

Optus Public Submission to
the Australian Competition and Consumer Commission
in response to its
Draft Decision on Telstra's PSTN OA Exemption Applications

September 2008

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1. Executive Summary

- 1.1 Telstra applied to the ACCC in October 2007 for exemption from regulation of the PSTN OA service in 387 exchange service areas (ESAs) in metropolitan areas and 17 ESAs in capital city CBDs.

The Draft Decision

- 1.2 The ACCC has proposed to grant an exemption in respect of 248 metropolitan ESAs and 15 CBD ESAs which meet certain criteria relating to the number of addressable SIOs and/or the number of ULLS-based competitors present (“the ACCC’s proposed exemption”). The proposed exemption is subject to certain conditions related to the availability of the ULLS and is to come into effect 12 months after the final decision.

Comments on the Draft Decision

- 1.3 Optus has significant concerns about the draft decision, which will undermine competition in preselected long distance services, a longstanding cornerstone of the telecommunications access regime. The draft decision would allow Telstra to take away consumers’ right to choose their long distance provider, and strengthen Telstra’s already dominant position in fixed line calling. Moreover, the decision does not adequately address the distinct requirements of corporate and government customers for complex features, business continuity and adequate timetables for migration of services.
- 1.4 The decision also assumes there will be sufficient time for access seekers to make a commercial return on DSLAM investment before deployment of the Broadband Network (NBN) occurs – without any reliable information and even though access seekers have overwhelmingly said the opposite. In the face of this uncertainty the ACCC cannot be satisfied that its decision is in the long term interests of end users (LTIE). It runs a significant risk that its proposed exemption will fail to promote either investment or competition.
- 1.5 In this paper Optus will submit that the ACCC has:
- underestimated the speed and extent of asset stranding likely to be caused by the impending NBN rollout and so overestimated the extent of investment in infrastructure and the duration of any benefits likely to flow from its proposed exemption;
 - not grasped the continuing pro-competitive role played by standalone long distance operators and has proposed an exemption which will not enhance competition in fixed voice services;
 - overestimated the extent to which the ULLS can substitute for resale services for corporate and government customers and not appreciated the substantial time and cost involved in migration of corporate customers to a new telecommunications platform; and

- misconstrued the alternative scenarios in the “With and Without test” and as a result overstated the benefits likely to flow from the proposed exemption.

Optus’ Proposed Conditions and Limitations

- 1.6 Optus considers that the ACCC’s proposed exemption is not in the LTIE due to negative impacts on efficiency and competition. Optus calls for the ACCC to reject the proposed exemption on the basis of a lack of certainty or defer its decision until better information is available around aspects of the NBN, in particular the timing of the deployment.
- 1.7 However in the event that the ACCC decides not to decline or defer the application, Optus submits that the ACCC can achieve all the benefits (in terms of encouragement of efficient investment and promotion of competition) that it is seeking from its proposed exemption¹ with fewer negative side effects by introducing the following new conditions and limitations:
- a condition that the exemption will cease to apply in any ESA for which the announced timetable for NBN deployment stipulates deployment of fibre to the node infrastructure prior to December 2010 (to mitigate the exemption’s negative impact on competition in the event of a rapid NBN deployment);
 - a limitation on the exemption so that it applies to mass market “voice resellers”² but not to “pure pre-selection providers”³; and
 - a limitation on the exemption so that it does not apply where services are provided to corporate and government customers.

Transition Period

- 1.8 The proposed 12 month transition period is insufficient for operators providing services to corporate customers for whom migrations onto a new telecommunications platform are lengthy and costly. Optus proposes that if the ACCC grants its proposed exemption, it should extend the transition period to 36 months for services provided to corporate customers.
- 1.9 An extended 36 month transition period would be in the LTIE because it would take account of the unique requirements for the supply of services to corporate customers – and thus impose fewer negative impacts upon efficiency and/or competition than the ACCC’s proposed exemption, while still achieving the positive outcomes the ACCC is seeking.

¹ Assuming for the moment that these benefits are indeed obtainable.

² The ACCC’s definition of “voice resellers”: Voice resellers are access seekers who wish to offer the full bundle of voice services to customers who will seek to acquire PSTN OA (used as an input to supply long distance services) with the LCS and WLR services (in order to supply a bundle of fixed voice services). ACCC, Draft Decision – PSTN OA exemption, pp53

³ The ACCC’s definition of “pure pre-selection providers”: The customer’s phone line is connected with one provider but is set to automatically direct all mobile, national long-distance and international calls through the pure pre-selection provider. The customer does not need to dial an access code. The end user receives one bill from the provider of its local calls and a separate bill from the provider of its long distance and FTM calls. ACCC, Draft Decision – PSTN OA exemption, pp52-53

2. Proposed Further Conditions and Limitations

- 2.1 Optus considers that the ACCC's proposed PSTN OA exemption is not in the long term interests of end users (LTIE) due to its negative impacts upon efficiency and competition. However a narrower exemption could be in the LTIE, if it was made subject to further conditions and limitations intended to preserve competition in the event that the NBN deployment is more rapid than the ACCC expects and to preserve competition in long distance calling services and in services for corporate and government customers.
- 2.2 The ACCC can achieve all the benefits (encouragement of efficient investment and promotion of competition) that it is seeking from its proposed exemption⁴ via narrower exemptions which impose fewer negative impacts upon efficiency and/or competition – specifically, by exemptions which do not apply in the event of a rapid NBN deployment, and which remove regulated access to the PSTN OA for mass market “voice resellers”⁵ but retain access both for mass market “pure pre-selection providers”⁶ and for operators providing services to corporate and government customers.
- 2.3 The additional conditions and limitations proposed by Optus are set out below.

Condition to address NBN-related uncertainty

- 2.4 Optus proposes that the ACCC impose a further condition to the effect that the exemption will cease to apply if the timetable announced in the NBN process does not allow sufficient time after the exemption comes into force for the costs of investment in DSLAM-based service provision to be recovered. Such a condition would be in the LTIE because it would allow each access seeker to choose the mode of competition it considers most likely to be sustainable – and thus impose fewer negative impacts upon efficiency and competition than those likely to flow from the ACCC's proposed exemption. Further, an exemption with such a condition is capable of achieving all the positive outcomes that the ACCC is seeking from its proposed exemption.

The impact on investment of NBN-related uncertainty

- 2.5 Neither the ACCC nor access seekers can know at this stage what the RFP process will reveal about the timing of the NBN rollout, as the ACCC itself

⁴ Assuming for the moment that these benefits are indeed obtainable.

⁵ The ACCC's definition of “voice resellers”: Voice resellers are access seekers who wish to offer the full bundle of voice services to customers who will seek to acquire PSTN OA (used as an input to supply long distance services) with the LCS and WLR services (in order to supply a bundle of fixed voice services). ACCC, Draft Decision – PSTN OA exemption, pp53

⁶ The ACCC's definition of “pure pre-selection providers”: The customer's phone line is connected with one provider but is set to automatically direct all mobile, national long-distance and international calls through the pure pre-selection provider. The customer does not need to dial an access code. The end user receives one bill from the provider of its local calls and a separate bill from the provider of its long distance and FTM calls. ACCC, Draft Decision – PSTN OA exemption, pp52-53

has recently recognised.⁷ However the ACCC's lack of information on this issue is particularly acute.

2.6 The ACCC faces an asymmetric information problem. The problem is threefold:

- First, the outcome for the LTIE of the proposed exemption depends entirely on access seekers' investment decisions. If access seekers fail to respond to the exemption as the ACCC expects, the exemption may well be detrimental to both investment and competition;
- Second, the imminent NBN deployment – not the proposed exemption – is the most important driver of access seekers' investment decisions. Each access seeker will form a view upon the scenario it considers is most likely with regard to the NBN deployment and accordingly choose the mode of competition it considers most likely to be sustainable.⁸
- Third, it is the opinion of *access seekers* – not the opinion of the ACCC – on the likely timetable for NBN deployment that determines access seekers' investment decisions.

