

**FUTURE SCOPE OF THE
LOCAL CARRIAGE SERVICE DECLARATION**

Telstra's Submission to the ACCC Discussion Paper

- Public Release Version -

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1. Introduction

The objective of the telecommunications regulatory regime set out in Part XIC, TPA (“the Act”) is to promote the long-term interests of end-users by promoting competition, achieving any-to-any connectivity and encouraging economic efficiency. However, regulation is never a precise process. Regulators are faced with complex market situations, and with significant information problems. Consequently, regulatory authorities, including the ACCC, need to be careful in managing the risks of unintended consequences of regulations.

In general, regulators face two types of risk. The first is that in the absence of adequate intervention, market participants may exercise market power against the interests of competitors and consumers. The second is that regulatory intervention may itself distort market behaviour, leading to inefficiencies which are ultimately detrimental to consumers’ interests. Changing market circumstances require careful weighing up of these two risks.

As markets becomes more competitive through entry and the introduction of new technologies, the risk that regulatory intervention will be distorting begins to outweigh the risk of the exercise of market power. This suggests that the legislative objectives with regard to the telecommunications industry would be best achieved if:

- Regulation is rolled back from those parts of the market where competitive forces would otherwise determine efficient outcomes.
- Regulatory intervention is reduced when the risk of regulatory gaming and distortion from regulation becomes significant.

In this submission, Telstra demonstrates that:

- market conditions already provide for the competitive supply of the local carriage service (LCS) in CBD areas both at the wholesale and retail layers;
- exemption of the local carriage service from the standard access obligations in CBD areas will further stimulate efficient facilities-based entry as new entrants will compete in supply if they can do so more efficiently than existing suppliers; and
- the proposed exemption will encourage the efficient investment in and use of existing network infrastructure as existing facilities-based competitors, faced with the threat and reality of by-pass, will have the incentives to set the prices for LCS at the lowest level consistent with cost recovery.

In addition, the fact that the achievement of any-to-any connectivity would not be impacted by the exemption of the local carriage service in CBD areas is a factor weighing in favour of granting an exemption.

Consequently, the costs associated with regulatory intervention, including regulatory failure, compliance and administration costs are no longer justified in the case of LCS in CBD areas. It follows that Telstra’s proposed exemption is consistent with promoting the long term interests of end-users.

This submission follows the structure of the ACCC’s discussion paper as follows:

- Section 2 comments on the market definition relevant to the LCS exemption analysis.
- Section 3 examines the competition aspects of the LCS exemption, including the current level of contestability and the viability of competitive facilities-based supply.
- Section 4 addresses the economic efficiency limb of the LTIE test.
- Section 5 discusses the issues raised in the ACCC's discussion paper regarding a class exemption and the appropriate timing for consideration of possible variations to the declaration.
- Section 6 provides answers to the specific questions posed in the Commission's discussion paper.

2. Market definition

The Commission invites comment on the market definition relevant to the analysis of the exemption. The comment sought by the Commission refers to the geographical, functional and product dimensions of the market. Telstra notes that the temporal dimension of the market may additionally be relevant.

As far as the geographical dimension of the market is concerned, Telstra believes that the CBDs constitute a distinct market because they have distinctive characteristics in terms of telecommunications demand and supply. On the demand side, the CBDs have an exceptionally high concentration of telecommunications outlays, both in absolute terms and relative to other areas. Demand in CBDs is also extremely skewed toward very large corporate customers. On the supply side, the concentration of a high volume of demand in a small geographical space, with many large multi-site lines, materially reduces the costs of by-pass, as there is especially great scope for directly connecting customer premises to fibre rings. As a result, one would expect, and indeed observes, distinctive patterns of competition in CBD areas. Indeed, many firms derive almost all of their line revenues from CBD customers. Prices and outputs could, and in Telstra's experience do, diverge as between these areas and others, making them a separate market for competition analysis purposes.

With respect to the functional nature of the relevant market, Telstra queries the degree to which a distinction between the wholesale and retail layers can meaningfully be drawn. It is not apparent to Telstra that the distinction would pass the standard test for functional market definition adopted by the National Competition Council in its analyses since the **Carpentaria** decision – that is, economic separability, including the use of specialised assets in the two layers. Having said that, Telstra does not believe that the functional market definition adopted ought to affect the substance of the Commission's decision in this matter, which should hinge on the extent to which declaration remains necessary to promote the LTIE.

In considering this question, Telstra believes that it is the product and temporal dimensions of the market that are of the greatest relevance.

