

Optus Submission to
Australian Competition and Consumer Commission
in response to
ACCC Fixed Services Review (FSR) Declaration Inquiry for the ULLS, LSS,
PSTN OA, PSTN TA, LCS and WLR Discussion Paper
Public Version

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1. Executive Summary

- 1.1 In November 2008 the ACCC began its review of the declaration of fixed line services and released a discussion paper for comment. Optus welcomes the opportunity to participate in the ACCC's review of the fixed line services.
- 1.2 In the terms of the framework the ACCC has developed for the review of existing fixed line declarations, Telstra's copper access network (CAN) is a bottleneck. Accordingly, not only would inefficient duplication of CAN infrastructure be a waste of society's resources, but premature removal of the regulation of that bottleneck would have serious consequences.
- 1.3 In the absence of pro-competitive safeguards, network effects in the telecommunications industry will act to entrench the dominance of an already powerful incumbent. Regulation should not be removed if it allows the incumbent to engage in anti competitive behaviour and/or poses an appreciable risk of harm to end users. Optus considers there is a real risk that Telstra would engage in foreclosure and price squeeze behaviour in the absence of declaration. We need only look to Telstra's conduct in respect of wholesale DSL to know that this will be the case. Wholesale DSL is not regulated but the ACCC has issued seven Competition Notices against Telstra in respect of its anti-competitive practices. More recently Telstra has denied access seekers the ability to access its ADSL2+ service except on terms that make it difficult to compete.
- 1.4 Optus submits that these risks associated with premature deregulation are sufficiently serious that the fixed line service declarations should not be revoked. The removal of regulation must not leave any entrant at the mercy of the incumbent. If the ACCC wishes to remove regulation it must be confident that those who were previously protected by the regulation will have an equality of opportunity to compete in the market. This equality of opportunity simply does not exist in the Australian market, so further deregulation would be unwise at this juncture. Optus supports the ACCC's preliminary view that the declarations of each of the fixed line services considered in this review should be extended.
- 1.5 Of the services under review, the ULLS in particular stands out as a regulatory policy success that is starting to deliver genuine competition. A key result from the recent exemption decisions was the ACCC's reliance on access to ULLS-based infrastructure as a strong conditional basis for the granting of exemptions in relation to resale services.
- 1.6 In the case of those resale services, Optus agrees strongly with the view that the exemptions have important conditions and limitations attached to them, and are therefore tightly linked to the underlying declarations for each of these services. As a result, any variation, revocation or lapsing of the declaration would nullify the effect of the conditions and limitations and risk leaving competitors at the mercy of the incumbent.

2. Background

Unconditioned local loop service (ULLS)

- 2.1 The ULLS is an access product used by operators for the provision of wholesale voice or wholesale DSL services. It can also directly be provided to end-users at the retail level for voice, broadband or bundled voice and broadband services.
- 2.2 The ULLS allows competitors direct access to Telstra's ubiquitous copper CAN connecting customers to local telephone exchanges. However the access seeker must deploy its own equipment, such as DSLAMs for the provision of xDSL, in Telstra's exchanges in order to provide their downstream services.
- 2.3 This service has no prescribed bandwidth, thereby allowing access seekers greater choice in regards to the range of products and service offerings they provide to end-users.

Line sharing service (LSS)

- 2.4 The LSS is an access product used by operators for the provision of wholesale voice services. It allows two separate carriers to provide separate voice and data services over a single copper line.
- 2.5 This service allows access seekers to provide high-speed broadband services to end-users through the higher frequency part of the copper line, while the access provider continues to supply the underlying PSTN voice service over the same copper line.

PSTN originating and terminating access services

- 2.6 The PSTN originating access (OA) and PSTN terminating access (TA) are wholesale inputs used by operators for the provision of voice services to end-users at the retail level.
- 2.7 The PSTN OA involves the carriage of telephony calls from the calling party to a point of interconnect (POI) with an access seekers' network. The PSTN TA involves the carriage of telephony calls from a POI within access seekers' network to the called party.

Local carriage service (LCS)

- 2.8 The LCS is a wholesale input used by operators for the provision of voice services to end-users at the retail level. It allows competitive entrants to resell local call services without the need to deploy substantial alternative infrastructure.
- 2.9 This service involves the carriage of an end-to-end telephony service between the called and the calling parties within the same standard zone.

Wholesale line rental (WLR) service

- 2.10 The WLR service is a wholesale input used by operators for the provision of voice services to end-users at the retail level. Similar to LCS, the WLR service allows competitive entrants to resell local call services without the need to deploy substantial alternative infrastructure.
- 2.11 This service involves the provision of a basic line rental service connecting the end-user to the PSTN, and providing end-users a telephone number and the ability to make and receive standard PSTN calls.

2006 Strategic Review of the Regulation of Fixed Network Services

- 2.12 The *Strategic Review of the Regulation of Fixed Network Services* examined a range of issues relating to key wholesale services delivered over Telstra's copper-based fixed network. The review considered whether the ULLS, PSTN OTA and CLLS declarations should be continued, as well as whether a wholesale DSL service should be declared.
- 2.13 As a result of this review, the ACCC concluded that:
- The ULLS declaration should be extended for a three year period to 31 July 2009, on a national basis. The ACCC considered that the re-declaration of the ULLS declaration would be in the LTIE given that the ULLS provides competitors with the ability to access Telstra's ubiquitous copper CAN to provide a large range of services.¹
 - The PSTN OTA declaration should be extended for a three year period to 31 July 2009, on a national basis. In addition, the ACCC considered it was appropriate to merge the separate local and domestic PSTN OTA service descriptions into a single originating and terminating service that can be provided at any feasible local or transit point of interconnection.²
 - The CLLS declaration should be allowed to expire at the end of its current declaration period as of 30 June 2006.
 - The wholesale DSL service should continue to remain undeclared given the prevailing uncertainties and lack of definitive understanding regarding the impact of any DSL declaration. However, the ACCC considers there may be some scope for reconsideration of these issues in the future.³

¹ ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS*, Final Determination, July 2006, p.39

² ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS*, Final Determination, July 2006, p.52

³ ACCC, *Strategic review of the regulation of fixed network services*, Position Paper, June 2006, p.93

2006 Local Services Review

- 2.14 The *Local Services Review* examined a range of issues relating to whether the LCS declaration should be continued, including whether a WLR service should be declared.
- 2.15 As a result of this review, the ACCC concluded that:
- The LCS declaration should be extended for a three year period to 31 July 2009. The ACCC considered that the re-declaration of LCS would be in the LTIE, through the promotion of competition in the local retail market, as well as in long distance preselection services.⁴
 - The WLR service would be declared as a separate service. The ACCC considered it was appropriate to declare the line rental service for a three year period to 31 July 2009, under similar conditions and limitations as the LCS declaration.⁵
 - Recognition of previous exemption applications granted to the LCS in the CBD areas of Sydney, Melbourne, Adelaide, Brisbane and Perth would be considered. Accordingly, the ACCC considered that the declaration should apply to all geographic areas, with the exception of the five identified CBD areas.⁶

2007 Review of LSS declaration

- 2.16 The release of the ACCC's second position paper in its ongoing *Fixed Services Review* (the FSR2) aimed to outline a framework for the upcoming review of existing service declarations. The FSR2 also launched an inquiry to examine a range of issues relating to whether the LSS declaration should be continued.
- 2.17 As a result of this review, the ACCC concluded that the LSS should be extended until 31 July 2009, on a national basis. The ACCC considered that the re-declaration of LSS would be in the LTIE by ensuring access seekers are better able to compete with Telstra in downstream markets.⁷

Telstra's WLR and LCS, PSTN OA and HFC exemption applications

- 2.18 Since 2007, the ACCC has released a number of important decisions in relation to Telstra's lodgement for exemption from Standard Access Obligations (SAOs) for the PSTN OA, LCS and WLR services, as well as in Optus' hybrid fibre-coaxial cable (HFC) network footprint.
- 2.19 The following discussion highlights the ACCC's key decisions and findings in relation to Telstra's exemption applications.

⁴ ACCC, *Local Services Review*, Final Decision, July 2006, p.46

⁵ ACCC, *Local Services Review*, Final Decision, July 2006, p.51

⁶ ACCC, *Local Services Review*, Final Decision, July 2006, p.9

⁷ ACCC, *Review of the Line Sharing Service Declaration*, Final Decision, October 2007, p.65

Telstra application for LCS and WLR exemptions

- 2.20 Telstra in July 2007 and October 2007 lodged four exemption applications in respect of WLR and LCS with the ACCC. Telstra sought an order from the ACCC to exempt itself from supplying WLR and LCS to access seekers in 387 ESAs.
- 2.21 On 22 August 2008, the ACCC granted Telstra exemptions from the SAOs in respect of the supply of the LCS and WLR services subject to a number of limitations and conditions.
- 2.22 These exemptions will apply to a total of 248 of the 387 ESAs, in which the geographic areas consist of those ESAs that have:
- 14,000 or more addressable SIOs; or
 - four or more ULLS-based competitors (including Telstra) within the ESA.
- 2.23 The conditions and limitations imposed address concerns raised regarding the substitutability of ULLS for LCS and WLR – in particular, capping, queuing and LSS to ULLS migration.
- 2.24 In relation to capping, “the conditions imposed on the Exemption Orders provide that as soon as Telstra purports an exchange to be “capped” or “potentially capped”, regardless of whether that exchange is, in fact, capped or potentially capped, the exemption ceases to apply in the relevant ESA.”⁸
- 2.25 In relation to queuing, “it would appear that where an access seeker is waiting in a queue to install their equipment in an exchange in order to be able to access the ULLS – the exemption ought not apply in that ESA in respect of any access seeker waiting in the queue.”⁹
- 2.26 In relation to LSS to ULLS migration, “where an access seeker is obtaining LCS/WLR in conjunction with LSS to supply an end-user with a bundled fixed voice and broadband service via that access seeker’s DSLAM equipment, the exemption should not apply in relation to that access seeker’s supply to that particular customer.”¹⁰
- 2.27 Furthermore the ACCC has recognised that “there are a variety of technical factors that can affect whether a particular end-user can be supplied a voice service via ULLS.”¹¹ In this situation, the ACCC is of the view that where ULLS cannot be applied then the exemption should not apply.

⁸ ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications*, Final Decision and Class Exemption, August 2008, p.148

⁹ ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications*, Final Decision and Class Exemption, August 2008, p.149

¹⁰ ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications*, Final Decision and Class Exemption, August 2008, p.151

¹¹ ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications*, Final Decision and Class Exemption, August 2008, p.154

- 2.28 The ACCC decided that exemption would come into effect following a 12 month transition period, and would expire on 31 December 2012 or the expiry or revocation of either the LCS Declaration (and/or the WLR Declaration) or the ULLS Declaration, whichever first occurs.
- 2.29 The ACCC's decision to grant Telstra's LCS and WLR exemption applications (to a reduced number of exchange areas than the applications initially applied) has since been considerably scrutinised by both the Australian Competition Tribunal and the Full Federal Court.
- 2.30 Chime Communications Pty Ltd applied to the Australian Competition Tribunal (ACT) to review the ACCC's decision in granting the exemption. Other access seekers including AAPT Limited, PowerTel Limited, Agile Pty Ltd, Macquarie Telecom Pty Limited and Primus Telecommunications Pty Ltd were also given leave to intervene in the review.
- 2.31 On 22 December 2008, the Australian Competition Tribunal (ACT) confirmed that there was an ongoing need for access to Telstra's network and that, in effect, the ACCC had proposed the roll back of existing LCS and WLR regulation too soon. This decision was appealed by Telstra to the Full Federal Court (FFC) for a judicial review.
- 2.32 The FFC in March 2009 made a decision to set aside the ACT's decision, having identified six discrete errors of law. The FFC ordered the exemption applications be remitted to the ACT.

Telstra application for domestic PSTN originating access services exemptions

- 2.33 On 29 October 2008, the ACCC granted Telstra exemptions from the SAOs in respect of the supply of the PSTN OA service subject to a number of conditions and limitations.
- 2.34 These exemptions will apply to a total of 248 of the 387 ESAs and 17 CBD ESAs in Sydney, Melbourne, Brisbane, Adelaide and Perth, in which the geographic areas consist of those ESAs that have:
- 14,000 or more addressable SIOs; or
 - four or more ULLS-based competitors (including Telstra) within the ESA.
- 2.35 The conditions and limitations imposed address concerns raised regarding the substitutability of ULLS for PSTN OA, with the majority of conditions imposed largely in line with those granted in the ACCC's August 2008 decision on Telstra's LCS and WLR exemption applications – in particular, the conditions applying to capping, queuing and LSS to ULLS migration.
- 2.36 In addition, in respect of Telstra's PSTN OA CBD Exemption, the ACCC was satisfied that granting the exemption "without conditions and

limitations regarding access to the ULLS (relating to capping, queuing and LSS-ULLS migration) will promote LTIE.”¹²

- 2.37 The ACCC decided that exemption would come into effect following a 12 month transition period, and would expire on 31 December 2012 or the expiry or revocation of either the PSTN OA Declaration or the ULLS Declaration, whichever first occurs.
- 2.38 A number of access seekers applied to the ACT to review the ACCC’s decision in granting the exemption. The case has not yet been heard.

Telstra application for fixed line services exemption in Optus cable network areas

- 2.39 On 11 November 2008, the ACCC rejected Telstra’s application for exemption from the SAOs in respect of the supply of ULLS, LLS, LCS, WLR and PSTN OA to Optus in a defined geographic area of any customer premises within 75 metres of Optus’ currently deployed HFC cable network in Sydney, Melbourne and Brisbane.
- 2.40 This exemption application has differed from the others recently submitted by Telstra in that “it seeks exemption from the SAOs only in respect of supply to Optus (or to any carrier who acquires the service from Telstra and resupplies it to Optus). Existing access rights of other carriers would not be affected by this exemption application (except to the extent they resupply services to Optus).”¹³
- 2.41 The ACCC’s two main issues of concern relate to the disincentive effects on investment resulting from a discriminatory access approach, and the consequences of Telstra’s 50 per cent interest in Foxtel.
- 2.42 The ACCC has noted that “there is significant overlap between the proposed exemption area in this application (i.e. the Optus HFC footprint) and the areas where exemptions have either recently been granted (LCS, WLR and PSTN OA).”¹⁴
- 2.43 The ACCC has therefore concluded that “it is not satisfied that the exemption would promote competition in the relevant markets or encourage the economically efficient use of, and investment in, infrastructure.”¹⁵
- 2.44 Telstra applied to the ACT to review the ACCC’s decision in granting the exemption. The case was heard in March however the ACT’s judgement has not yet been delivered.

¹² ACCC, *Telstra’s PSTN Originating Access exemption applications – CBD and Metropolitan areas*, Final Decision and Class Exemption, October 2008, p.167

¹³ ACCC, *Telstra’s exemption application in respect of the Optus HFC network*, Final Decision, November 2008, p.7

¹⁴ ACCC, *Telstra’s exemption application in respect of the Optus HFC network*, Final Decision, November 2008, p.23

¹⁵ ACCC, *Telstra’s exemption application in respect of the Optus HFC network*, Final Decision, November 2008, p.137

3. The Risks of Deregulation

Factors pertinent to considering whether to roll back regulation

- 3.1 In its 2007 *Fixed Services Review* position paper 2 (the FSR2) the ACCC developed an approach that stresses the importance of ensuring that regulation is precisely targeted so that it is limited to the particular areas where it is required to promote the LTIE, and not applied more generally.
- 3.2 As such, it proposes that this will take into account “both the state of *actual* competition in the relevant markets and the *potential* for effective competition developing, in seeking to determine whether ongoing declaration of particular services is required to promote competition in the relevant markets.”¹⁶
- 3.3 It follows that the ACCC’s general framework for the review of existing fixed-line declarations, within the LTIE framework, will involve the following considerations:
- i) Enduring bottlenecks;
 - ii) Assessment of the state of competition; and
 - iii) Assessment of remaining LTIE criteria.¹⁷
- 3.4 The following will discuss some of the key elements considered within the ACCC’s general approach, as provided in the FSR2.

Enduring bottleneck

- 3.5 Optus submits that access to Telstra’s ubiquitous copper network will continue to be an enduring bottleneck.
- 3.6 An enduring bottleneck refers to any “network element or facility that exhibits natural monopoly characteristics and is ‘essential’ to being able to provide services to end-users in downstream markets in a way that promotes the long-term interest of end-users (LTIE).”¹⁸
- 3.7 It may also arise in circumstances where an access seeker *must* purchase access to a particular service in order to ensure any-to-any connectivity of its service to end-users. For example, the purchase of termination services in order to complete calls on competitor networks.
- 3.8 Regardless, the ACCC continues to recognise that:

“Certain features of fixed-line markets suggest that there are likely to be enduring bottlenecks across particular elements of the network. At one level, these enduring bottlenecks may exist due to the ongoing

¹⁶ ACCC, *Fixed Services Review – A second position paper*, April 2007, p.iv

¹⁷ ACCC, *Fixed Services Review – A second position paper*, April 2007, p.iv

¹⁸ ACCC, *Fixed Services Review – A second position paper*, April 2007, p.ii

presence of natural monopoly cost characteristics across particular elements of the network, and because these elements continue to represent essential facilities for the provision of downstream services. For instance, the Commission has previously expressed the view that the Telstra's local customer access network (the 'CAN') is likely to exhibit natural monopoly characteristics in the foreseeable future, and remains an essential facility for the provision of certain downstream services."¹⁹ [emphasis added]

Natural monopoly

- 3.9 The term 'natural monopoly' is subject to a varying array of economic definitions. The New Zealand Ministry of Economic Development has stated that:

"Natural monopoly firms, by definition, do not face competitive pressures. Compared to firms in competitive industries, monopoly firms may have higher costs, may charge higher prices and may be slower to innovate or to introduce new technologies.