2.7 Not only is the ACCC unaware of the likely timetable for deployment of the NBN; but also it cannot be certain of the opinion of access seekers on that timetable – and thus the likely behaviour of access seekers once the exemption is granted. As a result, the ACCC cannot be have any certainty that its proposed exemption will result in the positive outcomes it is hoping for: if access seekers truly believe that the NBN deployment will be very rapid, then they will not invest and the ACCC's proposed exemption cannot result in a positive outcome for end users.

2.8 Given that access seekers have overwhelmingly submitted that they believe the NBN will discourage investment in DSLAMs and associated infrastructure, for the ACCC to grant the exemption it is effectively taking the position that:

- its opinion on the likely timetable for rollout of the NBN is more accurate than the opinion of access seekers; and also
- access seekers are misrepresenting their true opinions and if the exemption is granted they will in fact invest in DSLAMs and associated infrastructure, notwithstanding their stated position.

2.9 This is an extraordinarily risky position for the ACCC to be taking on the basis of extremely limited information. For the ACCC to decide in favour of an exemption now before these issues have been resolved would be to attempt

⁷ ACCC, September 2008, Draft decision on Telstra's exemption application in respect of Optus HFC area, pp.66-67

⁸ Those access seekers who truly believe the NBN rollout will be very rapid will be likely to choose to continue with resale-based competition since they will anticipate that the NBN rollout will strand DSLAMs rapidly. On the other hand, those access seekers who in fact consider (as the ACCC does) that the NBN rollout will allow sufficient time for an adequate return to be made on investments in DSLAMs might choose to invest in DSLAMs, since they would anticipate that the NBN rollout will not strand DSLAMs rapidly.

force access seekers to invest in a single mode of competition without any way of being satisfied that the decision is actually in the LTIE. In fact it would be taking a significant risk that the exemption would actually be detrimental to both efficient investment and competition (in the event that the NBN is deployed – and access seekers’ DSLAM investments stranded – very rapidly). The impact of the NBN deployment upon investment decisions is discussed in more detail in Chapter 4 (Efficient Use of and Investment in Infrastructure).

- 2.10 In the next section Optus proposes a condition that overcomes the asymmetric information problem faced by the ACCC and makes the regulatory environment responsive to new information.

Proposed condition to address NBN-related uncertainty

- 2.11 Optus submits that if the ACCC decides to grant a PSTN OA exemption, in order for the final decision to be consistent with the legislative criteria in section 152AT of the Trade Practices Act 1974 the ACCC should impose a further condition to the effect that the exemption will cease to apply in ESAs where the timetable announced in the NBN process does not allow sufficient time after the exemption comes into force for the costs of investment in DSLAM-based service provision to be recovered (where ‘sufficient time’ is predefined by the ACCC). This condition would retain any benefits⁹ of the draft decision, but avoid a significant proportion of the costs (negative impacts on efficiency and competition).

- 2.12 To make this more concrete, the condition could be phrased as follows:

The Exemption ceases to apply in respect of the supply by Telstra of the PSTN OA service in any ESA for which the announced timetable for NBN deployment stipulates deployment of fibre to the node infrastructure prior to [December 2010];

where “announced timetable for NBN deployment” is defined ... [by the ACCC, by reference to information provided in the Government’s RFP process for the National Broadband Network (NBN).]

- 2.13 The effect of such a condition would be to promote competition in a flexible manner by adjusting the regulatory environment in response to new information: it would promote DSLAM-based competition if that proved to be feasible, and otherwise preserve resale-based competition. The asymmetric information problem faced by the ACCC would thus be overcome, since the ACCC would not need to be certain of the likely behaviour of access seekers once the exemption is granted: it could be confident that the exemption would apply only where it would promote the LTIE.

- 2.14 The ‘upside’ of Optus’ proposed condition is readily apparent. Consider the scenario where the ACCC’s expectations about the NBN rollout are wrong (ie, deployment will actually be rapid, and will not allow sufficient time for an adequate return to be made on DSLAM investments), and where most access seekers correctly anticipate that the NBN rollout will be rapid. Then Optus’

⁹ Assuming for the moment that these benefits are indeed obtainable.

proposed condition would result in a significantly *better* outcome compared to the ACCC's current proposed exemption without the condition, since in this scenario resale competition through the PSTN OA is preserved.

- 2.15 However, the ACCC will also need to consider whether Optus' proposed condition has a 'downside': that is, it will consider whether there are circumstances in which Optus' proposed condition could encourage access seekers to defer investment they would otherwise have undertaken in the expectation that the condition will apply (and they can continue to use the PSTN OA service).
- 2.16 Optus submits that its proposed condition cannot produce an incentive to defer investment, because it applies only in the event that the NBN deployment is rapid. Thus the condition could only influence access seekers' investment decisions the NBN deployment to be rapid.¹⁰ And if access seekers expect the NBN deployment to be rapid, they will not invest in any case in infrastructure upon which they do not expect to make an adequate commercial return – so Optus' proposed condition has no impact upon their investment decision.
- 2.17 Conversely, if access seekers genuinely believe that the NBN deployment will not be rapid and that there would be adequate time for an investment in infrastructure to make a normal return on capital, then in certain circumstances it is possible that the proposed exemption could provide an incentive to make investments – but crucially in this case Optus' proposed condition would make no difference to those incentives, since access seekers would anticipate that the condition would not be likely to come into effect
- 2.18 In summary, there is no 'downside' to Optus' proposed condition, since it would not change access seekers' investment decisions. Access seekers will act according to their beliefs about the NBN deployment regardless of whether the condition is imposed or not.
- 2.19 It follows that the sole effect of Optus' proposed condition would be to mitigate the detrimental effects upon competition that would eventuate should the ACCC prove to be wrong about the timetable for the NBN deployment. If the ACCC is wrong about the timetable for the NBN deployment and access seekers are correct, then the ACCC's proposed exemption can have no benefits for investment or competition – but Optus' proposed exemption would at least preserve the resale competition that would otherwise be lost. And the ACCC can introduce the condition secure in the knowledge that if it is correct in its expectations about the NBN deployment timetable, then Optus' proposed condition will not change the outcome.
- 2.20 Optus considers that an exemption with its proposed condition would be more likely to promote competition compared to the ACCC's proposed exemption with no such condition. Optus' additional condition is in the LTIE since it will have no deleterious effects upon investment and competition even if the ACCC is correct in its expectations about the NBN rollout, but it will have significantly *better* outcomes compared to the ACCC's current proposed exemption (without the additional condition) in the event that the ACCC is wrong in its expectations about the rapidity of the NBN deployment.

¹⁰ If they do not, then they will not expect the condition to apply and will disregard it.

Limitation to preserve competition in long distance calling services

- 2.21 Optus proposes that the ACCC impose a limitation on its proposed exemption such that regulated access to the PSTN OA will be removed for “voice resellers” but be retained for “pure pre-selection providers”. Such a limitation is in the LTIE because it would protect competition in long distance calling services – and thus impose fewer negative impacts upon efficiency and/or competition than the ACCC’s proposed exemption. Further, an exemption with such a limitation is capable of achieving all the positive outcomes that the ACCC is seeking from its proposed exemption.

