TELSTRA CORPORATION LIMITED

Submission to the Australian Competition and Consumer Commission

Supplementary material in support of Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications

PUBLIC VERSION

Overview

This submission contains supplementary material in support of Telstra's Applications for Individual Exemptions from the Standard Access Obligations in relation to the supply of the Local Carriage Service (LCS) and the Line Rental Service (WLR) ("Exemption Applications").

Since lodging the Exemption Applications on July 9, additional competitive intelligence data has become available on the deployment of competitor DSLAMS in June and July. In addition, Telstra has examined previous competitive intelligence reports to provide a more complete picture of the emergence of competitive DSLAM infrastructure in the Exemption Area (and in Band 2 more generally) over the past two years.[1]

Telstra is providing this information to the Commission at this early stage of the Commission's inquiry to ensure the Commission is fully informed as to the dynamic state of competition and competitor DSLAM deployment within the Exemption Area.

This submission also contains information on recent developments in markets related to the supply of the WLR and LCS products — specifically, recent announcements pertaining to the ULL-based voice and data products and wireless broadband products.

Competitor DSLAM deployments

Since Telstra lodged the WLR and LCS Exemption Applications, competitors have continued to deploy DSLAM-based infrastructure in metropolitan (Band 2) ESAs (Table 1).

Table 1: Recent expansion and deepening of competitor DSLAM infrastructure in Band 2 ESAs

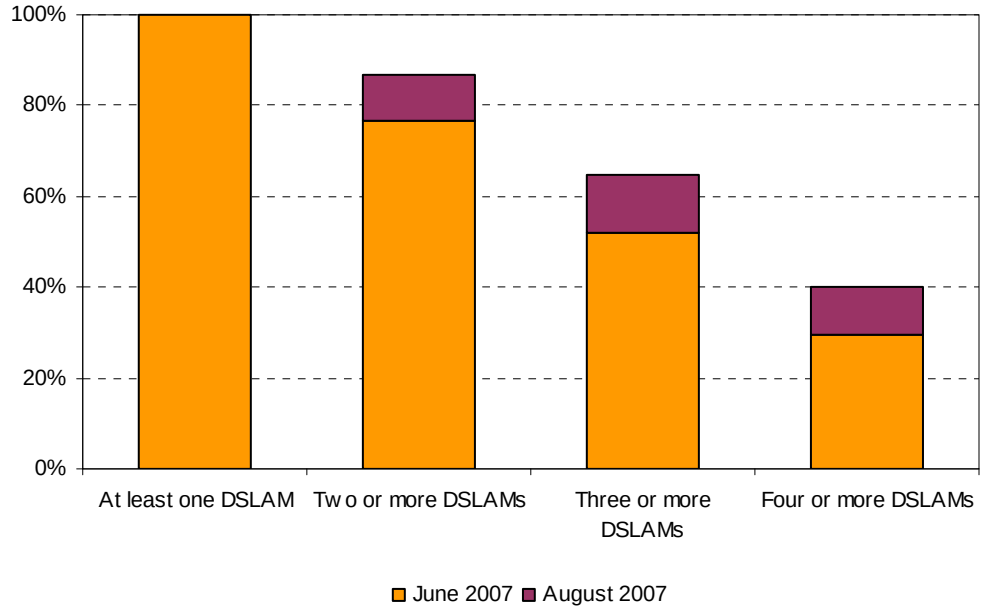
	WLR/LCS exemption application (June data)	July 2007	August 2007	Change (June to August 2007)
Band 2 customers covered [a]	5.2 million	5.3 million	5.4 million	179 118
Number of Band 2 ESAs covered [b]	371	381	387	16
Number of DSLAMS installed in Band 2 [b]	1084	1141	1213	165

[a] Refers to the number of PSTN SIOs served by ESAs in the Exemption Area in which competitor infrastructure has been identified. [b] Telstra has identified 11 companies (or related companies) that have deployed DSLAMs in ESAs in Exemption Area. This figure is conservative (see Box 1, Telstra's July Submission).
Source: Telstra analysis.

