
TELSTRA CORPORATION LIMITED

Response to the Commission's Superfast Broadband Access Service Declaration Inquiry – Draft Decision

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[CIC begins] = information not to be released without a confidentiality undertaking

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CONTENTS

EXECUTIVE SUMMARY	3
01 INTRODUCTION	6
02 DECLARATION OF SBAS	7
2.1. Declaration is in the LTIE if appropriately defined	7
2.2. Declaration should reflect government policy including exemptions	8
03 STATE OF COMPETITION	10
3.1. Market definition	10
3.2. State of competition in relevant markets	10
3.3. Draft decision	12
3.4. Promoting competition	13
04 TELSTRA'S FTTP NETWORKS IN SOUTH BRISBANE AND VELOCITY ESTATES	15
4.1. Telstra's FTTP networks in South Brisbane and Velocity estates	15
4.2. Telstra's Fibre Access Broadband service is not Layer 2 bitstream service	15
4.3. The costs of developing a Layer 2 bitstream service in South Brisbane and Velocity estates are significant	16
05 SERVICE DESCRIPTION	20
5.1. Service description	20
5.2. Exemptions from the service description	21
5.3. Timing and application of the declaration	22
ATTACHMENT A: 26 August 2011 letter to the ACCC re. South Brisbane Network Upgrade	23

EXECUTIVE SUMMARY

Telstra welcomes the opportunity to provide this submission to the Australian Competition and Consumer Commission's (ACCC's) Superfast Broadband Access Service Declaration Inquiry – Draft Decision, November 2015 (Draft Decision) relating to the declaration of a Superfast Broadband Access Service (SBAS).

Superfast broadband underpins the provision of many services that will deliver long-term benefits to consumers. Telstra therefore supports a legislative and regulatory environment that facilitates the provision of equivalent superfast broadband for consumers regardless of geographic location. However, this requires careful consideration of whether the imposition of new legislative or regulatory obligations will impose costs that outweigh the benefits to consumers and as a result are not in the long-term interests of consumers or infrastructure providers.

An appropriately defined SBAS declaration is in the LTIE

Telstra considers that the declaration of a SBAS would be in the long-term interests of end-users (**LTIE**), provided that the service description is appropriately defined to apply only to those carriage services where there is an enduring technical or commercial limitation to the provision of alternate broadband services to end-users. Any declaration should therefore seek to replicate the outcomes of the *Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Consumers) 2014 (CLCs)* which are aimed at ensuring that there is a level playing field for all carriers in the provision of superfast broadband services to residential (and small business) customers. Further, Telstra considers that declaration will only be in the LTIE if the service description is appropriately framed to ensure that it only captures those bottleneck services and does not retrospectively capture existing networks built in accordance with other regulatory and legislative obligations.

In declaring a SBAS, the ACCC should seek to ensure that it does not inadvertently create confusion or conflicts with the various other legislative provisions and government policies that are currently in place. Any declaration of a SBAS should recognise that there are legitimate reasons for the existing exemptions (whether ministerial or legislative) and undermining those reasons is not in the legitimate commercial interests of suppliers or, ultimately, the LTIE. An appropriately framed SBAS declaration alongside the existing LBAS declaration will retain the current legislative and regulatory framework and is consistent with Government policy in relation to superfast broadband services.

The ACCC has gone beyond the scope of any competition issue that needs to be addressed

Telstra considers that in its Draft Decision the ACCC has gone beyond the scope of the competition issue that any SBAS declaration is intended to address. The draft decision to extend the scope of a SBAS declaration to, with limited exceptions, all fixed-line networks including those with statutory or ministerial exemptions is contrary to established government policy and does not take into account the specific background associated with a number of networks, including Telstra's FTTP networks in South Brisbane and Velocity estates, which were in development and/or built before the level playing field provisions came into play.

Telstra does not provide a Layer 2 bitstream service in South Brisbane and Velocity estates

Notwithstanding the policy intent, the draft decision to include Telstra's FTTP networks in South Brisbane and Velocity estates is based on a misunderstanding of the service provided on those networks, as well

as the significant costs that would be involved in providing a declared SBAS as contemplated by the ACCC. Specifically, the ACCC considers that Telstra's Fibre Access Broadband (**FAB**) service is a Layer 2 bitstream service and therefore captured under the draft SBAS service description. However, while the FAB service emulates certain characteristics of a Layer 2 bitstream service, it does not meet all the requirements of a Layer 2 bitstream service.

The costs of complying with a Layer 2 bitstream requirement would outweigh the benefits of declaration

In 2011, Telstra estimated that the costs of developing a Layer 2 bitstream product as contemplated by the ACCC in South Brisbane alone would be over [c-i-c begins] [c-i-c ends], with product development taking up to 12 months. In the time available to respond to the Draft Decision, Telstra has been unable to update this estimate or estimate the cost of developing a Layer 2 bitstream product for the Velocity estates. However this is likely to be significant given the operational and technical complexities in migrating these networks to full Layer 2 bitstream networks, which will also impact on the end-user experience.

The fibre deployments in South Brisbane and Velocity estates were not made for the purpose of providing high speed broadband services but rather to replace or augment the PSTN network, which is reflected in network and product design. At the time, the FAB service provided the most efficient and cost-effective solution given the level of demand in those areas and the anticipated transition to the NBN which would render the network and IT systems obsolete within a relatively short period of time.

The ACCC has established precedent for not requiring Telstra to develop additional services at significant cost imposition as part of the WDSL Final Access Determination (**FAD**) Inquiry. The same reasoning is applicable to the development of a Layer 2 bitstream service in South Brisbane and Velocity estates. The outcome of declaring a SBAS should not be to increase costs and inconvenience ahead of migration of these networks to NBN-based supply or to otherwise effectively mandate a 'double migration' to NBN in these areas with all that entails in terms of cost and complexity. Whereas the VDSL Fibre-to-the-Basement (**FTTB**) service was developed as a long term business model to compete with NBN, Telstra's FAB service in its South Brisbane and Velocity estate networks will be migrated across to NBN in the next few years. It would be inefficient and costly to require customers to now migrate to another – more costly –service ahead of migration to the NBN.

