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SUBMISSION ON BEHALF OF THE COMPETITIVE CARRIERS' COALITION, INC. IN RELATION TO TELSTRA'S DECLARATION EXEMPTION APPLICATIONS

Overview

Telstra Corporation Limited ("**Telstra**") has lodged with the Australian Competition & Consumer Commission (the "**Commission**") a number of applications for exemptions from standard access obligations ("**SAOs**") in relation to the following services: the Wholesale Line Rental ("**WLR**") service, the Local Carriage Service ("**LCS**"), the Public Switched Telephone Network Originating Access ("**PSTN OA**") service, the Domestic Transmission Capacity Service ("**DTCS**") and a number of services within a defined geographical area in relation to Optus' HFC network (the "**Exemption Applications**").

This submission is made on behalf of the Competitive Carriers' Coalition, Inc. (the "**CCC**") in relation to all of the Exemption Applications, although it principally focuses on the Exemption Applications relating to WLR/LCS and PSTN OA. This submission addresses the following aspects of Telstra's Exemption Applications:

(a) in order for the Exemption Applications to be accepted by the Commission, Telstra must satisfy the Commission that the relevant exemptions will positively promote the long-term interests of end-users (the "**LTIE**"); and

(b) Telstra has not satisfied the test in (a), above.

The Exemption Applications are made pursuant to section 152AT of the *Trade Practices Act 1974* (Cth) (the "**TPA**"). Relevant sub-sections of section 152AT provide as follows:

> *Application for exemption order*
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> (1) A carrier or a carriage service provider may apply to the Commission for a written order exempting the carrier or provider from all or any of the obligations referred to in section 152AR.
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> *Commission must make exemption order or refuse application*
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> (3) After considering the application, the Commission must:
>
> (a) make a written order exempting the applicant from one or more of the obligations referred to in section 152AR; or
>
> (b) refuse the application.
>
> *Criteria for making exemption order*
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> (4) The Commission must not make an order under paragraph (3)(a) unless the Commission is satisfied that the making of the order will promote the long-term interests of end-users of carriage services or of services provided by means of carriage services.

Exemption orders

(5) An order under paragraph (3)(a) may be unconditional or subject to such conditions or limitations as are specified in the order.

The proper application of sub-section 152AT(4)

The CCC submits that the test in sub-section 152AT(4) of the TPA is a strict test and represents a high hurdle to be overcome by Telstra, for the following reasons:

(a) the test represents higher hurdle than other tests in Part XIC of the TPA. For example, the test which the Commission is to apply when determining whether the terms of a proposed access undertaking are reasonable (under section 152AH) requires the Commission to "have regard to whether" the proposed terms promote LTIE, as one of a number of relevant considerations. However, sub-section 152AT(4) requires the Commission not merely to have regard to whether certain requirements have or have not been satisfied, but requires the Commission not to make the exemption orders *unless* it is so satisfied. The CCC submits that this in turn means the evidentiary burden to be overcome in order to satisfy the test in sub-section 152AT(4) is very high;

(b) the test requires that the Commission must be *positively satisfied* that the exemption sought will promote the LTIE. In *Re Application by Telstra Corporation Limited* [2006] ACompT 4,[1] the Australian Competition Tribunal (the "**Tribunal**") took the approach that a requirement that the Commission "must not accept" an access undertaking unless it was satisfied as to certain criteria, as requiring that the Commission (and on review, the Tribunal) be "affirmatively satisfied" that those criteria had been satisfied.[2] In applying this approach to the present matter, the CCC submits that the Commission must not make the requested exemption orders unless it is positively satisfied that the exemption will promote the LTIE. It is therefore not merely a matter of being satisfied on the balance of probabilities, but requires the Commission to be satisfied to a very high degree of certainty before making the exemption orders;

(c) the test is a strict test, rather than a discretionary one. Again, it requires that the Commission *must* be satisfied that the exemption sought will promote the LTIE, rather than giving the Commission a discretion as to the matters on which it may be satisfied;[3]