With respect to the product dimension of the market, Telstra believes there is no doubt that, as a matter of commercial reality, competitors' own facilities are being extensively used in CBDs to provide a substitute to the local call resale service. A hypothetical monopolist of LCS, freed of any regulatory constraints over price, could not price local calls either at retail or at wholesale in a way that ignored the immediate, material constraint that substitution from facilities owned by

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competitors would bring. Moreover, Telstra submits that as a matter of commercial reality, the extent of those facilities is now such, and their extension so capable of prompt execution, as to mean that it does not have substantial market power in the supply of the service.

Additionally, Telstra believes that it is a matter of commercial reality that the PSTN originating and terminating access services can and are being used as an effective substitute for LCS in the relevant areas. As Telstra has noted, a very high share of telecommunications outlays in these areas are accounted for by multi-line sites. At these sites, use of PSTN access services as an alternative to LCS can be effected by the simple means of programming an access code into a PBX or key system, where necessary through an auto-dialler. Telstra submits that the extent of this substitution is such that it would make it unprofitable for a hypothetical monopolist of the LCS in these areas to increase the price of LCS durably above the competitive level, for so long as that monopolist faced a regulated price for the PSTN originating and terminating access services.

Even more plainly, the unconditioned local loop (ULL) service is a substitute for LCS. Here, following the Commission's line of reasoning, it may be admitted, for the current purpose, that LCS is not a substitute for ULL, though Telstra believes that this is not entirely correct as a matter of analysis. However, that does not imply that ULL cannot economically substitute LCS. Indeed, in Telstra's view, entities using ULL ought to be exploiting the economies of scope permitted by the copper pair, which involves joint supply of voice and data services. Telstra expects that the high absolute level of demand for data services in CBDs, and the strong growth of that demand, will encourage users of ULL to build networks that provide for integrated voice and data service.

Telstra notes that this expectation is entirely consistent with the Commission's own analysis of ULL, which has repeatedly stressed the effects ULL will have on competition in the voice service. Telstra does not believe that the Commission can exclude ULL from the relevant market for the purpose at hand without abandoning the reasoning that underpinned its decision to declare the ULL service.

As a result, Telstra submits that there are price-regulated substitutes for the local call resale service, including PSTN originating and terminating services and ULL.

Finally, with respect to the temporal dimension of the market, Telstra notes that competition is now extremely well-established in the CBDs. As a result, even a relatively short time frame would indicate that the conditions required for declaration or continued declaration are not met. However, Telstra submits that the ACCC should also take account of the positive effects exemption would have on conditions in the CBDs over the medium to longer term. More specifically, exemption would encourage the use of competing facilities to supply the full range of services, while reducing the costs and risks of regulatory failure.

3. Competition

Telstra agrees with the Commission that the concept of competition is of fundamental importance to the Act. It is plainly intended by the Act that where existing market conditions already provide for the competitive supply of services, the access regime should not impose regulated access¹. This recognises the fact that competition in supply is superior to the regulated outcome. Competition in supply means that competition will extend over a far wider range of services, compared to the relatively limited form of service re-packaging that is possible with regulated access of the incumbent's carriage services. Competition in supply also increases the rate of adoption of new technologies, increasing the likelihood of consumers enjoying the highest quality services at the lowest sustainable prices. Further, such competition will result in flexibility in pricing and service quality, which more accurately reflects demand and supply conditions, compared with the rigid terms and conditions required under regulated outcomes. Finally, competition in supply avoids the costs associated with regulatory failure, compliance and administration.

Given the clear benefits of facilities-based competition over regulated outcomes, which are recognised in the legislation, the ACCC's objective must be to determine whether competition in supply is efficient, and if so, how to best manage the transition from regulated competition to facilities-based competition. In practice, this issue translates into determining whether competition in supply is viable and the extent to which the declared carriage service and the provision of alternative facilities by competitors are substitutes.

On the one hand, it may appear prudent for the regulator to wait until there is observed facilities-based market penetration by competitors. The ability of consumers (wholesale and retail) to pick and choose among alternative facilities offered by competitors could be viewed as the ultimate test of substitutability. However, such a test is unduly conservative as it assumes that the regulated terms and conditions of access to the declared service are at present set efficiently. As the ACCC would be well aware, this is a formidable task and unlikely to ever occur in practice. This is particularly the case for the local carriage service given the considerable difficulties created by regulatory constraints on the retail pricing of the local call service. In Telstra's view, these constraints create substantial issues in terms of the pricing of the LCS, and notably in ensuring that this pricing creates incentives for efficient entry to occur on a timely basis. While the ACCC has sought to address these issues through its draft pricing principles, those principles are highly controversial, not least because they are inconsistent with the ACCC's own estimate of the efficient cost of providing the local carriage service. Because of this inconsistency, Telstra believes the principles could well undermine incentives for efficient entry and service provision by competitors.