*These concerns may be heightened if the monopolist is vertically-integrated into an upstream or downstream market. In this context the monopolist may, by restricting access to the natural monopoly facility, restrict or prevent competition in the related market."*²⁰

- 3.10 Natural monopolies typically arise in industries where there are high fixed and sunk costs, and lower marginal costs due to the presence of economies of scale, scope and/or density.
- 3.11 The ACCC has previously noted that a natural monopoly exists "where a good or service can be more cheaply produced by a single firm, rather than spreading production over multiple firms."²¹ Importantly, the ACCC also notes that "in fixed-line networks, natural monopoly cost conditions may exist over particular elements of the network, rather than across the entire supply chain."²²
- 3.12 Optus agrees with these observations of the ACCC. Applying them to the CAN, Optus submits that:
- Telstra's CAN is capable of supplying the entirety of existing demand for the declared fixed line services currently provided over the CAN;
 - it is self-evidently less costly for Telstra to continue to operate the existing CAN than for duplicate networks to be constructed to connect households to multiple fixed line networks;
 - to the extent that new services are demanded in the future, it will continue to be less costly for a single operator to continue to operate a

¹⁹ ACCC, *Fixed Services Review – A second position paper*, April 2007, p.ii

²⁰ NZ Ministry of Commerce and The Treasury, *Regulation of access to vertically-integrated natural monopolies*, Discussion Paper, August 1995, p.18

²¹ ACCC, *Fixed Services Review – A second position paper*, April 2007, pp.21-22

²² ACCC, *Fixed Services Review – A second position paper*, April 2007, p.ii

single fixed line network (ie, the NBN) than for duplicate networks to be constructed to connect households to multiple fixed line networks.

- 3.13 Accordingly, Optus submits that Telstra's CAN is a bottleneck and inefficient duplication of CAN infrastructure would be a waste of society's resources. The terms of the legislative criteria in Part XIC are intended to guard against this waste since it would lead to poorer outcomes for consumers. Any suggestion that the access regime should be biased in favour of investment in infrastructure that is not efficient should be strongly resisted. Consequently the fixed line service declarations should not be revoked.

Network effects

- 3.14 In addition to natural monopoly characteristics, Telstra's vertically integrated structure and dominance in both the wholesale and resale markets highlights the advantages of network effects in fixed-line telecommunications.
- 3.15 The concept of network effects for products and services is an increase in value as the size of the network increases. Thus, the network effect becomes more efficient as they grow larger, even while the market power associated with the incumbent becomes more durable and entrenched. The economic effect is therefore, in economic terms, one of increasing returns. However in competition terms, network effects can entrench and exacerbate structural impediments to effective competition.
- 3.16 Telecommunications networks are subject to a network externality (the 'network effect') – that is, when choosing between competing networks, consumers will usually select the most valuable network, which also tends to be largest network with the most users or number of nodes. As a result, this exacerbates the tendency towards natural monopoly. Therefore as consumers increasingly gravitate towards the largest network (also known as 'positive feedback') competing, smaller networks increasingly lose value and become squeezed from the market.
- 3.17 It therefore follows that network effects operate under a series of complementary cycles. The first is a 'positive feedback' cycle which allows operators with networks of sufficient size to enjoy an exponentially larger attraction for customers. While the second is a 'negative feedback' loop which ensures that competitors are less able to compete.
- 3.18 As a result, network effects therefore operate to:
- Increase the existing barriers to entry in telecommunications markets;
 - Limit the ability for consumers to experience the benefits of the services and products of new entrants;
 - Increase incentives for incumbents to maintain their market power, thereby heightening the incentive to engage in anti-competitive conduct and exclude entrants from the market or limit the interoperability of their networks;

- Perpetuate demand in favour of the incumbent’s offering and cement its position as the dominant operator; and
- Allow operators, once they have reached a position of dominance, to maintain that position easily at the expense of efficiency, innovation and competition.

Tipping

- 3.19 An extension of network effects, the ‘tipping point’ is a point at which network effects can lead towards a rapid acceleration in a firm’s growth at the expense of its competitors and consumers.
- 3.20 Many high technology industries are susceptible to tipping, particularly in terms of market share growth, due to the dynamic nature of product development and service innovations. For example, within the technology hardware and software markets. In each case, the company that gained a significant initial edge would cross the tipping point and experience significant growth to arrive at a position of market dominance with that particular product or service. Telecommunications markets increasingly exhibit similar characteristics, and tipping rapidly occurs in telecommunications networks due to low marginal costs and rapid distribution.
- 3.21 In traditional telecommunication markets, such as fixed voice telephony services, the incumbent already possesses very high levels of market power. Therefore the objective in those markets is to see the incumbent’s market share fall to (and remain at) a level below the tipping point.
- 3.22 Another problem in telecommunications markets is that the incumbent may leverage its existing market power into new markets. In effect, the cross market leverage allows the incumbent to more rapidly accelerate to and beyond the tipping point.
- 3.23 For example, through its “telephony defence strategy” Telstra sought to impede Optus’ entry into the fixed line services market by overbuilding the Optus cable network - such action was economically irrational absent the benefits associated with impeding competition.
- 3.24 More recently Telstra has sought to stall the impact of competitor investment in DSLAM infrastructure by capping capacity at certain key exchanges.
- 3.25 It therefore follows that premature removal of pro-competitive safeguards before the incumbent’s market share falls below the tipping point may mean that the prospects of that ever occurring in the foreseeable future would subsequently recede.
- 3.26 Economic theory suggests that in network industries, anti-competitive tactics can be crucial, even outcome determinative, regardless of whether an industry’s cost structure is conducive to competition or an entrant is more cost efficient than the entrenched incumbent. As such the ACCC must continue to be mindful that in encouraging access seekers to move up the ‘rungs’ of investment, it must be careful not to remove rungs

prematurely as this could leave access seekers in a very weak position compared to infrastructure owners.

- 3.27 The current regulatory system has not effectively controlled a powerful vertically integrated incumbent that is uncompromisingly determined to restrict competition. It should follow that there is simply no case, despite Telstra's contention, for relaxing regulations any further than that which has already been provided by the Exemption Application process.

Further deregulation is not in the LTIE

- 3.28 There is no better evidence of why Telstra's claims for a lighter form of regulation should be rejected than consideration of how it has behaved under the present regulatory regime over the past 11 years. The current regulatory framework has been in place since 1997. Most objective commentators would accept that this framework has been less than effective in both controlling Telstra and stimulating competition, especially in respect of the provision of fixed line services.
- 3.29 In framing the current telecommunications regulatory regime which took effect in 1997, policy makers took the view that a level playing field in the provision of telecommunication services could be achieved by a combination of general competition law principles coupled with telecommunications specific access regulation. Hence, under the current regime, introduced in 1997, Telstra remains vertically integrated but subject to specific regulation of the Trade Practices Act (TPA). Part XIB of the TPA deals with abuse of market power and anti-competitive conduct whilst Part XIC regulates the terms of access to services.
- 3.30 While the provisions of Part XIB and Part XIC of the Trade Practices Act are intended to prevent the various forms of anti-competitive conduct and foreclosure strategies, they arguably are not as effective in doing so. Instead they often result in a merry-go-round of regulatory disputes and delay, legal challenges and rule changes to reinforce the powers of the regulator. Consequently the cause of fixed line competition and consumer interests has been very poorly served by the system.
- 3.31 Evidence of the problem is provided by the tortuous process for arriving at a final price ruling on ULLS – an essential building block of competition in the fixed line network. Given the competitive opportunity ULLS has opened up, Telstra subjected the ULLS regulations to the full blast of its legal armoury. This includes using the Australian Competition Tribunal, the Federal Court and even the High Court to challenge the ACCC. Some 9 years after the service was first declared the ACCC has issued a final ruling on access prices – That ruling expired in June 2008 and the debate has reignited again, as Telstra has lodged yet another ambit claim. This process has resulted in significant uncertainty for access seekers and has arguably held back investment.
- 3.32 However despite all the weakness in the provision of Part XIB and Part XIC, it would remain in the interest of access seekers to continue to compete in regulated fixed line services market, than without. In the

absence of declaration, these provisions would no longer hold, and as such, access seekers will become vulnerable to the immediate risks of anti competitive and foreclosure strategies, with no assurance of continued supply. Hence this would result in a substantial lessening of competition in fixed line services.

- 3.33 It therefore follows that continued declaration of fixed-line services is the bare minimum required to mitigate the likelihood of such behaviour allowing Telstra to further entrench its position as one of the most powerful vertically integrated carriers in the world.

The ACT's approach to deregulation

- 3.34 It might be argued that the ACT's observations in its decision on Telstra's 2007 WLR and LCS exemption applications should be given no weight, given that its decision has been set aside. Optus submits that this argument would be wrong. Although the FFC made a decision to set aside the ACT's decision on Telstra's 2007 WLR and LCS exemption applications, the reasons for the FFC's decision were limited to six discrete errors of law; the FFC did *not* reject *all* of the ACT's observations and reasons for its decision and it would be quite inappropriate to dismiss every word in the decision as wrong. Optus submits that – with the exception of the identified errors of law – the observations made by the ACT in its judgement continue to be valuable insights and provide guidance upon the approach which should be followed with respect to regulation and deregulation under part XIC, and the ACCC should duly consider them in its declaration inquiry.
- 3.35 The following pages contain a discussion of some of the salient points from the ACT's decision.

Ladder of investment

- 3.36 The ACT considered that regulation should not be removed if it allows the incumbent to engage in anti competitive behaviour and/or poses an appreciable risk of harm to end users:

*“A decision to remove regulated access requires a balance to be struck between competing factors. On the one hand there is the risk that continued regulation will result in market distortions, high prices and fewer choices. On the other, there is the risk that premature deregulation will permit the still-dominant incumbent ... to engage in anti-competitive conduct, which will distort the market in the long term. The choice to be made is between ex-ante regulation of access and prices and ex-post law enforcement to deter anti-competitive conduct. **If there be any appreciable risk of harm to end-users, regulation will usually trump law enforcement...**”²³*

- 3.37 The ACT made some observations on Telstra's expert Martin Cave's ladder of investment hypothesis and warned that the removal of

²³ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008), paragraph 33

regulation must not leave any entrant at the mercy of the incumbent and that it must be confident that those who are previously protected by the regulation will have an equality of opportunity to compete in the market, either by retaining their old supply sources and conditions of supply, by entering into contracts with alternative suppliers, by investing in their own facilities, or by using excess capacity of other providers operating on the next rung of the ladder.²⁴

- 3.38 The ACT also considered that under Cave's ladder of investment hypothesis:

*"...it is the task of regulators to signal that the terms and conditions of access will change. That is, those seeking access to the incumbent's infrastructure will be put on notice that over time they need to increase their own infrastructure investment, and rely less on that of the incumbent. If not, then entrants run the risk that the incumbent's services will no longer be regulated and accordingly may not be supplied under the same (regulated) prices and conditions as before. It is the regulator's task to make this path both feasible and commercially available."*²⁵

- 3.39 The ACT further stated that it would normally be easier to revisit a decision at a later stage and subsequently withdraw regulation than it would be to re-regulate after the market had been divested of some or all of its regulatory constraints.²⁶

- 3.40 Telstra made submissions to the FFC that the ACT applied a presumption about the maintenance of existing regulation. Telstra's argument was subsequently rejected by the ACT:

"The remarks of the Tribunal relied upon by Telstra in support of this sub-argument do not, in our view, betray a bias or presumption on the part of the Tribunal in favour of the maintenance of existing regulation."

*"We do not think that the Tribunal approached its consideration of the applications before it with such a bias in favour of the existing state of affairs..."*²⁷

- 3.41 Telstra further relied on the ACT's observations on Cave's ladder of investment and argued that the ACT erred in misconstruing s152AB(2)(c) of the TPA by concentrating on advancement of individual competitors rather than the promotion of competition as a process within the relevant markets²⁸.

- 3.42 Similarly, this ground of appeal by Telstra was rejected by the FFC:

²⁴ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008), paragraph 50-53

²⁵ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008) paragraph 46

²⁶ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008), paragraph 51

²⁷ Telstra Corporation Limited v Australian Competition Tribunal [2009] FCAFC 23

²⁸ Telstra Corporation Limited v Australian Competition Tribunal [2009] FCAFC 23 paragraph 222

“In our view, these particular references relied upon by Telstra were no more than observations made by the Tribunal as part of its consideration of objective (c) in s152AB(2). The matter which the Tribunal had under consideration was the existing state of competition in the relevant markets. In the course of considering that matter, it made reference to various specific matters concerning the nature of that competition and the evidence which it had (and did not have) demonstrating the extent of that competition.

We do not think that the Tribunal placed an impermissible emphasis on the protection of competition rather than applying the appropriate test developed in its own jurisprudence as to the meaning of the concept of “promoting competition.”²⁹

- 3.43 It is therefore clear that the FFC did not reject but rather accepted the ACT’s observations on these issues – in particular, its remarks that a regulator must be confident that the removal of regulation would not result in access seekers facing an inequality of opportunity to compete with the incumbent and that its task is to ensure that access seekers would be able to, both feasibly and commercially, increase investment in their own infrastructure and rely less on the incumbent’s infrastructure over time.

The proposed rules of thumb used by Telstra and the ACCC

- 3.44 The ACT rejected Telstra’s and the ACCC’s approach to adopting a rule of thumb in determining which exchanges should be exempted from SAOs. The ACT considered that a fixed rule of thumb in the area of deregulation is just a shortcut and that it is a static indicator only which reveals nothing about market dynamics over time:

“The problem with a fixed rule of thumb in the area of deregulation is that it is just a shortcut. Simple numbers-based rules of thumb are not uncommonly used as a screening device to indicate thresholds beyond which markets might ordinarily be expected to work competitively. But a rule of thumb is a static indicator only and reveals nothing about market dynamics over time.”³⁰

- 3.45 The ACT then stated that Telstra’s and the ACCC’s rule of thumb gives no indication of:

“...(a) how this number of firms eventuated; (b) whether their presence (market share) in the market is growing or declining; (c) whether there has been exit over time and, if so, for what reason; (d) whether end-users attracted to new entrants are increasing; (e) whether entry was for strategic or indirect purposes designed to influence behaviour elsewhere to compete in the market (ie the particular exchange) in question. Nor can a rule of thumb reliably indicate anything about

²⁹ Telstra Corporation Limited v Australian Competition Tribunal [2009] FCAFC 23 paragraph 227-228

³⁰ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008), paragraph 58

past, present or importantly for regulatory purposes, likely future behaviour by either incumbents or potential entrants."³¹

3.46 The ACT considered that the principal indicators of a competitive market include:

- i) The number of new entrants;
- ii) The growth of the entrants' market share;
- iii) An increase in the range and quality of the services required; and
- iv) A reduction in the price of services.³²

3.47 The FFC neither accepted nor rejected the ACT's decision in rejecting the proposed rules of thumb. Rather, it considered:

*"The question of satisfaction is for the ACCC and the Tribunal on review..."*³³

3.48 The FFC then went on and discussed how s152ATA and s152ASA complement s152AT and s152AS. Although Telstra may take some comfort from the way in which the FFC stated that "*[i]t may be impossible for an application under that section to adduce any empirical evidence or any hard evidence at all. An applicant may have to rely entirely on expert evidence of a predicative nature.*"³⁴, it however appears that the FFC was only making a general statement that there are instances where it is difficult for the applicant to adduce empirical evidence. The FFC did not make an explicit statement that 'rule of thumb' were acceptable. Rather, it stated that this is a decision which ought to be made by the Tribunal and the ACCC.

3.49 It is therefore important that in examining the likely impact on the state of competition in the future 'with' and 'without' world of regulation (unless there is absolutely no hard evidence available at all), the ACCC ought not to rely solely on a static indicator but ought to engage in further market analysis, including the principal indicators the ACT mentioned above.