(d) the Commission must be satisfied that the exemption sought *will* promote the LTIE. This further requires the Commission to be satisfied to a very high degree of certainty, as opposed to it merely being satisfied that the exemption sought "may" or "is likely to" promote the LTIE. In this regard, the CCC notes that much of the so-called evidence provided by Telstra in support of its Exemption Applications is not evidence at all, but merely speculation. Indeed, Telstra posits in its submissions in support of the Exemption Applications that the exemptions sought could, in certain circumstances, or at some point in time, promote competition and efficiency in the abstract; this is far short of the requirement that the exemptions sought *will*, with certainty, promote the LTIE. Upon close examination it becomes clear that Telstra has in fact provided no evidence that the exemptions sought *will* promote the LTIE;

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[1] The "**Telstra LSS case**".
[2] Telstra LSS case, paragraph 8.
[3] *Cf.* sub-section 33(2A) of the *Acts Interpretation Act 1901* (Cth), which provides that where an Act provides that a person, court or body may do a particular act or thing, and the word ***may*** is used, the act or thing may be done at the discretion of the person, court or body.

(e) Telstra bears the onus of proving that the test in sub-section 152AT(4) has been satisfied. The CCC submits, with respect, that the Tribunal expounded the correct approach in the Telstra LSS case (albeit in the context of an access undertaking, but applying corresponding principles):

> Telstra was well aware that the statutory scheme required the Commission (and on review the Tribunal) to be satisfied affirmatively of the reasonableness of the terms and conditions of the access undertaking proffered by Telstra before it could approve the access undertaking. Not only was Telstra aware of the fact that it bore this onus…[4]

Do the exemptions sought by Telstra promote the LTIE?

Promotion of competition

Telstra argues in its submissions in support of the Exemption Applications that the presence of at least one competitor's DSLAM (and in many instances, multiple competitors' DSLAMs) in each ESA covered by the Exemption Applications means that there is "workable competition" in the markets for retail services being supplied by WLR/LCS and PSTN OA. The most relevant of such retail services is fixed-line voice telephony services.

However, the CCC submits that this approach is overly simplistic: "workable competition" is not simply a function of the number of competitors in a market. Rather, the appropriate question in the present context is whether granting the exemptions is likely to create the conditions or environment for improving competition. In short, will the competitive environment for fixed-line voice telephony services be better with or without Telstra being required to supply WLR/LCS and PSTN OA in the relevant ESAs?

This approach is supported by various *dicta* by the Tribunal.

In *Re Application by Sydney International Airport* [2000] ACompT 7,[5] the Tribunal said:

> The Tribunal does not consider that the notion of "promoting" competition in s 44H(4)(a) [in Part IIIA of the TPA] requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of "promoting" competition in s 44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.
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> …
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> In reaching a view as to whether increased access "would promote competition", the Tribunal must look to the future on a similar basis to the way it looks at the authorisation provisions, namely the future with or without declaration. Clearly, the Tribunal must have regard to the factual position as it now stands, with the tender process completed and Jardine and Ogden selected. But it must also determine what impact, if any, declaration would have on competitive conditions over and above the post-tender outcomes.[6]

In *Re Application by Telstra Corporation Limited* (No.3) [2007] ACompT 3,[7] the Tribunal said:

> Competition is a process, rather than a situation: *Re Queensland Co-Operative Milling Association and Defiance Holdings* (1976) 8 ALR 481 at 514-515. It is the way in which firms interact, and respond to each other, to ensure they best achieve their individual objectives. Under traditional economic theories of the firm, firms are normally considered to operate with the objective of maximising profits. In general, it is

[4] Telstra LSS case, paragraph 20.
[5] The "**Sydney Airport case**".
[6] Sydney Airport case, paras 106 and 111.
[7] The "**Telstra ULLS case**".

assumed that firms with this objective will compete to win market share from each other. In turn, competition between firms in this way is desirable from a consumer perspective because it creates incentives for firms:

- to lower their prices towards their costs of production in order to attract more consumers to their business so that they can expand their market share; and
- to seek greater productive efficiencies (now and over time) so that they may lower their costs of production. In turn, this enables them profitably to lower prices for consumers in ways that will attract more consumers to their business in order to increase their share of the market.