Inclusion of Telstra's FTTP networks in South Brisbane and Velocity estates is not in the LTIE

The draft decision to include Telstra's FTTP networks in South Brisbane and Velocity estates in any SBAS declaration is unlikely to promote competition for end-users of those networks for a number of reasons. Firstly, no competition concerns have been raised in relation to those networks. The ACCC has been cognisant of the nature, scope and pricing of the FAB service¹ and has previously expressed the view that Telstra's offer satisfies any concerns raised by access seekers. Secondly, the FAB service is required to be supplied by the ministerial exemptions and wholesale access is further underpinned by regulation of Wholesale Line Rental (**WLR**) and Local Carriage Service (**LCS**). This provides the appropriate regulatory backstop to ensure that competition continues to be effective in these areas. Any further regulation would be disproportionate to any competition concerns.

¹ See, for example, Attachment A to this submission

The FTTP networks in South Brisbane and Velocity estates should be exempt from any SBAS declaration given that (a) the FAB service is not a Layer 2 bitstream service; and (b) any requirement to provide a Layer 2 bitstream service over those networks would incur substantial and unnecessary costs and operational and technical complexity that would significantly outweigh any benefits (which are minimal given the operation of existing regulation or regulatory oversight applied to these networks under existing regulatory principles for these types of circumstances).

01 INTRODUCTION

This submission is structured as follows:

- a. Section 3 sets out Telstra's views on the declaration of a SBAS.
- b. Section 4 responds to the ACCC's views on the state of competition in the relevant markets for SBAS.
- c. Section 5 sets out Telstra's views on whether the ACCC's Draft Decision will promote competition.
- d. Section 6 provides Telstra's response to the draft decision to include Telstra's FTTP networks in South Brisbane and Velocity estates in any SBAS declaration.
- e. Section 7 includes Telstra's views to the ACCC's preliminary view on exemptions to any SBAS declaration, as well as timing and application of the declaration.

02 DECLARATION OF SBAS

2.1. Declaration is in the LTIE if appropriately defined

As set out in the response to the ACCC's Discussion Paper, Telstra considers that the declaration of a SBAS would be in the LTIE, provided that the service description is appropriately defined to apply only to those carriage services where there is a technical or commercial limitation to the provision of equivalent broadband services to end-users. Any declaration should seek to replicate the outcomes of existing legislative obligations (and exemptions), including the CLCs, which are aimed at ensuring that there is a level playing field for all carriers in the provision of superfast broadband services to residential (and small business) customers.

This position reflects the initial drivers of the SBAS declaration inquiry – the recommendations made by the Vertigan Committee and the outcomes of the ACCC investigation into the TPG FTTB rollout. As noted in the Draft Decision, the Vertigan Committee raised specific concerns in relation to the supply of superfast broadband using vectored VDSL2 technology, as well as general concerns about the effect of the level playing field provisions on investment and competition.

The recommendation for the ACCC to investigate declaring VDSL services was intended to focus on the potential competition issues that arose due to the technical features of vectored VDSL that may exclude provision of alternate broadband technologies to residential and small business customers. These issues were specifically related to TPG's plans to roll out a vectored VDSL network by extending its existing fibre networks by less than one kilometre to supply superfast broadband services to residential buildings in metropolitan areas. The ACCC concluded that these plans were not captured by the level playing field provisions or the LBAS declaration and subsequently announced that it would commence the current declaration inquiry into whether a superfast broadband service like the type provided by TPG should be declared.²

In the meantime, the CLCs were introduced to ensure that networks like that proposed by TPG would be subject to obligations effectively equivalent to the level playing field obligations. The CLCs are due to expire on 31 December 2016.

The general concerns identified by Vertigan that the level playing field provisions stifle investment and infrastructure-competition with NBN Co are intended to be addressed through repeal of Part 7 of the Act, which requires that providers of superfast services supply a Layer 2 bitstream service. The Government announced that it would introduce legislation to repeal Part 7 with intended effect from 1 January 2017 with access to services then being dealt with under Part XIC of the *Competition and Consumer Act 2011* (CCA). Other planned amendments relate to the structural separation of new networks and the removal of the one kilometre statutory exemption.

Although the specifics of planned amendments to the Act have not yet been detailed, Telstra understands that these are likely to be consistent with the Government response³ to the Vertigan recommendations.

² <https://www.accc.gov.au/media-release/accc-not-to-take-action-to-block-tpgs-fibre-to-the-basement-network-rollout>

³ Australian Government, *Telecommunications Regulatory and Structural Reform*, December 2014.

2.2. Declaration should reflect government policy including exemptions

Given that the specifics of the legislative framework that is intended to apply from 1 January 2017 are unknown, it is difficult to assess where potential competition issues may arise that need to be addressed through any SBAS declaration (and subsequent FAD) inquiry. However, Telstra considers that the scope of any declaration should focus on recognising and reflecting existing government policy in relation to superfast broadband services, including the legitimate rationale for legislative and ministerial exemptions. This is consistent with the Vertigan recommendations, as well as the Government response to those recommendations, and will continue to facilitate third party access as well as ensure that customers are able to benefit from equivalent outcomes that they would otherwise enjoy on the NBN.

Telstra considers that declaration will only be in the LTIE if the service description is appropriately framed to ensure that it only captures bottleneck services and does not retrospectively capture existing networks built in accordance with other regulatory and legislative obligations, including statutory and ministerial exemptions. At a general level, the legislative exemptions were intended to permit existing networks to continue without being subject to the (new) level playing field provisions and thus minimise disruption to existing investments.⁴ The rationale for these exemptions still applies and is recognised in the Government response to the Vertigan recommendations. The draft decision to include pre-1 January 2011 networks in any SBAS declaration fails to recognise the legislative and regulatory context under which the significant investments were made in order to build these networks.

The purpose of the ministerial exemptions that currently apply varies depending on the specific network(s) in question. In determining whether an exemption should be granted, the Minister may consider a range of factors including:

- The impact on investors of having to change existing plans, particularly where projects are underway, contracts are signed or negotiations are well advanced;
- The technological capabilities and adaptability of the technologies involved; and
- The availability of other wholesale services on the network.

