



**Submission by AAPT Limited and PowerTel Limited to the
Australian Competition and Consumer Commission in
response to
*Telstra's local carriage service and wholesale line rental
exemption applications*
*Draft decision and Proposed Class Exemption, April 2008***



Introduction

1. AAPT Limited and PowerTel Limited (together **AAPT**) welcome the opportunity to comment on the Australian Competition and Consumer Commission's (the **Commission's**) April 2008 draft decision and proposed class exemption (**proposed exemption**) relating to Telstra's wholesale line rental (**WLR**) and local carriage service (**LCS**) exemption applications (**exemption application**).
2. AAPT is stunned by the proposed exemption and considers that, while certainly a moderation on Telstra's ludicrous exemption application claims, it is nevertheless illogical, apparently lacking an understanding of the commercial realities faced by the industry, seemingly ideologically driven (ie infrastructure based competition is better, regardless of circumstance) and ultimately harmful to competition in retail voice markets.
3. AAPT considers that removing a critical rung on the ladder of investment while most access seekers are still standing on it and while the next rung-up is in the process of being sawn off is not and can not be in the long term interests of end users (**LTIE**).
4. Finally, the Commission's reference to Part XIB of the *Trade Practices Act 1974* (**TPA**) as a form of safety net should Telstra misbehave if the proposed exemption goes ahead offers no comfort whatsoever to AAPT. Part XIB has a number of significant issues which render it practically useless. AAPT considers that any Part XIB safety net is essentially illusory in nature.

The Commission has developed a fundamentally flawed test for determining whether or not the granting of the exemption will promote the LTIE

5. AAPT considers that the Commission has made a number of errors leading to a fundamentally flawed test for determining whether or not the granting of the exemption will promote the LTIE. Specifically:
 - the Commission has wrongly concluded that the ULLS is a substitute for WLR and LCS, ie that an access seeker utilising a ULLS is necessarily able to use that ULLS to provide voice services that can compete with Telstra;
 - the Commission has apparently relied, at least partly, on the approach adopted by Ofcom in the UK to the roll back of *ex ante* regulation but in doing so has referred to an outdated version of a document setting out that approach which has since shifted in a significant way;
 - the Commission has wrongly assumed the proposed exemption will lead to greater investment in ULLS based infrastructure; and
 - if, in the unlikely event the proposed exemption does lead to greater investment in ULLS based infrastructure, the Commission has wrongly concluded that the long term benefits of such an investment will outweigh the short term efficiency losses.
6. In short, if the Commission proceeds with the proposed exemption, AAPT considers that the only beneficiary will be Telstra which will be able to leverage the exemption in its commercial negotiations with access seekers to extract even greater supra-normal profits.

The 152AT test

7. The Commission notes in the draft decision that it has applied the test set out in section 152AT of the TPA to the exemption application, ie **will granting the exemptions promote the LTIE**. In doing so the Commission has had regard to the objectives set out in 152AB(3) of the TPA, most importantly the promotion of competition and the efficient use of and investment in infrastructure¹.
8. AAPT acknowledges that this is the right test to apply but submits that this is a strict test requiring the Commission to be satisfied that the exemption sought **will in fact** promote the LTIE. This is a higher threshold than for example a requirement that the Commission be satisfied that the exemption is **likely** to promote the LTIE and AAPT notes that the word “**likely**” is quite frequently used in the proposed exemption. AAPT is concerned that the Commission may have misapplied the 152AT test in this regard.

Telstra has significant market power in the relevant markets

9. The Commission considers and AAPT agrees that the markets relevant to the exemption application are²:
 - the wholesale market for the supply of wholesale fixed voice services to access seekers (the **upstream market**); and
 - the retail market for the supply of a bundle of fixed voice services to consumers (the **downstream market**).

¹ Proposed exemption, page 2

² Proposed exemption, page 44

10. The Commission concludes and AAPT agrees that Telstra has significant market power in the relevant upstream market and that while competition is increasing in the retail fixed voice market, competition is still not fully effective at the retail level with Telstra still accounting for 75% of basic access services in the exemption areas³.
11. AAPT considers that granting relief to Telstra from regulated access to WLR and LCS when Telstra has significant market power in both the relevant upstream and downstream markets is simply nonsensical and contrary to the approach adopted by Ofcom in the UK (as discussed in more detail below).