Distinction between voice resellers and pure pre-selection providers

- 2.22 By granting its proposed exemption, the ACCC seeks to introduce specific positive outcomes or benefits to end users, which relate to the encouragement of efficient investment and the promotion of competition. While the ACCC has also identified some costs that will flow from the exemption (ie, negative impacts upon efficiency and/or competition), it considers that the benefits it has identified exceed those costs.¹¹
- 2.23 The identified benefits are considered likely to flow from the additional use of and investment in infrastructure used to deliver services in conjunction with the ULLS which the ACCC considers to be the likely result of its proposed exemption. The ACCC considers that removal of PSTN OA regulation will stimulate additional use of and investment in the ULLS because it considers that the ability of access seekers to obtain regulated access to “the fixed voice bundle” (that is, the WLR service, the LCS service and the PSTN OA service) is holding back investment in the ULLS that would otherwise occur.
- 2.24 To summarise, the ACCC has identified that regulated access to “the fixed voice bundle” is holding back investment in the ULLS, and this finding is the basis for its proposal to remove regulated access to the PSTN. The positive outcomes for end users which are the justification for the proposed exemption depend upon the exemption’s removal of the ability of access seekers who would otherwise gain access to “the fixed voice bundle” to do so.
- 2.25 However, “pure pre-selection providers” do not gain access to “the fixed voice bundle” (ie, WLR, LCS and PSTN OA). Pure pre-selection providers, according to the ACCC’s definition, provide only fixed to mobile, national long-distance and international calls – they acquire the PSTN OA, but do not acquire the remaining elements of the “fixed voice bundle” (WLR and LCS). Accordingly, regulated access to the fixed voice bundle does not hold back investment in infrastructure by pure preselection providers. It follows from the ACCC’s logic that to remove regulated access to the PSTN OA for pure pre-selection providers will not result in any incremental investment in infrastructure used in conjunction with the ULLS, or any incremental encouragement of efficient investment or promotion of competition. This conclusion holds even if it is accepted that to remove regulated access to the fixed voice bundle for voice resellers¹² will result in such a benefit.

¹¹ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.11

¹² At least, voice resellers operating in the mass market.

- 2.26 However, to remove regulated access to the PSTN OA for pure pre-selection providers would certainly result in costs (ie, negative impacts upon efficiency and/or competition) – as the ACCC has itself recognised. These costs include a reduction in competitive tension in long distance calling and potentially the removal of the ability to preselect a long distance provider, so that end user consumers of fixed voice services would no longer have access to the rapid reductions in rates and the introduction of new and innovative services brought about by competition from preselection providers. The exemption’s likely impact upon competition in long distance calling is discussed in more detail in Chapter 5 (Promotion of Competition).
- 2.27 Optus submits that all the benefits (encouragement of efficient investment and promotion of competition) that the ACCC is seeking may be obtained¹³ via a narrower exemption which imposes fewer negative impacts upon efficiency and/or competition – specifically, by an exemption which removes regulated access to the PSTN OA for mass market “voice resellers” but retains access for mass market “pure pre-selection providers”.

Proposed limitation to preserve competition by pure pre-selection providers

- 2.28 Optus submits that in order for the final decision to be consistent with the legislative criteria in section 152AT of the Trade Practices Act 1974, if the ACCC grants a PSTN OA exemption, it should be a narrower exemption which removes regulated access to the PSTN OA for mass market “voice resellers”¹⁴ but continues to allow mass market “pure pre-selection providers” to have regulated access to the PSTN OA. Such an exemption would retain all the benefits¹⁵ of the draft decision as it stands, but avoid a significant proportion of the costs (negative impacts upon efficiency and/or competition).
- 2.29 Such a limitation could be drafted in various ways. Two alternatives are proposed here. One potential phrasing of the limitation is as follows:

The Exemption does not apply in respect of the supply by Telstra of the PSTN OA service to an Access Seeker in respect of a particular SIO where either:

- *that Access Seeker is a “pure pre-selection provider”, or*
- *that Access Seeker resells the PSTN OA service in respect of the particular SIO to a “pure pre-selection provider”.*

where “pure pre-selection provider” is defined as a carriage service provider whose customers’ phone line is connected with one provider but is set to automatically direct all mobile, national long-distance and international calls through the pure pre-selection provider.

- 2.30 An alternative potential phrasing of the limitation is as follows:

The Exemption does not apply in respect of the supply by Telstra of the PSTN OA service to an Access Seeker in respect of a particular SIO if

¹³ Assuming for the moment that these benefits are indeed obtainable.

¹⁴ At least, voice resellers operating in the mass market.

¹⁵ Assuming for the moment that these benefits are indeed obtainable.

the Access Seeker was not supplied with a WLR or a LCS service by Telstra in respect of that SIO.

Limitation to preserve competition in services for corporate customers

- 2.31 Optus proposes that the ACCC impose a limitation on its proposed exemption such that regulated access to the PSTN OA will be removed for mass market voice resellers but be retained for supply of services to corporate or government customers. Such a limitation is in the LTIE because it would protect competition in the supply of services to corporate customers – and thus impose fewer negative impacts upon efficiency and/or competition than the ACCC’s proposed exemption. Further, an exemption with such a limitation is capable of achieving all the positive outcomes that the ACCC is seeking from its proposed exemption.

Distinction between supply of mass market customers vs corporate customers

- 2.32 The ACCC has identified that regulated access to “the fixed voice bundle” is holding back investment in the ULLS. The positive outcomes for end users which are the justification for the proposed exemption depend upon the additional use of and investment in the ULLS that the ACCC considers will be stimulated by the proposed exemption.
- 2.33 However, CiC
- 2.34 Accordingly, regulated access to the PSTN OA does not hold back investment in infrastructure used in conjunction with the ULLS for supply of services to existing corporate or government customers. It follows that to remove regulated access to the PSTN OA for supply of services to corporate or government customers will not result in any incremental investment in infrastructure used in conjunction with the ULLS, or any incremental encouragement of efficient investment or promotion of competition. This conclusion holds even if it is accepted that to remove regulated access to the fixed voice bundle for voice resellers operating in the consumer market will result in such a benefit.
- 2.35 However, to remove regulated access to the PSTN OA for supply of services to corporate or government customers will certainly result in costs (ie, negative impacts upon efficiency and/or competition). Since the ULLS is not a substitute for the supply of services to corporate customers, in the event the exemption is granted, there will be nothing to prevent Telstra from exercising its market power by increasing the price of the PSTN OA wholesale services to CSPs supplying services to corporate and government customers, with the flow-on effect of a reduction in competitive tension in the supply of services to corporate and government customers.
- 2.36 Optus submits that all the benefits (encouragement of efficient investment and promotion of competition) that the ACCC is seeking may be obtained¹⁶ via a narrower exemption which imposes fewer negative impacts upon efficiency and/or competition – specifically, by an exemption which removes regulated

¹⁶ Assuming for the moment that these benefits are indeed obtainable.

access to the PSTN OA for mass market “voice resellers” but retains access for the supply of services to corporate and government customers.

Proposed limitation to preserve competition in services for corporate customers

2.37 Optus submits that in order for the final decision to be consistent with the legislative criteria in section 152AT of the Trade Practices Act 1974, if the ACCC grants a PSTN OA exemption, it should be a narrower exemption which removes regulated access to the PSTN OA for mass market voice resellers but continues to allow operators to have regulated access to the PSTN OA for the purposes of supplying services to corporate and government customers. Such an exemption would retain all the benefits¹⁷ of the draft decision as it stands, but avoid a significant proportion of the costs (negative impacts upon efficiency and/or competition).

2.38 In order to achieve this objective, Optus proposes the following limitation:

Subject to the conditions specified in item [] below, Telstra is exempt from the standard access obligations as they relate to the supply of PSTN OA within the ESAs listed in [Attachment X] to this order to carriage service providers other than supply for the purposes of re-supply to a C&G customer.