Given the possibility that the LCS declaration could be impeding efficient, facilities-based competition from occurring, Telstra submits that a prudent regulator would exempt LCS from declaration at a point where there is a clearly viable facilities-based option. If facilities-based entry is clearly viable then the LCS exemption is essentially a one-way bet for the regulator.

- With viable facilities options underpinning the competitors' negotiating position, Telstra would be neither able nor interested in setting LCS prices at above-competitive levels. Telstra has an incentive to offer LCS at commercially competitive prices rather than drive competitors towards inefficient investment in facilities, since in the former case it retains the wholesale revenues.

¹ Trade Practices (Telecommunications) Amendment Act 1997, Explanatory Memorandum, p.41.

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- With viable facilities options, Telstra's competitors can only benefit from the declaration of LCS if they can extract lower than commercially competitive prices through the arbitration process. From the competitors' point of view, declaration is only a useful tool if it can lead to prices that are lower than they could have negotiated otherwise. Therefore, if facilities competition is clearly viable, then Telstra's proposed exemption will avoid the costs associated with setting inefficiently low access charges.

In this regard, Telstra is encouraged by the Commission's competition analysis, which is not limited to considering the level of existing competition in the wholesale supply of LCS, but is extended to examine whether the exemption will facilitate competition.

In the following subsections, Telstra addresses each of competitive indicators identified in the Commission's discussion paper. Telstra places particular emphasis on the barriers to entry as competitive supply is likely to be affected by the level of charges set for declared services, including LCS, and the uncertainty surrounding the ACCC's deliberations over the pricing principles for LCS. If the ACCC sets the charge for the declared LCS service below efficient levels then obviously the buy option becomes more attractive for potential entrants. Even if there are other benefits to entrants from investing in their own facilities, the fact that their infrastructure will be subject to the ACCC's pricing principles will discourage efficient investment if the ACCC's pricing principles set access charges too low.

Moreover, it is not necessary for investment to occur to achieve competitive outcomes. As long as the build option is viable then the threat of entry (ie contestability) alone is sufficient to restrain the pricing of Telstra's LCS service. As demonstrated in the previous section, facilities-based entry is viable in CBD areas and hence Telstra's LCS charges would be effectively constrained in the absence of the declaration. Telstra also has every incentive to continue to supply LCS if demand exists, as the alternative is complete bypass of Telstra's network, in which case Telstra secures no revenue from competitors.

3.1 Market share, new entrants and network roll-out

Telstra has three main sources of information on the current state of supply competition in CBD areas – competitor traffic information, reported information on competitor infrastructure and competitive bid information – which are summarised in this section for the ACCC's consideration.

3.1.1 [BLANKED OUT DUE TO COMMERCIAL SENSITIVITY]

3.1.2 Reported information on competitor infrastructure

Telstra has collected publicly available information on competitor infrastructure in CBD areas. This information reveals strong and increasing competition in the supply of wholesale and retail local carriage services in CBD areas.

In June 2000, Optus reported that it had 9,600 km of optic fibre cable in CBD and metropolitan areas, with cabling in areas of Sydney, Melbourne and Brisbane. In February 2000, Optus announced that it had 300,000 directly connected local telephony customers, three times the number it had one year previously, and is continuing to add 5,000 customers every week. Optus claims that with the deployment of dense wave division multiplexing along and other technologies

it is developing across its networks that it will be able to offer tailor made voice and high speed data solutions to **every** Australian business².

AAPT reports that it is constructing CBD fibre rings in Sydney, Melbourne, Brisbane, Perth, Adelaide and Canberra³. At December 1999, AAPT had laid 235 km of fibre optic cable in 6 capital cities, 130 buildings wired with 336 buildings expected to be wired by July 2000. AAPT acquired exclusive 15 year, Australia-wide, 28-31 Mhz licence in February 1999. LMDS is a broadband wireless technology that can deliver up to 100+ mbps per customer site. LMDS is a point-to-multipoint distribution service utilising microwave in the 25 GHz and higher frequencies. It requires line of sight between the central hub LMDS node and the customer building - the maximum distance being typically around 5 km. The key advantages of LMDS are its rapid deployment and high speed. AAPT will use this spectrum to deploy a LMDS network in order to gain direct access to customers. AAPT will initially build in CBD areas, but will also move into regional areas. AAPT expect to build up to 146 nodes in 2 phases over a two and a half year period. AAPT announced in March 2000 that it had 2 nodes live, one each in Melbourne and Sydney.