The roadmap

3.50 The ACT considered it would be useful to formulate a set of rules that provide a roadmap for deregulation. The roadmap includes at least eight factors which provide a basis for drawing inferences on whether deregulation is likely to result in the achievement of the objective or promoting competition:

"(a) the total number of addressable SIOs in the market; (b) the number of exchanges in which there is at least one entrant; (c) the

³¹ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008), paragraph 59

³² Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008), paragraph 56

³³ Telstra Corporation Limited v Australian Competition Tribunal [2009] FCAFC 23 paragraph 153

³⁴ Telstra Corporation Limited v Australian Competition Tribunal [2009] FCAFC 23 paragraph 153

number of entrants; (d) the total number of addressable SIOs broken down on an exchange by exchange basis in the subject exchanges; (e) the share of SIOs that the entrants have taken from the incumbent; (f) the physical capacity and operational willingness of the entrant to take more market share; (g) the cost and ease of installing new infrastructure; and (h) the capacity and technology status of each DSLAM in each exchange.”³⁵

- 3.51 Telstra submitted to the FFC that the ACT made an error of law in demanding Telstra produce empirical evidence which far exceeded those that are authorised by the relevant provisions of Part XIC of the TPA.
- 3.52 The FFC subsequently accepted Telstra’s argument that the ACT applied the wrong test that in order for Telstra to satisfy the requirement of s152AT(4), it was necessary for Telstra to adduce empirical evidence which addressed the various matters set out in the roadmap.
- 3.53 Although the FFC upheld this ground of appeal of Telstra, Optus considers the eight factors listed in the roadmap could still be useful in providing the ACCC with a useful insight into the level of competition in the market.
- 3.54 Optus acknowledges it is not a mandatory requirement for the ACCC to take into account all eight factors when making a decision to regulate or not regulate. The FFC however did not rule that these eight factors play no relevance in considering the state of competition in the market. Optus therefore considers these eight factors could still be used by the ACCC as declaration guidelines in this inquiry.

The risks ‘without’ declaration

- 3.55 Optus considers there is a real risk for Telstra to engage in foreclosure and price squeeze behaviour in the absence of declaration. Consider the situations where:
- i) The incumbent operator does not provide a particular product or service, usually because this service is not (or no longer) declared.
 - ii) The incumbent operator provides a particular product or service, often because this service is declared. However the incumbent is the only provider of this service in the market and there are no wholesale demand substitutes provided by other operators.
- 3.56 In both cases, it would appear that there is no competitive constraint which would force the incumbent operator to offer the access input, nor prevent it from raising the wholesale prices above a competitive level to competitors.

³⁵ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008), paragraph 72

- 3.57 In the first instance, there are no competitive controls that can be directly enforced in the transaction between the incumbent and other operators. It follows that a commercial wholesale product may no longer be made available to competitors at the incumbent's discretion or rather a commercial wholesale arrangement will be developed, providing the competitor continued supply of the product at a re-negotiated price with some level of margin squeeze.
- 3.58 In the second instance where a service is regulated, the incumbent remains the only provider of that service. It follows that, although access to the service has been mandated, the incumbent is similarly able to self supply to itself the upstream inputs and therefore compete in the downstream markets with the competitors to whom it supplies. As a result the impact of competitive constraints in the instance of a vertically integrated incumbent, that is also a sole supplier in an upstream market, will be limited.
- 3.59 For example, in areas where Telstra is a monopoly (or near-monopoly) provider of basic access services, as a vertically integrated operator it may face strong incentives to:
- i) Exclude competitors in downstream markets; or
 - ii) Disadvantage competitors by selling upstream services at discriminatory rates.
- 3.60 There are a number of competition foreclosure strategies that may arise in the fixed line services sector. However the likelihood that such strategies are adopted may be exacerbated in the absence of declaration. These are discussed as follows.

Margin squeeze

- 3.61 A margin squeeze, also known as a price squeeze, is a situation where a firm with market power in a key upstream market, supplies its competitors in associated downstream markets and sets prices for the input in a way that renders the activities of its competitors in the retail market unprofitable. This is particularly the case in the telecommunications market, where the incumbent operator is characterised as a vertically integrated network operator providing access to its competitors.
- 3.62 Margin squeeze practices can occur under both ex-ante and ex-post regulatory conditions. However where ex-ante regulations apply, the regulator is able to intervene and initiate proceedings to reach a more competitive outcome.

Increased risk of collusive behaviour

- 3.63 In the absence of declaration, the vertically integrated firm (usually the incumbent) may choose to engage in collusive behaviour. This can occur in several forms, which may include engaging in discriminatory approaches; the provision of exclusive contracts; and predatory pricing.

Discriminatory approach

- 3.64 The integrated firm can refuse to deal with potential customers by denying access to the essential bottleneck service. This may take form through the incumbent's action to make the bottleneck service incompatible with its competitors' products or technologies, engage in tie-in and refuse to unbundle.

Exclusive contracts

- 3.65 The integrated firm can grant exclusivity to a subset of potential customers, or tie its essential bottleneck service with selected products on the complementary segment, thereby de facto excluding its rivals.

Predatory pricing

- 3.66 The integrated firm can price discriminate its essential bottleneck service across its potential customer base, such that different (cost-adjusted prices) can be set for different customers.
- 3.67 The use of exclusivity and tying arrangements therefore can be used to favour some customers over the others, while still providing the bottleneck owner with some flexibility in serving its discriminated-against customers.
- 3.68 Similarly, in offering substantial price discounts, this may allow the bottleneck owner to influence the survival of only a few competitors.

4. Relevant Markets

The ACCC seeks submissions from parties on the relevant markets for this declaration inquiry

- 4.1 Optus concurs with the ACCC's preliminary view that some of the relevant markets for this declaration inquiry include:³⁶
- i) The retail and wholesale provision of voice services;
 - ii) The retail and wholesale provision of broadband services; and
 - iii) The retail and wholesale provision of bundled voice and broadband services.
- 4.2 However, in addition to the above residential markets there is also a need for recognition of the separate corporate and government market, and also the standalone market for long distance services.

Current use of declared fixed-line services

- 4.3 The ACCC's 2007 *Fixed Services Review* (the FSR2) aimed to outline a framework for the current review of existing fixed line service declarations. It considers that a key "feature of the current mix of declared services is that access seekers are permitted mandated access to Telstra's fixed-line network at different network layers."³⁷
- 4.4 As a result, the regulated services can be used for the provision of standalone services or bundled in different combinations to supply these downstream products. For example, "the ACCC considers it is appropriate to include basic access, local calls, national and international long distance calls and fixed to mobile calls within a bundle of fixed voice services (together, "Fixed Voice Services")."³⁸
- 4.5 Furthermore, "the ACCC understands that WLR and LCS (along with PSTN OTA) are currently the predominant inputs used by providers other than Telstra to supply Fixed Voice Services to end-users."³⁹
- 4.6 The following table illustrates the various declared fixed-line services and the downstream services they are, or can be, used to supply.

³⁶ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.35

³⁷ ACCC, *Fixed Services Review – A second position paper*, April 2007, p.19

³⁸ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.21

³⁹ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.21

Table 1: Use of currently declared fixed-line services to supply downstream retail services ⁴⁰

Retail downstream services	Declared fixed-line services				
	PSTN OTA	ULLS	WLR	LCS	LSS
National long distance voice calls	◇	◇			
International calls	◇	◇			
Local calls		◇		◇	
Line rental (access)		◇	◇		
Dial-up internet services		◇		◇	
Broadband data services (incl. xDSL)		◇			◇
Fixed-to-mobile calls	◇ (PSTN OA only)	◇			

Voice alternatives

4.7 There are currently 413 voice service providers operating in Australia – of these, 104 offer services over the conventional PSTN, 162 operate in the VoIP market, 106 offer both PSTN and VoIP services, and 37 include calling card service providers. ⁴¹

4.8 As a result the ACCC has noted that “there are two alternative voice services that could be used instead of fixed voice services: VoIP or Mobile.” ⁴² The substitutability of these alternative voice services is discussed as follows.

Fixed to VoIP substitution

4.9 VoIP provides basic voice communications service over a broadband connection. The majority of VoIP services operate over fixed networks however the proliferation of mobile VoIP is also gaining momentum.

4.10 In broad terms, there are three main types of VoIP services available to consumers: ⁴³

- i) ‘POTS emulation’ – using soft-switching and the ULLS

⁴⁰ ACCC, *Fixed Services Review – A second position paper*, April 2007, p.19

⁴¹ In this context, the VoIP market consists of VoIP service providers, resellers and system integrators.

ACMA/ACCC, *Communications Services Availability in Australia 2008*, November 2008, p.28

⁴² ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.21

⁴³ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.22

ii) Carrier-grade VoIP – using internet access device (IAD) and the ULLS/LSS

iii) Application layer VoIP – using VoIP and the ULLS/LSS

4.11 In terms of substitutability, the ACCC considers that the first service ('POTS emulation') is "likely to be substitutable on the demand-side, because the experience from the customer's perspective would be identical."⁴⁴ At this stage, carrier-grade and application layer VoIP services are considered unlikely to be effective substitutes due to the current limitations concerning the quality characteristics and equipment requirements associated with the VoIP service.⁴⁵ The ACCC also notes that LSS-based VoIP is generally considered a complementary service to the traditional fixed-line.

4.12 Optus submits that its VoIP is currently not a significant substitute to provide an effective competitive constraint on Telstra's pricing in the context of a fixed line market with a dominant incumbent. Some issues include:

(a) Quality of service (QoS) – VoIP utilises IP technology which is packet-based and best-effort. Hence this may not always be the best solution for real-time communication.

(b) Call routing – VoIP requires an IP address on an IP network.

(c) Terminal location – Voice telephony generally requires both the called and the calling party to have a phone number. VoIP generally provides users with a nomadic number, hence could exist anywhere on the network.

(d) Interoperability – Service level and network connectivity can not always be guaranteed. Hence any disruption to the IP network, including disruptions to the access network on which the IP network is provided, could interrupt the QoS of the VoIP application.

4.13 The ACCC similarly concludes that it "does not consider that the availability of VoIP services would be sufficient to prevent a SSNIP in relation to fixed voice services within the foreseeable future."⁴⁶

Fixed to mobile substitution

4.14 The mobile services market in Australia is one of the fastest growing telecommunications markets with mobile penetration growth surpassing 100 per cent in 2007.⁴⁷

⁴⁴ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.22

⁴⁵ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.23

⁴⁶ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.23

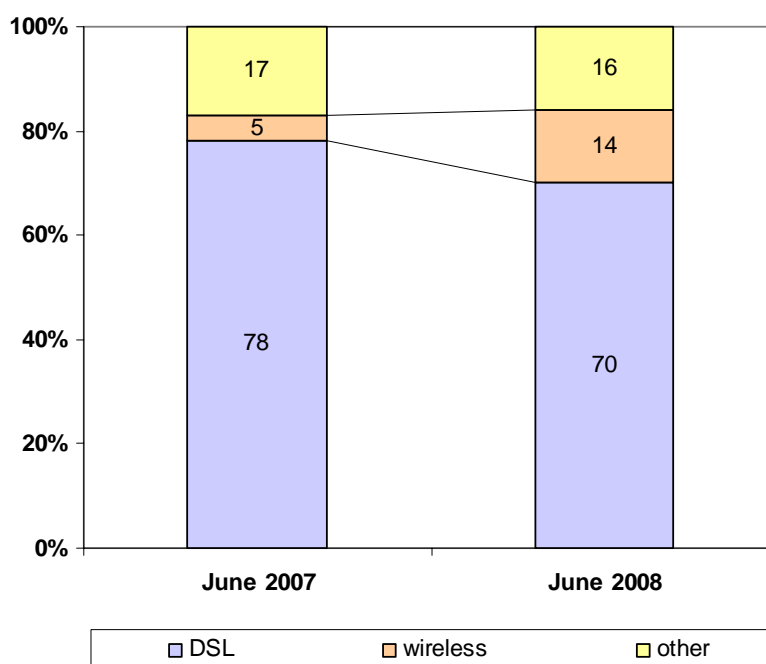
⁴⁷ In 2007, mobile cellular subscription in Australia per 100 inhabitants reached 102.49. ITU, *Mobile cellular subscribers per 100 inhabitants*, ITU ICT Eye database 2007, <http://www.itu.int/ITU-D/ICTEYE/Indicators/Indicators.aspx#> [accessed 12/1/09]

- 4.15 Mobile networks can be used to provide end users with voice telephony services. However, there are differences between mobile telephony services and traditional voice services supplied over a PSTN, and these services are usually considered to be provided in separate markets. Despite some evidence of fixed to mobile substitution, it is not the case yet that a substantial number of end users in Australia have been prepared to give up their fixed line in favour of a mobile telephone.
- 4.16 Fixed wireless services provided over mobile networks (such as the service provided by Virgin Mobile) are likely to be a better substitute in at least some respects for traditional fixed line voice services, compared to a standard mobile service.
- 4.17 It follows that the competitive constraint provided by fixed wireless services provided over mobile networks is currently limited, since these services are typically deployed as a “niche play” to use excess or idle capacity on mobile networks. That is, in areas where the relevant mobile network is at capacity, these fixed wireless services will not be provided.
- 4.18 Fixed wireless services currently have a limited ability to act as a substitute for traditional fixed line services and cannot be relied on to provide a competitive constraint on Telstra’s pricing.
- 4.19 The ACCC has similarly considered that “the relevant product dimension at the downstream level is for fixed voice services (excluding VoIP and mobile services).”

Broadband and bundles

- 4.20 Optus submits that while it recognises the existence of alternative platforms for the delivery of broadband services, the use of these alternative platform technologies cannot serve as an effective competitive constraint with the entirety of Telstra’ ubiquitous copper fixed-line network.
- 4.21 The following figure provides a comparison of the main broadband service mediums used in Australia. It shows that while xDSL remains the dominant broadband service medium; there has also been an increase in the uptake of other broadband service mediums, in particular wireless broadband.

Figure 1: Comparison of broadband service share, by technology type^{48 49}



4.22 Optus considers that alternative technologies such as mobile and HFC may substitute for the provision of the fixed line voice services to a limited extent, but remain subject to technical and geographic limitations. As a result these technologies currently cannot serve as an effective competitive constraint for access seekers in the provision of fixed line voice services in downstream markets wishing to use these technologies as an alternative to the current regulated wholesale inputs.

4.23 For example, one of the key limitations of these alternative technology platforms relate to achievable network speeds, which limit the ability of Telstra’s wireless competitors to provide an effective constraint upon Telstra’s conduct in the fixed line market. The following table provides a guide of the speed end users can expect to receive on each of the networks.

Table 2: Comparison of broadband speeds across different technologies⁵⁰

Network technology	Practical speed	Maximum theoretical speed
Fixed broadband		
Optus Cable DSL Direct	8 – 20 Mbps	Up to 20 Mbps
Wireless broadband		

⁴⁸ ACCC, *Communications infrastructure and services availability in Australia 2006-07*, 2007

⁴⁹ ACCC, *Communications infrastructure and services availability in Australia 2008*, November 2008

⁵⁰ The following network speed information only provides a guide for the expected speeds available to the consumer market, and is available from the Optus website.

Network technology	Practical speed	Maximum theoretical speed
3G/'yes' G	512 – 1500 kbps	Up to and between 3 and 3.6 Mbps
GSM	20 – 40 kbps	Up to 50 kbps
Satellite broadband	256 – 1042 kbps	
Dial-up internet	Up to 256 kbps	

4.24 A summary of these alternative technologies is provided as follows.

Hybrid fibre-coaxial (HFC)

4.25 HFC networks can be used to deliver voice, high speed broadband and pay TV services to end users. However HFC networks are currently limited in geographic coverage and this lack of ubiquity means that alternative access provisions are required in many geographic regions.

4.26 Since voice services (as well as broadband and Pay TV services) can be supplied to end users using HFC, it follows that competitor HFC networks,⁵¹ where available, have some impact on competition in downstream markets.

4.27 However that impact is limited by the geographical extent of competitor HFC networks. For example, there is a considerable degree of overlap between the two major HFC networks operating in Australia, which have a combined coverage of 2.6 million homes.⁵²

4.28 A number of serviceability and technical limitations further limit the ability of these HFC networks from providing effective competitive constraints.

4.29 First, many homes within Optus' HFC footprint, particularly multi-dwelling units (MDUs) and some single-dwelling units (SDUs), are not serviceable via HFC. As such, even in geographic areas served by the HFC network, large numbers of customers (primarily those living in MDUs) cannot be served by HFC.

4.30 Further, these customers are not likely to become serviceable in the near-future. Technical reasons why Optus may be unable to provide telephony services via its HFC network to an MDU has been discussed extensively in Optus' submissions in response to Telstra's exemption application for fixed line services with respect to HFC areas.

4.31 Second, the geographic footprint of the HFC network does not necessarily coincide with the boundaries of Telstra's ESAs. Optus also

⁵¹ Networks owned by Telstra's competitors may be taken into account, however the largest HFC network is largely irrelevant to the discussion since it is owned by Telstra and thus does not provide a competitive constraint on Telstra's pricing or an independent source of competition in retail markets.

⁵² Telstra's HFC network passes 2.5 million homes in Adelaide, Brisbane, the Gold Coast, Melbourne, Perth and Sydney; while Optus' HFC network is capable of serving approximately 1.4 million homes in Brisbane, Melbourne and Sydney. ACMA/ACCC, *Communications Services Availability in Australia 2008*, November 2008, p.11

notes that Telstra's HFC network does not provide a voice service. It follows that, when Telstra states that Optus' HFC network is present within a given ESA, it also neglects to highlight the fact that substantial geographic areas of the ESA are not served by the HFC network.

- 4.32 Finally, the possibility that HFC could serve as an effective competitive constraint is further constrained by the reality that third-party access to HFC networks is neither sought, nor easily engineered. It follows that HFC would therefore have limited utility as a wholesale constraint on Telstra.

Wireless / Mobile

- 4.33 Wireless networks may be used to supply high speed broadband, however Optus contends that they have significant limitation that do not allow them to be considered as complete substitutes for fixed line broadband.