[1] As outlined in Telstra's July submission in support of is LCS and WLR Exemption Applications, the Exemption Area comprises 371 metropolitan, Band 2 ESAs where at least one competitor has been identified as having installed DSLAM-based infrastructure (See p. 9, July submission).

The majority of the additional competitive infrastructure that has been identified as coming online since Telstra lodged its WLR and LCS exemptions is in the Exemption Area. Since June 2007 an additional 147 competitor DSLAMs have been brought online within the Exemption Area. As a result, the percentage of ESAs covered by only one competitor DSLAM has fallen from 23 per cent to 13 per cent (figure 1). Conversely, the number of ESAs in which three or more competitor DSLAMs are operating has increased from 52 per cent to 63 per cent, while the number of ESAs in which four or more DSLAMs have been installed has increased from 29 per cent to 40 per cent.

Figure 1: Percent of ESAs in the Exemption Area covered by competitor DSLAMs: deployments since Telstra lodged its WLR and LCS Exemption Applications.



Source: Telstra analysis.

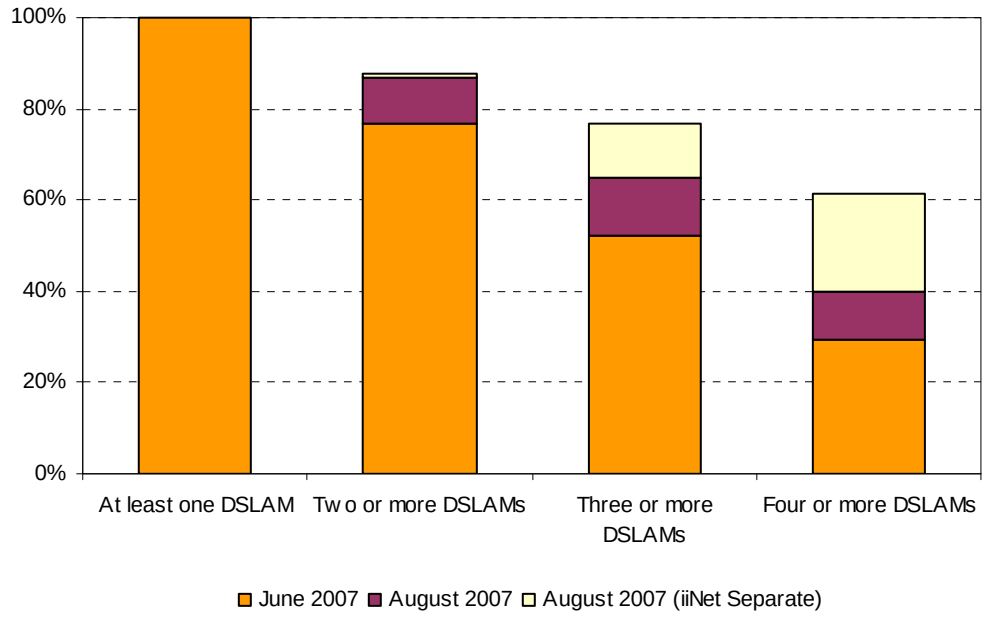
As outlined in Telstra's July submission, Telstra has taken a conservative approach in using competitive intelligence data to assess the depth and breadth of competitor DSLAM-based infrastructure competition.[2] It is likely however that one of the rules that was used in preparing the competitive intelligence leads to a significant understatement of the true depth of DSLAM-based competition within the exemption area. In using its competitive intelligence material, Telstra has taken the very conservative step of not counting identified DSLAM deployments by AAPT/Powertel and iiNet separately, due to announced wholesale arrangements between these companies. As both of these companies remain separate

[2] See Box 1, p.16, July submission.

entities and each have made statements relating to their existing and planned future DSLAM build, this approach is in all likelihood overly conservative.[3]

It is noteworthy then, that if the DSLAM deployments of AAPT/Powertel and iiNet are separately counted, the percentage of ESAs in the Exemption Area identified as having three or more competitor DSLAMs increases significantly (65 per cent to 72 per cent), and the percentage with four or more competitor DSLAMs increases to over 60 per cent, from 40 per cent (Figure 2).