PowerTel Limited reports that it has recently signed an agreement with Uecomm which gives it access to buildings wired by the UEL subsidiary which provides access to a broader customer base⁴. PowerTel has recently announced that it will be extending its network to cover St Kilda Road in Melbourne, parts of Sydney metro and the Pacific Innovation Corridor link from Brisbane to the Gold Coast. By December 2000, PowerTel claims that its network will measure in excess of 2,400 kilometres. PowerTel states that the completion of its core Brisbane to Melbourne network allows the company to focus on the task of meeting its target of 325 buildings access by the end year (currently 215). PowerTel reports that its ultimate aim is to sign up over a thousand corporate customers with the majority spending between \$500k and \$1m a year on a range of mainly data but also voice services.

Uecomm reports that it has 1000 kilometres of cable within Australian capital cities⁵. Uecomm states that its network is expanding fast, in parallel with Internet growth and growing demand for e-commerce, data and video solutions. Uecomm's bandwidth solutions range from 2 Mb/s to over 1 Gb/s. Uecomm claims that it has consciously sought to network Melbourne, Sydney and Brisbane, and on its website provides network maps of each city indicating where it is already providing service and areas in progress.

One.Tel has offered CBD customers local calls at 12 cents per call and claims that it delivers this service using Telstra's local call infrastructure to any destination within the metropolitan dialling area. One.Tel claims that the customer's outbound connections from its PABX are directly connected to One.Tel's closest CBD switch using either Telstra's premium DDS Fastway service or a fibre connection from another carrier⁶. One.Tel claims that the only addition/change to the customers' current local call interface is a One.Tel provided tail circuit to its closest switch at no charge to the client.

² Cable & Wireless Optus Media Release, "Optus Expands Optical Network", 8 June 2000.

³ AAPT Business Overview 2000 Presentation.

⁴ ABN AMRO Flashnote, PowerTel Limited, Eastern seaboard link completed, 28 June 2000.

⁵ <http://www.uecomm.com.au>

⁶ One.Tel's High Quality, Low Cost Telephony Services, April 2000.

Amcom reports that it has already completed the first stage of its fibre optic network rollout in Perth, Adelaide and Darwin and has commenced a rollout in Hobart⁷. In all of these cities Amcom claims that it is negotiating access to a large and rapidly growing pool of CBD buildings. In Perth, Amcom reports that it has in excess of 200 kilometres of fibre optic cabling and claims to complete another 35 kilometres by the end of 2000. In Adelaide, Amcom has laid 22 kilometres and will complete a further 18 kilometres by the end of 2000. In Perth alone, Amcom states that it has negotiated access to some 200 buildings and work is progressing to access additional buildings in all the cities in its "last mile" program.

Davnet reports that it implements high-capacity, securely managed Internet radio or terrestrial link from hub to satellite building⁸. On its website, Davnet provides a full list of the buildings to which it currently provides access.

In addition to strong competition at the wholesale level in CBD areas, service providers are competing at the retail level for local call services using PSTN originating and terminating access services. It is clear from the offers of service providers that PSTN originating and terminating access provides a direct substitute for the declared local carriage service. For example, RSL Com offers a service called BusinessTalk 1488 that provides business customers with local calls at an untime rate of 15 cents per call⁹. To access this service, customers must dial RSL Com's over-ride code of 1488, which means that RSL Com is using PSTN access rather than LCS to provide the retail local call service. RSL Com also offers a service called EZItalk 1488 which again offers local calls at the rate of 15 cents per call using an over-ride code. Similarly, DigiPlus is currently offering local calls at 15 cents per call using a dial over-ride code (1441)¹⁰. In addition, service providers are offering timed local calls using over-ride codes further demonstrating the substitutability between LCS and PSTN access.

3.1.3 [BLANKED OUT DUE TO COMMERCIAL SENSITIVITY]

3.2 Barriers to entry

The extent of competition discussed in the previous section highlights the low entry barriers to competition in CBD areas. Another useful indication is to examine the absolute capital requirements of a new entrant. Traditionally, the key barriers to entry into the local access market have been the high costs associated with providing alternative facilities to customers. With respect to the CBD market segment, these barriers are no longer significant enough to prevent entry. To demonstrate that facilities based competition provides a viable substitute to the declared LCS in the CBD areas, Telstra has estimated the annual build cost of providing telephony services in CBD areas and compared this with the avoided costs associated with access-based entry and the additional annual revenues that a new entrant could expect to secure from providing telephony services on a facilities basis to CBD customers. This analysis suggests that in practice [BLANKED OUT DUE TO COMMERCIAL SENSITIVITY] of sites are undoubtedly viable for competitive supply of the local carriage service and it is highly likely that virtually all sites in CBD areas are viable if service providers exploit available economies of scale and scope.