The promotion of competition

12. The Commission notes and AAPT agrees that when considering whether to grant the exemption, a key issue to consider is the extent to which access seekers can compete in downstream markets for fixed voice through use of the ULLS in the absence of regulate access to WLR and LCS.
13. The Commission goes on to state that⁴:
- increased ULLS based provision of voice services will be in the LTIE as it will enable competitors to compete on greater dimensions of supply leading to more sustainable competition compared to pure resale models in the longer term; and
 - increased ULLS based competition may also stimulate the provision of WLR and LCS from ULLS based competitors seeking to exploit unused capacity on

³ Proposed exemption, page 4

⁴ Proposed exemption, page 5

their ULL based networks which could provide increased competitive tension at the wholesale level and possibly constrain Telstra's ability to price WLR and LCS services at supra-competitive levels.

14. AAPT agrees that infrastructure based competition is in general better for consumers in the longer term than a pure resale model. However, AAPT does not consider that trying to force, at this point in time, an increase in ULLS based provision of voice services by removing regulated access to WLR and LCS is in the LTIE.
15. AAPT considers removal of regulated access to WLR and LCS will not in fact lead to an increase in ULLS based infrastructure. AAPT (along with most if not all other access seekers) is currently questioning any further investment in DSLAMs given the current real risk of having those assets stranded by a fibre to the node (FTTN) network. Removing regulated access to WLR and LCS at this time is unlikely to have any impact on these investment deliberations.
16. The Commission notes the significance of re-sale services such as WLR and LCS in facilitating the growth in take-up of ULLS competition, however, the Commission also notes that it is mindful that ongoing regulation of WLR and LCS may hinder the extent and speed of transition to ULLS based competition.
17. AAPT agrees that WLR and LCS have facilitated growth in the take up of ULLS based competition but strongly disagrees that ongoing regulation of WLR and LCS may hinder the extent and speed of transition to ULLS based competition and notes that the Commission has not pointed to any evidence on which to base such a view. In fact the Commission itself even acknowledges that "*over the last 12 months ULLS based provision has increased by over 100% and appears to be in a*

*highly dynamic growth phase*⁵. AAPT notes that this dynamic growth phase has in fact developed during a period of regulated access to WLR and LCS and considers that this is quite compelling evidence that regulated access to WLR and LCS is not hindering ULLS take up at all.

18. In addition, AAPT considers that there are many other practical and commercial factors influencing the use of ULLS for the provision of voice services. AAPT, for example, can use the ULLS to provide voice over DSL (**VoDSL**) services but only by deploying an Integrated Access Device (**IAD**) at the customer's premises. While this may be suitable for AAPT's business customers, it may have only limited application, if at all, in the residential market. There are also many other hurdles to overcome before AAPT could reasonably consider the ULLS as a substitute for WLR and LCS such as the development of a suitable LSS to ULLS migration process, the requirement for a Cat D port of the customer's local number and a number of internal IT and process issues to address.
19. In the meantime, while these various practical and commercial issues are being addressed, AAPT needs to be able to bundle Telstra's WLR and LCS wholesale services with long distance and broadband services using its own infrastructure to offer competition in the retail market with consumers being the ultimate beneficiary.

The Commission's formulation of the appropriate test

20. In assessing whether granting the exemptions will promote competition, the Commission has undertaken an analysis and formed a view on the exchange

⁵ Proposed exemption, page 98

service areas (**ESAs**) in which ULLS based entry and effective competition is likely to occur in the absence of regulated access to WLR and LCS.

21. The Commission considers that the use of an SIO threshold that provides an addressable market that can support at least four competitors (including Telstra) may be the appropriate benchmark for it to be satisfied that the removal of WLR and LCS would promote the LTIE⁶.
22. The Commission concludes that the use of ESAs with greater than 14,000 SIOs (determined after subtracting lines affected by pair gain systems and RIMs) is an appropriate generalised proxy for when effective ULLS based competition may be viable and where removal of WLR and LCS declaration will promote the LTIE⁷.
23. Based on the fact that some ESAs have more than four ULLS based competitors (including Telstra) but a total number of SIOs below 14,000, the Commission then goes on to conclude that those ESAs must also be attractive for ULLS based competition and the Commission is therefore satisfied that to include these ESAs in the list of ESAs likely to attract further ULLS based competition on the granting of the exemption application⁸.
24. On this basis , the Commission concludes that granting the exemption will promote the LTIE in those ESAs which⁹:
 - have more than 14,000 SIOs (excluding those effected by pair gain systems or RIMs); **or**
 - have four or more ULLS based competitors (including Telstra).