The objective of ministerial exemptions is to “...provide flexibility so that if there are circumstances in which the application of the obligations have unforeseen and disproportionate consequences, the obligations could be removed.”⁵

Telstra currently has ministerial exemptions from Parts 7 and 8 of the Act for the FTTP networks in South Brisbane and Velocity estates. These exemptions were granted in recognition of the fact that, amongst other things: **[c-i-c begins] [c-i-c ends]**

Telstra's position on the application of any SBAS declaration to the FTTP networks in South Brisbane and Velocity estates is discussed in detail in Section 6 of this submission. As with the legislative exemptions, Telstra considers that the ACCC has not sufficiently taken into account the impact that inclusion of these networks will have.

⁴ CLC Regulatory Impact Statement (p.2) and Explanatory Statement (p.6)

⁵ *Telecommunications Legislation Amendment (National Broadband Measures – Access Arrangements) Bill 2011 - Supplementary explanatory memorandum, p.24*

The Vertigan Committee recommended that, while the Ministerial exemption process should be repealed, there should be “...*appropriate grandfathering provisions for infrastructure already subject to these exemptions.*”⁶ This was also recognised in the Government response to the Vertigan recommendations. In determining the scope of any SBAS declaration the ACCC should have regard to existing exemptions, the underlying rationale for these exemptions and the matters that the Minister currently takes into account when assessing applications for exemption. To do otherwise risks the legitimate commercial interests of infrastructure providers and is therefore not in the LTIE.

⁶ *Independent cost-benefit analysis of broadband and review of regulation*, p.84

03 STATE OF COMPETITION

3.1. Market definition

The ACCC's Draft Decision is that the relevant markets for the purposes of the declaration inquiry are the “...*retail and wholesale markets for superfast broadband services, that is, fixed-line broadband services providing download rates normally greater than 25Mbps with monthly download limits of around 50GB.*”⁷ Further, the ACCC considers that it is appropriate to adopt a national market definition, noting that it will consider the competition effects in specific geographic segments for wholesale and retail services where appropriate.

As set out in our submission to the Discussion Paper, Telstra agrees that the relevant markets are the retail and wholesale markets for the provision of superfast broadband services and that any SBAS declaration should apply on a national basis. This is consistent with the operation of the NBN and reduces the risk of other providers cherry-picking service provision which is contrary to government policy and the intent of the NBN rollout.

In the Draft Decision, the ACCC states “...*given some networks are being rolled out to discrete geographic localities rather than providing broad contiguous coverage, in assessing the LTIE, the ACCC will consider the competition effects in specific geographic segments for wholesale and retail services where appropriate.*” It may be appropriate to, for example, apply exemptions from any SBAS declaration based on an assessment of competition in certain geographic locations. However it is unclear from the Draft Decision how this type of exemption would work in practice.

3.2. State of competition in relevant markets

The Draft Decision sets out the ACCC's assessment of the current state of competition in the relevant markets. Overall, the ACCC considers that there is sufficient competition in the supply of premium services to business customers, as well as to public bodies and charity customers operating in the same areas. In medium to low density areas, the ACCC considers that the presence of competing infrastructure is more limited and that the retail and wholesale markets for the supply of superfast broadband services do not generally display the characteristics of an effectively competitive market.

At the retail level, the ACCC assessment of the current state of competition is based on the number of retail providers in addition to network owners, market shares and retail pricing. This has led to the conclusion that, while retail markets for superfast broadband services are showing mixed signs of becoming effectively competitive, price competition is limited where vertically-integrated operators are present and where there are no or limited wholesale products available.

The ACCC assessment considers the number of retail providers (in addition to Telstra Retail) on Telstra's FTTP networks in South Brisbane and Velocity estates. Although noting that the list is not exhaustive, the inclusion of only two additional retail providers (Internode and Exetel) is a significant understatement. **[c-i-c begins] [c-i-c ends]**. This reflects the state of competition across the national market for broadband services and does not indicate that there is any competition issue that requires addressing through the inclusion of these networks in any SBAS declaration.

⁷ ACCC, SBAS Draft Decision, p.18

The ACCC has also undertaken an assessment of retail pricing plans for superfast broadband services on a number of networks, including the FTTP networks in South Brisbane and Velocity estates, compared to regulated networks. In this regard, it is not reasonable to compare the pricing in South Brisbane and Velocity estates to regulated networks given the differences between the FAB service and regulated superfast broadband services. However, based on the ACCC's analysis, the retail price offerings in South Brisbane and Velocity estates appear to compare favourably to the regulated services. For example, entry level plans – 25/5Mbps plus a 50GB download allowance – start at \$60 per month. In South Brisbane, Telstra offers a bundled (i.e. including telephone) service of 30/1Mbps with 100GB download for \$75 per month. Similarly, Internode offers a bundled 30/1Mbps service with 75GB download in Velocity estates. This retail price comparison does not support the ACCC's view that a lack of competitive pressure may, over time, lead to a larger divergence between retail price offerings by vertically integrated providers not subject to regulation and those where wholesale competition is present.

The market for voice and broadband is a national one. The South Brisbane and Velocity estates are part of this, rather than separate individual geographic markets. Any competitive effects should therefore be considered at the national level – that is, the competitive constraints that operate at the national level for the supply of these services are very much in play. For example, a ULLS operator that supplies services in adjoining areas to the networks being considered by the ACCC can complement ULLS based services with resale using consistent inputs supplied at consistent wholesale prices and compete effectively downstream across the broader area. This is evidenced in practice.

At the wholesale level, the ACCC's draft decision is that there is likely to be effective competition in the supply of wholesale superfast broadband to business customers as well as public bodies or charity customers operating in the same areas, while in areas serving both business and residential customers the limited physical presence of competitive networks leads the ACCC to conclude that competition is not effective.

While economies of scale and large sunk costs mean that superfast broadband networks may tend towards natural monopoly characteristics, the level playing field provisions ensure that end-users have access to NBN-equivalent services – and the expected positive impacts on retail competition – regardless of the underlying service. As stated elsewhere, the aim of any SBAS declaration should be to ensure that the policy intent behind the level playing field provisions remains absent the existing legislative provisions.