Figure 2: Percent of ESAs in the Exemption Area covered by competitor DSLAMs: additional deployments since Telstra lodged its WLR and LCS Exemption Applications (iiNet DSLAMs separately identified from AAPT/Powertel DSLAMS).



Source: Telstra analysis.

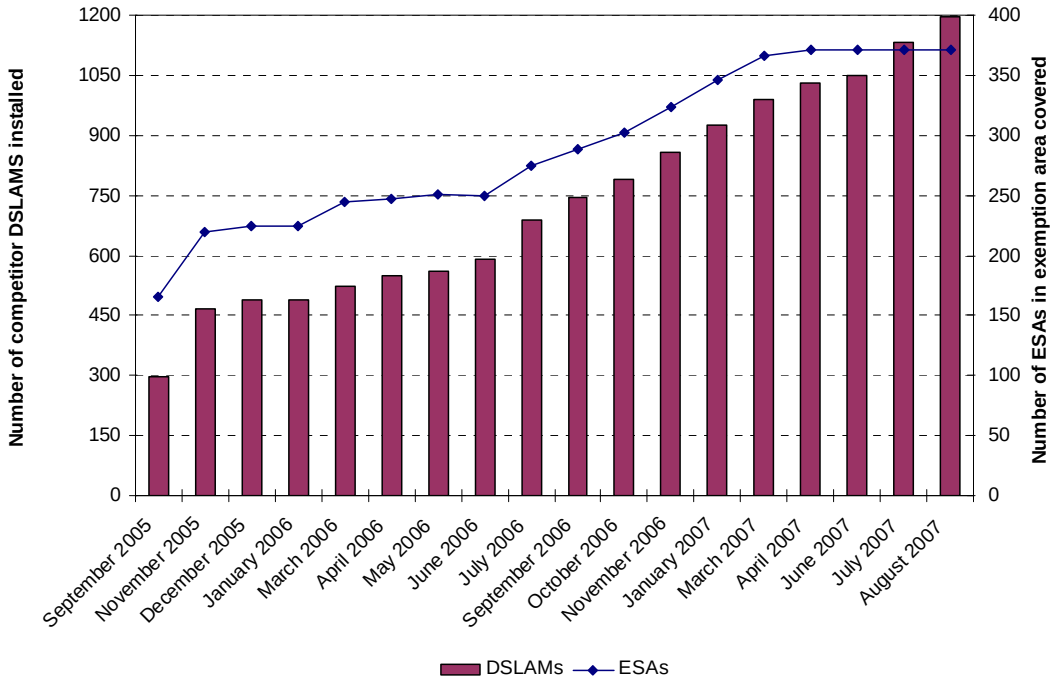
In addition to examining the most recent competitor intelligence material on DSLAM deployment, Telstra has also re-examined historic data over the past two years to obtain a 'time series' of actual and planned competitor DSLAM build, based on publicly available data. Based on this material, it is possible to examine the incremental expansion of competitor DSLAM-based infrastructure throughout the Exemption Area, as well as the 'deepening' of competitor build (Figure 3).

As can be seen in Figure 3, the number of ESAs covered by competitive DSLAM-based infrastructure within the Exemption Area increased steadily throughout 2005-06, with coverage increasing at a faster rate in 2006-07, until April 2007 when all 371 Exemption Area

[3] See iiNet *FY07 Annual Results*, available at http://www.iinet.com.au/about/investor/20070807_ASXANN_Full_Year_Presentation.pdf.