- 4.34 There are currently two wireless network platforms available in providing broadband in Australia – fixed and mobile.

- i) The fixed wireless network operates using an air interface as an alternative to other access media to connect a broadband service. There are currently 225 companies provided fixed wireless broadband services in Australia – the majority of which provide services to regional areas.⁵³
- ii) Mobile wireless networks operated by Telstra's competitors connect wireless broadband customers using the 3G mobile phone network, operating the HSPDA protocol.

- 4.35 The speed of service is a key issue (in addition to the other issues noted above under voice alternatives). Actual speeds offered over wireless networks will vary and may be slower, which limits the ability of Telstra's wireless competitors to provide an effective constraint upon Telstra's conduct in the fixed line market.. The key factors affecting speed include:

- The end-user's location and distance from the mobile base station;
- The network used to connect the service, for example the Optus 3G/'yes' G or GSM network;
- The number of users sharing the network;
- The source of downloaded material;
- General internet traffic; and
- The end-user's hardware and software configuration.

- 4.36 Pricing is also an issue. Mobile services may be priced at a premium above fixed voice prices.

⁵³ ACMA/ACCC, *Communications Services Availability in Australia 2008*, November 2008, p.10

Satellite

- 4.37 Satellite broadband is generally provided as a last resort broadband infrastructure where alternative infrastructure is not available. It is able to provide 100 per cent coverage of Australia's land area, however remains limited in its ability to provide a substitutable xDSL service in terms of quality of service, price and access.
- 4.38 There are around 48 satellite broadband service providers operating in Australia – the majority of which are regional ISPs that resell satellite broadband to regional, rural and remote customers.⁵⁴

Implications for Corporate and Government customers

- 4.39 Optus submits that there needs to be recognition of the separate 'corporate and government' (C&G) market. The C&G market is a separate market specially catered for business with at least 200 customers and government agencies. This market is particularly sensitive to the availability of access to Telstra telecommunications infrastructure; more so than the consumer market where needs are less complex and more localised, allowing infrastructure based competition.
- 4.40 The competitive drivers unique to C&G customers include:
- Procurement of services on a 'whole of business' (WOB) basis with preferences for single billing, multiple services and products included on a single invoice and single point of contact for all telecommunications needs;
 - Requirements for ubiquitous coverage of specialised and complex features on top of basic telephony services; and
 - High incumbent inertia with enduring impacts due to high costs of changing providers.
- 4.41 If Optus and other service providers are to compete in this market and meet its demand for WOB offerings, there needs to be certainty of access to Telstra's underlying infrastructure and products. For example, even established operators such as Optus rely on wholesale inputs because it may not be feasible to connect to connect all C&G customers directly via Optus infrastructure due to various technological limitations.
- 4.42 The requirement for certainty of access to Telstra infrastructure and products is particularly acute in the corporate market. Duplication of Telstra's network on a partial basis may be sufficient to compete profitably in the residential market, since residential consumers require connection to only a single residence, However competition by serving limited premises is not feasible in the corporate market due to its WOB and ubiquity requirements. Corporate customers require supply to all of their multiple premises and an entire corporate account may be lost if even one such location is inaccessible (perhaps due to the presence of a

⁵⁴ ACMA/ACCC, *Communications Services Availability in Australia 2008*, November 2008, p.13

RIM or pair gain system in the exchange, or a distance limitation impeding the supply of services via the ULLS).

The standalone long distance services segment

- 4.43 Optus considers that the ACCC should consider separately competition for customers who wish to preselect an alternative carrier for long distance services.
- 4.44 Optus contends that the PSTN OA service plays a role in promoting competition in long distance communications services (including international services).
- 4.45 The PSTN OTA declaration allows this market segment to be unbundled from network access, such that customers can potentially purchase line rental services from one provider and long distance calling from a separate provider. This enables competitive providers to offer long distance services to any given end user, regardless of which carrier is providing underlying network access to that end user.
- 4.46 Optus' arguments in this regard are set out in more detail in its submissions in the PSTN OA exemption matter.

5. State of Competition

The ACCC seeks submissions from parties on the state of competition for this declaration inquiry

- 5.1 Optus concurs with the ACCC's preliminary view that "Telstra has significant market power in the upstream market for fixed voice services, standalone broadband services and bundled fixed voice and broadband services."⁵⁵
- 5.2 This section of the submission sets out a number of key trends in fixed line telecommunications that have taken place since 2006 including:
- Telstra's dominance in fixed line services;
 - Improved ULLS-based competition in recent years.
- 5.3 The following discussion highlights the main impacts on competition in fixed line communications.

Telstra's dominant position in fixed line telecommunications

- 5.4 Telstra retains a dominant position in fixed line telecommunications, as the Australian Competition Tribunal recognised in its December 2008 decision on Telstra's WLR and LCS exemption application, in which the Tribunal observed that "on any view Telstra still has significant market power with 89% of all fixed voice lines being supplied over Telstra's PSTN, of which approximately 80% are lines retained by Telstra".⁵⁶
- 5.5 The fact remains that Telstra is one of the most vertically integrated carriers in the world. Telstra has been able to take a strong position in almost all sectors of the industry, as highlighted by its position as:
- i) The owner of the copper local loop access network;
 - ii) Both the largest retail and wholesale provider of fixed-line voice and broadband services in Australia;
 - iii) The owner of an HFC cable network – the second largest fixed-line network in Australia, after Telstra's own copper local loop network;
 - iv) The dominant provider of pay-tv services in Australia, through its 50% ownership in Foxtel which is provided over its HFC cable network;
 - v) The dominant provider of directory information services, through its Sensis subsidiary; and

⁵⁵ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.46

⁵⁶ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008) at paragraph 33

- vi) The largest mobile network operator (MNO) in Australia.
- 5.6 Competition in fixed line telecommunications has failed to develop to more than a limited extent since 1997. This was especially the case in the period up to 2005-06 when competitors relied heavily on a resale model to build scale and to compete with Telstra. This exposed competitors to the full impact of Telstra's anti-competitive practices. The result was that Telstra's rivals were not able to make significant in-roads into the incumbent's dominance in the proportion of customers served, in revenue, or in profitability. In some areas Telstra's dominance even increased over this period.
- 5.7 In 1998, Telstra had 99 per cent of basic access lines.⁵⁷ Two decades later, Telstra still accounts for 85 per cent of all fixed voice lines in Australia (2007-08 figures). More significantly 84 per cent of these lines on the network are retailed by Telstra.⁵⁸
- 5.8 The following table, sourced from a 2008 ACMA report, illustrates the number of basic access lines in operation in Australia over the period 2005-06 to 2007-08. The declining trend in wholesale voice services can be attributed to the increasing trend for CSPs to supply services using ULLS.

⁵⁷ Productivity Commission, *Telecommunications Competition Regulation*, September 2001, p.107

⁵⁸ ACMA, *ACMA Communications report 2007-08*, November 2008, p.48

Table 3: Number of fixed-line telephone services in operation (millions), 2005-06 to 2007-08 ⁵⁹

All CSPs	2005-06	2006-07	2007-08
Retail (own network)	8.75	8.69	9.40
Wholesale	2.50	2.23	1.60
<i>Total</i>	<i>11.25</i>	<i>10.92</i>	<i>11.00</i>
Telstra services only	2005-06	2006-07	2007-08
Residential (retail)	5.46	5.53	5.56
Business (retail)	2.32	2.25	2.31
Wholesale	2.16	1.98	1.50
<i>Total</i>	<i>9.94</i>	<i>9.76</i>	<i>9.36</i>
Total Telstra services represented as a percentage of all fixed voice lines in Australia	88.4 %	89.4 %	85.1 %

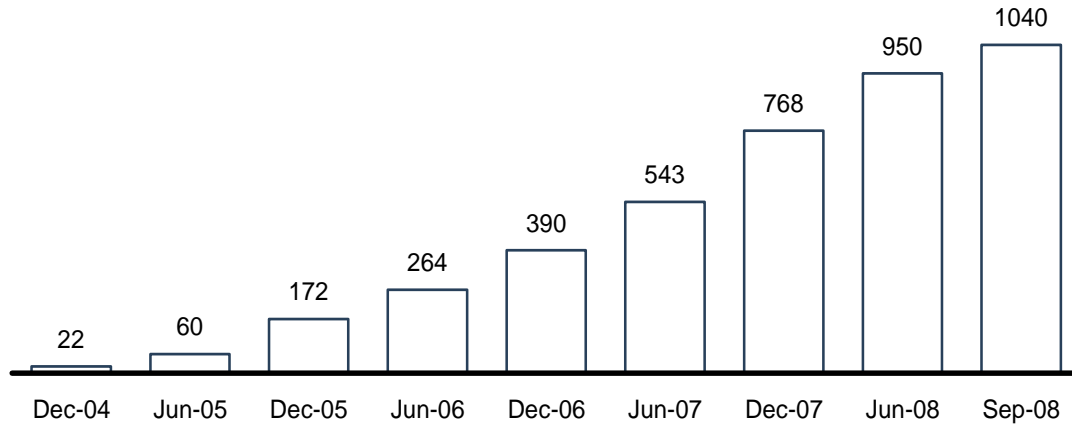
ULLS-based competition has improved in recent years

- 5.9 There has been one recent stand-out regulatory policy success that is starting to deliver genuine competition. This is the requirement for Telstra to unbundle its local copper loop network.
- 5.10 The decision to require Telstra to unbundle its copper loop and provide competitors with direct access to the copper was taken as long ago as 1999 with the declaration of the Unbundled Local Loop Service (ULLS) and Line Sharing Services (LSS). However, it is only recently with changes in equipment costs and clearer access price signals from the ACCC that use of this service for the mass consumer market has become viable.
- 5.11 This service has enabled competitors like Optus, Primus, Internode and iiNet to deploy their own electronic equipment in the Telstra exchange, known as a DSLAM, to provide both voice and high-speed data services in direct competition to Telstra.
- 5.12 There has been a strong positive trend in ULLS uptake since the roll-out of these DSLAM networks commenced in 2005. As indicated in the figure below there has been an increased take up of unconditioned local loop (ULL) and line sharing service (LSS), which grew in the order of

⁵⁹ Adapted from ACMA, *ACMA Communications report 2007-08*, November 2008, p.48

100 per cent in 2006. ⁶⁰ There are now over a million unbundled services currently in operation ⁶¹ being used by Telstra’s competitors to serve a significant customer base.

Figure 2: Australian unbundled lines - migrated customers (000s) ⁶² ⁶³



- 5.13 Overall investment in DSLAMs and associated infrastructure by access seekers has steadily increased in recent years. As at 30 June 2008, there were 2,757 DSL-enabled exchanges providing ADSL service coverage to 98 per cent of the Australian population. ⁶⁴
- 5.14 This development has driven important benefits to consumers – through lower prices, improved quality of service and greater innovation.
- 5.15 Competitors are using their own infrastructure to deliver innovative services such as Optus’ Fusion product (\$79/month for broadband plus telephony with unlimited local, long distance and calls to Optus Mobile) and iiNet’s Naked DSL (\$49.95 for broadband – without the requirement to pay for line rental).
- 5.16 The strengthening of competition is helping Australia’s broadband market to catch up with the world, recovering from a delayed and sluggish start. The chart below shows how growth has jumped sharply since competitors such as Optus entered the DSL market.

⁶⁰ ACCC, *Fixed Services Review – A second position paper*, April 2007, p.3

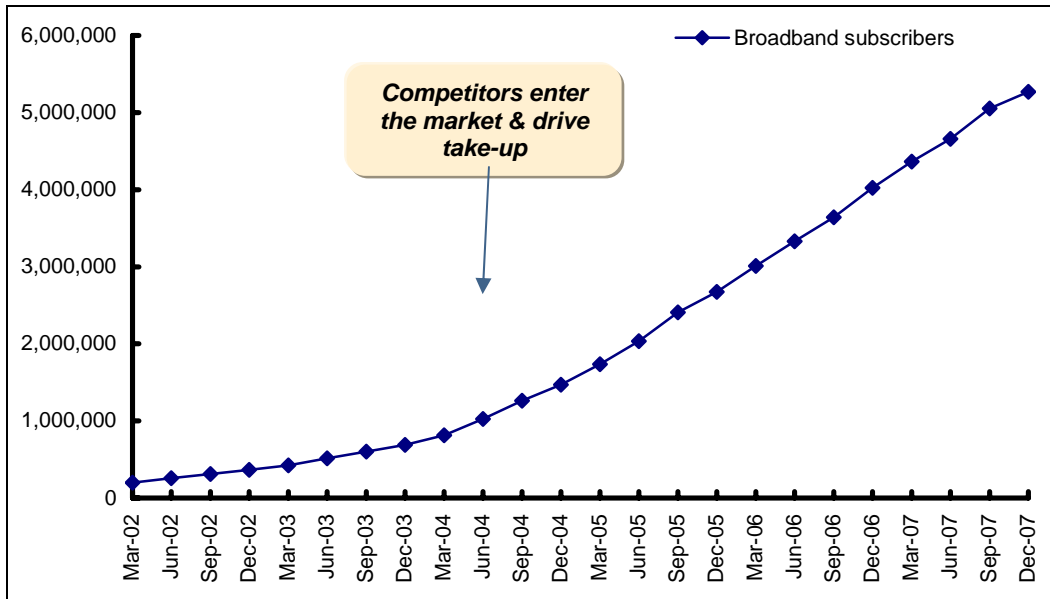
⁶¹ ACMA, *Communications Infrastructure and Services Availability in Australia 2008*, 2008, p.3

⁶² These customer migration figures represent ULL migration by both ULL and LSS unbundling methods. JP Morgan, *Australian broadband market in 2007*, 17 March 2008, p.14

⁶³ ACMA, *Communications Infrastructure and Services Availability in Australia 2008*, 2008, p.5

⁶⁴ ACMA, *Communications Infrastructure and Services Availability in Australia 2008*, 2008, p.5

Figure 3: Australian broadband take-up ⁶⁵



⁶⁵ Spectrum Value Partners analysis; ACCC, *Snapshot of broadband deployment as at 30 September 2006*; JP Morgan, *Australian broadband market 2007*, 17 March 2008

6. Unconditioned Local Loop Service

The ACCC is seeking submissions from interested parties on whether the ULLS declaration should be:

- extended (to 31 July 2010 or another date); or*
- revoked; or*
- allowed to expire without making a new declaration; or*
- allowed to expire and the ACCC should make a new declaration*

6.1 Optus supports the ACCC’s preliminary view that an extension for the ULLS declaration would promote the LTIE.

Continued declaration of the ULLS would promote competition

6.2 Optus considers that continued declaration of the ULLS service is vital to the development of sustainable competition in the provision of voice, broadband, and bundled voice and broadband services.

6.3 For example, during the 2006 inquiry into the re-declaration of ULLS, the ACCC highlighted the following issues to support the continuation of the ULLS declaration:

- Alternative platforms for delivering broadband services;
- Flexibility of service offerings;
- Provision of business-grade data services; and
- Price competition.

6.4 Further, Telstra’s dominant position in fixed line services is in effect unrivalled due to its control of the underlying access infrastructure. With the exception of new build, any access seeker seeking to compete with Telstra at the wholesale level would “still essentially require access to Telstra’s underlying infrastructure via the use of ULLS.”⁶⁶

6.5 The following discussion will provide insight into the role of ULLS and its importance towards achieving the goal of facilities-based competition, while taking into consideration the concerns raised during the last declaration review.

6.6 It follows that despite the improvement in ULLS-based competition in recent years, many of these issues continue to be relevant to this declaration enquiry.

Facilities-based competition versus resale-based competition

6.7 Access to ULLS-based infrastructure has been an important means for competition in basic access, voice and broadband services. The ACCC in

⁶⁶ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.84

its *Fixed Services Review* (the FSR2) considers the role of efficient, facilities-based competition to be ‘effective’ for two main reasons:

*“Efficient, facilities based competition is more likely to be ‘effective competition’ (and therefore promote the LTIE) because rivals are able to differentiate their services and compete more vigorously across greater elements of the network (and supply) chain. It is also more likely to produce enduring benefits because competitors that have invested in their own infrastructure are more likely to remain in the market (because of high sunk costs).”*⁶⁷ [emphasis added]

- 6.8 Note that these advantages of facilities-based competition also extend to quasi facilities-based competition, or access-based competition such as the ULLS. ULLS has served (and continues to serve) in providing an efficient and viable method of entry by access seekers into the basic access, voice and broadband market.

*“The ULLS is an important platform for competition in basic access, voice and broadband services. The ACCC believes that in the absence of a ULLS declaration and effective ULLS competition, retail competition in customer access, voice and broadband services would be limited to service providers on-selling Telstra’s wholesale products. Retail competition would be stifled as customers would not have the same degree of choice as is available via ULLS-based competition.”*⁶⁸

- 6.9 The ACCC further acknowledges the role of facilities-based competition in its decision to grant Telstra’s LCS and LWR exemptions, where it has noted that:

*“In relation to provision of voice services, the ACCC considers that ULLS-based competition is a preferable form of competition to re-sale competition because it has longer-term benefits. **The ACCC is of the view that ULLS-based competition encourages competitors to compete on greater dimensions of supply, such as price and quality, which allows them to dynamically innovate their services. Also, by reducing reliance on competitors’ network assets and related services it can lead to more sustainable competition.**”*⁶⁹ [emphasis added]

ULLS-based competition

- 6.10 The significant investments in DSLAMs and associated infrastructure by non-Telstra players noted in this paper are being used to by Telstra’s competitors to serve a significant customer base. There has been a strong positive trend in ULLS uptake since 2005. The significant take up of ULLS and subsequent improvements in consumer pricing and broadband uptake in Australia are discussed earlier in this paper in the section on the state of competition. On this basis Optus submits that ULLS declaration has driven

⁶⁷ ACCC, *Fixed Services Review – A second position paper*, April 2007, p.29

⁶⁸ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.52

⁶⁹ ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications*, Final Decision and Class Exemptions, August 2008, p.28

important benefits to consumers – through lower prices, improved quality of service and greater innovation.