- *where C&G customer means an end-user with more than 200 employees.*

2.39 Alternatively, if the ACCC does not accept that such a limitation to the scope of the exemption is necessary or appropriate, then at least a 'safety net' condition should be added, to apply for at least five years after the exemptions take effect, which may help ameliorate some of the worst of the adverse competition issues otherwise arising in the corporate and government market segment as a result of the exemption. Optus suggests that at a minimum a further condition is necessary and appropriate in the following terms:

If, during the term of the order, Telstra refuses to supply the PSTN OA service on reasonable terms and conditions where supply is sought by a carriage service provider for the purposes of re-supply to a C&G customer, then the exemption will cease to apply to any such service.

- *where C&G customer means an end-user with more than 200 employees.*

2.40 Such a condition would set a clear expectation that Telstra should continue to supply services on reasonable terms and conditions as that term is understood in the TPA (for example, at a price no greater than the price which Telstra charges to end user customers for the same or similar service on a retail basis) where it is necessary to ensure competition is not harmed in respect of the provision of telecommunications services to large corporate and government customers. The provisions of Part XIB and s46 simply do not give adequate or

¹⁷ Assuming for the moment that these benefits are indeed obtainable.

timely protection for carriage service providers against such a refusal to supply, as was shown in respect of the ACCC Competition Notice and Optus' own action against Telstra when WLR prices were increased by Telstra prior to their declaration.

3. Proposed Extended Transition Period to Enable Corporate Migrations

- 3.1 The ACCC in its draft decision has proposed a 12 month transition period for all access seekers.
- 3.2 Optus considers that a 12 month transition period is insufficient, particularly for operators providing services to corporate and government customers. Such operators require a longer transition period because migrations of customers in the corporate space onto a new telecommunications platform are lengthy and costly for the end user customer.
- 3.3 Optus proposes that the ACCC retain the 12 month transition period for mass market operators but grant an extended 36 month transition period for services provided to corporate customers. This would be in the LTIE because it would take account of the unique requirements for the supply of services to corporate customers – and thus impose fewer negative impacts upon efficiency and/or competition than the ACCC’s proposed exemption. Further, an exemption with such an extended transition period is capable of achieving all the positive outcomes that the ACCC is seeking from its proposed exemption.

Migration of corporate customers

- 3.4 The ACCC has identified that regulated access to “the fixed voice bundle” is holding back use of and investment in infrastructure used to supply services in conjunction with the ULLS. The positive outcomes for end users which are the justification for the proposed exemption depend upon the incremental use of and investment in such infrastructure that the ACCC considers will be stimulated by the proposed exemption. An example of this alternative infrastructure is provided by Optus Evolve, the new IP-based network that Optus is increasingly using to supply services to its corporate and government customers.
- 3.5 However, before existing customers can be supplied using alternative infrastructure such as Optus Evolve, they must be migrated onto the new platform. The requirement for migration is relevant to the length of the transition period for the supply of services to corporate customers, for several reasons.
- 3.6 **CiC**
- 3.7 For these reasons, existing corporate customers who have access to workable telecommunications technology typically have a strong preference to continue to use that service – and to defer migration to a new telecommunications platform – for as long as possible.
- 3.8 The strong preference of corporate customers to defer migration is relevant to the ACCC’s decision on the length of the transition period for its proposed exemption because it impacts on the promotion of competition in the supply of services to corporate customers.

A short (12 month) transition period: impact on competition

- 3.9 As noted, stability of service provision and return on investment (in the current platform) are key elements of the overall service offering provided to a corporate customer by a telecommunications provider. **CiC** An exemption with only a 12 month transition period would not promote competition in the provision of services to corporate customers.

An extended transition period for corporate customers

- 3.10 By contrast a longer transition period which allowed a phased transition process and provided corporate customers with adequate notice of the need to migrate – and allowed them to obtain an adequate return on their investment (in the current platform) could well be in the LTIE, since a longer transition period would reduce the costs of the exemption in terms of damage to competition in the corporate space.
- 3.11 Further, granting the proposed exemption with a longer transition period (compared with a transition period of only 12 months) would neither reduce the extent of nor delay any incremental enhancements to infrastructure investment or competition that might be promoted by the exemption. Given the lengthy nature of migrations in the corporate space, such incremental enhancements would take a number of years in any case and a short transition period would not hasten them.
- 3.12 Optus submits that all the benefits (encouragement of efficient investment and promotion of competition) that the ACCC is seeking may be obtained¹⁸ via an exemption which imposes fewer negative impacts upon efficiency and/or competition – specifically, by an exemption with a transition period of 36 months.
- 3.13 Optus considers that the damage to efficient investment incentives and competition for corporate customers could be limited by the imposition of an intermediate length transition period specifically for services provided to corporate customers.
- 3.14 Accordingly, Optus submits that in order for the final decision to be consistent with the legislative criteria in section 152AT of the Trade Practices Act 1974, if the ACCC grants a PSTN OA exemption, it should grant an extended 36 month transition period for services provided to corporate customers. Such a limitation would retain the benefits¹⁹ of the draft decision as it stands, but avoid a significant proportion of the costs (negative impacts upon efficiency and/or competition).

¹⁸ Assuming for the moment that these benefits are indeed obtainable.

¹⁹ Assuming for the moment that these benefits are indeed obtainable.

4. Efficient Use of and Investment in Infrastructure

- 4.1 The ACCC in its draft decision has taken the view that its proposed exemption would encourage efficient use of infrastructure and also “encourage access seekers to invest in ULLS-based DSLAM/MSAN infrastructure in the Proposed CBD and Metropolitan Exemption Areas” and found that the resulting short-term efficiency losses “would be outweighed by the long-term benefits flowing to consumers from the increased take-up of the ULLS, and the flow-on competition benefits to consumers”.²⁰
- 4.2 Optus considers that the ACCC has underestimated the speed and extent of asset stranding likely to be caused by the impending NBN rollout and so overestimated both the extent of the likely impact of the ACCC’s proposed exemption on investment in infrastructure; and the duration of any benefits likely to flow from the ACCC’s proposed exemption.
- 4.3 Optus submits that the granting of the PSTN OA exemptions is unlikely to encourage the efficient use of and investment in infrastructure and would not promote the long term interests of end users.

Asset Stranding: the Impending NBN Rollout

- 4.4 Optus has submitted material on this subject to the ACCC in its June 2008 response to the ACCC’s draft decision on Telstra’s LCS and WLR exemption applications.²¹ Much of this material is relevant to the current matter, and Optus refers the ACCC to its previous submission.
- 4.5 The ACCC acknowledged in its draft decision on the PSTN OA exemption application that NBN-related uncertainty could impact investment decisions.²² However, the ACCC largely dismisses this “possibility”, taking the view that:²³
- “access seekers will have sufficient opportunity to recoup investments prior to any fibre upgrade due to the reasonable expectation that any party rolling out fibre would be subject to appropriate notice periods as well as the certainties provided by the Government’s RFP process.”*
- 4.6 The ACCC has made a number of observations in support of this view. First, it observed that the Government’s NBN Request for Proposals requires proponents to provide various information including network rollout timeframes.²⁴

²⁰ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.11

²¹ Optus, June 2008, *Confidential Submission to the Australian Competition and Consumer Commission in response to Draft Decision on Telstra’s LCS and WLR Exemption Applications*

²² ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.87-88

²³ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.118

²⁴ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, pp.89-90

- 4.7 Optus considers that in weighing the impact of NBN-related uncertainty upon investment decisions, the ACCC has placed excessive weight on these RFP information requirements. The critical question is whether there is likely to be sufficient time for access seekers to make an adequate return on investment in DSLAMs and associated infrastructure. There is currently a high level of uncertainty around this question. The RFP process may in time provide further certainty about the timing of the NBN rollout, however the timetable thereby revealed may not – and Optus considers probably will not – allow sufficient time for access seekers to make an adequate return on investment.
- 4.8 Second, the ACCC observed that if “*cutover does not occur in the ESAs at Appendix B until later periods of the NBN deployment, then NBN will not likely impact significantly upon the value extracted by access seekers from DSLAM/MSAN investments...*”²⁵
- 4.9 Optus considers that this observation is speculative and does not take sufficient account incentives. The NBN rollout will be rapid, involving up to 300 nodes being deployed per month. If Telstra wins it will target ESAs with competitor DSLAMs first. Optus considered the likely timing of the fibre rollout relating to the NBN in its June 2008 submission in response to the ACCC’s draft decision on Telstra’s WLR and LCS exemption, and the relevant analysis of this issue is reproduced at Appendix A. In June 2008 Optus concluded that if Telstra is the NBN operator, then (if its statements last year are any guide) access seekers’ investments in DSLAMs in all fibred exchanges will be unable to serve any customers and thus completely stranded by its network deployment – by the end of 2009. Since June 2008 the timetable for the Government’s RFP process has been somewhat delayed. Nevertheless even on a conservative estimate Optus submits that it is likely that access seekers’ investments in DSLAMs will be completely stranded by the fibre network deployment by June 2010 – and thus NBN will indeed impact significantly upon the value extracted by access seekers from DSLAM/MSAN investments.
- 4.10 Third, the ACCC observed that previous announcements by Telstra (in 2005) do not appear to have discouraged investment in DSLAM/MSAN infrastructure.²⁶
- 4.11 Optus considers that this observation demonstrates that the ACCC’s thinking is muddled. Telstra made its 2005 announcement once carriers such as Optus had committed to – and were part way through – an extensive ULLS rollout. Further, Telstra’s announcement had a significant caveat: ie, it would only occur if the existing regulatory regime were scrapped. This was easy to dismiss. Now we have a competitive tender process so we can be confident that an NBN rollout will occur.
- 4.12 Fourth, the ACCC stated that “*the further investment that may be required by the granting of the Proposed Exemption Orders is a factor that the ACCC*

²⁵ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.89

²⁶ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.88

considers the Government should take into account in formulating transitional arrangements to fibre-based supply of fixed voice services.”²⁷

- 4.13 Finally, it observed that reasonable notice periods for network modernisation have been offered in other countries, for example, “The “MDF Agreement” drafted for KPN and its access seekers will provide access seekers with at least 24 months notice of areas to be migrated”²⁸
- 4.14 Optus considers that the ACCC’s observations on what the Government “should” do, and on what carriers in other countries have done do not address the relevant question. Optus considers that the ACCC has no reasonable basis for any expectation that any party rolling out fibre would be subject to notice periods that would take account of DSLAM operators’ requirement to recoup their investment. No doubt the government “should” take into account asset stranding in formulating transitional arrangements to the NBN, but the appropriate question is not whether it should do so, but whether it is likely to do so, bearing in mind the chief influences upon such policy-making (including, not least, political considerations), and bearing in mind the government’s statements upon the matter.
- 4.15 In this regard, Optus considers that a rapid rollout in the ESAs proposed for exemption (without “appropriate notice periods”) should be considered a high probability, given the Government’s stated policy intention to have the NBN deployed as quickly as possible. Three weeks ago Senator Conroy said publicly that the Government “want[s] to complete this project as fast as we can...”²⁹
- 4.16 In sum, the ACCC’s reasoning supporting its “reasonable expectation that any party rolling out fibre would be subject to appropriate notice periods” is not compelling. Optus considers that it is likely that the draft decision underestimates the speed and extent of asset stranding likely to be caused by the impending NBN deployment.
- 4.17 Neither the ACCC nor access seekers can be certain at this stage about the timing of the NBN deployment. As the ACCC has recently recognised, “several elements of the NBN rollout are currently unknown, including who the owner of the NBN will be, the regulation that will apply to it, and the extent to which the NBN will interconnect with or use existing infrastructure... or whether it will overbuild or replace existing infrastructure”.³⁰ Optus submits that to decide in favour of an exemption now before these questions have been resolved would not only be reckless and misguided policy-making; but also it would be to make a decision without a clear view of whether or not that decision would be in the LTIE.

²⁷ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.90

²⁸ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.91

²⁹ Australian, 3 September 2008, “Broadband plan in starter’s hands”. Full quote: “We want this to be a proper and transparent process,” Senator Conroy said. “We also want to complete this project as fast as we can and we are progressing as fast as possible with the information that has been available.”

³⁰ ACCC, September 2008, Draft decision on Telstra’s exemption application in respect of Optus HFC area, pp.66-67

- 4.18 The ACCC has a number of options to resolve this very real problem. It should, at the very least, defer its decision on this exemption until certainty is available. If it considers this option is not open to it, then it can either reject the exemption on the basis of a lack of certainty that it the exemption will have any positive effect, or it can grant the exemption subject to additional conditions designed to address NBN-related uncertainty.

Impact on efficient investment in infrastructure of the ACCC's proposed exemption

- 4.19 Having dismissed NBN-related uncertainty as a significant factor impeding investment in DSLAMs, the ACCC concludes that “removal of PSTN OA access regulation will, on the whole, also encourage access seekers to invest in ULLS-based DSLAM/MSAN infrastructure in the Proposed CBD and Metropolitan Exemption Areas”³¹ Optus considers that this view is based upon the ACCC's underestimate of the speed and extent of asset stranding likely to be caused by the impending NBN deployment.
- 4.20 Optus considers that in reality access seekers are not likely to invest in ULLS-based DSLAM/MSAN infrastructure in the ESAs proposed for exemption because the impending deployment of the NBN (which will prevent ULLS-based service provision) will discourage most such investment. Optus has submitted material on this subject to the ACCC in its June 2008 response to the ACCC's draft decision on Telstra's LCS and WLR exemption applications.³² Much of this material is relevant to the current matter, and Optus refers the ACCC to its previous submission.
- 4.21 **CiC**
- 4.22 Optus submits that the ACCC has overestimated the extent of the likely impact on investment in infrastructure of the ACCC's proposed exemption.
- 4.23 Turning to the efficiency of investment, the ACCC in its draft decision stated that if access seekers do invest in ULLS-based DSLAM/MSAN infrastructure in the ESAs proposed for exemption, this would be an efficient outcome. It noted that:³³

“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 PSTN OA- type service or, at the extreme, exiting the market altogether), these would be outweighed by the long-term benefits flowing to consumers from the increased take-up of the ULLS, and the flow-on competition benefits to consumers.”

- 4.24 Optus disagrees with this conclusion, for three reasons. First, the ACCC does not appear to have taken into account the inefficiency (waste of resources)

³¹ ACCC, *Telstra's PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p138

³² Optus, June 2008, *Confidential Submission to the Australian Competition and Consumer Commission in response to Draft Decision on Telstra's LCS and WLR Exemption Applications*

³³ ACCC, *Telstra's PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.138

implied by encouraging new investment in infrastructure that will shortly be made redundant.

- 4.25 Second, the ACCC itself has admitted that any investment that does occur would be very minor and insubstantial. In its discussion of the NBN, the ACCC found that “any additional investment required as a result of the Draft Exemption Orders is likely to be limited to a relatively small number of ESAs and by a limited number of access seekers.”³⁴ It seems implausible that such a limited investment result could “outweigh” the significant negative consequences of the exemption.
- 4.26 Third, there will in fact be no “long-term benefits flowing to consumers from the increased take-up of the ULLS” because in the medium-term the NBN will prevent ULLS-based service provision. The ACCC appears to expect “long term” benefits to occur within a two year timeframe. This is not in accordance with commercial reality. It is unrealistic to expect that two years is sufficient time for all existing and potential competitors to “adjust to the outcome of the decision, make investment decisions and implement growth - as well as entry and/or exit strategies”.³⁵ Optus considers that the ACCC has overestimated the duration of any benefits flowing from the ACCC’s proposed exemption.
- 4.27 Optus considers that to remove the PSTN OA regulation could only encourage inefficient investment. In practice, however, it is more likely that such investment will simply not occur; rather, access seekers will cease supply to the affected customers – and Telstra’s dominant market position will be entrenched.