The ACCC analysis of wholesale access to superfast broadband services considers the number of suppliers and wholesale price structures. As part of this, the ACCC notes that:

“Networks that operate under a ministerial exemption from the Layer 2 bitstream requirement are required to provide wholesale access. Telstra is obliged to provide the Layer 2 Fibre Access Broadband service on its South Brisbane and Velocity networks for access seekers to supply retail services.”⁸

As set out in Section 6 of this submission, this is not correct. While the FAB service emulates characteristics of a Layer 2 bitstream service, it does not have all the characteristics required of a Layer

⁸ ACCC, Draft Decision, p.31

2 bitstream service. The differences between the two services therefore make it difficult to compare wholesale price structures and reach the conclusion made by the ACCC that Telstra is “...charging prices for...wholesale services, or tying their supply to the purchase of other services, that do not appear to be set at a level at which the ACCC would otherwise consider appropriate or cost-reflective.”⁹

In accordance with the ministerial exemption, the FAB service is supplied to access seekers on an open and equitable basis. The ACCC concern that the FAB service in South Brisbane and Velocity estates is “tied” to the supply of other services (namely, WLR) ignores the fact that there is a technical requirement for an underlying basic telephone service to an end user’s premise. Key points in this regard are that:

- There are a number of products supplied by Telstra – Retail and Wholesale – that use the common Telstra DSL network. The FAB service is one of these products and provides a fibre, rather than copper, access to that network. Accordingly, as part of the architecture of supplying the FAB service, there is a technical requirement for there to be an underlying basic telephone service.
- Telstra does not require wholesale customers to acquire a bundle of WLR and the FAB service from Telstra. The requirement is that there must be a basic telephone service being provided at the end user premises. In other words, it is open for the end user to acquire their voice and broadband services from different providers.

Further, as set out in Section 6, the ACCC has previously recognised the legitimacy of the technical requirement for an underlying PSTN service as part of the WDSL FAD Inquiry.

It is also incorrect that the exemption instrument that applies to South Brisbane set a regulated price between 19 December 2013 and 30 September 2014. Rather, Telstra offered a rebate to wholesale customers who migrated services from the copper access network to the FAB service (or a bundle of WLR and FAB) over the FTTP network. The migration rebates were designed to alleviate concerns that wholesale customers would face an increase in charges as a result of the migration from copper to fibre (although for resellers relevant inputs and costs were not materially affected) and were always intended to apply on an interim basis.

The ACCC already has effective oversight of the pricing of services in South Brisbane and Velocity estates and has previously expressed the view that, in South Brisbane specifically, Telstra’s reference offer satisfied any concerns raised by access seekers particularly with regard to the pricing of the WLR and FAB services. For example, as part of the LBAS Declaration Inquiry, the ACCC concluded that “[t]he ACCC does not consider that the current terms of access to Telstra’s South Brisbane fibre network raise competition concerns.”¹⁰ The ACCC also directly regulates the majority of components of the FAB service – the existing legacy regulation of WLR and commercial supply of FAB on a similar basis to regulated WADSL ensures that, consistent with the LTIE, competition continues to be effective in these areas.

3.3. Draft decision

The ACCC’s draft decision is that the declaration of a SBAS is in the LTIE for the following reasons:

- Superfast broadband networks display natural monopoly characteristics.

⁹ ACCC, Draft Decision, p.42

¹⁰ ACCC, *Layer 2 bitstream service declaration - Final Report*, p.10

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- The extent to which these networks will face competitive tension from infrastructure competition is limited and most can be considered to be enduring bottlenecks.
 - Superfast broadband services are increasingly sought after by end-users and access seekers will increasingly need access to wholesale superfast broadband services in order to be able to effectively compete in downstream markets.
 - Declaration will promote competition among and between access seekers in supplying superfast broadband services to end-users. However the ACCC recognises that this is dependent on access seekers taking up the SBAS and using it to compete in retail service delivery.
 - The ACCC recognises that there may be some costs in establishing wholesale Layer 2 bitstream services for some access providers. However, the ACCC's draft view is that overall declaration will produce benefits that outweigh these costs. Where the ACCC considers that the likely costs on a carrier complying with the declaration are disproportionate to the likely competition benefits it may be appropriate to put in place an exemption mechanism.

Telstra agrees that superfast broadband services are of increasing importance to end-users. The rollout of the NBN is intended to ensure that all Australians have access to such services on an equitable basis. However, the existence of alternate networks where there is no incentive for infrastructure competition (for commercial or technical reasons) means that there is a need to ensure that there is a level playing field for all carriers in the provisions of services to retail customers.

We understand that the goal of the ACCC in declaring a SBAS is to promote competition among and between access seekers. However, the declaration of a SBAS will be only be in the LTIE if the scope of the declaration is appropriately defined. Any SBAS declaration should be aimed at those carriage services where there is a technical or commercial limitation to the provision of alternate broadband services to end-users. It should also recognise the legitimacy of the statutory and ministerial exemptions that currently apply to networks.

The Draft Decision does not adequately take into account the legitimate reasons why the current legislative and ministerial exemptions are in place. In the case of Telstra's FTTP networks in South Brisbane and Velocity estates, the ACCC's misunderstanding of the technical nature of those networks has resulted in a flawed cost-benefit analysis that significantly understates the costs of those networks complying with a Layer 2 bitstream service requirement as contemplated by the ACCC.

3.4. Promoting competition

In determining whether declaration of a SBAS would promote the LTIE, the ACCC has applied the 'with and without' test to assess whether declaration would result in the promotion of competition in the relevant markets.

Without declaration, the ACCC considers that small localised geographic monopolies currently exist, or will exist, with operators who have the incentive and opportunity to:

- Avoid supplying a wholesale product so as to extract monopoly rents from end-users in retail markets; or
- Supply a wholesale product at a price and on terms that favour its own downstream operations.