⁷ <http://www.amcom.com.au>

⁸ <http://www.davnet.com.au>

⁹ <http://www.rslcom.com.au>

¹⁰ <http://www.digiplus.com.au>

For this analysis, three facilities-based options have been considered. The first case, the greenfield option, considers the extreme case where a new entrant to the local service market has no existing infrastructure and provides service to single sites on a stand-alone basis. The following two cases, the incremental service option and the multiple site option, consider more realistic scenarios by relaxing some of the assumptions in the greenfield case.

3.2.1 [BLANKED OUT DUE TO COMMERCIAL SENSITIVITY]

3.3 Market growth

In Telstra's view, of far greater relevance to competition than local call traffic growth is the huge growth in demand for data services. This is the main reason that service providers have entered the CBD market deploying their own networks, and is the reason cited by many new entrants for extending their existing infrastructure. Huge growth in data demand means that new capacity can be absorbed quickly. Hence, despite sunk costs, the risks involved in entry are low. Also, strong demand growth means that a lot of demand is effectively uncommitted - which increases the elasticity of demand and again reduces the risk associated with entry.

In addition, once service providers have infrastructure in place for providing data services, the viability threshold for providing telephony services, including local call services, is very low. Thus the rapid growth in demand for data services in CBD areas prevents Telstra from setting the price for local call service above efficient levels. Telstra suggests that in considering the proposal for LCS exemption in CBD areas the ACCC examine the current and future forecasts for demand for data services and other bandwidth intensive applications.

It is also important to note that even in the absence of the declaration current access providers will not withdraw the wholesale supply of end-to-end local calls. Given that competitive supply is clearly viable for the majority, if not all, lines in CBD areas then Telstra and other existing facilities-based entrants have every incentive to provide a wholesale local call service as long as the price for that service is set to cover efficient costs. That is, if Telstra and other access providers withhold the wholesale local call service then it is viable for new entrants to compete in supply by deploying their own infrastructure. In this case, Telstra and other access providers would forego both the wholesale and retail revenue. Clearly, access providers are better off providing the wholesale service to competitors than facing complete bypass.

4. Economic efficiency

The Commission states that, in its preliminary view, the consideration of the legitimate commercial interests of carriers in supplying the local carriage services in regard to pricing is a matter for the relevant pricing principles concerned and may not go to whether an exemption is made.¹¹ Telstra respectfully submits that the Commission's interpretation in relation to this aspect of the LTIE is entirely erroneous and if not remedied by the Commission, then any decision by the Commission on this matter would involve a clear error of law. In Telstra's view, it is simply not open to the Commission to arbitrarily pick and choose between the different LTIE criteria in assessing whether to grant an exemption in relation to the local carriage service. In assessing the case for granting an exemption, the Commission must have regard to the LTIE;¹² that is: (i) competition; (ii) any to any connectivity and (iii) investment¹³ – and the legitimate commercial interests of access providers, including their ability to exploit economies of scale and scope¹⁴ are clearly relevant to this third limb of the LTIE under the relevant provisions of the Act. There is absolutely no basis whatsoever for confining this analysis to the application of pricing principles in relation to a declared service and not considering its relevance to granting a revocation in relation to that declared service.

Rather, the formidable difficulties associated with pricing of LCS as a result of the price control arrangements are particularly relevant to economic efficiency and hence the exemption decision.

If the regulator applies a retail minus avoidable cost approach then it forces the access provider to price the service below cost. Setting the price of LCS below its efficient cost of supply distorts the consumption of the LCS service both at the wholesale and retail levels. The cost of providing LCS will exceed consumers' valuation of the service, giving rise to allocative efficiency losses. Existing access providers will be discouraged from investing in local network infrastructure as they will not be permitted to recover these costs in a competitively neutral manner. New entrants will be discouraged from competing in the supply of local carriage services because they know that the regulator will require them to sell the service below cost. The overall result being that consumers will face deteriorating local network infrastructure, congested by excessive demand. The local call market will remain characterised by the incumbent's service at a regulated price with no new innovation or flexibility in service quality or pricing.