Impact on efficient use of infrastructure of the ACCC’s proposed exemption

- 4.28 The ACCC justifies its draft decision to grant an exemption in reliance upon an anticipated increase in the use of DSLAM infrastructure, which it considers to be a more efficient mode of competition compared to the PSTN OA, which it sees as a resale service.
- 4.29 However, the draft decision does not take adequate account of the network infrastructure used in conjunction with the PSTN OA service to provide long distance, international and fixed to mobile services. For example, many Optus wholesale customers (including for example CiC amongst a number of others) have long distance network infrastructure and switches in every Australian city.
- 4.30 By restricting competition to a smaller number of DSLAM infrastructure players and restricting the ability of pure long distance operators to participate in the market, the proposed exemption is likely to reduce the efficient use of this existing long distance network and switching infrastructure.
- 4.31 Further, the draft decision does not take adequate account of the numerous investments made by carriage service providers and by their customers (including business customers) in reliance upon the availability of regulated

³⁴ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.89

³⁵ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.127

access to preselected long distance telecommunication services. The proposed exemption is likely to reduce the efficient use of these investments too (in addition to deterring future such investments).

- 4.32 Optus considers it likely that by not taking adequate account of these negative effects, the draft decision overestimates the impact on efficient use of infrastructure of the ACCC's proposed exemption.

5. Promotion of Competition

- 5.1 The ACCC in its draft decision has taken the view that its proposed exemption is likely to promote competition in fixed voice services “principally by promotion of ULLS-based competition”.³⁶
- 5.2 Optus considers that the ACCC has not grasped the continuing and important role played by standalone providers of long distance calling services in promoting competition in the market for fixed voice services and has proposed an exemption which will not enhance competition in fixed voice services generally, and long distance calling in particular.
- 5.3 Further, Optus considers that the ACCC has overestimated the extent to which the ULLS can be used as a substitute for resale services by providers of services to corporate and government customers and not appreciated the duration and cost involved in migration of corporate and government customers to a new telecommunications platform and on that basis proposed an exemption which will not enhance competition in services for corporate and government customers.
- 5.4 Finally, the ACCC has misconstrued the alternative scenarios in the “With and Without test” and as a result of this error and other incorrect assumptions formed a mistaken conclusion on the benefits likely to flow from the ACCC’s proposed exemption.
- 5.5 Optus submits that the granting of the PSTN OA exemptions would not result in the promotion of competition in relevant markets and would not promote the long term interests of end users.

Impact on Competition in Long Distance Calling

- 5.6 The ACCC must consider whether granting the proposed exemptions would promote competition in the relevant telecommunications markets. The ACCC has taken the position that there is not a standalone market for long distance calling. Accordingly, it has not taken into account the impact of the exemption upon competition in the standalone market for long distance calling. The ACCC has considered the impact on competition in the market for fixed voice services, and concluded that there will be no “detrimental outcome” relative to the ‘future without’ scenario for consumers of fixed voice services (including long distance services) as a result of the exemption, and that its proposed exemption would promote competition in that market.
- 5.7 Optus considers that the ACCC’s conclusion is incorrect for a number of reasons. First, there is a standalone market for long distance calling, and the ACCC’s proposed exemption will impact upon competition in that market. Second, regardless of whether there is or is not a standalone market for long distance calling, the choice of preselecting a long distance service provider is valuable to consumers and if the ACCC’s proposed exemption is granted there will be a “detrimental outcome” relative to the ‘future without’ scenario for

³⁶ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.8

consumers of fixed voice services generally, and of long distance services in particular.

- 5.8 It follows that the ACCC's proposed exemption as it stands is unlikely to be in the LTIE, and the ACCC should either reject Telstra's exemption application or impose further conditions in order to ensure that competition in long distance calling is preserved.

Market definition: - Standalone market for long distance services

- 5.9 The ACCC has taken the position that there is not a standalone market for long distance calling. It bases this position upon a number of findings, including:

- almost all acquirers of PSTN OA can be classified as voice resellers;
- a steady decline in the use of PSTN OA;
- a trend away from preselect towards bundles while the price of long distance and FTM calls offered by all providers fell;
- likelihood that customers will churn away from Telstra to competitors' fixed-voice bundles in the event of price rises.

- 5.10 Optus considers that these findings cannot be relied upon.

- 5.11 The ACCC's view that almost all acquirers of PSTN OA can be classified as voice resellers is based upon Telstra's "reported number of acquirers of Telstra's PSTN OA service who can be classified in the "pure pre-selector" category" (CiC).³⁷

- 5.12 Optus considers that Telstra's submission on this point is misleading, and that in reliance on Telstra's submission, the ACCC has drawn towards an erroneous conclusion on this point. There are in fact many telecommunication businesses that rely on the PSTN OA service, and who can be classified in the "pure pre-selector" category.

- 5.13 Optus sells long distance services at wholesale to CiC customers, of which many are pure preselection providers in that they do not concurrently offer a basic access service to their customers. Optus itself does not purchase local call or basic access services from Telstra for its wholesale business – although Optus does acquire such services in order to resell at a retail level to its corporate customers. Taking Optus' wholesale business in isolation, many of Optus Wholesale's customers (and possibly Optus Wholesale itself) can be classified in the "pure pre-selector" category.

- 5.14 The ACCC's view that there has been a steady decline in the use of PSTN OA³⁸ is not borne out by Optus' experience. CiC

- 5.15 The ACCC in its draft decision notes a "noticeable customer trend away from override and preselect services, occurring while the average costs for long

³⁷ ACCC, *Telstra's PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.55

³⁸ ACCC, *Telstra's PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.55

distance calls is falling, is not consistent with the existence of a standalone market for long distance services”.³⁹

- 5.16 It is not clear why the ACCC considers the quoted price movement relevant to the definition of a standalone long distance market. The relevant question is the likely conduct of customers in the event that the price of standalone long distance services increased relative to the price of long distance services offered in bundles.⁴⁰ It is the relative price that is important, as the ACCC has apparently recognised – “...if its customers are subject to a change in the relative price of standalone long distance services ...”⁴¹ However the evidence relied upon by the ACCC does not appear to shed any light upon this question, since it does not relate to changes in the price of standalone long distance calling relative to bundles. Rather it refers to the average cost of long distance and fixed-to-mobile calls offered by all providers.
- 5.17 The ACCC has noted from Telstra’s submission “that if its customers are subject to a change in the relative price of standalone long distance services they will churn away from Telstra to competitors’ fixed-voice bundles.”⁴²
- 5.18 Optus submits this is not the case. Telstra’s “rusted-on” customer base is reluctant to churn away from Telstra to other providers. Telstra’s continuing dominance of the fixed line market and the relatively low market share achieved to date by ULLS-based competitors to Telstra should serve as evidence of this point. Further, customer inertia is a real phenomenon that can make customers unwilling to change telecommunication providers. This has been recognised in the academic literature. For example Gutierrez and Phumpiu found that inertia and switching costs had led to the dominance of the incumbent firm in the Peruvian long distance market. They observed that:⁴³

“The existence of inertia and switching costs is likely to make the task of gaining market share by new entrant carriers quite challenging .”