The example used to illustrate this scenario used by the ACCC is that of South Brisbane:

"For example, the level of competition in the supply of retail broadband services in the South Brisbane exchange area appears to have diminished since Telstra replaced its existing copper

network with a fibre-to-the-premises network and the originally agreed rebates on its wholesale FAB product expired.”¹¹

The ACCC notes that it is aware of only two providers currently providing services over this network in addition to Telstra and implies that this is a decrease from information provided by Telstra in June 2013 in its application for an extension to its ministerial exemptions. As stated elsewhere in this submission, **[c-i-c begins] [c-i-c ends]**.

The ACCC also states that Telstra has charged higher wholesale access prices since the South Brisbane rebate expired, which has led to higher retail prices for end-users. The rebates applied in South Brisbane were offered by Telstra to compensate wholesale customers who were required to migrate from copper to fibre and were always intended to apply on an interim basis (although for resellers their inputs and costs remained materially unaffected). Further, Telstra's retail offerings in South Brisbane are based on its national average pricing approach which ensures that our customers can access the same price regardless of geographic location. The Telstra Retail offering in South Brisbane is therefore consistent with the regulated WLR and WDSL service.

The ACCC considers that applying a SBAS declaration, and subsequently a regulated price, will mean that the SBAS is likely to be available:

- In more areas (specifically, local monopoly areas) than is currently the case (particularly where vertically-integrated operators are present), and
- On terms that are more likely to reflect the underlying efficient costs of providing superfast broadband access services.

Regarding the services supplied in South Brisbane and Velocity estates, Telstra considers that the ACCC's view of the market is too narrow – thereby suggesting a competition issue which does not in fact exist. Telstra's FAB service requires that there be an in-use PSTN service to the end-user (retail or wholesale via WLR) which – if acquired from Telstra - is supplied on a national basis. In this sense, FAB is a PSTN-configured service – the inputs to which are largely regulated on a national basis. There is simply no evidence to suggest that retail competition is constrained in South Brisbane and Velocity estates as a result of the wholesale FAB service offered in those areas.

Further, the ACCC's draft decision that declaration would “...bring some benefit to competition to the end-users serviced by these networks” is based on the assumption that there will be no implementation costs to Telstra. This is not the case. Rather, the costs involved in migrating the South Brisbane and Velocity estate FTTP networks to a Layer 2 bitstream service are significant.

¹¹ ACCC, Draft Decision, p.39

04 TELSTRA'S FTTP NETWORKS IN SOUTH BRISBANE AND VELOCITY ESTATES

4.1. Telstra's FTTP networks in South Brisbane and Velocity estates

The ACCC considers that Telstra's FAB service is a Layer 2 Ethernet bitstream service and therefore captured under the draft SBAS service description. Telstra believes that this is based on a misunderstanding of the service provided on those networks, as well as the significant costs that would be involved in providing a declared layer 2 Ethernet bitstream service.

This section describes in more detail the technical aspects of the FAB service provided in South Brisbane and Velocity estates, as well as the costs associated with migrating these networks to a Layer 2 bitstream service as contemplated by the ACCC in the Draft Decision.

4.2. Telstra's Fibre Access Broadband service is not Layer 2 bitstream service

In the Draft Decision the ACCC considers that Telstra's FAB service – in South Brisbane and Velocity estates – is a Layer 2 Ethernet bitstream service. This is not the case. The FAB service was defined by the Commonwealth in both the *Telecommunications (Network Exemption—Telstra South Brisbane Network) Instrument 2012* and the *Telecommunications (Network Exemption Specified Velocity Networks) Instrument 2012* as follows:

Fibre Access Broadband Service means a carriage service that:

- a. is offered to be supplied on a wholesale basis; and
 - b. is supplied by means of an optical fibre line; and
 - c. is offered to be supplied at each of the following maximum transmission speeds:
 - i. download transmission speed of 8Mbps and upload transmission speed of 384kbps;
 - ii. download transmission speed of 30Mbps and upload transmission speed of 1Mbps;
 - iii. download transmission speed of 100Mbps and upload transmission speed of 5Mbps; and
 - d. has the following configurations:
 - i. a 'best effort' or non-prioritised service, as characterised by the Differentiated Services Code Point Default Forwarding per-hop behaviour; and
 - ii. connectivity made with static Layer 2 Tunnelling Protocol (L2TP) tunnels and Broadband Virtual Local Area Networks, giving direct access to end user sessions; and
- i. end-user sessions are aggregated together in the Telstra network via static L2TP tunnels supplied over Ethernet.

Although the FAB service emulates some characteristics of a Layer 2 service (through the use of Layer 2 Point to Point Protocol (PPP) via L2TP tunnels), it is not equivalent to the Layer 2 Ethernet bitstream service as deployed by NBN (to comply with its statutory obligations around Layer 2 bitstream services). In its Final LBAS Decision, the ACCC stated that the "Layer 2 bitstream declaration will cover products similar to the NBN Co Fibre Access Service that are provided over designated superfast telecommunications networks."¹² To supply a Layer 2 bitstream service, NBN uses Ethernet technology that enables Quality of Service (QoS) and the provision of standalone broadband or the provision of multicast services which reduces the bandwidth on aggregation backhaul. In contrast, FAB is

¹² ACCC, *Layer 2 bitstream service declaration - Final report*, February 2012

configured (as set out in the Instrument) to use L2TP architecture, the functionality of which does not support these features:

- Quality of service – as configured, FAB is “a *best effort* or *non-prioritised service*” and not capable of supporting QoS.
- Standalone broadband services - FAB does not enable standalone broadband services. To acquire FAB, an end user must acquire a PSTN service either from a wholesale service provider or Telstra Retail. If the wholesale service provider wishes to be the provider of this PSTN service, they would need to acquire Wholesale Line Rental (**WLR**), Local Carriage Service (**LCS**) and either Originating and Terminating Access (**OTA**) or rebill calling products (Subscriber Trunk Dialling (**STD**)/International Direct Dialling (**IDD**)/etc). In South Brisbane and Velocity estates, Telstra provides wholesale customers with FAB and WLR which in technical and pricing construct terms is essentially a fibre-based version of the copper-based wholesale DSL (**WDSL**). The requirement for an underlying PSTN service is not a commercial bundling construct; rather, it is a function of Telstra's network architecture and is integral to how Telstra provisions these services. Telstra does not forcibly bundle FAB and PSTN access services. It is simply a technical requirement that FAB services require an active PSTN service on the copper line. The PSTN service is essential for the ordering, provision and management of the FAB service.
- Multicast services - FAB is not capable of delivering NBN's design of multicast services.