On the other hand, if the regulator applies a TSLRIC approach then the price of LCS will be set above the current retail price, and above the retail price-cap. The ACCC appears to believe this creates competitive neutrality concerns.

Given these difficulties, any regulatory approach to LCS pricing will be distorting. Hence, the Commission should take the first opportunity possible to reduce these distortions by removing the need for regulated pricing of LCS. Telstra's application for LCS exemption in CBD areas provides this opportunity.

¹¹ ACCC (2000), p.23.

¹² See section 152AS(4) of the Act.

¹³ See section 152AB of the Act.

¹⁴ See section 152AB(6)(b) of the Act.

5. Class exemption and possible variation of declaration

In addition to calling for comment in relation to Telstra's application for individual exemption from its standard access obligations in relation to specified CBD areas the Commission has sought submissions from interested parties with respect to:

- the making of a class exemption pursuant to section 152AS of the Act on terms similar to those expressed in Telstra's individual exemption application; and
- whether and when it should consider variations to the Local Carriage Service declaration pursuant to section 152AO of the Act.

5.1 Class exemption

Section 152AS of the Act provides that the Commission can determine that each member of a specified class of carrier or carriage service provider be exempt from any or all of the standard access obligations applying to a declared service.

In its Discussion Paper, the Commission indicated that it had decided to consider in conjunction with Telstra's individual exemption application, a class exemption under section 152AS of the Act with respect to current and future carriers supplying the local carriage service in relevant CBDs. The rationale given by the Commission for considering a class exemption was that:

"If an individual exemption is provided to Telstra, it is appropriate to consider a class exemption, as the reasons for providing an individual exemption to the largest carrier may suggest that other carriers should likewise be exempted." (page 3 of Discussion Paper)

Telstra agrees that in the event that the Commission is satisfied, for the purpose of section 152AT(4) of the Act, that it is in the long term interests of end users for exemption to be granted in relation to the supply of the local carriage service in specified CBD areas, because of the reasonable availability of alternative infrastructure to supply competing services to end-users, then equally it may be in the long term interests of end-users for the owners of such infrastructure also to be exempted, on either a class or individual basis, to ensure that facilities-based competition in those areas proceeds on a competitively neutral basis as regards the obligation to meet requests for access.

Telstra submits however that the appropriate time for the Commission to enquire into this question is after it has completed investigating and has determined Telstra's individual exemption application. When the Commission declared the service it consciously included within the scope of the declaration all carriers or carriage service providers who may from time to time own infrastructure which could be used to supply competing local call services. In doing so, the Commission considered that until facilities-based competition was sufficiently mature, the long-term interests of end-users were more likely to be advanced by all potential access providers being subject to the declaration. It follows logically that if the Commission was to conclude, in relation to Telstra's application for individual exemption, that facilities-based competition is insufficiently developed to warrant exempting Telstra, then all other things being equal, such competition must be insufficiently developed to warrant exempting other access providers as well.

This is not to say, as the Commission recognised in its declaration decision, that circumstances might arise in which individual carriers or carriage service providers, or a class or classes of such persons sharing common characteristics, might seek and be granted individual or class exemption. The kinds of situations which the Commission gave as examples where such exemption might be granted in relation to such persons were where the declaration in respect of such persons is having

an adverse impact on economically efficient investment, or where requiring a new entrant to supply services, including the local carriage service, to other service providers is impacting on the viability of investment in alternative customer access infrastructure.

However, there is no suggestion that either of these situations arises here such as to provide a justification for a class exemption for other infrastructure owners. Indeed, Telstra is unaware of any other carrier or carriage service provider who might be the subject of the class exemption, who is presently supplying the local carriage service, or even subject to an access request in relation to the service, in the specified CBD areas. Assuming this to be the case, then there is no apparent basis upon which the Commission might satisfy itself that at the present time it would be in the long-term interests of end users to exempt such persons, there clearly being no basis for any suggestion that by not exempting such persons end-users' long term interests might be harmed. Such harm could only potentially arise, in Telstra's view, once the Commission has exempted Telstra.

For the above reasons, Telstra respectfully submits that the Commission should decline to further investigate the possible making of a class exemption as outlined in the discussion paper, at least until it has determined to exempt Telstra pursuant to its individual application.

5.2 Possible variation of declaration

In its exemption application, dated 7 June 2000, Telstra noted that this is one of several proposed applications for exemption orders designed to phase out Telstra's standard access obligations relating to the supply of local carriage services over a 12-month period. The application indicated that this reflected Telstra's expectation that facilities-based alternatives would become available progressively over that period as a means of competition for local services.