- 6.11 The clear competitive benefits of unbundling have been recognised by the Chairman of the ACCC, Graeme Samuel, in a speech to the Australian Telecommunications Users Group:⁷⁰

“Increased competition in the provision of broadband services has seen progressively lower broadband prices, increased data caps, better speeds and new innovation and products (such as naked DSL). This increased competition in broadband by other ISPs and carriers owes a significant debt to being able to obtain access to Telstra’s copper loop. Competitors have this access through the declaration of the unconditioned local loop service (ULLS) and the line sharing service (LSS)”

- 6.12 This importance of continued access to Telstra’s network was highlighted by the ACCC in its *Competitive Safeguards* report, which notes that:

*“The ACCC views the ability for competitors to access Telstra’s copper network to provide a range of services as an important part of promoting outcomes for users. It is particularly important given there are no widespread cable or wireless CAN networks available or in prospect to compete with the ubiquitous copper network.”*⁷¹

Increase in the price of ULLS would reverse competitive gains

- 6.13 Optus notes that if the ULLS declaration was revoked, then Telstra would have the freedom to raise prices. Hence declaration serves to mitigate the reversal of competitive gains through the setting of appropriate pricing principles and indicative prices.
- 6.14 There has been substantial DSLAM investment made by access seekers in recent years which has stimulated competition (as discussed earlier in this paper). This has only been made possible through declaration of the ULLS and its subsequent setting of pricing principles and indicative prices to provide clearer access price signals. It therefore follows that an increase in the price of ULLS would reverse the competitive gains, thus make the decision to engage in ULLS-based competition less viable.
- 6.15 Optus submits that if Telstra raised ULLS access prices, this would reverse the competitive gains brought about by access seekers utilising ULLS services. Since regulation, Telstra has submitted four undertakings with the ACCC with respect to the ULLS. Each undertaking was subsequently rejected on the grounds that Telstra’s proposed method of recovering cost was not reasonable.⁷² In May 2007, the Australian Competition Tribunal upheld the ACCC’s decision to reject Telstra’s 2005 undertaking.

⁷⁰ ATUG 2008 Annual Conference, Graeme Samuel – 13 March 2008

⁷¹ ACCC, *Telecommunications competitive safeguards for 2005-2006*, May 2007, p.16

⁷² ACCC, *Unconditioned local loop service (ULLS) – Final pricing principles*, November 2007, p.28. The ACCC also considered that geographically averaged pricing was unreasonable. ACCC, *Unconditioned local loop service (ULLS) – Final pricing principles*, November 2007, p.19

- 6.16 The Tribunal discussed the legislative objective which lay behind the promotion of competition concept in the decision on the ULLS (Telstra Corporation Ltd (No 3) [2007] ACompT 3), where it stated:
- “...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.”*⁷³
- 6.17 As the ACCC has recognised, the setting of ULLS prices above efficient costs will only “inflate costs to access seekers who use the ULLS to compete with Telstra in the voice and DSL markets using their own DSLAM infrastructure.”⁷⁴
- 6.18 The impact of such an increase in the ULLS price would only be exacerbated by the fact that the ACCC has recently decided to grant exemptions from regulation of the WLR and LCS and PSTN OA services within identified metropolitan exchanges with the objective of encouraging access seekers to rely to a greater extent on the ULLS.⁷⁵ These decisions remove from access seekers the possibility of alternative sources of supply and would exacerbate the impact on competition of an increase in the ULLS price.
- 6.19 The ACCC has considered that in the absence of ULLS declaration, access seekers would become largely reliant on the resale of wholesale DSL broadband access in order to provide high-speed internet services in more densely populated areas. As a result, the reselling of Telstra’s services would provide limited scope for competition since “wholesale customers are subject to Telstra’s control over the price, quality, and terms and conditions of access to wholesale xDSL.”⁷⁶
- 6.20 It follows that this impact on access to broadband services will increase the uncertainty of access seekers and end-users as to the provision and pricing of broadband services. Where access seekers are unable to effectively compete against the incumbent, it will be likely that customers will leave access seekers and become Telstra customers, thereby returning the nature of the facilities-based competition to its original monopolistic state. In so doing this would result in a lessening in competition for broadband services.
- 6.21 Therefore any proposed increase in the ULLS price would thus have the effect of reducing competition and strengthening Telstra’s monopoly position in fixed line telecommunications.

⁷³ Re Telstra Corporation Ltd (No 3) [2007] ACompT 3 (17 May 2007) at paragraph 99

⁷⁴ ACCC, *Unconditioned Local Loop Service Access Dispute between Telstra and Chime Communications – Statement of Reasons for Final Determination*, March 2008, p.22

⁷⁵ ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications – Final Decision*, August 2008; ACCC, *Telstra’s PSTN originating access exemption applications – CBD and metropolitan areas*, Final Decision, October 2008

⁷⁶ In addition, although the issue of wholesale DSL services was raised during the 2006 declaration inquiry, wholesale DSL remains an undeclared service. As such, there is no guarantee that Telstra will supply the service, or that it will be under reasonable terms. ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS*, Final Determination, July 2006, p.32

Potential failure to fulfil standard access obligations

- 6.22 On 19 March 2009, the ACCC instituted proceedings in the Federal Court against Telstra for alleged contraventions of the *Trade Practices Act 1974* (TPA) and the *telecommunications Act 1997* (Telco Act) in relation to its standard access obligations (SAOs) for the ULLS and LSS.
- 6.23 An important feature of declarations requires operators to satisfy a number of SAOs. In this instance:
- “The standard access obligations under section 152AR of the TPA require Telstra to permit interconnection of facilities to enable the supply of the ULLS and the LSS to access seekers, so they can provide voice and/or ADSL2+ broadband services to retail customers. In addition, Telstra must ensure that access seekers receive equivalent technical and operational quality and timing of interconnection to that which Telstra provides itself.”*⁷⁷
- 6.24 As a result, the ACCC’s allegations against Telstra include:
- (a) Refusal of access seekers requests for interconnection at seven key metropolitan exchanges, resulting from lack of capacity in ‘capped’ exchanges. However the ACCC argues that there was capacity available or that could have been made available.
 - (b) Breach of access regime in the Telco Act, in regards to provision of access to facilities. In addition to SAOs, these constitute breaches of conditions of Telstra’s carrier licence.
 - (c) Engagement in misleading and deceptive conduct by representing to access seekers on individual basis and on lists of ‘capped’ exchanges published on company website.⁷⁸
- 6.25 This shows that even with regulation, access cannot be taken for granted. Without regulation it is clear Telstra would do everything it could to deny access.

Declaration encourages efficient use of & investment in infrastructure

- 6.26 Optus considers that the removal of regulated access to fixed line services would, in most cases, likely discourage access seekers from investing in their own infrastructure. The following will discuss a number of issues affecting ULLS-based infrastructure investment, including barriers to entry and the impact of NBN deployment. Further, it will show that while a number of issues can lead to uncertainty by access seekers, regulated access also plays an important role in encouraging facilities-based investment. Further details on the current state of competition in fixed line communications can be found in Section 5.

⁷⁷ ACCC, “ACCC institutes proceedings against Telstra for alleged breach of standard access obligations,” News Release 053/09, 19 March 2009, <http://www.accc.gov.au/content/index.phtml/itemId/864998>

⁷⁸ ACCC, “ACCC institutes proceedings against Telstra for alleged breach of standard access obligations,” News Release 053/09, 19 March 2009, <http://www.accc.gov.au/content/index.phtml/itemId/864998>

Barriers to entry

- 6.27 Access seekers continually face high barriers to effective and sustainable competition in fixed line communications, from the cost required to deploy new infrastructure to difficulties in building market share.
- 6.28 Effective investment remains a challenging process for access seekers, as building market share is itself met with barriers such as high customer switching costs, customer inertia and reliance of Telstra for the provision of underlying wholesale inputs. In particular, the ACCC has recognised that:

*“[T]he high barriers to facilities-based competition in fixed-line services arise from substantial sunk costs and economies of scale. These limit the ability of new entrants and existing players to deploy network infrastructure that can serve as an effective substitute for Telstra’s CAN.”*⁷⁹

- 6.29 With regards to facilities-based competition, continued access to ULLS is regarded as the preferred means, in both practical and economic terms, for access-seekers to compete in the provision of fixed line services. The ACCC has considered that:

*“[D]irect access to the local loop enabled competitors to bypass large sections of Telstra’s network, making the deployment of new infrastructure (such as DSLAMs for xDSL provision) more economic and practical, thereby promoting ULLS-based competition.”*⁸⁰

- 6.30 On the issue of barriers to customer substitution, the ACCC has also noted the relevance of customer switching costs involved in switching to alternative infrastructure, stating that:

*“[T]he differing technology of the HFC network compared to the CAN may mean that there will be switching costs for consumers in changing their customers premises equipment from ULLS-based provision to the HFC-based provision or vice versa, even if the premises is serviceable by HFC.”*⁸¹

Impact from the impending deployment of NBN

- 6.31 Optus considers that removing regulated access to fixed line services would not encourage access seekers to invest in their own infrastructure given the imminent deployment of a NBN which would have a severe and immediate negative impact upon the economics of any such investment.
- 6.32 The Government’s objective, of a ubiquitous broadband network based on FTTN, would if achieved represent a major improvement in the

⁷⁹ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.36

⁸⁰ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.49

⁸¹ ACCC, *Telstra’s exemption application in respect of the Optus HFC network*, Draft Decision, September 2008, p.53

technological standard of Australia’s broadband infrastructure. However it would, at the same time, raise very serious issues for emergent competition in the local loop.

6.33 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.”⁸² It is critical to realise the implications of that uncertainty: potential investors will delay investment until the uncertainty is resolved.

Regulated access encourages investment

6.34 Regulated access has contributed towards the take up of ULLS-based competition, particularly in terms of the role of indicative prices and the ladder of investment.

6.35 Overall investment in DSLAMs and associated infrastructure by access seekers has steadily increased in recent years. As at 30 June 2008, there were 2,757 DSL-enabled exchanges providing ADSL service coverage to 98 per cent of the Australian population.⁸³

6.36 The table below shows the number of DSLAM installed by ISPs in recent years. It shows that the DSLAM footprint of access seekers including Optus and TPG have almost tripled over a period of 2 years. As at January 2007, there was a total 3,768 DSLAMs installed.⁸⁴ As at November 2008, there was a total 4,775 DSLAMs installed.

Table 1: Number of DSL-enabled exchanges by carrier^{85 86}

Service providers with own DSLAM infrastructure	DSL-enabled exchanges			
	Jun 2006	Jan 2007	Nov 2008	
AAPT	22	22	n/a	
Adam Internet	25	29	33	
Amcom	34	34	37	
EFTel	n/a	n/a	58	additional 29 listed as planned/in build
iiNet	245	266	308	additional 31 listed as proposed/in progress
Internode/Agile	47	73	115	additional 55 listed as planned/in build
MySoul	n/a	22	27	additional 1 listed as in build
Netspace Networks	n/a	20	413 ⁸⁷	additional 19 listed as proposed/soon
Nextep	n/a	95	n/a	

⁸² ACCC, *Telstra’s exemption application in respect of Optus’ HFC area*, Draft Decision, September 2008, pp. 66-67

⁸³ ACMA, *Communications Infrastructure and Services Availability in Australia 2008*, 2008, p.5

⁸⁴ ACMA, *Communications Infrastructure and Services Availability in Australia 2006-07*, 2007, p.5

⁸⁵ ACMA, *Communications Infrastructure and Services Availability in Australia 2006-07*, 2007, p.5

⁸⁶ These only include all active DSLAM enabled exchanges, as at 30 November 2008. [adsl2exchanges.com](http://www.adsl2exchanges.com), *ADSL2+ for Provider*, <http://www.adsl2exchanges.com.au> [accessed 4/12/08]

⁸⁷ This figure includes a mix of both Netspace’s own DSLAMs and access via wholesale arrangements. Netspace Online Systems, “New plans and upgrades set Netspace apart,” 11 August 2008, <http://www.netspace.net.au/pdfs/press/2008/netspace-press-20080811.pdf>

Service providers with own DSLAM infrastructure	DSL-enabled exchanges			
	Jun 2006	Jan 2007	Nov 2008	
Onthenet	8	8	8	
Optus	100	304	366	additional 2 listed as soon
PowerTel	126	130	130 ⁸⁸	
Primus	182	182	212	additional 26 listed as soon
Regional Internet Aust	6	6	n/a	
Telstra	2,109	2,432	2,754 ⁸⁹	
TPG	65	145	300	
TransACT	n/a	9	n/a	
TSN Internet	4	4	5	
Westvic Broadband	n/a	n/a	1	
Wideband Networks	1	2	5	
Widelinx	n/a	3	3 ⁹⁰	
TOTAL	2,974	3,786	4,775	
TOTAL (excl.Telstra)	865	1,354	2,021	

- 6.37 Optus submits that investment by access seekers in order to supply services via unbundling is efficient. Bloch *et al.* (2001) conclude that “diminishing natural monopoly characteristics also suggests that market co-ordination between separate firms through networking is able to achieve similar economies as internal co-ordination with a monopoly. This finding is important given the trend towards unbundling telecommunications network elements, and the provision of telecommunications services through interconnection.”⁹¹

Ladder of investment

- 6.38 The ‘ladder of investment’ hypothesis remains as relevant today as it did in the past. The ladder of investment hypothesis is based on the notion that access regulation can encourage efficient entry by access seekers through the progressive acquisition of infrastructure assets, who would otherwise have difficulties in replicating the incumbent network’s bottleneck facilities.⁹²
- 6.39 Under this hypothesis, the Australian Competition Tribunal in its December 2008 decision on Telstra’s WLR and LCS exemption application, considers that:

“[I]t is the task of regulators to signal that the terms and conditions of access will change. That is, those seeking access to the incumbent’s infrastructure will be put on notice that over time they need to increase their own infrastructure investment, and rely less on that of the

⁸⁸ JP Morgan, *Australian broadband market 2007*, 17 March 2008, p.1

⁸⁹ ACMA, *Communications Infrastructure and Services Availability in Australia 2008*, 2008, p.5

⁹⁰ Widelinx website, *ADSL2+*, http://www.widelinx.com.au/comm_serv_adsl2.html [accessed 4/12/08]

⁹¹ Bloch *et al.* (2001), *The cost structure of Australian Telecommunications*, *The Economic Record*, Vol.77, No.239, December 2001, pp. 338-350

⁹² OECD, *The influence of market developments and policies on telecommunication investment*, Working Party on Communication Infrastructures and Services Policy, January 2009, p.11

*incumbent. If not, then entrants run the risk that the incumbent's services will no longer be regulated and accordingly may not be supplied under the same (regulated) prices and conditions as before. It is the regulator's task to make this path both feasible and commercially available."*⁹³ [emphasis added]

- 6.40 The ladder of investment therefore serves to encourage facilities-based investment among access seekers. Encouragingly, access seekers have continued to invest in alternative infrastructure, such as DSLAMs and wireless networks in recent years. While these may not prove complete substitutes for fixed line services, they do provide access seekers the ability to offer a wider range of products and services.
- 6.41 The ladder of investment hypothesis is borne out in that access regulation can achieve the final objective of facilities-based competition. For example, Internode has recently announced its intention to begin launching 100 Mbps FTTH infrastructure in greenfield estates. This would not have been possible, had Internode not initially entered the telecommunications sector through resale and access-based services.

Evidence of facilities-based investment

- 6.42 The following case studies illustrate the role regulated access to fixed-line services have towards facilities-based competition by access seekers. However it should be noted that the network coverage of these new investments will only cover a selected area, therefore should not be considered as a complete substitute with the entirety of Telstra's ubiquitous network coverage.
- (a) Case Study: Internode
- Established in 1991, Internode is an Australian internet service provider (ISP) offering a range of high quality voice, data and entertainment services. The various service types of Internode ADSL are currently offered across three access networks (Internode/Agile,⁹⁴ Optus Wholesale and Telstra Wholesale).
 - Since its beginnings as a provider of internet services via wholesale DSL, the company has progressed to facilities-based infrastructure, such as ULLS⁹⁵ and wireless networks. Furthermore its future outlook now looks set to include fibre-to-the home (FTTH) infrastructure.
 - On 25 February 2009, Internode announced its intention to begin launching 100 Mbps FTTH infrastructure in greenfield developments around Australia. The initiative will see Internode partner with housing

⁹³ Application by Chime Communications Pty Ltd [2008] ACompT 4 (22 December 2008) at paragraph 46

⁹⁴ Agile Communications was founded as a sister company to Internode in 1997. It primarily concentrates on building and operating telecommunications infrastructure.