ESAs were covered. Similarly, the rate of deployment of additional competitor DSLAM deployment increased in 2006/07 compared to 2005/06. Between September 2005 and September 2006, an average of 37 additional competitor DSLAMs were installed in the Exemption Area each month. In the 11 months between September 2006 and August 2007 the rate was and average of 41 additional DSLAMs a month. The rate of deployment has been even higher in the past three months (June to August), with an average deployment rate in the Exemption Area of 49 competitor DSLAMs a month.

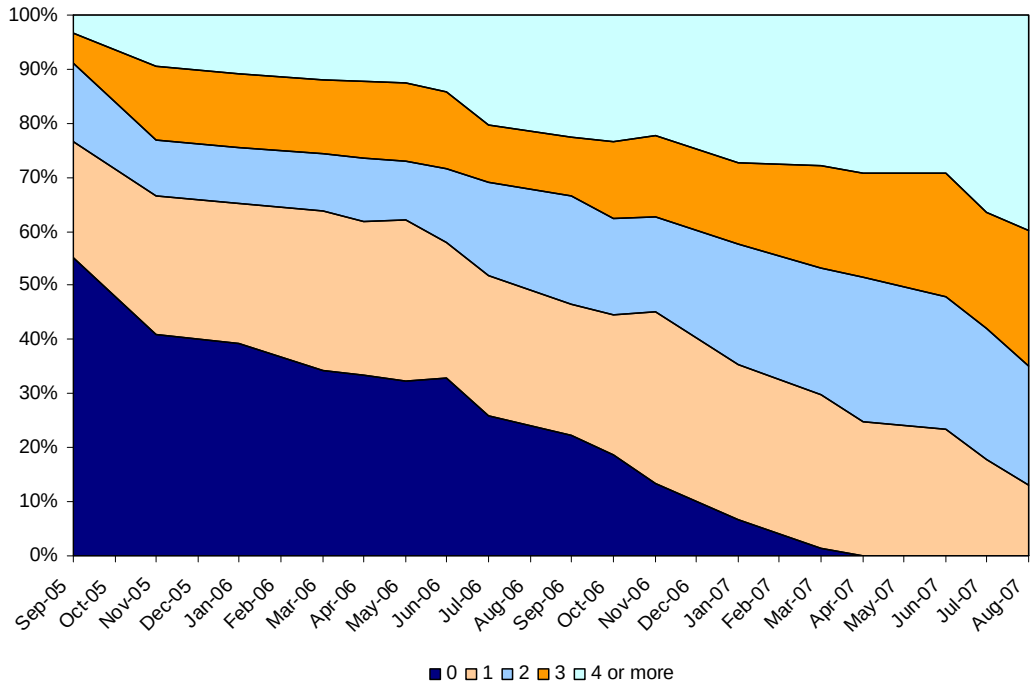
Figure 3: Growth in the number of ESAs covered, and DSLAMs installed in the WLR and LCS Exemption Area



Source: Telstra analysis.

The expansion and deepening of competitor DSLAM infrastructure within the Exemption Area has been significant over the nearly two years since September 2005. In September 2005, only a handful (12) of ESAs in the Exemption Area were identified as containing four or more competitor DSLAMs, whereas today 148 ESAs (40 per cent) are identified as having four or more (Figure 4).