⁶ Proposed exemption, page 102

⁷ Proposed exemption, page 103

⁸ Proposed exemption, page 103

⁹ Proposed exemption, page 104

25. AAPT considers that the Commission's formulation of the appropriate test for assessing whether or not the granting of the exemption will be in the LTIE is flawed.
26. AAPT considers that the Commission has failed to distinguish ULLS based infrastructure deployed to provide only broadband services and the difficulties in using that same infrastructure to provide voice services.
27. The mere presence of four ULLS based infrastructure operators (including Telstra) in a particular ESA does not mean that those operators (other than Telstra) are ready or even able to provide voice services to customers in that ESA. Most of the ULLS based operators have established DSLAM infrastructure in ESAs to provide only broadband services to customers.

The Commission has apparently relied on an outdated Ofcom position

28. The Commission notes that in the UK, Ofcom (based on its 2006/07 review of wholesale broadband access markets) has determined that ex ante regulation should be removed in ESAs where there are four or more competitors (including the incumbent) and where the ESA serves more than 10,000 homes and businesses¹⁰.
29. AAPT notes that Ofcom has since released its May 2008 review of wholesale broadband access markets (admittedly this was after the Commission released its proposed exemption) where it concluded that removal of ex ante regulation of wholesale broadband access was appropriate in areas where there are four or more

¹⁰ Proposed exemption, page 102

operators **and** where no operator holds significant market power (the so called “Market 3” area).

30. AAPT notes that this is quite different from the test which the Commission proposes to apply in this case, ie deregulation is appropriate where there are four or more operators **or** the number of addressable SIOs is greater than 14,000. This approach makes no reference to significant market power in the relevant market.
31. AAPT considers that the Commission should reassess the proposed exemption in view of the UK approach and the fact that Telstra has significant market power in both the relevant upstream (wholesale) and downstream (retail) markets.

The efficient use of and investment in infrastructure

32. The Commission considers that it is satisfied that removal of WLR and LCS regulation in the proposed exemption areas is likely to, on the whole, encourage access seekers to invest in ULLS based DSLAM/MSAN infrastructure, and that, if they did so, this would be an efficient outcome.
33. AAPT strongly disagrees. Access seekers are unlikely to invest in DSLAMs/MSANs at present due to the very high level of uncertainty relating to imminent roll out of a FTTN network and the anticipated stranding of DSLAM/MSAN assets in the near future.
34. The Commission also notes that while there may be some allocative and/or productive efficiency losses in the short term (in the event of access seekers having to commercially negotiate for a WLR and LCS service or at the extreme

exiting the market altogether), these would be outweighed by the long term benefits flowing to consumers from the increased ULLS based competition¹¹.

35. AAPT considers that the Commission has correctly identified that the exemption would result in allocative and productive efficiency losses in the short to medium term. However, AAPT submits that the Commission has incorrectly assumed that these would be outweighed by the long term benefits to consumers as there wont be any long term benefits because the ULLS based infrastructure will be made redundant in the medium term by a FTTN network.

36. The Commission also considers that the exemption may encourage ULLS based access seekers to make greater use of their DSLAM investments perhaps to offer wholesale voice, ie it would encourage efficient use of existing infrastructure¹².

37. AAPT does not consider that ULLS based access seekers are under utilising their DSLAM investments. AAPT invests very carefully in DSLAM infrastructure and only up to a level sufficient to meet its own requirements.

The efficient use of and investment in infrastructure

38. AAPT (along with many other access seekers) remains dependent on the acquisition of WLR and LCS from Telstra in metro areas (these services continue to exhibit bottleneck characteristics) and AAPT urges the Commission to engage in a fundamental rethink of its approach to the assessment of the exemption application.

¹¹ Proposed exemption, page 7

¹² Proposed exemption, page 7