⁹⁵ As of 31 January 2007, internode/Agile operated 73 DSLAMs in existing Telstra exchanges. ACCC, *Communications Infrastructure and Services Availability in Australia 2006–07, 2007*, p.5

estate telecoms specialist OptiComm, in rolling out FTTH in a number of new estates being established across Australia.⁹⁶

- With regards to FTTH, Internode MD Simon Hackett was noted saying:

*"This is an example of one of the many projects Internode has been quietly working away on for a while. We think it's a very exciting initiative, demonstrating that in the real world, the future for residential broadband is clearly Fibre to the Home - and Internode is thrilled to be a part of making it happen - today."*⁹⁷

- This illustrates the rise of Internode up the ladder of competition, from being a resale provider of internet services, to an ULLS-based competitor, and now to a future facilities-based infrastructure competitor – critically this has only occurred with regulated access being available.

(b) Case Study: TransACT

- Established in 2000, TransACT Communications was formed after the ACT's electricity and water utility ACTEW successfully completed trials for a broadband network to be rolled out throughout the ACT.
- Since 2001 TransACT has been rolling out a fibre-optic access network throughout Canberra and Queanbeyan, which offers customers a suite of Pay TV, broadband and voice services.
- On 23 March 2009, TransACT announced it has commenced an upgrade of its access network across the ACT to VDSL2, beginning its upgrade with a number of medium to high density developments in Canberra's more established suburbs.⁹⁸
- With regards to this investment, TransACT CEO Ivan Slavich was noted saying:

*"Through this VDSL2 upgrade program and the rollout of FTTH to selected new suburbs, TransACT is heavily investing in Canberra to ensure that the broadband access we provide is first-class."*⁹⁹

- As a result, this illustrates that regulated access to fixed-line services does not necessarily impede infrastructure investment.

⁹⁶ Internode, "Internode launches 100 Mbps Fibre to the Home," Media Release, 25 February 2009, <http://www.internode.on.net/news/2009/02/125.php>

⁹⁷ Internode, "Internode launches 100 Mbps Fibre to the Home," Media Release, 25 February 2009, <http://www.internode.on.net/news/2009/02/125.php>

⁹⁸ TransACT, "TransACT one of the first globally to upgrade its network to VDSL2," News Release, 23 March 2009, <http://www.transact.com.au/news/Article.aspx?id=987>

⁹⁹ TransACT, "TransACT one of the first globally to upgrade its network to VDSL2," News Release, 23 March 2009, <http://www.transact.com.au/news/Article.aspx?id=987>

- 6.43 Optus considers that these case studies provide a very strong demonstration of the ladder of competition hypothesis in action. In particular, it shows that smaller carriers, such as Internode, start at the lower rung of the ladder then over time continue to progress up the rungs of the ladder. Hence it can be inferred that without regulated access, such facilities-based investment would not have been viable – and deregulation is not necessary to encourage facilities-based investment.
- 6.44 These case studies also show that while facilities-based competition can be achieved, it may well remain limited in scale and overall coverage. As a result, while facilities-based competition will be strengthened in some areas, overall it is unlikely that access seekers will build or deploy a network which encompasses and directly competes with the entirety of Telstra's ubiquitous copper network.

Optus makes efficient use of the ULLS and other declared services

- 6.45 Telstra often uses Optus as its chief example to illustrate its attacks on the Part XIC access regime. It makes the claim that as a result of the ULLS declaration Optus purchases access to Telstra's network where it could be using its own HFC cable network in Sydney, Melbourne and Brisbane. Typically these attacks are supported by references to overseas cable operators.
- 6.46 Optus considers that this line of argument by Telstra is demonstrably wrong, for the reasons set out below.
- 6.47 The proposition that the Optus HFC Network effectively duplicates the Telstra copper customer access network (CAN) within its footprint is inaccurate. The Optus HFC Network is not a complete substitute for the Telstra CAN; it cannot be employed for the delivery of the relevant services to all premises within its footprint. A critical distinction exists between those premises that are serviceable by the Optus HFC network and those premises which are not serviceable. For a variety of reasons, a significant proportion of premises within the Exemption Area (approximately CiC) are not serviceable by the Optus HFC Network.
- 6.48 For premises which are serviceable, Optus already uses its HFC Network, in preference to accessing the declared services, to provide such services to residential end-users at serviceable premises. Optus also makes such investments in its HFC Network as are necessary and efficient for the continued operation of the network to service serviceable premises. In order to provide telecommunications services to those premises which are considered unserviceable by the Optus HFC Network, Optus makes use of regulated access to several declared services through Part XIC. Through accessing these services, Optus has been able to have a significant pro-competitive impact on market outcomes.¹⁰⁰
- 6.49 Optus submits that the Optus HFC Network is already efficiently used to provide telecommunications services to premises which are serviceable

¹⁰⁰ See CEG Report October 2008

by the network. It would not be efficient for Optus to make the required investments to duplicate last half-mile infrastructure where existing networks (including Telstra's own HFC network as well as its copper access network) are already in place with capacity to service downstream markets.

- 6.50 Further, there are serious doubts about whether investment in HFC cable infrastructure would be an efficient investment, which has been highlighted in a recent paper by the consultancy CEG. CEG recently carried out a review of the performance of HFC cable infrastructure compared with DSL infrastructure in overseas jurisdictions (at Optus' request, in the context of Telstra's HFC exemption application). CEG found that despite attempts to promote facilities-based competition in overseas markets through roll-back of access regulation, cable is losing market share to DSL internationally:¹⁰¹

“The overall picture that emerges from the international evidence is that while cable was initially strong in a number of markets, it has been losing ground in recent years in both the key revenue sources of pay TV and broadband.”

- 6.51 CEG concluded that:

Cable's loss of market share internationally supports the view that DSL is a more efficient (lower cost) means of service delivery compared to cable, particularly for new connections where copper legacy infrastructure is in place and equivalent cable infrastructure is not.”

- 6.52 In support of its thesis, Telstra often points to the success of cable companies in other jurisdictions. Optus submits that such comparison with cable companies in other jurisdictions is misleading, since there are fundamental differences between the competitive conditions facing HFC network operators in Australia and those facing cable competitors overseas. These include:

- (a) While pay TV has been a key driver for demand on HFC networks and an important part of expected revenues for cable operators overseas, Australian operators (and Optus in particular) have lower expected revenues from pay TV when compared with overseas operators. This is because:
 - i) pay TV penetration in Australia is low by international standards, at approximately 27 to 29 per cent of households passed, as compared to 62 per cent in the United States and 65 per cent in Canada; and
 - ii) pay TV operators in Australia pay some of highest prices in the world for content.

¹⁰¹ CEG, *Assessing the Likely Effects of Asymmetric Access Regulation in Australia: Telstra's Proposed HFC Exemption*, October 2008, p.24

- (b) Australia is one of only two OECD countries (the other being Portugal) where there is significant overlap between cable networks (where there are overbuilders in the United States, they are marginal players). Telstra's deliberate overbuild of Optus' HFC network with its own network (which Telstra undertook in order to protect its existing fixed line profits from platform competition) has had the impact of significantly harming the commercial prospects of Optus' HFC network, as evidenced by the write-downs that have occurred on the value of both networks.
 - (c) In Canada, the United States, the United Kingdom and the Netherlands, there is no or minimal incumbent local exchange carrier ownership in HFC networks.
- 6.53 These factors are conveniently overlooked by Telstra because they highlight the unprecedented advantage it has enjoyed over its international peers.
- 6.54 Telstra has recently run this argument in an application to the ACCC to bar Optus from access to regulated services to all premises within the HFC network footprint (whether serviceable or unserviceable). After extensive investigation, on 11 November 2008 the ACCC issued a Final Decision that which found that Telstra's proposed exemption order would not promote competition or efficient investment in infrastructure, and accordingly was not in the long term interests of end users. In the course of its investigation the ACCC revealed many of Telstra's arguments and supporting evidence to be misleading. In order to give proper context to any claims Telstra may make in the course of the current review, Optus refers the ACCC to its final decision on the 'HFC exemption' matter.
- 6.55 Optus submits that the ACCC should reject any suggestion that Optus' use of the ULLS or other declared services amounts to evidence that the ULLS declaration is not promoting efficient investment. The evidence submitted to support any such claim should be scrutinised very closely. To the contrary, Optus' use of declared services amounts to evidence that the ULLS declaration is successful in promoting facilities-based competition where it is efficient to do so.

International evidence confirms access regulation does not discourage investment

- 6.56 An argument frequently made by Telstra and other incumbents is that regulated access leads to lessened investment in the telecommunications industry. However, this claim has been refuted in empirical research. On the contrary, there have been a number of studies which demonstrate the positive effects of unbundling on investment. For example:
- i) Willig et al. (2002) confirmed the alternative 'competitive stimulus hypothesis': they found that low unbundling rates induce competition and stimulate investment by incumbents,

such that “a one percent decrease in the UNE-P rate¹⁰² generated between a 2,1 and 2.9 percent increase in ILEC investment.”¹⁰³

- ii) Willig (2003) noted that “the Competitive Stimulus Hypothesis follows naturally from basic economic theory and its understanding of competitive markets. Increased competition enabled by UNEs can be expected to result in lower retail prices both because of efficiency improvements induced by competition and because of the pressure competition places on above-cost pricing. .. Additionally, in a competitive environment, both the incumbent and the entrant will face enhanced incentives to improve quality and innovate with respect to services, leading to further investment.”¹⁰⁴
- iii) Hassett and Kotlikoff (2002) raise a number of interesting results in their study of market dynamics under a variety of potential industry structures. “First, telecom investment and output generally increase significantly and telecom prices decrease significantly when new firms enter a market. This is true whether or not the entry occurs because of normal economic forces or as a result of wholesaling arrangements under which competitors rent access to customers from incumbents. ... Second, *unbundling* (forcing the ILECs to rent to the CLECs all or part of their network elements) can dramatically increase CLEC entry by lowering their costs of doing so. Third, competition raises consumer welfare relative to having a regulated monopoly in local voice and unregulated duopoly in broadband.”¹⁰⁵
- iv) Ford and Spiwak (2004) conducted an econometric analysis to test the ‘unbundling deters investment’ hypothesis, in terms of the relationship between broadband deployment and local loop prices. The study found the opposite to be true, that “unbundled loop prices based on Total Element Long Run Incremental Cost (“TELRIC”) actually lead to *increased availability* of broadband services and increased availability of *competitive* broadband services defined as area with at least four broadband providers.”¹⁰⁶ The authors conclude that “this study adds to the mounting work showing that wholesale network access

¹⁰² UNE: unbundled network elements (US). UNE-P: a combination of UNEs including the local loop and switching that allow end-to-end service delivery by an access seeker in the US.

¹⁰³ Based on Makova (2006) in Heinacher and Preissl, *Fibre-optic networks: On investment, regulation and competition*, CESifo DICE Report 3/2006, p.24.

¹⁰⁴ Willig, *Investment is appropriately stimulated by TELRIC*, unpublished manuscript, October 2003. Available from URL: http://psc.ky.gov/pscecf/2003-00379/5200700_efs/04132004/MCI_ST_MTB_EX_14_04%2013%2004.pdf

¹⁰⁵ Hassett and Kotlikoff, *The role of competition in stimulating telecom investment*, October 2002, p.3

¹⁰⁶ Ford and Spiwak, *The positive effects of unbundling on broadband deployment*, Phoenix Center Policy Paper No. 19, September 2004, p.4

requirements (like unbundling) do not dampen broadband availability or investment incentives more generally.”¹⁰⁷

6.57 Further, the Ford and Spiwak (2004) study also cites a number of studies in support of their empirical findings:¹⁰⁸

- i) Research has already conclusively proved that the competition produced by the market opening provisions of the 1996 Act increased the incumbent Bell companies’ average net CapEx investment by \$759 per year, or about 6.4% per year in the aggregate, for each UNE-P access line. PHOENIX CENTER POLICY BULLETIN NO. 5, *Competition and Bell Company Investment in Telecommunications Plant: The Effects of UNE-P* (17 September 2003) (<http://www.phoenixcenter.org/PolicyBulletin/PolicyBulletin5.pdf>). *See also:*
- ii) PHOENIX CENTER POLICY BULLETIN NO. 6: *UNE-P Drives Bell Investment - A Synthesis Model* (17 September 2003) (available at: <http://www.phoenix-center.org/PolicyBulletin/PolicyBulletin6Final.pdf>);
- iii) G. S. Ford and M. D. Pelcovits, *Unbundling and Facilities-Based Entry by CLECs: Two Empirical Tests* (July 2002): www.telepolicy.com;
- iv) T. R. Beard, R. B. Ekelund Jr., and G.S. Ford, *Pursuing Competition in Local Telephony: The Law and Economics of Unbundling and Impairment* (November 2002)(www.telepolicy.com);
- v) T. R. Beard, G. S. Ford, and T.M. Koutsky, *Mandated Access and the Make-or-Buy Decision: The Case of Local Telecommunications Competition* (December 2002) (www.telepolicy.com);
- vi) R. D. Willig, W. H. Lehr, J. P. Bigelow, and S. B. Levinson, *Stimulating Investment and the Telecommunications Act of 1996*, Unpublished Manuscript (October 2002);
- vii) K A. Hassett and L. J. Kotlikoff, *The Role of Competition in Stimulating Telecom Investment*, AEI PUBLICATION (October 2, 2002) (www.aei.org/publications/pubID.14873/pub_detail.asp). Hassett *et al.* (2002) perform a simulation rather than using actual data. *See also, Does Unbundling Really Discourage Facilities-Based Entry? An Econometric Examination of the Unbundled Local Switching Restriction*, Z-TEL POLICY PAPER NO. 4 (February 2002)(www.telepolicy.com);

¹⁰⁷ Ford and Spiwak, *The positive effects of unbundling on broadband deployment*, Phoenix Center Policy Paper No. 19, September 2004, p.12

¹⁰⁸ Ford and Spiwak, *The positive effects of unbundling on broadband deployment*, Phoenix Center Policy Paper No. 19, September 2004, p.2

viii) *Competition at the Crossroads: Can Public Utility Commissions Save Local Telephone Competition?*, Consumer Federation of America (October 2003) (<http://www.consumerfed.org/pr10.07.03.html>).

6.58 Optus submits that effective access regulation does not discourage efficient investment in infrastructure, and roll-back of access regulation does not encourage such investment.

Proposed variation to the ULLS declaration

The ACCC is seeking submissions on whether the ULLS declaration should be varied.

- 6.59 Given the imminent NBN decision, Optus has no comment on the ACCC's preliminary view that the ULLS service description should not be varied as part of the current declaration enquiry. However it considers that the ULLS service variation will need to be reviewed in due course.

7. Line Sharing Service

The ACCC is seeking submissions from interested parties on whether the LSS declaration should be:

- extended (to 31 July 2010 or another date); or*
- revoked; or*
- varied; or*
- allowed to expire without making a new declaration; or*
- allowed to expire and the ACCC should make a new declaration*

- 7.1 Optus supports the ACCC’s preliminary view that an extension for the LSS declaration would promote the LTIE, particularly given the uncertainty of the outcome of the upcoming NBN process.

Continued declaration of the LSS would promote competition

- 7.2 Line sharing allows a competitor access to the high frequency portion of Telstra’s local copper loop on an individual customer basis. It allows that competitor to compete against Telstra to supply that customer with broadband services. High speed broadband services are the predominant use of the high frequency portion of the copper loop.
- 7.3 Optus considers that the continued declaration of the LSS would promote competition given that LSS is a necessary input to a key form of competition in the broadband services market – that is, xDSL based broadband.
- 7.4 The ACCC in its discussion paper notes that declaration can “provide end-users with additional choices in terms of service provider, increased competition on the retail service dimensions, and, depending on the service provider’s costs, lead to lower priced calls for end-users. These benefits are likely to continue to be enjoyed on an ongoing basis by those end-users who are unlikely to be served by alternative customer access infrastructure in the foreseeable future.”¹⁰⁹
- 7.5 Despite the improvement in ULLS-based competition in recent years (refer to Section 5), ULLS is not necessarily always the most efficient or viable form of entry for all access seekers, nor across all geographic regions. The table below illustrates the distribution of LSS take-up across the four geographic regions. This shows that while the number of LSS access seekers has increased, the distribution proportion of LSS access seekers remains relatively unchanged during the reported period.

¹⁰⁹ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.83

Table 4: Distribution of LSS access seekers in each geographic region as a percentage of total LSS access seekers ¹¹⁰

	Sept 2007	Dec 2007	Mar 2008	June 2008	Sept 2008	Dec 2008
LSS access seekers in each geographic region represented as a percentage of total LSS access seekers ¹¹¹						
Band 1	5.07 %	4.88 %	4.75 %	4.64 %	4.52 %	4.44 %
Band 2	92.94 %	93.12 %	92.91 %	92.86 %	92.80 %	92.93 %
Band 3	1.80 %	1.82 %	2.17 %	2.33 %	2.52 %	2.64 %
Band 4	0.19 %	0.18 %	0.18 %	0.17 %	0.16 %	0.17 %
Total number of ULLS access seekers	338,200	373,288	405,029	434,859	469,725	498,988

7.6 An alternative input to the provision of xDSL based broadband services is the ULLS. The ULLS provides competitors with the control of the copper loop, allowing them to use the low frequency portion of the copper loop to provide voice services over the PSTN. ULLS-based competitors to Telstra provide a competitive constraint on above cost pricing in the retail market for voice telephony, to the extent that access to the ULLS is provided on reasonable price and non-price terms.