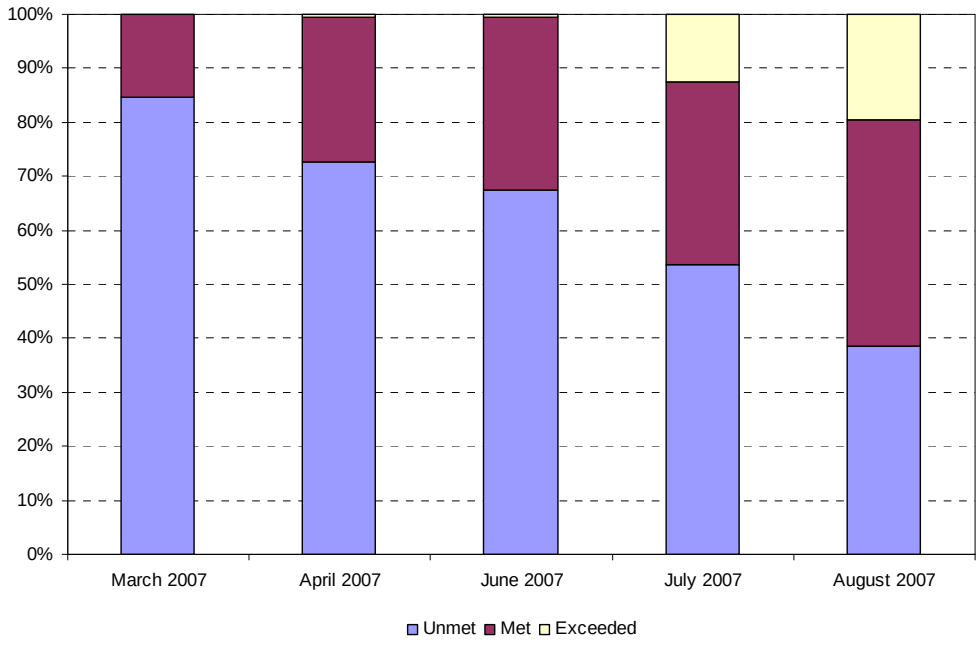
Figure 4: Change in DSLAM deployment in the Exemption Area since September 2005.



Source: Telstra analysis.

It is also interesting to examine the rate at which competitor's announced DSLAM deployment plans have been met or exceeded. Based on publicly available ESA by ESA deployment plans from January 2007, Telstra has compared these planned investments with actual deployment in subsequent months (Figure 5). Based on plans announced in January, competitors had committed to deploy additional DSLAM-based infrastructure in 194 ESAs. In the eight months, these plans have been met or exceeded in 61 per cent of those ESAs (119).

Figure 5: Planned deployments versus actual build (January 2007).

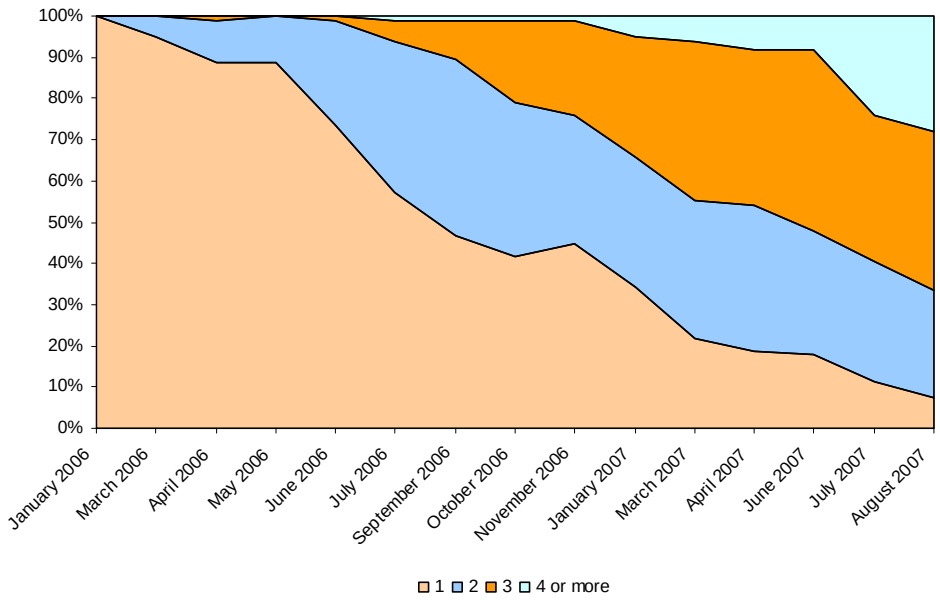


Source: Telstra analysis.

Analysis of previously recorded competitive intelligence data also provides support for the argument that once a competitor has installed an initial DSLAM in an ESA, further competitor DSLAMs are likely to be introduced. In this way the installation of a competitor DSLAM in metropolitan ESAs reveals valuable information on the competitive characteristics of the voice and broadband market within that ESA.