It is in the interests of consumers that efficient producers of services survive the process of competition as they ensure that a given service can be profitably produced at the lowest possible cost. In turn, efficient producers are able profitably to provide services to consumers at lower prices. The process of competition allows efficient suppliers to survive and displace less efficient suppliers in well functioning markets. Inefficient suppliers will produce their services at a higher cost than their rivals. They will be unable profitably to lower the prices they set for consumers to the same level as more efficient producers, with the consequence that they will be unable to win consumers and will therefore be forced out of the market. If, however, efficient suppliers are unable for other reasons to remain in the market, prices will not reduce to levels consistent with the costs of the efficient suppliers.

Accordingly, we believe it is important not to confuse the objective of promoting competition with the outcome of ensuring the greatest number of competitors. That is, the Act aims to promote competition because of the benefits that result from the process of competition, such as lower prices for consumers and the displacement of inefficient suppliers by efficient suppliers of services. As the Tribunal observed in *Sydney International Airport* (supra) at par [108]:

> "The Tribunal is concerned with furthering competition in a forward looking way, not furthering a particular type or number of competitors."[8]

And in *Re Application by Services Sydney Pty Ltd* [2005] ACompT 7,[9] the Tribunal said:

> The aim is not to ensure that the greatest number of competitors – irrespective of their level of efficiency – can enter and successfully remain in relevant markets. Rather, it is to ensure the existence of the conditions necessary to promote effective competition.[10]

Efficient investment

Particularly in markets where there is nascent competition (such as the developing market for voice services supplied by means of DSLAM infrastructure), the existence and continued application of SAOs in relation to a declared service is important to maintain pressure on firms to supply inputs and provide services in an efficient manner. So, with WLR/LCS and PSTN OA, the CCC submits that exempting Telstra from the SAOs at this stage of the development of competitive infrastructure is likely to threaten the ongoing development of a competitive market and to dramatically restrict the ability of competitors to engage in efficient investment.

The Commission made the following observations in the LSS Pricing Principles (albeit in the context of the declaration of a different declared service, but applying relevant principles):

> …Further, in the absence of declaration (or the threat thereof) it is also unclear whether Telstra would have an incentive to agree to terms and conditions consistent with the LTIE into the future. To the extent that Telstra might have an incentive to set terms and conditions in a fashion different to that which one might expect in a competitive markets [*sic.*] for this service, declaration can serve to provide a means to remedy this form of market failure. This is particularly important as the Commission believes any moves by an

[8] Telstra ULLS case, paras 96-100.
[9] The "**Services Sydney case**".
[10] Services Sydney case, para 136.

> access provider to set terms and conditions differently to those that would arise in competitive markets would be likely to prevent participants in downstream markets from competing with Telstra effectively in those markets. This would be likely to reduce allocative and dynamic efficiency in these markets since it will impact on competitors' ability to offer innovative and higher quality products to consumers and limit the extent to which the prices of final services consumed by end-users reflect the efficient costs of their production.[11]

Telstra has provided insubstantial and inclusive evidence to support the Exemption Applications

The CCC submits that Telstra bears the onus of proving that the Exemption Applications ought to be accepted and it has not discharged that onus:[12] Telstra has provided no cogent evidence that the exemptions sought *will* promote the LTIE.

The most relevant retail service in the context of this matter is the fixed-line voice telephony service. The CCC submits that, were the Commission to grant the exemptions sought, Telstra would then either refuse to supply WLR/LCS and PSTN OA, or it would substantially increase the prices of those services. This would, in turn, dramatically reduce the degree of competition and efficient investment in the retail market for fixed-line voice telephony services.

In the *Local Services Review – Final Decision* (July 2006), the Commission noted that given the lack of widespread facilities-based competition to the LCS, service providers resupplying Telstra's services were likely to be the main source of retail market competition for local telephony services. It considered that declaration would mandate access to the LCS on reasonable terms, constrain Telstra's ability to influence competition in the retail local telephony market and promote competition in the long-distance telephony market because of bundling.