7.7 However there are a number of factors that can impede a LSS access seeker's substitution to the provision of services via the ULLS. These barriers of entry for LSS-to-ULLS migration include:

- The pricing disparity between the access costs for these inputs. The price of the ULLS (\$16.00 ¹¹²) is substantially higher than the price of the LSS (\$2.50 ¹¹³);
- There are likely to be substantial costs imposed on access seekers resulting from the migration to the use of ULLS; and
- Barriers to competition in the local call market, highlighted by the dominance of the incumbent in fixed line communications (as discussed in Section 5).

Declaration encourages efficient use of & investment in infrastructure

7.8 Optus submits that the continued declaration of the LSS is likely to promote the efficient use of infrastructure, by promoting cost-reflective

¹¹⁰ Adapted from reported ULLS access seeker figures provided in ACCC, *Snapshot of Telstra's customer access network*, September 2007 to December 2008.

¹¹¹ Percentages have been calculated and rounded to the nearest 2 decimal place.

¹¹² This price is based on the indicative ULLS (Band 2) monthly charge for the period 1 July 2008 to 31 July 2009. ACCC, *Unconditioned Local Loop Service – Pricing principles and indicative prices*, June 2008

¹¹³ This price is based on the indicative LSS monthly charge for the period 1 January 2008 to 31 July 2009. ACCC, *Review of the Line Sharing Service Declaration*, Final Decision, October 2007

prices and reducing the potential for inefficient duplication of infrastructure.

- 7.9 The ACCC in its 2007 *Review of the LSS Declaration* has previously considered, and still considers, that:

*“[T]he current market structure of the market for the LSS confers significant and ongoing market power upon Telstra in the negotiation of terms and conditions for the service. At this time, Telstra remains the sole supplier of the LSS. Under these conditions, Telstra could withhold supply of the LSS or set prices at supra-competitive levels absent the declaration.”*¹¹⁴

- 7.10 This reliance on Telstra by access seekers is further highlighted through the ACCC’s recognition that:

*“[D]eployment of competitive access networks is likely to be limited and competitors will continue to rely on access to Telstra’s fixed inputs such as the LSS and ULLS in order to compete in downstream broadband markets.”*¹¹⁵

- 7.11 However,

“[W]hile ULLS-based provision would allow some access seekers to compete as quasi-facilities-based providers across both voice and broadband services, the absence of a LSS declaration will likely lead to some current retail providers reverting to wholesale DSL-based provision or exiting the market altogether, even in the case where continued service provision might be efficient. ...

*Relying on ULLS-based competition in the absence of regulated LSS would also mean that quasi-infrastructure based competition based solely on broadband services may be compromised.”*¹¹⁶

- 7.12 Optus concurs with these observations and considers that these factors are still as relevant today as they were in the past. Little has changed in terms of Telstra’s dominance in fixed-line telecommunications (highlighted in Section 4) or Telstra’s standing as the sole supplier of the LSS since the last declaration inquiry.

¹¹⁴ ACCC, *Review of the Line Sharing Service Declaration*, Final Decision, October 2007, p.8 This is also cited in ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.63

¹¹⁵ ACCC, *Review of the Line Sharing Service Declaration*, Final Decision, October 2007, p.46

¹¹⁶ ACCC, *Review of the Line Sharing Service Declaration*, Final Decision, October 2007, p.53-54

8. Local Carriage Service and Wholesale Line Rental

The ACCC is seeking submissions from interested parties on whether the LCS and WLR declaration should be:

- extended (to 31 July 2010 or another date); or*
- revoked; or*
- varied; or*
- allowed to expire without making a new declaration; or*
- allowed to expire and the ACCC should make a new declaration*

- 8.1 Optus supports the ACCC’s preliminary view that an extension for the LCS and WLR declarations would promote the LTIE.

Continued declaration of LCS and WLR would promote competition

- 8.2 The ACCC notes that declaration can “provide end-users with additional choices in terms of service provider, increased competition on the retail service dimensions, and, depending on the service provider’s costs, lead to lower priced calls for end-users. These benefits are likely to continue to be enjoyed on an ongoing basis by those end-users who are unlikely to be served by alternative customer access infrastructure in the foreseeable future.”¹¹⁷

- 8.3 This is particularly the case for competition in service provision to Corporate and Government (C&G) customers. The crux of Optus’ argument focused on the ability of access seekers to offer enhanced managed service offerings, cost of migration of C&G customers to new platforms, as well as the impacts on C& G customers.

- (a) Procurement of services occurs on a ‘whole of business’ (WOB) basis
 - Optus submits that a distinctive feature of the C&G market is the preference by C&G customers to place a premium on simplicity and convenience, with preference for a single bill and a single point of contact for all telecommunications needs.
- (b) C&G customers require specialised and complex features
 - Optus submits that C&G customers often require a number of specialised and complex features as minimum requirements, in addition to the provision of basic telephony services, required to service their business needs.
 - In some cases, C&G customers demand services that are only available from Telstra, and the volume of services demanded is insufficient to justify investment by other service providers. Hence, without regulated

¹¹⁷ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.83

access, Telstra becomes the only network operator currently capable of supplying all the complex business features to all business sites.

- (c) There is a high cost of migration to new platforms
- Optus submits that it currently purchases a number of complex features from Telstra Wholesale, and provides them to C&G customers in combination with WLR as part of its managed service offerings because not all complex features can be supplied on Optus' network using legacy technologies.
 - In addition, the relevant costs of enhanced services and migration to new platforms are high. These include software and hardware costs, licensing fees, switching costs, development costs and costs associated with billing and provisioning system changes.

(d) Impact on C&G customers

- Optus submits that the PSTN OA exemptions may have grave implications for competition in the provision of services to large C&G customers. As a result of the typical requirements for complex features, ubiquitous offerings and WOB contracts in the C&G market, it is generally not possible to substitute consumer offerings for business offerings, so Telstra's competitors in the consumer space cannot necessarily exert a competitive constraint on Telstra's pricing conduct in the C&G market.
- The precise terms and conditions contained in service level agreements (SLAs) are critical when services are being sold in the corporate market. Business customers in particular require high standards (e.g. minimal disruption in the case of outages) for their SLAs.
- The types of SLAs Optus can offer in the market are important when it is attempting to source new customers. In corporate markets, large contracts are generally acquired through tender processes. This means that a client will detail the service standards it requires. Optus, as a potential supplier, then puts together a proposal that responds to the customer's requirements and guarantees certain service standards at (or above) the level that has been requested.

8.4 Optus considers that the promotion of competition in the C&G market requires robust protection for competition in the provision of services to large C&G customers. Revocation would leave Telstra with no effective constraint on its conduct in pricing PSTN OA services for resupply to C&G customers. It would leave Optus and other entrants at the mercy of the incumbent and remove their existing fragile equality of opportunity to compete in the corporate market against Telstra, and thereby seriously damage competition. Declaration would promote competition in the corporate and government market.

Declaration encourages efficient use of & investment in infrastructure

- 8.5 The ACCC in its discussion paper considers that continued declaration of the LCS and WLR will “continue to facilitate market entry and enable service providers to obtain information about demand characteristics and the likely responses of competitors, thus reducing the risks associated with infrastructure deployment”.¹¹⁸ It also notes that “ULLS-based competition is preferable to pure resale competition as it provides more dynamic and sustainable competition in the provision of services.”

Corporate and Government market

- 8.6 Investment in alternative infrastructure in the C&G market is already occurring, irrespective of regulatory settings – however the migration of customers to the new infrastructure requires very long lead-times. Before existing customers can be supplied using alternative infrastructure such as Optus Evolve, they must be migrated onto the new platform.
- 8.7 **CiC**
- 8.8 **CiC**
- 8.9 **CiC**
- 8.10 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. These issues are explained in more detail in Optus’ submissions in the WLR and PSTN OA exemption processes.
- 8.11 It follows that revocation of the declaration would not encourage efficient investment in infrastructure in the C&G market – it would deny customers a choice, and simply hurt competition with no corresponding gain.

Barriers to entry

- 8.12 The ACCC has stated in the past that the “use of the ULLS to provide voice and broadband service requires significant investment by potential competitors. The risks of investment are high. Furthermore, new entrants need to acquire large numbers of customers to achieve minimum efficient scale to be able to compete effectively with Telstra.”¹¹⁹
- 8.13 Optus reiterates that there are a number of actual or potential constraints that could limit or adversely impact access seekers’ use of ULLS, namely:
- The uncertainty of ULLS access and pricing;
 - Non-price issues;

¹¹⁸ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.87

¹¹⁹ ACCC, *Telecommunications competitive safeguards for 2005-2006*, May 2007, p.16

- Pair gain system / RIM;
- Capacity constraints; and
- Network upgrade.¹²⁰

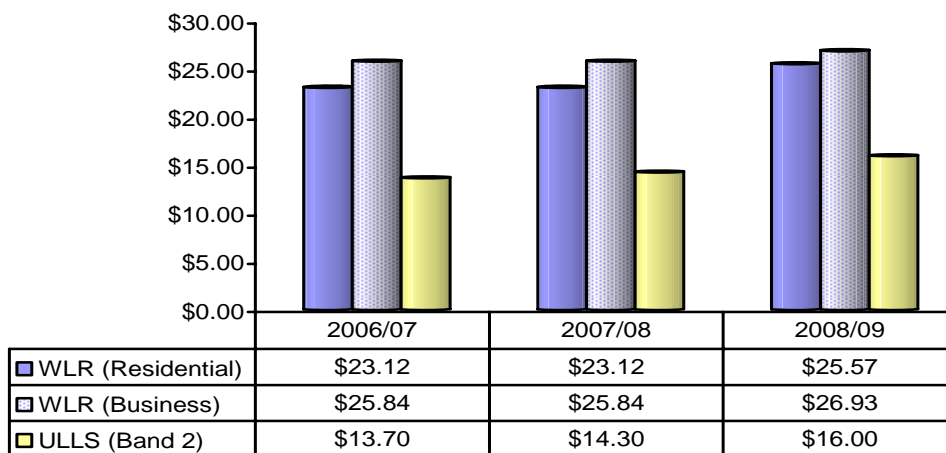
8.14 In addition to the material previously submitted in Optus' response to Telstra's exemption applications for LCS and WLR, as well as PSTN OA, the following will highlight a number of issues affecting ULLS as an alternative to resale-based competition.

Difference in access prices for WLR and ULLS

8.15 Optus submits that there is a relatively large gap between the wholesale prices for WLR and LCS and ULLS (largely due to the fact that the ULLS is regulated at cost whereas the WLR is regulated at retail-minus) which, under declaration, provides strong incentives for access seekers to 'move up' the ladder of investment. Hence access seekers are likely to acquire access to basic fixed line services via ULLS.

8.16 The following figure illustrates the relatively large gap in access prices between WLR and ULLS. It shows that there is a significant difference in access prices between WLR and ULLS (Band 2). For example, for the 2008/09 period, the difference between the residential WLR and Band 2 ULLS price is \$9.57 per line per month – this is representative of 37.4 per cent of the total residential WLR access price.

Figure 4: Difference between access prices of WLR and ULLS



8.17 It follows that reasonable indicative prices provide a strong incentive for access seekers to migrate towards access-based competition via ULLS.

Practical constraints as barriers of entry

¹²⁰ These issues have been widely discussed in previous Optus submissions in response to Telstra's exemption applications for PSTN OA and WLR/LCS.

8.18 However, Optus submits that an access seeker's ability to utilise the ULLS is fettered by a number of practical constraints on their ability to access a ULLS in any given ESA. Access may be affected due to:

(a) Pair gain system / RIM

- ULLS relies on the presence of a continuous copper loop. In this loop is broken, as would be in the case where Telstra has deployed a pair-gain system or RIM between the exchange and the customer.
- **CiC** This constraint acts to constrain the number of customers that can be serviced via ULLS. As a result, the affected exchange would no longer provide an appropriate substitute for fixed-line service, hence may lead to a lessening of competition within the affected ESA.
- Absent regulation there is the prospect that ULLS-based competition could be hampered with an increase in the deployment of RIM in exchanges. For example, Telstra has recently announced its intention to install a RIM system into its Deakin exchange which essentially will strand DSLAM investment by access seekers and hence ULLS-based competition within the affected DAs.

(b) Capacity constraints

- Access to ULLS requires access seekers to deploy a DSLAM in close proximity to the Telstra exchange. This typically requires the access seeker to 'rent' space in a Telstra exchange, which is further subject to a number of terms and conditions for access and supply of ULLS in Telstra's exchanges often relating to the Telstra Exchange Building Access (TEBA) agreements for access to the facilities.
- Under the terms of its TEBA agreement Telstra provides a separate room within its exchange building for access seekers to deploy their interconnect equipment. TEBA space is effectively partitioned into lots of a set size and this is allocated to access seekers on a first come first served basis. The space is used for all interconnect purposes, not simply DSLAM access.
- However TEBA space appears to be a limited ¹²¹ commodity, which means that access seekers may not be able to deploy sufficient future rack capacity in those exchanges to meet future requirements.
- In its DSLAM roll-out Optus has typically **CiC** However, it appears that a number of Telstra exchanges have limited space available. That is, the exchange becomes listed as 'capped' or 'potentially capped' and no further access equipment can be deployed in those exchanges.
- Without access to TEBA, access seekers may only ever be able to serve a small proportion of lines from certain exchanges. In effect this means that Telstra is protected from losing a certain percentage of service to competitors in these exchanges.

¹²¹ Optus understands that TEBA space may be limited for physical constraints, which act to place a constraint on the proportion of services within that ESA that could be acquired by access seekers.

(c) Queuing

- An extension of the capacity constraint issue is the onerous process involved in gaining the access to enter into an exchange.
- The ACCC in its decision to grant Telstra's LCS and WLR exemptions notes that "queuing can be as much of an impediment to access to the ULLS as capping – in the sense that access seekers are routinely required to wait in a 'queue' for months (or even years) in order to be able to enter into an exchange."¹²²
- The first significant step involves the access seeker submitting to Telstra a preliminary study request (PSR). Subject to approval by Telstra a number of planning and construction processes may ensue, and upon completion of the works in the relevant exchange, a joint completion inspection (JCI) will be undertaken. Only when this JCI is complete would an access seeker consider the barriers to ULLS-based competition in the relevant exchange become overcome.
- When PSR requests are submitted, they are essentially placed into a queue to await approval. This period can last for months, or sometimes years, depending on a number of factors:
 - i) Telstra only allows one PSR request, and its subsequent build if approved, to be actioned at any one period of time. As a result, access seekers are required to wait until all current work is completed before any future PSR can be considered.
 - ii) On average, Optus submits that it takes approximately **CiC** months to complete the process from submission of the first PSR to the final JCI. In addition, if any modifications need to be made to the initial PSR (after approval), a subsequent PSR will need to be submitted and the process restarts.
 - iii) All access to an exchange can be put 'on hold' if the Telstra exchange is affected by exchange issues or requires upgrades to existing equipment.
- Optus submits that the taken by an access seeker to submit a PSR to the final completion of the build, hence the passing of the JCI, can be a timely process. **CiC** This shows that even though a PSR is submitted, it will not always process to build. Hence this limits the access seeker's ability to engage in ULLS-based competition.

(d) Distance limitations

- The map of the Castle Hill exchange area (provided in Attachment A) emphasises the distance limitations of ULLS in serving the entirety of an exchange area.
- **CiC**

¹²² ACCC, *Telstra's local carriage service and wholesale line rental exemption applications*, Final Decision and Class Exemption, August 2008, p.149

- **CiC**
- (e) Network upgrade
 - Since the ULLS was declared Telstra has repeatedly raised issues concerning its plans to upgrade or augment its network.
 - It follows that as Telstra engages in network modernisation activities, this can impact or impede an access seeker's ability to utilise ULLS within an exchange. In addition, it could also strand existing equipment installed by access seekers.

Geographical issues

8.19 Despite the improvement in ULLS-based competition in recent years (refer to Section 5), ULLS is not necessarily always the most efficient or viable form of entry for all access seekers, nor across all geographic regions. The table below illustrates the distribution of ULLS take-up across the four geographic regions. This shows that while the number of ULLS access seekers has essentially doubled, the distribution proportion of ULLS access seekers remains relatively unchanged during the reported period.

Table 5: Distribution of ULLS access seekers in each geographic region as a percentage of total ULLS access seekers¹²³

	Sept 2007	Dec 2007	Mar 2008	June 2008	Sept 2008	Dec 2008
ULLS access seekers in each geographic region represented as a percentage of total ULLS access seekers ¹²⁴						
Band 1	6.83 %	5.99 %	5.45 %	5.06 %	4.84 %	4.66 %
Band 2	92.16 %	93.04 %	93.50 %	93.84 %	93.96 %	94.08 %
Band 3	0.98 %	0.94 %	1.03 %	1.08 %	1.19 %	1.24 %
Band 4	0.02 %	0.02 %	0.02 %	0.02 %	0.02 %	0.02 %
Total number of ULLS access seekers	306,248	382,209	447,455	520,592	574,205	610,600

8.20 It follows that the issue of viability of entry will undoubtedly arise with some geographic regions. The ACCC has considered that there may be legitimate reasons for this occurrence:

“This may be because of issues such as the economies of scale that are achievable. Access seekers have suggested to the ACCC in various processes that they do not expect significant ULLS-based entry to occur, or to provide a competitive alternative to LCS and WLR, in a

¹²³ Adapted from reported ULLS access seeker figures provided in ACCC, *Snapshot of Telstra's customer access network*, September 2007 to December 2008.