For example, in January 2006, 96 ESAs in the WLR/LCS Exemption Area were identified as having only 1 competitor DSLAM. Tracking those ESAs through to August 2007 reveals the high degree to which competitive DSLAM-based infrastructure has deepened in those same ESAs (Figure 6).

Figure 6: 'Deepening' of competitor DSLAM infrastructure in :



Source: Telstra analysis.

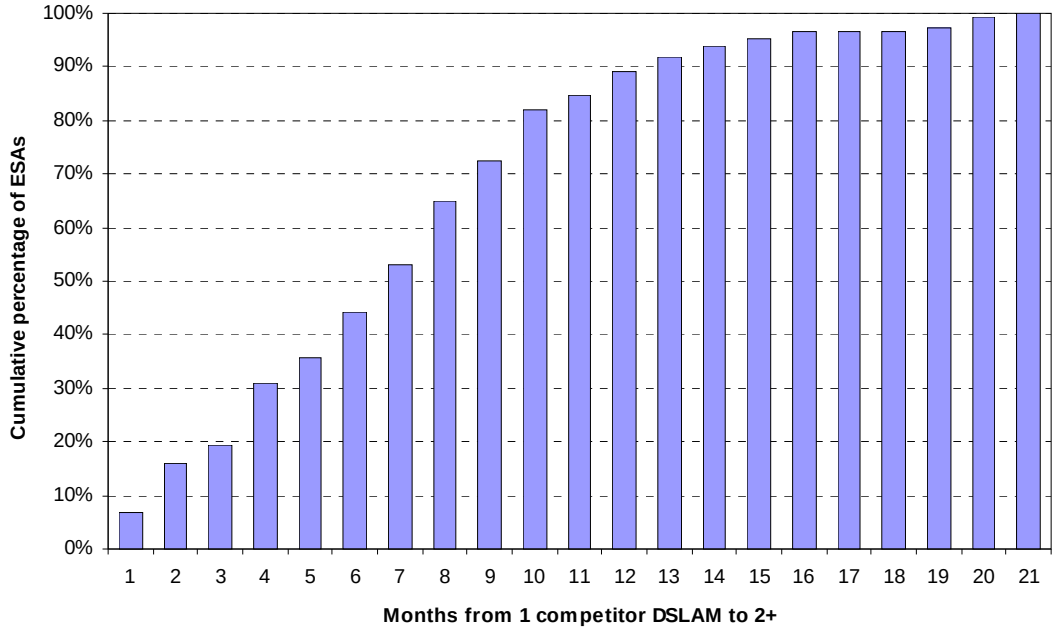
Another way to examine the rate at which a second competitive DSLAM is likely to follow an initial competitive roll-out in an ESA is to examine the cumulative frequency distribution in those ESAs where an initial and subsequent DSLAM deployment occurred in timeframe for which competitive intelligence data are available (Figure 7).

Based on Telstra's competitive intelligence data, between September 2005 and August 2007, 149 ESAs in the Exemption Area went from having no competitor DSLAMs installed to having an initial competitor DSLAM, followed by at least one other competitive build.[4] As can be seen in Figure 6:

- 50 percent of ESAs added a second competitive DSLAM within 7 months,
- 80 per cent of ESAs added a second competitive DSLAM within 10 months,
- 90 per cent of ESAs added a second competitive DSLAM with 12 months.

[4] Of the remaining 222 ESAs in the Exemption Area, 166 ESAs had at least one competitive DSLAM installed in September 2005, 13 went from having no competitive DSLAMs installed to two or more in a single month and 56 added an initial competitive DSLAM in the period but have not as yet added subsequent competitive infrastructure. Of these 56, the median time these ESAs have had only a single competitive DSLAM installed (as at August 2007) was 7 months.

Figure 7: Rate at which a second competitor DSLAM is brought online, following initial roll-out of competitive DSLAM infrastructure in an ESA in the Exemption Area



Source: Telstra analysis.