It is not correct to suggest that the FAB service is a Layer 2 Ethernet bitstream service, and it has never been envisaged Telstra would be providing Layer 2 bitstream services in the South Brisbane and Velocity estates equivalent to NBN's layer 2 bitstream service offerings over FTTP.

4.3. The costs of developing a Layer 2 bitstream service in South Brisbane and Velocity estates are significant

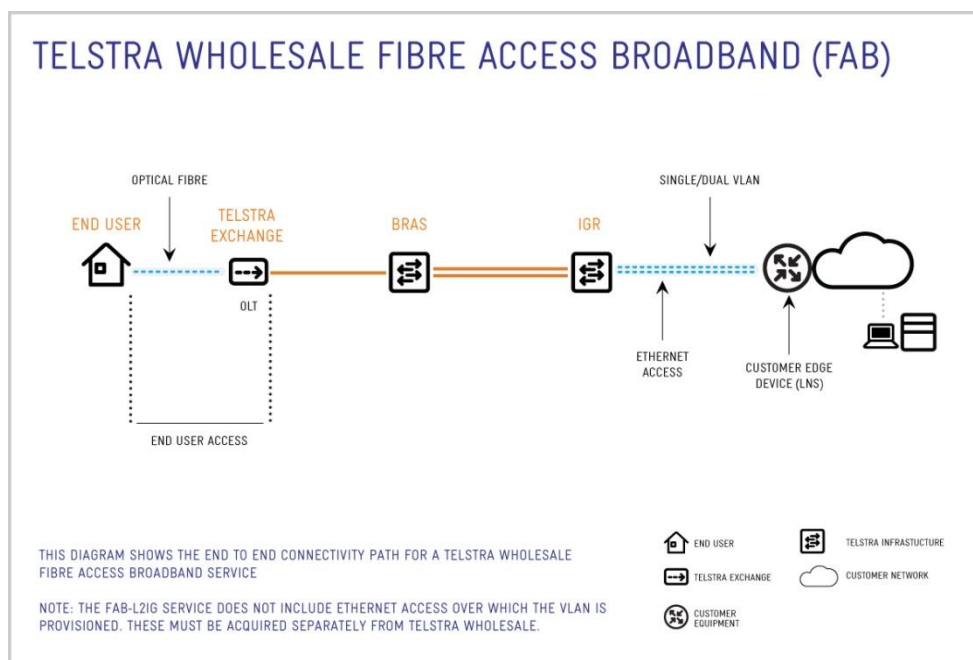
On the basis of its view that Telstra's FAB service is a Layer 2 Ethernet bitstream service, the ACCC concludes that the costs of complying with a SBAS declaration are likely to be minimal and would be outweighed by the benefits of declaration. However, the costs of complying with a SBAS declaration as contemplated by the ACCC would be significant.

If required to provide the proposed Layer 2 Ethernet bitstream service in the South Brisbane and Velocity estates Telstra would need to build a comprehensive Layer 2 bitstream service with all the necessary features of such a service. This would require significant systems and process modifications, including changes to Telstra's network architecture, equipment selection, provisioning and service assurance processes, IT support systems and billing platforms to enable a layer 2 bitstream service to be provisioned as a separate service that is independent of an underlying PSTN service. Telstra may also need to construct new points of interconnect with wholesale customers, develop new B2B capability for interaction with wholesale customers, and develop new commercial and technical product constructs.

In South Brisbane alone the cost would be at least **[c-i-c begins] [c-i-c ends]**. This estimate was originally provided to the ACCC in 2011 in the context of the South Brisbane Upgrade. Since then, the costs would have risen significantly. In addition, it does not include the costs of developing such a service in all Velocity estates. In order to properly estimate the current costs of providing a layer 2 bitstream service for both South Brisbane and Velocity estates Telstra would need to undertake a full scale scoping exercise., Telstra estimates that it would take up to 12 months to develop a layer 2 bitstream product and approximately another 3 months to rollout, including to allow for wholesale customers to undertake the necessary changes to their systems so they could consume the layer 2 bitstream.

As set out in a letter to the ACCC on 26 August 2011 (see **Attachment A**), FAB is based on the DSL IG product which is delivered through exchanges on a state-by-state basis. A diagram of the end-to-end connectivity path for Telstra's FAB service is set out below.

Figure 1 Telstra's Wholesale FAB service



To support network resilience in South Brisbane and Velocity estates there are Internet Gateway Routers (**IGRs**) at points of interconnection (**POIs**). Connection to these IGRs is made by the Business Grade Ethernet (**BGE**) access network. Although an access seeker may therefore send and receive FAB traffic via BGE access to the POI, the traffic would still be traversing Telstra's aggregation network in the normal way. The way that the FAB and associated VLAN products are provided operationally, means that an access seeker cannot establish a direct fibre link at the POI so as to make use of the FAB product without also making use of the VLAN product. The reasons for this are:

- The Gigabit-capable Passive Optical Networks (**GPON**) design provides for 2 common Virtual Private Networks (**VPNs**), one for PSTN voice traffic and one for (internet grade) data traffic; each of these VPNs is shared between all service providers (Telstra Retail and wholesale customers). GPON traffic is aggregated at the relevant exchange using an Ethernet Access Switch (**EAS**), and at this point the PSTN voice traffic is diverted onto the standard PSTN network. The data traffic enters the Ethernet Aggregation Network (EAN) and the Broadband Remote Access Server (**BRAS**) manages delivery of the traffic to the respective service provider (Telstra Retail or a wholesale customer, connected to the IGRs as described above). The BRAS routes traffic using the Port ID assigned to each service provider.
- In order to intercept data traffic before it enters the EAN, an access seeker would need to effect interconnection to the EAS. To make this work, a number of network changes would be required:
 - VPNs based on the Virtual Private LAN Services (**VPLS**) would need to be introduced for each end-user within the GPON design. These would then have to be grouped at the EAS for delivery to their respective service provider.

