetable for revising the LCS declaration needs to ensure not only that there are adequate competing carrier networks, but also that they have time to deploy their local services and migrate LCS customers over, prior to any LCS exemption taking effect.

In particular it is critical to continue to have LCS supply until all lines have been migrated to the competitors infrastructure.

Issues and timeframes relating to building a skilled workforce, gathering details of line setup from individual customers, and actual construction will be substantial. Primus estimates a complete migration from LCS to facilities-based services to take at least 3 years.

## **Market Segments**

The request for an exemption from LCS within the CBD areas needs to be considered in terms of residential and business as separate markets. Residential users pay lower line rentals and make fewer calls, and as such are not the preferred target market for carriers. From Primus' business analysis the residential market is unlikely to see facilities-based competition for local line services, based on access to ULL services.

## **Exceptions**

Furthermore, consideration needs to be given to LCS exemptions in relation to service variants, which cannot be provided by competing operators. Without LCS available for these "ancillary" services, such services must remain with Telstra, and a single-bill and relationship with the customer remains beyond the reach of all competitors.

LCS services, which should continue to be provided under the declared services framework, include lines with special functionality which are cost-prohibitive for competitors to duplicate. This includes lines equipped with faxstream, meter pulsing, CustomNet Spectrum, and Sitaline. Certainly further time should be allocated for the withdrawal of resale of these services, to allow for the development of competing products.

## **5. The LTIE test**

From a users perspective, it is important that they have a choice of phone services from a range of carriers (including local line rental, local calls, service support and billing). This enables integrated support and billing for local calls with a range of complementary services provided by competitive infrastructure, such as preselected long-distance calls, 18/13 tollfree services, and other leased line and internet services.

Since the declaration, retail prices for local call services have reduced. Clearly the threat to the dominant carrier of regulation (as a direct result of the declaration) of its LCS, has resulted in lower prices for consumers and users. Should Telstra be exempted from this declaration, that threat of regulatory intervention is removed and Telstra will be in a position to reimpose its market dominance via its bottleneck control over local services. It would be free to increase retail prices, given it would be under no obligation to supply the wholesale service to competing carriers.

Currently there is very limited local service competition, except possibly for larger corporate customers. This in large part is because infrastructure rollout to smaller markets is cost prohibitive for new entrants. Typically it is only cost effective to deploy direct building access infrastructure for customers with a minimum spend of about \$10,000/month. The majority of SME's are well below this level and currently have no alternative to Telstra's local call service other than via LCS resale. This is likely to remain the case for some time until new entrants establish themselves to a point where they have the economies of scale to build out infrastructure to "smaller" markets.

The ACCC's decision in August 1999 to make ULLS a declared service, provides alternate carriers with access to Telstra's copper. This access method lowers the spend threshold for competitive local access networks.

However, ULLS supply agreements are yet to be put in place for most of the industry. According to recent press articles only Optus and RequestDSL have completed agreements during Aug/Sep 00.

No supply of basic line service to individual users has yet been observed, and it is expected that it will be 2 to 3 years before such services will be prevalent and have replaced the use of LCS for competitive supply to the SME segment.

This indicates that Telstra's request for an exemption is premature by 2 to 3 years.

For very small users, supply of a basic line service directly over ULLS is expected to be the only delivery option possible. The viability of this low-density deployment method is unlikely given the known costs.

## **6. Incentives for investment in existing and new infrastructure**

Primus agrees with the Commission that declaration encourages entry of efficient providers of retail services, and improves the ability of local call re-sellers to use re-supply as a stepping stone to the roll out of their own infrastructure.

The LCS declaration encourages economic efficiency.

We are now seeing the types of outcomes which the ACCC had intended when it made the declaration, that is;

“.....facilitate market entry and enable local call re-sellers to obtain information about demand characteristics and the likely responses of competitors, thus reducing the risks associated with infrastructure deployment”.

Retaining the LCS declaration is critical in order to allow low-risk market entry, at least until a fully competitive local marketplace is seen to exist.

Indeed, the optimal time to reconsider the LCS declaration is when a fully competitive local market place is already in operation throughout a geographic area, and a competitive wholesale market exists for LCS.

### **Level of Investment**

Primus announced in Feb 2000 its major rollout of access equipment into 122 Telstra local exchanges in the 5 CBD areas. Primus is deploying fibre cable to link the exchange sites back to the central Primus switch location in each city.

The network will provide a full range of access services, notably xDSL and basic line services. To date over \$20M has been spent in this rollout, in addition to the pre-existing network facilities. A total budget of \$120M has been announced.