ULL Developments

In recent months, there have been several noteworthy developments relating to the use of ULL-based services in the voice and broadband markets. In particular, Singtel Optus have recently announced a voice and broadband product utilising its ULL and HFC network. At the same time several carriers and ISPs have announced plans to begin offering naked DSL products.

Optus Fusion: ULL-based voice and broadband product

On July 12 2007, Singtel Optus (Optus) launched its 'Fusion' product. The fusion offer is touted by Optus as "Australia's first fixed voice and broadband cap, where,

For one fixed price per month, customers who sign up to an Optus Fusion Cap will get unlimited local and national calls; unlimited calls to Optus mobiles; fast broadband with no excess download charges; and included line rental.[5]

Significantly, the fusion offer is only offered to customers who have access to Optus' DSLAM or HFC network. Analysis of the offer has highlighted the competitive impact that the use of the Optus DSLAM-based network will have on the voice and broadband market. For instance, Macquarie equities note:

"Optus is protecting pricing on broadband, while attacking fixed line voice: Effectively, Optus is giving away the bundled voice services at cost, and charging market rates for broadband services. This is a clear strategy to protect pricing on the growth medium, broadband, at the expense of voice. We expect Optus to back these new plans with an aggressive TV advertising campaign from this weekend.

...

Optus is clearly using its ULL footprint (in addition to cable) to bring pressure to bear upon Telstra's fixed line voice revenues." [6]

GoldmanSachsJBWere similarly noted the implications of this product launch and the impact it is likely to have for competition in the fixed voice and broadband market:

"*ULL impact is coming: Over the past 12-24 months, various players in the Australian market began deploying DSLAM broadband networks, clearly relishing the move to the improved economics possible with ULL. Today's launch from Optus is the first clear example of what ULL can deliver in a product/pricing sense."* [7]

JPMorgan conclude that the launch of the Fusion product is an example of the competitive possibilities offered by ULL-based deployments.

"Now that on-net revenues exceed off-net, we believe that Optus might be more inclined to launch disruptive technologies like VoIP in the consumer market. Because Optus ULL margins are much higher than Resale margins (30%+ vs 10%), Optus can absorb the revenue cannibalization effect of VoIP on ULL but not on resale. We believe that the

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[5] Singtel Optus media release, *Optus launches Australia's first combined phone and broadband cap*, available at http://www.optus.com.au, 12 July 2007.
[6] Macquarie Research Equities, *Optus sets a monkey amongst the penguins*, 13 July 2007.
[7] GoldmanSachsJBwere, *Optus Launches Australia's first combined fixed + broadband cap*, Telecommunications Sector Commentary, 12 July 2007.

recently launched Optus Fusion is an example of how the ULL economics will allow Optus to be much more aggressive in the Consumer and SMB fixed line market."[8]

In addition to the launch of the Fusion product, Optus has also further developed its wholesale offerings based on its ULL DSLAM network. Recently, M2 Telecommunications signed a telephony and broadband wholesale/resale relationship with Optus, utilising that company's ULL-based DSLAM network.[9] This further deepens the ULL-based wholesale market, with M2 Telecommunications offering smaller retail ISPs access to Optus' ULL-based network.

Naked DSL products

In recent months, several companies have made announcements relating to the delivery of broadband products based on ULL without an underlying PSTN voice service (so called "naked DSL"). This type of product offering would enable an ISP to deliver a broadband service (potentially including a VoIP telephony service) via ULL without the need to acquire traditional voice circuit switching. Naked DSL products has for some time been expected to increase competition not only in the broadband market.[10]

Speaking at a recent industry conference, AAPT/Powertel CEO Paul Broad, commented that:

the naked DSL (Digital Subscriber Line) product will be available before Christmas but refused to give further details of where the service will be launched.

Broad did, however, reveal the naked DSL product will be available as both a wholesale and retail offering.