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- On Telstra's aggregation network (relevant to Telstra Retail and those wholesale customers who continue to use Telstra's EAN), the BRAS configuration would need to be changed to support VPLS identifiers rather than Port ID.

In the WADSL FAD inquiry, the ACCC decided against declaring a Wholesale Naked DSL service because Telstra did not sell retail 'Naked DSL' products using its copper network and would need to change its systems to be able to offer these services, which would be a costly exercise. The ACCC accepted "*that the existence of an underlying PSTN service on a line is a technical requirement of the way Telstra currently supplies its ADSL services*" and considered "*that it would be in Telstra's legitimate business interests to recover the costs to modify its network to accommodate a fully or hybrid unbundled service.*" In doing this, the ACCC found that it would "not [be] unreasonable that Telstra seek to recover its capital costs, which would involve costs to modify its operational and business support systems." It accepted that "*[t]hese costs are likely to be high and will involve testing and the costs associated with obtaining and developing the expertise required to upgrade PSTN legacy systems.*"¹³ The same reasoning is applicable in respect of developing a Layer 2 bitstream service in South Brisbane and Velocity Estates.

Telstra would be unable to recoup the costs of developing layer 2 bitstream services for South Brisbane and Velocity estates without charging significantly higher wholesale prices which would be contrary to the LTIE. This is because:

- Telstra has no clear capacity under its Velocity agreements with developers to recover a contribution to these costs.
- There are a relatively small number of services in South Brisbane over which the costs of the solution could be spread (a situation which is changed only very little if services in other Telstra GPON sites are also taken into consideration). **[c-i-c begins] [c-i-c ends]**.

In addition, the period for possible cost recovery is likely to be limited to just a few years until the NBN transition occurs, further limiting the ability for Telstra to recoup costs. In South Brisbane, the likely transition of the GPON to NBN (which is in parallel developing its own products, processes and systems) means that NBN would likely have no use or interest in re-using a layer 2 bitstream service capability (developed by Telstra) post-transition. The timing of transition under the NBN Definitive Agreements is beyond Telstra's control and depends on NBN's deployment schedule. This means Telstra has limited certainty about the period of time over which it could recover its costs.

If Telstra introduced a layer 2 bitstream service, wholesale customers would need to undertake matching IT changes to interface with new or modified systems. This investment by wholesale customers would also be wasted as they will likely acquire layer 2 bitstream services directly from NBN Co after the South Brisbane FTTP Network is folded into the NBN and would have to invest again in interfaces with NBN systems.

Telstra's fibre deployments in South Brisbane and Velocity estates were a direct result of the construction of the Queensland Children's Hospital (South Brisbane) and the need for a cost effective choice in new (Velocity) estates (as opposed to copper extension). These deployments were not made for the purpose of providing high speed broadband services but rather to replace or augment our PSTN network. Telstra's network and product design was targeted to PSTN emulation to mirror our existing (non-NBN; non-NGN) network capabilities rather than to provide new fully function Layer 2 bitstream services that enable a suite of IP-based NGN services as per NBN and other new superfast networks .

Telstra could not commercially justify developing solutions to meet requests for, as an example, a multicast service (which NBN's layer 2 bitstream service is capable of providing). The costs were (and still are) simply too high, the demand base too low and the transition to NBN would render obsolete

¹³ ACCC, *Public inquiry to make a final access determination for the Wholesale ADSL service – Final Report*, page 76

essentially all of the network and IT development within a relatively short period of time (and potentially some or all of the development undertaken by wholesale customers in rebuilding their interfaces to the Telstra systems to handle transactions relating to any new products). In view of these considerations, Telstra's existing FAB product provided the most efficient interim solution pending the availability of NBN Co's Layer 2 product on integration of the South Brisbane fibre network into the NBN. This was set out in the appended letter to the ACCC in 2011.

It is clearly contrary to the LTIE to require Telstra to develop a layer 2 bitstream service in circumstances where the costs of developing such a service outweigh any benefit over a short time period, and when – given the limited services and time in question – the costs of doing so will not be able to be recouped without setting high wholesale prices to allow for reasonable cost recovery. From an access seekers point of view, the requirement for them to undertake IT changes to interface with Telstra's new or modified systems in circumstances where soon after they will be required to then invest again in interfaces with NBN Co systems is inefficient and contrary to the LTIE.

05 SERVICE DESCRIPTION

The ACCC has decided to declare a SBAS that is technology neutral and includes all fixed-line connections with a downstream rate that is normally more than 25 Mbps. The service description applies to superfast broadband services supplied on all networks with the following exceptions:

- On the NBN
- Exclusively to businesses, public bodies and charity customers from a single DSLAM or access multiplexer device
- On HFC networks that will be transferred to NBN Co
- On networks that are regulated under the LBAS declaration

The ACCC considers that the SBAS declaration should apply immediately, for a period of five years.

5.1. Service description

For the reasons set out in this submission, Telstra believes that:

- (a) To address the competition concern leading to the Declaration Inquiry – and to avoid unnecessary and complex regulation – the service description for a SBAS should adopt and build on the existing legislative definition for a superfast carriage service and maintain consistency with the CLCs.
- (b) If the Commission is minded to adopt a broader service definition, it should exempt Telstra's FTTP networks in South Brisbane exchange and Velocity estates from any SBAS declaration for the following reasons:
 - i. It is unnecessary to further regulate the FAB service, the majority of inputs to which are already regulated and set at a price allowing for effective downstream competition with Telstra Retail – unnecessary and duplicative regulation gives rise to uncertainty and is contrary to the LTIE.
 - ii. Telstra's FAB service is not a Layer 2 bitstream service and it is contrary to the LTIE to require Telstra to develop and offer a Layer 2 bitstream service in South Brisbane and Velocity estates in circumstances where it currently does not do so and to do so would involve significant costs and time.

Proposed service description

The Draft Decision defines a SBAS as a point to point service for the carriage of communications in digital form between a network-network interface and a user-network interface that is:

- (a) a Layer 2 bitstream service; and
- (b) a superfast carriage service.