An exemption to the LCS declaration will substantially increase the commercial risk to Primus of continuing its network rollout plan, as it is in large part predicated on achieving initial market entry and establishing a customer base using LCS. In the case of LCS not being available, Primus would be compelled to reconsider the commercial viability of proceeding with its current network roll out plans. We believe this would not be in the long term interests of end users.

## **7. Further Geographic Expansion**

To review plans now for the rollout of competing network infrastructures beyond the CBD of the five capital cities, is premature.

Certainly effective competition in metropolitan areas will occur much later than that for the 5 capital CBD's, and the number of local market entrants is expected to be lower than in CBD areas.

No decision to review the LCS declaration for additional geographic areas should be contemplated at this time.

## 8. ACCC specific questions

In addition to views expressed under the previous sections, Primus makes the following specific comments in relation to several questions posed by the ACCC.

*How should CBD areas be defined?*

In its application Telstra suggests that CBD's be defined according to its manual "Telstra Ordering and Provisioning". However CBDs are defined, Telstra should not be given the discretion to determine this in isolation. This issue should be the subject of further industry discussion.

*What substitute technologies are currently used to provide the local carriage service or are substitutes for the local carriage service, in the CBD areas?*

As stated under section 4, Primus considers there are few if any, substitute technologies used to provide LCS.

Local Multipoint Distribution Systems (LMDS) have not yet been commercially rolled out. Further, because of spectrum limitations there will be few competitors using this technology to enter the local carriage market. AAPT effectively has sole rights to that technology through its ownership of the spectrum in Australia necessary to provide service using LMDS.

ULL is a possible alternative however the industry is a long way from agreeing terms and conditions and technical issues for the effective wholesale supply of ULL. Pricing for wholesale ULL will also be an issue, which from experience in previous negotiations with Telstra on other services, will take time to resolve. Indeed Primus has recently notified the ACCC of a dispute it has with Telstra about the pricing of ULL. Actual commercial implementation is likely to be several years away.

Optic fibre is the only viable alternative and even then the implementation of that technology is very much in its early days and certainly a long way from being a ubiquitous platform.

*Since the Commission's report on Local Telecommunications Services, have new carriers begun supplying the local carriage service at a wholesale level?*

*Are there likely to be further new carriers supplying the local carriage service at a wholesale level in the foreseeable future and what types of technologies would be used?*

There is no real effective competition at the wholesale level. Optus is the only other carrier that is in a position to offer wholesale LCS however this is unlikely because of the low level of penetration of its network.

Even then, fibre will be limited to specific target markets and it will be some time before fibre has anywhere near comparable reach to Telstra's network.

***Are there any other barriers to entry for new carriers supplying the local carriage service at the wholesale level in CBD areas, such as Telstra's market share?***

Access to the LCS at reasonable terms and conditions is proving to be a significant barrier to entry. If investment in new infrastructure is to be encouraged then the regulatory framework must provide for new entrants to first establish a customer base. New entrants can only achieve this by having access to wholesale services from the incumbent at reasonable terms and conditions.

Without this, new entrants will be deterred from infrastructure investment because this barrier impedes the establishment of a customer base.

***What would be the impact on the legitimate commercial interests of the carriers supplying the local carriage service at a wholesale level if an individual or class exemption was provided?***

This could only serve to benefit Telstra because it will have control over a bottleneck service. Consequently it will be detrimental to access seekers because they will not have access to such services at cost based pricing. This can therefore not be considered as a legitimate outcome.

***What are the views of the industry, and the general public, as to the appropriate timing for consideration of a possible variation to the LCS declaration?***

This should only be considered when there is tangible and demonstrable evidence of effective competition in the wholesale supply of local carriage services.

## 9. Summary

Primus strongly opposes providing an exemption to Telstra from the standard access obligations relating to the supply of local carriage service. Primus recommends that the ACCC reject Telstra's application, because:

- Telstra's application is predicated upon facilities based competition being available within 12 months. Primus submits that this level of competition is several years away, at least.
- It is only 12 months since the declaration and little has changed in the competitive supply of local carriage services. Unconditioned Local Loop is unavailable at reasonable terms and conditions, wholesale pricing of LCS remains an issue with five disputes with the ACCC for arbitration and pricing principles for LCS are yet to be finalised.
- Prior to any consideration of an exemption to the declaration, there must be open and public debate upon such a key issue with Telstra's arguments for an exemption made available to those who will be materially affected. The ACCC should also conduct an audit of facilities based competition in the local call market.
- Primus submits that granting such an exemption to Telstra would force new entrants to reconsider network rollout plans given the resultant increase in commercial risk.

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