- 5.19 The role of inertia has also been recognised in the past by the ACCC. For example, the ACCC noted in its 2005-06 *Competitive Safeguards* report that:⁴⁴

“Customer inertia, or status quo bias, also acts as a barrier to achieving sufficient scale to compete effectively. When combined with actual switching costs (such as contract lock-in) and information asymmetry about the range of available contracts, Telstra has considerable

³⁹ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.56

⁴⁰ If an increase (or SSNIP) in the price of standalone calling relative to the price of calls in bundled offerings is likely to cause customers to switch to bundled service offerings, then this is evidence against the existence of a standalone long distance market. If, on the other hand, such a price increase (or SSNIP) is not likely to cause customers to switch to bundled service offerings, then this is evidence in favour of the existence of a standalone long distance market.

⁴¹ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.55

⁴² ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.55

⁴³ Gutierrez, M. and Phumpiu, P., 2004, *Inertia, switching costs, and competitive dynamics: The case of long-distance services in Peru*, ITS – 15th Biennial, Berlin, September 2004, p.3

⁴⁴ ACCC, *ACCC telecommunications reports 2005-06*, 24 April 2007, p.18

advantages as the incumbent default provider of local telecommunications [services].”

- 5.20 In summary, Optus submits that a standalone market for long distance calling continues to exist and is not in terminal decline. Whilst there is a trend towards bundling, Optus submits that there remains a significant section of the market which requires preselect long distance services. The ACCC should take into account the exemption’s impact upon competition in that market.
- 5.21 Nevertheless, regardless of whether or not the ACCC finds that there is a standalone market for long distance calling, Optus considers that there will be a “detrimental outcome” for consumers of long distance calling services as a result of the exemption.

Impact of exemption upon competition in fixed voice services (including LD services)

- 5.22 The ACCC has concluded that there will be no “detrimental outcome” relative to the ‘future without’ scenario for consumers of LD services as a result of the exemption.
- 5.23 This conclusion depends on the finding that for end users who consume preselect long distance calling services, a bundled service including both fixed long distance and access services is perfectly substitutable for their current service choice. This finding is equivalent to concluding that the choice of preselecting a long distance service provider is not of significant value to consumers, and allows the ACCC to give little weight to the potential for the demise of providers of preselected long distance services.
- 5.24 Optus considers that in fact the ability to preselect a long distance service provider is valuable to consumers. This is well recognised around the world. For example, the Competition Bureau Canada found that competition in long distance communications brought rapid reductions in rates and the introduction of new and innovative services.⁴⁵ In its recent Telecoms Review, Ofcom recognised that long-distance network competition “allows some scope for innovation, but only where competitors can provide the new product using the local access part of the network that they buy from the established operator”, noting that such competition “typically requires regulation to allow the competitor access to the established operator’s network”.⁴⁶ Many Optus wholesale customers (including for example CiC) fall into this ‘long-distance network competition’ category, since they have long distance network infrastructure and switches in every Australian city.
- 5.25 The PSTN OA service has been a cornerstone of telecommunications access regime in Australia for a number of years and there is a significant segment of customers who take long distance services from standalone long distance providers. These customers have obtained significant benefits from the enhanced level of competition provided by preselect operators. In particular, the significant additional competitive tension provided by preselection

⁴⁵ Competition Bureau Canada, The state of telecommunications competition in Canada, Remarks by Gilles Ménard, presented to The Canadian Institute, Canadian Telecommunications Superconference, 18 June 1996

⁴⁶ Ofcom, *The performance of the UK telecoms sector*, Annex H: Telecoms Review, 18 March 2005

providers appears likely to have driven lower prices for long distance calling. The trend of competitive pricing in long distance calling is a continuing one. For example, as reported in ACMA's Communication Report, while fixed-line subscribers paid 9.9 percent higher prices for basic access in 2006-07,⁴⁷ average call costs for long distance calling declined by the following:⁴⁸

- national call costs decreased by 7.2 percent to 10.8 cents per call minute;
- international call costs decreased by 10.3 percent to 20.4 cents per call minute; and
- fixed-to-mobile call costs decreased by 4.5 percent to 31.7 cents per minute.

5.26 Optus suggests that if the ACCC grants this exemption, such competitive pricing is unlikely to be repeated. The exemption will allow Telstra to raise the price of preselect services – and potentially remove the ability to preselect a long distance provider. A direct result of the exemption will be a deterioration in competition in long distance calling services. If the price of preselect services is raised, there will be a reduction in competitive tension in long distance calling as pure preselection providers are forced to raise their prices. If Telstra withdraws the PSTN OA service, pure preselection providers will be forced to exit the market, and end user consumers of fixed voice services will no longer have access to the rapid reductions in rates and the introduction of new and innovative services brought about by competition from preselection providers.

5.27 The ACCC appears to consider that these negative consequences will not eventuate, because in the event of a price rise in standalone services either preselection providers will become DSLAM operators or consumers will churn to bundled services.

5.28 Optus considers that it is unlikely that preselection providers will become DSLAM operators. Not only is the impending NBN deployment likely to strand any new DSLAM investments,⁴⁹ but also there is not room in the market for a significant influx of new DSLAM operators. The fixed costs required for entry into DSLAM competition are significant,⁵⁰ and it is unrealistic to expect many resellers to simultaneously enter and recover their costs. Optus would observe that there are a large number of preselection providers – far more than the number of DSLAM operators – and this reflects the relatively low barriers to entry in long distance competition. A far more likely consequence of the exemption is that preselection providers will exit the market, and reduce competitive tension in long distance services.

⁴⁷ ACMA, ACMA Communications Report 2006-07, 2007, p.184

⁴⁸ ACMA, ACMA Communications Report 2006-07, 2007, p.183

⁴⁹ See Chapter 4 for discussion of this point.

⁵⁰ The ACCC is seeking to promote a shift from service provision based on resale to service provision based on DSLAMs. Access seekers making such a shift would need to invest in significantly more resources than just electronics in an individual exchange. Even if backhaul could be leased, new provisioning systems and network management systems would still be required. Optus' own consumer DSLAM rollout in its entirety has a payback period of **CiC**.

- 5.29 Further, Optus considers it unlikely that a price rise in LD services would cause consumers to churn to bundled service provision. Given that the prices of a number of services are involved in the comparison, the extent of the price rise is likely to be unclear to consumers. As has been recognised in the literature, in some circumstances bundling can have the effect of ‘confusing’ the price signals to consumers.⁵¹ And as noted in the previous section, consumer inertia means that Telstra’s fixed access customers are unlikely to churn readily. A more likely consequence of the exemption is that these customers will revert to Telstra. The proposed exemption will therefore cause a significant “detrimental outcome” relative to the ‘future without’ scenario for consumers of fixed voice services generally, and of long distance services in particular.
- 5.30 Optus submits that the ACCC has not appreciated the continuing and important role played by standalone providers of long distance calling services in fixed telecommunications and has proposed an exemption which will not enhance competition in long distance calling.