A Layer 2 bitstream service is defined in section 152AC of the CCA to have the same meaning as in the *Telecommunications Act 1997*. The Act defines a Layer 2 bitstream service as follows (section 7)

Layer 2 bitstream service means a carriage service that is:

(a) *either:*

(i) *a Layer 2 Ethernet bitstream service; or*

(ii) a Layer 2 bitstream service specified in a legislative instrument made by the ACMA for the purposes of this subparagraph; and

(b) a listed carriage service; and

(c) supplied using a line to premises occupied or used by an end-user.

For this purpose, Layer 2 has the same meaning as in the Open System Interconnection (OSI) Reference Model for data exchange.

As set out in its response to the ACCC's Discussion Paper, Telstra considers that the declaration of a SBAS would be in the LTIE provided that the service description is appropriately defined to apply only to those carriage services where there is a technical or commercial limitation to the provision of equivalent broadband services to end-users. That is, declaration should be restricted to apply only to those superfast carriage services where it is not possible to provide an alternative service (either at all or without degrading existing services resulting in sub-optimal outcomes for consumers). Telstra's position on the appropriate service description was set out in Section 2 of its response to the Discussion Paper.

The SBAS Declaration Inquiry originated in response to a recommendation made by the Vertigan Committee regarding competition concerns around the supply of vectored VDSL2 services. The competition concerns arise from the fact that in certain circumstances, competing vectoring systems in one building can lead to the degradation of end-user services. In order to address this concern, the Minister for Communications made the CLC, which was aimed at ensuring that there is a level playing field for all carriers in the provision of superfast broadband services to retail customers. In effect, it sought to address a 'loophole' in the Telecommunications Act which meant that certain categories of superfast carriage services were not captured by the level playing field requirements in Parts 7 and 8 even where there was an effective monopoly.

As set out in Telstra's response to the Discussion Paper and consistent with the principles and detail of the submission made by the Communications Alliance Working Committee 58 (WC58), the service description for a SBAS should adopt and build on the existing legislative definition for a superfast carriage service and maintain consistency with the CLCs. This will result in a service description with technical elements that specify a download data rate at layer 2 of at least 25 Mbps, supplied to an end-user by metallic twisted pair cable and makes use of spectrum above 2.2MHz which will ensure that only the intended services are captured by declaration. Although specifying technical characteristics, the service description is intended to be technology neutral to the extent possible in order to provide for coverage of existing and likely future twisted pair technologies that may emerge. Telstra further considers that, in keeping with the coverage of the CLCs, any SBAS service description should expressly only apply to residential (and small business) customers.

In its Draft Decision, the ACCC has gone beyond the scope of the competition issue that any SBAS declaration was initially intended to address. The ACCC Draft Decision to extend the scope of a SBAS declaration to, with limited exceptions, all fixed-line networks including those with statutory or ministerial exemptions is contrary to established government policy and does not take into account the specific background associated with a number of networks, including Telstra's FTTP networks in South Brisbane and Velocity estates, which were in development and/or built before the level playing field provisions came into play – and the inputs into which are already largely regulated.

5.2. Exemptions from the service description

The ACCC has the discretion to make exemptions to a declaration on the basis of geography or certain service providers/classes of service providers. The Draft Decision includes a preliminary view that exemptions from any SBAS declaration should apply to:

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- Networks subject to infrastructure-based competition – specifically superfast broadband access services if they are supplied exclusively to business customers, public bodies or charity customers from a single DSLAM or access multiplexer device.
 - HFC networks – including the Telstra and Optus HFC networks on the basis that they will be transferred to NBN Co but not including the iiNet HFC network.
 - Services subject to the LBAS declaration – to avoid duplication of regulation although to the extent that the LBAS obligation falls away (or the declaration is revoked), the SBAS declaration will apply to services currently supplied under the LBAS declaration.

Telstra agrees with the ACCC's draft decision to exempt the Telstra and Optus HFC networks on the basis that it would not be in the LTIE to configure these networks to meet the requirements of any SBAS declaration before they transfer to NBN Co. The ACCC's view is based on a consideration that the cost of configuring the networks would outweigh the benefits in competition in downstream markets. As set out elsewhere in this submission, the same consideration should apply to Telstra's FTTP networks in South Brisbane and Velocity estates. Further, it is still intended that the FTTP network in South Brisbane be transferred to NBN Co although negotiations in relation to this transfer have been put on hold while other NBN transition-related activities have taken priority.

Telstra also agrees with the draft decision to exempt services subject to the LBAS declaration to avoid duplication of regulation. Telstra's position is that an appropriately framed SBAS declaration alongside the existing LBAS declaration retains the current legislative and regulatory framework and is consistent with Government policy in relation to superfast broadband services.

The ACCC's decision to exempt services exclusively supplied to business customers, public bodies or charity customers is based on a view that this option is most appropriate as a proxy for effective competition. Elsewhere in the Draft Decision, the ACCC notes that it will consider the competition effects in specific geographic segments where appropriate. It is unclear how these two positions interact, if at all. As set out elsewhere in this submission, Telstra reserves its position on the use of geographic exemptions pending further details of how this might apply. With respect to exempting services exclusively applied to business customers, public bodies or charity customers, Telstra notes that this is consistent with existing government policy which applies the level playing field provisions to residential and small business customers only. The Vertigan Committee also considered that 'larger business customers' are unlikely to require special intervention given the responsiveness of service providers to the needs of those customers. Telstra therefore agrees with the ACCC's preliminary position with respect to exempting business customers although considers that it may be in the LTIE to exclude 'small' business customers from this exemption consistent with existing government policy.

5.3. Timing and application of the declaration

Telstra agrees with the ACCC's draft decision that the duration of any SBAS declaration should be five years from the date the declaration is made. This is consistent with Telstra's position in response to the Discussion Paper that this will ensure that residential and small business customers enjoy the benefits of access to NBN-equivalent services even where the underlying superfast broadband service is provided by an alternate carrier.

ATTACHMENT A: 26 August 2011 letter to the ACCC re. South Brisbane Network Upgrade

[c-i-c begins] [c-i-c ends]