TELSTRA CORPORATION LIMITED

Domestic Transmission Capacity Service – Response to the Commission's Draft Report on Re-declaration of the Service

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Overview

The Australian Competition and Consumer Commission (**Commission**) has requested comments from interested parties on the Commission's report entitled "An ACCC Draft Report on reviewing the declaration of the domestic transmission capacity service" (**Draft Report**) released in February 2009. Telstra considers that there are a number of important factors regarding the declaration of the domestic transmission capacity service (**DTCS**) that remain to be fully addressed and that these factors may have a lasting impact on the development of competition in the industry.

Most importantly, Telstra is concerned that the Commission has not properly considered whether declaration of the service as proposed would be in the long-term interest of end-users (**LTIE**). The empowering legislation provides that the Commission must be satisfied that the LTIE criteria is met in the declaration of the service, yet the Draft Report provides no basis for being confident that the Commission has sufficiently informed itself or analysed information available to it to make this judgement. It is apparent that the Commission has relied on facts and analysis in its previous declaration and exemption proceedings, requiring parties to produce evidence of changed circumstances in order to persuade it that the declaration should *not* be made, while relying on the existence of the exemption process to protect the LTIE in the event that services are consequently "over-declared". This is not the process set out in Part XIC of the Trade Practices Act 1974 (Cth) (**TPA**).

As a result, the Commission proposes to declare too broad a range of DTCS, for too long a period. Telstra submits that on proper analysis, it is evident that certain aspects of the proposed service ought not be declared, such as tail end DTCS for which symmetric high-bitrate digital subscriber loop (ShDSL) delivered over ULLS is a substitute.

The history of transmission capacity regulation in Australia shows progressively more intense and widespread competition, and progressive de-regulation. It is important that the Commission continue along the path of recognising this increased competition by withdrawing regulation where it is no longer needed – an essential step in promoting efficient investment, and the long-term interests of end users. In these proceedings, it is critical that the Commission informs itself with up-to-date information to determine whether the LTIE is met by declaration. Information acquired by the Commission under its record-keeping rules (**RKR**) is particularly relevant, and will be available to the Commission several weeks prior to making its final decision. Telstra submits that this information should be a key consideration in the Commission's deliberations and must be taken into account, both now and as it becomes available in future reporting periods.

The appropriate application of the LTIE test would result in a declaration that is more targeted in scope than the declaration proposed by the Commission. While the exemption process does exist, it does not do so in order to compensate for shortcomings in the application of the declaration criteria, nor can it provide an adequate remedy to the harm which may be caused by poorly targeted or over-reaching regulation.

A Applying the LTIE criteria

A.1 The Commission must be affirmatively satisfied that the LTIE are served by declaration

Telstra's main concern with the Draft Report is that the LTIE criteria have not been properly applied by the Commission in its draft decision.

Under Part XIC of the Trade Practices Act (**TPA**), the criterion for declaration is the LTIE test. Under section 152AL(3) – the provision that empowers the Commission to make declarations – says:

> *The Commission **may**, by written instrument, declare that a specified eligible service is a declared service **if**:*
>
> *...*
>
> *(d) **the Commission is satisfied** that the making of the declaration will promote the long-term interests of end-users of carriage services or of services provide by means of carriage services.*
>
> *[emphasis added]*

It is clear from this provision that the Commission must be satisfied that the LTIE is met, and that it may only make the declaration if it is, at the time of declaration, so satisfied.

In determining whether the declaration promotes the LTIE, regard must be had to the extent to which the declaration is likely to result in the achievement of only the following objectives:

- promoting competition in markets for listed services;
- achieving any-to-any connectivity in relation to carriage services that involve communications between end-users; and
- encouraging the economically efficient use of, and the economically efficient investment in: (i) the infrastructure by which listed services are supplied; and (ii) any other infrastructure by which listed services are, or are likely to become, capable of being supplied.