Impact on Competition in the Corporate and Government market

- 5.31 The ACCC has taken the position that there is not a separate market for the provision of corporate and government customers. From a demand perspective, the ACCC acknowledges that corporate and government customers may seek particular service requirements that distinctly vary from other customers. However this is balanced against the likely “sufficiently large degree of supply-side substitution such that supply to residential customers is likely to be a substitutable service for supply to corporate and government customers.”⁵² Further, the ACCC argues that it need not form a concrete view on the market definition for the provision of voice services to corporate and government customers. Even if such a market exists, “the ACCC does not consider that granting the Exemption Applications would have a material effect on such a market.”⁵³

Deficiencies of the ULLS for service provision to corporate customers

- 5.32 The key question in assessing the proposed exemption’s impact on competition in the corporate and government market is the extent to which the ULLS can be used as a substitute for resale services by providers of services to corporate and government customers. Optus submits that the potential for such supply-side substitution is very limited, and has been overestimated by the ACCC. Optus has submitted material on this subject to the ACCC in its June 2008 response to the ACCC’s draft decision on Telstra’s LCS and WLR

⁵¹ Papandrea, F., Stoeckl, N. and Daly, A., 2001, *Impact of bundling of telecommunications services on consumers, industry and competition*, Working Paper, March 2001, Communication and Media Policy Institute, University of Canberra, p.10; [Joshua Gans, Real Consumers and Telco Choice: The Road to Confusopoly, Presentation to the Australian Telecommunications Summit, Sydney, 21st November 2005]

⁵² ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.61

⁵³ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.61

exemption applications.⁵⁴ Much of this material is relevant to the current matter, and Optus refers the ACCC to its previous submission.

- 5.33 There are a number of reasons contributing to this lack of substitutability. **CiC**
- 5.34 The ACCC has responded to Optus' submissions that granting the exemptions would have negative impact in the corporate and government market sector, by making a number of points. It observes that the 'complex features' that Optus acquires from Telstra are not regulated.⁵⁵ This observation appears to suggest that the complex services are likely to continue to be available to Optus on a commercial basis after an exemption is granted.
- 5.35 However, this does not address Optus' point **CiC**
- 5.36 The ACCC has also observed that Optus appears to be able to self-supply complex features (given that it is investing in NGN technology which will be capable of providing complex features).⁵⁶
- 5.37 Optus is indeed already investing in NGN technology which will be capable of providing complex features. **CiC**
- 5.38 In conclusion, Optus submits that the ACCC has misjudged the extent to which the ULLS can be used as a substitute for resale services by providers of services to corporate and government customers and on that basis proposed an exemption which will not enhance competition in services for corporate and government customers.

'With and without' test

- 5.39 The ACCC in its draft decision appears to have erred in its application of the 'with and without' test to determine the overall impact of the exemption on competition.
- 5.40 The 'with and without' test is intended to compare the situation with the exemption to the situation without. The situation 'without' the PSTN OA exemption should take into account recent final regulatory decisions, including the final decision to grant a WLR and LCS exemption. However, the ACCC does appear to have taken this decision into account in its application of the 'with and without' test. For example, it has stated that:

"The ACCC is concerned that, in the absence of granting exemptions, ULLS take-up may be hindered by the availability of the Fixed Voice Bundle (PSTN OA, WLR and LCS). In this sense, the ACCC is concerned that some firms may choose to acquire the Fixed Voice Bundle (due to the low fixed costs involved in take-up as compared to ULLS take-up)

⁵⁴ Optus, June 2008, *Confidential Submission to the Australian Competition and Consumer Commission in response to Draft Decision on Telstra's LCS and WLR Exemption Applications*

⁵⁵ ACCC, *Telstra's PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.118

⁵⁶ ACCC, *Telstra's PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.118

where, in fact, more efficient and competitive outcomes for consumers would be achieved via ULLS based competition.”⁵⁷

5.41 Similarly, the ACCC has also stated that:⁵⁸

“At the wholesale level, in relation to the “future without” scenario (i.e. where the exemption applications are not granted) access seekers seeking to acquire a wholesale Fixed Voice Bundle would have the following options available to them: reselling voice services using regulated access to PSTN OA, LCS and WLR from Telstra...”

5.42 The ACCC makes this statement under its discussion of the “future without” the proposed exemptions. The ACCC describes this scenario as being the scenario “where regulated access to PSTN OA supplied by Telstra continues to be available”. However, it is clear from the quotation that the ACCC is characterising the test incorrectly in that, in its discussion of the “future without” scenario the ACCC is not, as it should be, considering the scenario “where regulated access to PSTN OA supplied by Telstra continues to be available”. Rather, it is actually considering the scenario “where regulated access to the Fixed Voice Bundle (PSTN OA, WLR and LCS) continues to be available”. The latter question is incorrect because the ACCC’s task in the context of the present application is to consider whether to grant an exemption in respect of the PSTN OA service – not an exemption in respect of the Fixed Voice Bundle (PSTN OA, WLR and LCS).

5.43 If the ACCC was really considering the correct question then the statement above is wrong, since in relation to the “future without” scenario (i.e. where the PSTN OA exemption applications are not granted) access seekers seeking to acquire a wholesale Fixed Voice Bundle would not have the option available of reselling voice services using regulated access to PSTN OA, LCS and WLR from Telstra (after August 2009 Telstra will be exempted from the SAOs in respect of the LCS and WLR services in the ESAs proposed for exemption).

5.44 The ACCC’s mischaracterisation of the test has real consequences because the answer to the question being asked (that is, “Will granting the exemptions promote competition in retail voice markets?”) differs depending on which of the two possible characterisations is adopted.

5.45 In answering the question “Will granting the exemptions promote competition in retail voice markets?” the ACCC concludes that “ongoing regulation of the Fixed Voice Bundle may hinder the extent and speed of transition to ULLS-based competition where this supply option may be viable.”⁵⁹

5.46 Optus notes that this is an answer to the wrong question. In fact, if the PSTN OA exemption is not granted there will be no ongoing regulation of the Fixed Voice Bundle in the ESAs proposed for exemption because after August 2009

⁵⁷ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.117

⁵⁸ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p.122

⁵⁹ ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metro areas, Draft Decision and Proposed Class Exemption*, September 2008, p. 134

Telstra will be exempted from the SAOs in respect of the LCS and WLR services in the ESAs proposed for exemption. Given that the ACCC itself has found that there is no significant standalone long distance market and that the vast majority of access seekers require the entire fixed voice bundle (which includes WLR and LCS), it would be entirely inconsistent for the ACCC to find that the ongoing regulation of the PSTN OA alone (without ongoing regulation of other components of the fixed voice bundle) could hinder the extent and speed of transition to ULLS-based competition. Indeed, in its final decision on the WLR exemption, the ACCC found that if the WLR exemption was granted, that exemption (and that alone) would be sufficient to promote the transition to ULLS-based competition

- 5.47 It follows that the ACCC's analysis is in fact not relevant to the question "Will granting the [PSTN OA] exemptions promote competition in retail voice markets?" The real answer to this question follows from the ACCC's findings (with respect to standalone long distance market and impact of the WLR exemption) discussed above: any resellers of the complete fixed voice bundle who might be stimulated to shift to ULLS-based service provision as the result of an inability to acquire the complete fixed voice bundle would already, by October 2009,⁶⁰ have been stimulated to do so by the WLR exemption coming into effect in August 2009. If the ACCC is to be consistent with the findings just discussed, then it must conclude that in fact ongoing regulation of the PSTN OA would *not* hinder the transition to ULLS-based competition and therefore the PSTN OA exemption will not have any positive impact on investment or competition additional to the (already realised) impact of the WLR exemption.
- 5.48 The PSTN OA exemption will, nevertheless, have negative impacts on competition, since it potentially removes the ability of consumers to preselect their long distance provider, and decreases competitive tension in the supply of services to corporate customers. These negative impacts appear likely to be the dominant result of the PSTN OA exemption – which thus cannot be in the LTIE.
- 5.49 In conclusion, Optus submits that the ACCC has misconstrued the alternative scenarios in the "With and Without test" and as a result of this error overstated the benefits likely to flow from its proposed exemption.

⁶⁰ Suppose that a final decision on the PSTN OA is made by October 2008 (and would come into effect in October 2009).

Appendix A: Likely Timing of NBN Fibre Roll-out to ACCC's ESA Footprint

[Document provided separately.]

Appendix B: Evidence Relating to Long Distance Customers

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Appendix C: Evidence Relating to Corporate and Government Customers

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