¹²⁴ Percentages have been calculated and rounded to the nearest 2 decimal place.

*number of ESAs, particularly in Band 3, Band 4 and certain ESAs in Band 2.”*¹²⁵

Impact from the impending deployment of NBN

- 8.21 Optus considers that removing regulated access to fixed line services would not encourage access seekers to invest in ULLS infrastructure given the imminent deployment of a NBN which would strand any such investments immediately.
- 8.22 The ACCC in its *Competitive Safeguards Report for 2006-07* has noted that “upgrading networks by pushing fibre closer to end users may mean that certain currently regulated bottleneck services, such as the ULLS and LSS may no longer be available, with consequential implications for the effectiveness of competition in telecommunications markets.”¹²⁶
- 8.23 It follows that at least some resale-based access seekers will be vulnerable to an increase in the price of the affected services by Telstra or to a greater extent, an outright refusal to supply. Indeed, such an anti-competitive tactic would enable Telstra to grow its market share in voice services at the expense of resellers at the very time that the NBN is being rolled out (secure in the knowledge that no resellers will risk investing in DSLAMs that will immediately be stranded). This would enable Telstra to entrench its already dominant position in fixed line communications in preparation for the transition to the new NBN environment.
- 8.24 In conclusion Optus submits that the existing declarations should not be revoked. The exemption process provides access providers an appropriate avenue to apply for rollback of regulation where sufficient competition already exists, and hence is in the LTIE.

The exempted ESAs should remain declared

- 8.25 The ACCC in its assessment of Telstra’s application for LCS and WLR exemptions conducted a thorough analysis of competition in the WLR and LCS markets, to reach its decision to grant exemptions to regulation in a number of ESAs. A key caveat to this decision was that the exemptions have important conditions and limitations attached to them, and are therefore tightly linked to the underlying declarations for each of these services.¹²⁷
- 8.26 The exemptions are due to come into effect on 22 August 2009. However the final decision on the WLR and LCS exemption is due to be re-reviewed by the Australian Competition Tribunal, after the Full Federal Court upheld Telstra’s appeal of the Tribunal’s original decision. The final Tribunal decision should be expected by mid-2009.

¹²⁵ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.84

¹²⁶ ACCC, *Telecommunications competitive safeguards for 2006-07*, May 2008, p.2

¹²⁷ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.94

8.27 The conditions and limitations currently imposed in the LCS and WLR exemptions have been imposed to address the concerns raised regarding the substitutability of ULLS for LCS and WLR – in particular, capping, queuing and LSS to ULLS migration (discussed below). As a result, any variation, revocation or lapsing of the declaration will nullify the effect of the conditions and limitations. Optus agrees with the ACCC’s statement that:

*“The exemptions granted by the ACCC to Telstra have been crafted to only work in conjunction with the underlying declarations. **If Telstra cannot satisfy the conditions and limitations outlined in the exemption orders then the SAOs in relation to the supply of the LCS and WLR will be reinstated in the relevant ESAs.**”*¹²⁸ [emphasis added]

8.28 Optus therefore considers that where the ULLS is not sufficiently available, continued regulated access to the WLR and LCS is required to ensure the promotion of competition in downstream fixed voice services in all geographic regions. Unconditional revocation would remove resale access without ensuring adequate availability of ULLS and thereby permit the dominant incumbent to engage in anti-competitive conduct, which will seriously damage competition and distort the market in the long term. The exempted ESAs should remain declared.

¹²⁸ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.87

9. PSTN Originating and Terminating Access Services

PSTN originating access

The ACCC is seeking submissions from interested parties on whether the PSTN OA declaration should be:

- extended (to 31 July 2010 or another date); or*
- revoked; or*
- varied; or*
- allowed to expire without making a new declaration; or*
- allowed to expire and the ACCC should make a new declaration*

- 9.1 Optus supports the ACCC’s preliminary view that an extension for the PSTN OA declaration would promote the LTIE.

Continued declaration of PSTN OA would promote competition

- 9.2 The ACCC in its last declaration inquiry noted that “as alternative networks become more developed over the next few years, this will change the market dynamics of providing voice services ... Once this occurs, it would be expected that originating access in metropolitan and regional areas would become a much less vital part of interconnection and access arrangements.”¹²⁹

Long distance customers

- 9.3 Optus contends that the PSTN OA service plays a role in promoting competition in long distance communications services (including international services).
- 9.4 The PSTN OTA declaration allows this market segment to be unbundled from network access, such that customers can potentially purchase line rental services from one provider and long distance calling from a separate provider. This enables competitive providers to offer long distance services to any given end user, regardless of which carrier is providing underlying network access to that end user.
- 9.5 The ACCC in its recent decision to grant Telstra’s PSTN OA exemptions has noted that “in some areas there is a sufficient level of infrastructure competition to Telstra to begin withdrawing regulation of the service.”¹³⁰ However, the outcome in this decision could yet be overturned by Tribunal following its decision on Telstra’s WLR and LCS exemption application.
- 9.6 Optus submits that while it concurs with the ACCC’s recognition that “regulated access to Telstra’s PSTN, either via ULLS or PSTN OA,

¹²⁹ ACCC, *Declaration Inquiry for the ULLS, PSTN OTA and CLLS*, Final Determination, July 2006, p.52

¹³⁰ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.70

remains necessary for many access seeker wishing to provide the full suite of fixed voice services,”¹³¹ it also accepts the principle that layers of regulation may be withdrawn where they are not required to promote competition.

- 9.7 However in the absence of regulation, particularly in locations where Telstra is a monopoly (or near-monopoly) wholesale provider of basic access services, Optus is concerned that Telstra’s would put into effect its ability and incentive to reduce competitors’ ability to compete in the standalone long distance market.
- 9.8 Telstra’s incentive to prevent competitors from competing in the standalone long distance market arises through its position as a vertically integrated provider. It follows that Telstra may face strong incentives to exclude retail competitors from markets downstream to PSTN OTA; or disadvantage competitors by selling PSTN OTA services at discriminatory rates. As such, Telstra’s ability to carry out such a foreclosure strategy would be enhanced.
- 9.9 Absent regulation of wholesale services including the PSTN OA in a given market (or exchange area), Telstra may have the ability to raise the relative price of voice services supplied on a standalone basis to encourage customers to take a bundle of voice and broadband services from Telstra. This could be executed via a discount on the bundle of services. Competitors offering only broadband services (over the LSS) would have difficulty in acquiring customers even if they were more efficient in supplying broadband services than Telstra. This is because those customers’ total cost of voice and broadband services (with voice from Telstra and broadband from the competitor) could be higher than the price offered by Telstra for the bundle of voice and broadband. Therefore this would not be in the LTIE because competitors would not be competing on their merits.
- 9.10 Optus therefore considers that continued regulation is required to place competitive pressures and mitigate any effects of foreclosure and market squeeze behaviour (discussed in Section 5).
- 9.11 The exemptions granted by the ACCC failed to take into account Optus’ arguments regarding the ability of access seekers to compete in long distance services. There is a standalone long distance market segment. In competing for customers, Telstra commonly bundles its voice and telephony services. Therefore, absent regulation of wholesale services including the PSTN OA in a given market (or exchange area), Telstra may have the ability to raise the relative price of voice services supplied on a standalone basis to encourage customers to take a bundle of voice and broadband services from Telstra.
- 9.12 Optus submits in the absence of declaration, it is likely that competition in the provision of voice services would be lessened. In particular, it would lead to diminishing competition in the long distance services.

¹³¹ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.72

- 9.13 Optus has long argued that there exists a standalone market for long distance services. Further, it reiterates that in the context of the standalone long distance market, the relevant bottleneck infrastructure is the individual customer's line. That is, provided an end user continues to purchase line rental services from Telstra, only Telstra can offer long distance services with respect to that customer. Substitution to another provider with respect to standalone long distance services is only made possible through the PSTN OA declaration. Hence only Telstra, as the ubiquitous PSTN operator, can offer wholesale PSTN OA services with respect to that customer.
- 9.14 It follows that the continued declaration of the PSTN OA service would therefore enable "end-users to gain access to an increased choice of telephony service providers, therefore improving their access to those services and providing greater scope for price competition."¹³²

Impact on C&G customers

- 9.15 Optus submits that the PSTN OA exemptions may have grave implications for competition in the provision of services to C&G customers. The issues in this regard are very similar to the issues which arise in the C&G segment in respect of the WLR / LCS services. Optus refers the ACCC to the discussion earlier in this paper and to Optus' submissions in the various exemption applications processes.

Continued declaration would encourage the economically efficient use of, and investment in, infrastructure

- 9.16 The ACCC also notes that:

*"While there may be some allocative and/or productive efficiency losses in the short-term (in the event of access seekers having to commercially negotiate for a PSTN OA-type service or, at the extreme, exiting the market altogether), these would be outweighed by the long-term benefits to consumers from the increased take-up of the ULLS or (in the case of CBD areas) use of investment in alternative infrastructure, and the flow-on competition benefits to consumers."*¹³³

- 9.17 Optus submits that it continues to disagree with this conclusion, for three reasons. First, the ACCC does not appear to have taken into account the inefficiency (waste of resources) implied by encouraging new investment in infrastructure that will shortly be made redundant.
- 9.18 Second, the ACCC itself has admitted that any investment that does occur would be very minor and insubstantial. In its final decision, the ACCC found that:

¹³² ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.72

¹³³ ACCC, *Telstra's PSTN originating access exemption application – CBD and Metropolitan areas*, Final Decision, October 2008, pp.149-150

*“[A]ny additional investment required as a result of granting the ACCC’s Proposed Metropolitan Exemption Order set out in Appendix E is likely to be limited to a relatively small number of ESAs and by a limited number of access seekers.”*¹³⁴

- 9.19 It follows that it seems implausible how such a limited investment result could ‘outweigh’ the significant negative consequences of the exemption.
- 9.20 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. Similarly as can be seen in the Castle Hill exchange map, in Attachment A, there is a substantial proportion of the ESA where access seekers will be unable to engage in ULLS-based competition – namely, in areas where pair gain exists. Hence this shows that a key limitation of the ULLS is that it is not universally available.
- 9.21 Optus therefore considers that the removal of PSTN OA regulation can 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.
- 9.22 The issues canvassed under this heading in respect of the WLR / LCS services are also relevant to PSTN OA. Optus refers the ACCC to the discussion earlier in this paper.

The exempted ESAs should remain declared

- 9.23 The ACCC in its assessment of Telstra’s application for LCS and WLR exemptions conducted a thorough analysis of competition in the WLR and LCS markets, to reach their decision to grant exemptions to regulation in a number of ESAs. A key caveat to this decision was the number of conditions and limits imposed on ESAs before any such exemption could come into effect.
- 9.24 The issues in this regard are very similar to the issues which arise in the C&G segment in respect of the WLR / LCS services. Optus refers the ACCC to the discussion earlier in this paper.

¹³⁴ ACCC, *Telstra’s PSTN originating access exemption application – CBD and Metropolitan areas*, Final Decision, October 2008, p.146

PSTN terminating access

The ACCC is seeking submissions from interested parties on whether the PSTN TA declaration should be:

- extended (to 31 July 2010 or another date); or*
- revoked; or*
- varied; or*
- allowed to expire without making a new declaration; or*
- allowed to expire and the ACCC should make a new declaration*

- 9.25 Optus supports the ACCC’s preliminary view that an extension for the PSTN TA declaration would promote the LTIE.

Continued declaration of PSTN TA would promote competition

- 9.26 Optus submits that the nature of the PSTN TA service itself provides compelling evidence for the need to continue declaration of PSTN TA – that is, the continuing utility of the terminating access service is imperative for access seekers in the provision of voice services to end users,¹³⁵ for both the completion of interconnect and achievement of any-to-any connectivity.
- 9.27 Despite the existence of alternative access networks, such as Telstra and Optus’ HFC networks, the ACCC has noted that “there are currently no competing fixed-line networks that are comparable to Telstra’s CAN on a national scale.”¹³⁶
- 9.28 Optus reiterates that it supplies its residential customers via its HFC network, where serviceability permits. However in terms of coverage, the size of Optus’ HFC network remains inevitably smaller than that of Telstra’s CAN network. It is therefore this considerable disparity and asymmetry in size and reach of the network which impacts on Optus’ (and other competitors) ability to compete in the ubiquitous provision of fixed voice services.
- 9.29 Clearly, refusal by an access provider to sell terminating services to a competitor would preclude the achievement of any-to-any connectivity. It follows that the “termination bottleneck” problem is endemic to the entire telecommunications sector under current interconnection arrangements.
- 9.30 Hence if PSTN TA services were not redeclared then Telstra, as the owner of the ubiquitous PSTN, could potentially be the only provider of the relevant downstream retail service.

¹³⁵ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.74

¹³⁶ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.75

Continued declaration would encourage the economically efficient use of, and investment in, infrastructure

- 9.31 The ACCC in its last declaration inquiry noted that “even where competitive infrastructure is available, the competing network would still need to interconnect with other networks to terminate services.”¹³⁷
- 9.32 Therefore, not unlike PSTN OA, the ACCC in its discussion paper recognises that “continued declaration of the PSTN TA would enable access seekers to combine existing customer access and switching infrastructure with their own equipment so as to provide end-to-end retail and wholesale local and long-distance voice services to end-users, as well as to other service providers.”¹³⁸
- 9.33 Optus concurs with this recognition and subsequently acknowledges that in the absence of declaration, it is likely that competition in the provision of voice services would be lessened. In particular, it would lead to diminishing competition in the long distance services.

¹³⁷ ACCC, *Declaration Inquiry for the ULLS, PSTN OTA and CLLS*, Final Determination, July 2006, p.52

¹³⁸ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.76

10. Duration Of Extensions for the Fixed Services Declarations

The ACCC seeks submissions from parties on the proposed 12 month extension for the expiry date of the ULLS, LSS, WLR, LCS, PSTN OA and PSTN TA declarations. If an interested party believes a different extension duration would be more appropriate, this should be stated and explained in the submission.

- 10.1 Optus considers that the fixed line service declarations should apply for a period longer than 12 months. Extension for one year will simply add to uncertainty and there is no reason why NBN should necessarily preclude further extension of the declaration.
- 10.2 Further, Optus submits there are reasons warranting the extension of the fixed services declarations beyond the preliminary 12 month period considered in the declaration review.
- 10.3 First, there has been a level of regulatory uncertainty surrounding the current NBN process. The impact of the NBN continues to create business uncertainty for both access seekers and end-users alike. Extending the declaration for a longer period would help to mitigate this uncertainty.
- 10.4 Second, the exemption process provides network operators a mechanism to seek the roll back of regulation. The ACCC has recently granted Telstra LCS and WLR, as well as PSTN OA, exemptions in a number of exchange areas, which have only been crafted to apply in conjunction with the underlying declaration of those services.

NBN uncertainty

- 10.5 The ACCC in its discussion paper was of the preliminary view that setting “a short-term extension of the declarations will minimise the likelihood of regulatory uncertainty and allow the Government’s decision on the NBN, in particular, to be finalised prior to considering longer term regulatory arrangements.”¹³⁹
- 10.6 While Optus submits there may be some merit to this approach, it also considers that an extension beyond one year would be more appropriate in addressing the NBN issue. Extending the declaration for a longer period would help to mitigate the uncertainty faced by access seekers.
- 10.7 In addition, there is no reason why the NBN process necessarily precludes the continuation of the existing declarations. Declaration could continue to apply in areas where the NBN has not yet been deployed until at least such time as deployment takes place.

¹³⁹ ACCC, *Fixed Services Review – Declaration inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, Discussion Paper, November 2008, p.94

- 10.8 Optus therefore considers it is justified to extend the expiry of the ULLS declaration to a date which, at a minimum, encompasses the early deployment phase of the NBN rollout, or approximately three years.
- 10.9 Optus also considers that the declaration period could be extended to align with the 31 December 2012 expiry currently set for the PSTN OA, WLR and LCS exemption applications.
- 10.10 This position is not outside the current approach taken by the ACCC in its recent DTCS Declaration draft decision. In reaching its preliminary view, the ACCC “considers that varying the declaration with an expiry in 5 years will ensure that the intention of the Final Exemption Decision is fully effected.”¹⁴⁰
- 10.11 Declaration should be extended until such time that it is no longer warranted. However, in areas where it is warranted, the roll back of regulation should continue to be determined on case-by-case basis through the exemption mechanism.

¹⁴⁰ The draft DTCS declaration incorporates the entire duration of the DTCS exemptions (valid for a three year period from 25 November 2009) within the five year term of the declaration due to expire on 31 March 2014. ACCC, *Domestic Transmission Capacity Service*, Draft Report, February 2009, p.30

Attachment A: Castle Hill exchange area

[Attached as separate document]