In its discussion paper, the Commission noted Telstra's intentions and stated that:

"This raises the issue of whether it would be preferable for the Commission to consider a further series of exemption applications or alternatively hold a public inquiry into possible variations to the local carriage service declaration." (Discussion Paper, page 8).

The Commission also indicated that it considered that establishing a future timeframe in which it would consider possible variations to the local carriage service declaration would increase certainty for carriers and service providers, which may be particularly important for the future investment decisions of existing carriers and new entrants.

For these reasons, the Commission sought comment on the appropriate timing for consideration of possible variations to the local carriage service, if any.

In general, Telstra considers that it is premature for the Commission at this point in time to establish a public inquiry into the possible variation, or a revocation, of the local carriage service declaration, or even to establish a timetable for such an inquiry.

An important consideration is that the potential for infrastructure-based competition is likely to develop at different rates in different geographic areas. We have already witnessed this in the accelerated development of facilities-based options in CBD areas, where customers are far more highly concentrated and entry costs are therefore lower. Telstra anticipates that this trend will continue with the economics of new entrants' business case pushing them towards building infrastructure selectively so as to target high value, low cost customers.

In this regard, while there remains some uncertainty about precisely how facilities-based competition is likely to evolve, it is relatively clear that the next significant development in this

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area is the availability of the unconditioned local loop (ULL) service to provide voice and data services to customers in non-CBD areas. Telstra's present best estimate is that the availability and operation of the ULL service will be sufficiently developed to justify Telstra to make a further exemption application in relation to relevant metropolitan areas by late calendar 2000 or early 2001. Follow up applications, the scope and precise timing of which are presently uncertain, will be lodged progressively thereafter, with a tentative target date for removal of all SAOs by the end of calendar 2001.

In the present circumstances, Telstra does not consider it appropriate for the Commission to speculate, in the context of a costly public enquiry, about the likely timing of variations or a revocation of the declaration. Far from increasing certainty as the Commission has suggested it would, such an inquiry, if initiated now, could only serve to confuse carriers and service providers who might be considering making investments, given the necessarily partial and qualified nature of any conclusions or views which the Commission could express in such a context, about how competition outside the CBD areas might develop over the coming period.

Telstra considers by far the preferable course in the circumstances is for the Commission to finalise its consideration of Telstra's present application for exemption in relation to CBD areas where it is submitted there is clear evidence of viable supply competition based upon service providers' own infrastructure, before considering further how best to deal with remaining areas.

In relation to the remaining areas, it becomes much more difficult for the Commission to anticipate market developments, although Telstra's present expectation is that the process of dismantling the standard access obligations outside relevant CBDs, whether through a series of further exemption applications, or through a public enquiry into variation or revocation, should occur by the end of calendar 2001.

Finally, Telstra notes the suggestion in the passage extracted above from the Commission's discussion paper that it considers the further series of exemption applications foreshadowed in Telstra's first application, and a public inquiry into the variation or revocation of the declaration, to be alternatives between which the Commission might choose. Telstra disagrees. Clearly an individual exemption application is an appropriate vehicle for the Commission to consider the question of the desirability of the SAOs continuing to apply in a geographically or otherwise limited class of cases (as is the case here, and as is likely to be the case with respect to Telstra's forthcoming application based on ULL availability). Moreover, the Commission has a duty under section 152AT of the Act, to determine any such application (including the present application), regardless of whether it initiates a separate inquiry into the variation or revocation of the declaration.

In summary, in Telstra's view, the Commission's consideration of establishing such an enquiry ought await further market developments, and certainly should not commence before later calendar 2000 or early 2001, at which time Telstra proposes to review market conditions with a view to lodging a further exemption application at that time if appropriate.

6. Answers to the ACCC's specific questions

Is there a market that involves the wholesale supply of the local carriage service by carriers to themselves and other carriers?

See Section 2.

How should CBD areas be described?

In Telstra's view, CBD areas should be defined as proposed in Telstra's application for exemption.

What substitute technologies are currently used to provide the local carriage service, or are substitutes for the local carriage service in the CBD areas? What technologies are likely to be used to supply the local carriage service or local calls in CBD areas in the foreseeable future?

In Section 3.1 of the submission, Telstra identifies some of the technologies that are currently being used by service providers to service CBD areas. PSTN access is also a substitute for LCS in CBD areas and Section 3.1 of the submission identifies cases where service providers are using PSTN access to provide retail local call services. In Telstra's view, optical fibre technologies are likely to be the dominant technology for supplying services in CBD areas, at least in the short-term, given the high and rapidly increasing bandwidth requirements of CBD customers. However, other wireless technologies are also clearly viable substitutes, already being used by service providers in CBD areas to compete for voice and telephony services.