"We're looking at effectively a primary line replacement product ... in my place in Sydney, I don't have a fixed line nor do I want one -- not at AU$30 month," he told delegates. [11]

In addition to AAPT/Powetel, several other carriers/ISPs have revealed plans to offer naked DSL services:

- TPG is reported to soon begin offering ULL-based 'naked DSL' products over its DSLAM network.[12]

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[8] JPMorgan, *Singapore Telecom: 1Q FY08 results*, pp.9-10, 14 August 2007.
[9] Exchange, *M2 launches wholesale ADSL2+ & telephony bundle*, vol. 19, no. 32, p. 9, 24 August 2007.
[10] IDC, *Australia Broadband Market 2005-2009 Forecast: Naked DSL to Become Lethal to PSTN*, October 18, 2005.
[11] Best, J *AAPT Promises 'Naked DSL' by Christmas*, ZDNet, available at http://www.zdnet.com.au/news/communications/soa/AAPT-promises-naked-DSL-by-Christmas/0,130061791,339281360,00.htm, 21 August 2007.

- iiNet has announced and commenced trials of naked DSL.[13]

- VoIP provider engin is "committed to launching a landline free broadband product before the end of the year"[14] utilising Optus' ULL-based network:

> "[The engin naked DSL product] *will enable subscribers to receive high-speed broadband internet and phone services over a local phone line without paying line rental fees.*" [15]

Wireless broadband developments

Since Telstra lodged its WLR and LCS exemption applications in July, several developments have occurred in the wireless broadband and voice market. Most significantly, Optus' Virgin brand has launched a 'fixed'-wireless voice and broadband consumer product, utilising the Optus HSDPA enabled 3GSM mobile network.[16] Virgin claim that,

> *This is the first wireless triple play in Australia and the first for any Virgin mobile company in the world.*[17]

Industry commentators have noted the significance of this product and the competitive threat it poses to the fixed-line voice market. One commentator suggesting that the Virgin offer was "poised to slaughter Telstra's landline profit" and,

> *The official launch of Virgin's broadband and home phone service today made something very clear: if Telstra thought its landline monopoly was under threat from capped mobile plans, it ain't seen nothing yet.* [18]

Other recent developments in the wireless broadband and voice market include:

- Wireless provider Spin Internet has launched a free wireless broadband service in Sydney.[19]

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[12] Commsday Weekly, *TPG reveals new ADSL2+ ULL plans*, p. 9, 2 August 2007.
[13] iiNet, *naked broadband trial terms & conditions*, available at http://www.iinet.net.au/products/naked/trialterms.html 25 August 2007.
[14] Best, J *AAPT Promises 'Naked DSL' by Christmas*, ZDNet, available at http://www.zdnet.com.au/news/communications/soa/AAPT-promises-naked-DSL-by-Christmas/0,130061791,339281360,00.htm, 21 August 2007.
[15] Sinclair, L. *Engin starts its TiVo push*, The Australian IT, available at http://www.australianit.news.com.au/story/0,24897,22000788-15306,00.html, 2 July 2007.
[16] REF
[17] Quoted in Corner, S. Virgin Mobile launches 3G-based 'fixed line' broadband bundle, ITwire, available at, http://www.itwire.com/content/view/13671/
[18] Warne, D. Virgin Broadband poised to slaughter Telstra's landline profit, 26 July 2007, available at http://apcmag.com/6795/virgin_broadband_it_will_slaughter_telstras_profit

- **Hutchison "3" have** dropped prices for their "x-series" wireless broadband service based on that company's HSDPA-enabled 3GSM network. [20] **These price changes increase the competitiveness of this service relative to traditional ADSL-based broadband services.**

[19] Spin Internet media release, *Spin Internet launches Free Mobile Broadband for Sydney in world first,* available at http://www2.spin.net.au/pressreleases/#20070817T102 16 August 2007.
[20] Corner, S. *3 cuts HSDPA prices: 1GB for $29 per month*, ITWire, available at http://www.itwire.com/content/view/13534/1095/ 16 July 2007.