The Commission refers in its discussion paper in relation to Telstra's WLR and LCS Exemption Applications (the "**WLR/LCS Exemption Application Discussion Paper**")[13] to a number of different technological "options" available for providing fixed-line voice telephony services in the absence of WLR/LCS.[14] The CCC notes that, in spite of such "options" existing, and whilst they represent potential future direction for the voice telephony market, there is currently no compelling evidence (sufficient to satisfy the strict test in sub-section 152AT(4)), that end-users have (or are likely in any quantifiable future period to have) taken up such services in sufficient quantities to justify displacing WLR/LCS and PSTN OA. In short, the Commission cannot be satisfied to the requisite degree as required by sub-section 152AT(4) in the absence of such evidence *actually existing* at the time of making its decision pursuant to sub-section 152AT(3).

In the CCC's submission, these conditions continue to exist and Telstra has not presented any compelling evidence otherwise. The CCC makes the following observations in relation to the evidence presented by Telstra in support of its contention that the exemptions sought will promote the LTIE:

- Telstra says in its submissions in support of its Exemption Applications that there are around 5.4 million PSTN services in operation ("**SIOs**") in the geographical area covered by the Exemption Applications;

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[11] ACCC, *Line Sharing Service - Final Decision on whether or not a Line Sharing Service should be declared under Part XIC of the Trade Practices Act 1974* (August 2002), section 6.1.
[12] Telstra LSS case, paragraph 20.
[13] See ACCC, *Telstra's local carriage service and wholesale line rental exemption applications – Discussion Paper* (August 2007).
[14] WLR/LCS Exemption Application Discussion Paper, pp.18-19.

- Telstra estimates in its submissions in support of its Exemption Applications that there are (as at the time of the Exemption Applications) around 100,000 paid VoIP SIOs. This represents **less than 2%** of total fixed-line services in the ESAs covered by the Exemption Applications;

- Engin has publicly estimated that it had a 44 per cent revenue share of the Australian VoIP market with 52,500 paying subscriber lines at 31 December 2006, and 58,000 at 27 February 2007;[15]

- Telstra states in its response to an information request from the Commission (in relation to its WLR/LCS Exemption Application): "According to the Paterson Statement of 30 October 2007, there may be as many as 200,000 VoIP SIOs." In other words, even the most favourable evidence proffered by Telstra shows that VoIP currently accounts for **less than 4%** of total fixed-line services in the ESAs covered by the Exemption Applications;

- Telstra estimates in its response to an information request from the Commission (in relation to its WLR/LCS Exemption Application) that VoIP services will climb to around 2.8 million by 2011. This still only represents less than one third of total fixed-line services in the ESAs covered by the Exemption Applications and, moreover, was a prediction as to the state of the market four years out from the time it was made.

The ACCC/ACMA *Communications Infrastructure and Service Availability in Australia 2006/2007 Report* found (at p.27) that:

> Overall, 18 per cent of ISPs provide VoIP services as part of a bundled internet package to consumers, with approximately 30 per cent of large and very large ISPs [excluding Telstra] providing VoIP services. This indicates that there is still room for more than 80 per cent of ISPs to provide a fixed-voice product as a bundle with their internet services. Table 7 also shows that 33 per cent of small ISPs provide VoIP services. Given their low subscriber numbers, many small ISPs may be servicing a distinct regional, rural or remote location area, providing alternative voice options in regional voice markets.

Further, anecdotal evidence supports the view that even where end-users have a VoIP service, they generally retain a traditional fixed-line (LCS/WLR/PSTN OA-based) service, for example, for emergency calls, for perceived quality of service and reliability reasons, for perceived network security and privacy reasons, and for disability-compliant services.

The above survey of available data indicates that whilst VoIP is emerging as a potential service type, it is simply fanciful for Telstra to assert that DSLAM-based infrastructure currently represents a competitive alternative to fixed-line voice telephony services which are currently provided by means of WLR/LCS and PSTN OA.

Conclusion

Having regard to the proper application of the test in sub-section 152AT(4) of the TPA and the lack of evidence provided by Telstra in support of its Exemption Applications, the CCC submits that the Commission ought to refuse each of the Exemption Applications pursuant to sub-section 152AT(3)(b) of the TPA.

[15] See WLR/LCS Exemption Application Discussion Paper, fn. 86.