Since the Commission's report on Local Telecommunications Services, have new carriers begun supplying the local carriage service at a wholesale level? If so, what technologies are being used by the new carriers to supply the local carriage service, or local calls, and has entry occurred in CBD areas (if so, in which CBD areas)?

Telstra does not have information on the availability of the local carriage service at the wholesale level, however, there is substantial evidence in Telstra's submission that substitute services and infrastructure options are available and viable alternatives to LCS.

Are there likely to be further new carriers supplying the local carriage service at a wholesale level in the foreseeable future? What type of technologies would new carriers be expected to use, and would entry be expected in the CBD areas (if so, in which areas)?

As shown in Section 3.1 of Telstra's submission, the growth in competitor activity in CBD areas has increased dramatically over the past 12 months. There is no reason to expect that this activity will slow in the foreseeable future. Regarding the type of technologies that new carriers would be expected to use see Section 3.2 and 3.1 of Telstra's submission and the answer to question 3 above.

What level of local call resale competition is occurring in CBD areas and is it expected to increase in the foreseeable future?

Telstra does not have information on the level of LCS competition in CBD areas, however, Telstra has provided substantial information in this submission demonstrating the vigorous level of competition that is occurring in CBD areas and the viability of competing on a facilities basis, both at the wholesale and retail layers.

Would providing an individual and/or class exemption change the incentives for carriers supplying the local carriage service at a wholesale level or new re-sellers supplying local calls at a retail level? If so, how?

Given the strong network competition in CBD areas it is highly unlikely that the exemption of LCS in CBD areas would effect the incentives for supplying LCS at the wholesale level or new resellers

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supplying local calls at the retail level. As explained in Telstra's submission, the viability of facilities-based competition means that access providers will continue to supply services at the wholesale level to secure wholesale revenues rather than face complete bypass. Further, as discussed in Section 4 of Telstra's submission, the LCS exemption is likely to increase wholesale competition. Consequently, it is difficult to understand how the proposed exemption could reduce the efficient incentives for supply local calls at the retail level.

Are the sunk costs associated with rolling out new networks a significant barrier to entry for carriers supplying the local carriage service at a wholesale level in CBD areas? Do the sunk costs differ substantially between different technologies?

See Section 3.2 of Telstra's submission.

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?

The lack of complex local number portability (LNP) up to November 1999 may have been perceived by some parties as a barrier to entry for new carriers, however, Telstra is now required to provide complex LNP and currently does so. Moreover, as discussed in Section 3.1 of Telstra's submission, new entrants have been extremely successful in winning bids for large CBD customers and in Telstra's view this, together with the other evidence provided in Section 3.1, demonstrates the fact that the barriers to entry for new carriers are extremely low.

Are there any barriers to entry for new re-sellers supplying local calls at a retail level?

Telstra does not believe that there are any barriers for new re-sellers supplying local calls at the retail level.

Has there been growth in the demand for local calls in CBD areas since the local carriage service was declared (if so, in which CBD areas)? If so, has the growth been captured by incumbent carriers or new market entrants?

See Section 3.3 of Telstra's submission.

Is it expected that there will be growth in the demand for local calls in CBD areas over the foreseeable future (if so, which CBD areas)?

See Section 3.3 of Telstra's submission.

Since the Commission's report on the Local Telecommunications Services, what has been the impact of the declaration on the legitimate commercial interests of the carriers supplying the local carriage services at a wholesale level (Telstra and other carriers)?

As Telstra has demonstrated in past submissions to the ACCC in other contexts, the LCS declaration has forced Telstra to incur losses in the supply of LCS.

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

The impact on the legitimate commercial interests of carriers supplying LCS if the proposed exemption was provided would, in Telstra's view, be minimal. In CBD areas, competition in supply determines the price for telephony services. However, Telstra believes that the LCS exemption in CBD areas will send important signals to new carriers in terms of the future scope of the declaration in other areas of Australia. As explained in Section 4 of Telstra's submission, the

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exemption is likely to encourage carriers to undertake efficient investment, as they will be able to recover the costs of their investments.

What are the views of industry participants, and the general public, as to the appropriate timing for consideration of possible variations to the local carriage service declaration, if any? Using the same framework as provided in section 4 of this discussion paper, what considerations are used to support these views?

See Section 5 of Telstra's submission.

Over what geographic area should the inquiry, or inquiries, be focused?

See Section 5 of Telstra's submission.