That the LTIE is consistently applied is important because, among other reasons:

- it promotes regulatory certainty, sending consistent signals to investors and access seekers in line with efficiency standards; and
- it ensures that regulation and appropriate regulatory rollback occur in line with the emergence of competition, as recognised by the LTIE tests, rather than in a delayed and piecemeal fashion.

The Commission itself has alluded to the benefits which are derived from an effective application of the LTIE test, in deciding whether to regulate or not. In particular, the Draft Report states:

> *"Regulation will only be desirable where it leads to benefits in terms of lower prices, better services or improved service quality for end-users that outweigh any costs of regulation."*[1]

For these reasons, in Telstra's submission, the need to apply the LTIE afresh prior to any declaration or re-declaration is both clear under the TPA, and desirable.

A.2 Draft Report does not apply the LTIE test

The Draft Report, however, does not reveal the bases upon which the Commission could be presently satisfied that the LTIE are served by the proposed declaration. For example:

- the conclusions in the Draft Report are backward-looking and draw heavily on the DTCS 2004 Final Report[2] (now five years old) and the Final Exemption Decision.[3]

- the inquiry varies the declaration only to the extent that the exemptions granted in November 2008 are noted and extended by 15 months; and

- there is no indication in the Draft Report that the Commission has undertaken any current analysis of the declaration on the LTIE.

The Draft Report is bereft of any details of rigorous analysis of the LTIE and therefore lacks transparency in arriving at a 'finding' that:

> *"...with the exception of the services identified in the Final Exemption Decision, the assessment of competition in the 2004 Final Decision remains pertinent. There are not yet the conditions conducive to effective competition in the remaining transmission markets to warrant the removal of these services from the scope of the declaration."* [4]

But the issue in this declaration inquiry is not whether the Commission was persuaded that the LTIE were served by declaration in 2004, or whether Telstra had discharged the burden of demonstrating that the LTIE were served by the granting of any narrowly-focussed exemption at an earlier point in time.

The issue in this declaration inquiry is whether the LTIE is satisfied in respect of this proposed declaration, in all of its dimensions including geography, service type and time. The Commission cannot assume a default position under an existing set of declarations and exemptions, then merely extend them on the basis that their need has not been disproved by any submitter. To do so betrays a misunderstanding of the threshold to be met for declaration. The TPA requires that the Commission must be

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1 Draft Report, page 43.
2 ACCC, Transmission Capacity Service – Review of the declaration for the domestic transmission capacity service – Final Report, April 2004
3 ACCC, Telstra's domestic transmission capacity service exemption applications – Final decision, November 2008
4 Draft Report, page 24.

satisfied that the declaration promotes the LTIE. It is the Commission that bears this onus – and it cannot simply rely on previous processes to satisfy it.

A.3 Declarations and exemptions attract their own responsibilities

The Commission's approach suggests that it regards declarations and exemptions as part of the same process, under which the onus of altering existing regulation falls to submitting parties. This is not the case.

Unlike the declaration process, the exemption process commences with the applicant submitting information to assist the Commission in its consideration of the LTIE, including supplying further information in response to requests from the Commission. In this way the applicant is an active participant in triggering the Commission's inquiry, and in gathering and supplying information about competition and other relevant matters that assist the Commission to assess the LTIE impacts specific to the application. More importantly, however, the exemption process is typically more narrowly focussed: for example, the previous exemption applications made by Telstra considered only very narrow types of DTCS, and only one or two types of substitute services. They were not broad-ranging inquiries that looked at all possible options for alternative services, nor did they consider all of the different types of DTCS that were supplied.

In a declaration process, however, the focus is on the full range of services that encompass the DTCS, with the Commission obliged to hold a public inquiry in order to gather together the necessary information to make a proper assessment prior to making its decision. Yet several points in the Draft Report indicate that the Commission considers it to be the responsibility of submitters to supply all the relevant data in order to persuade it that existing regulation is *not* in the LTIE. For instance:

> *"In light of the submissions received in relation to this review, no compelling information has been provided that would suggest alternative technologies for transmission services have become more viable since the 2004 Final Decision of the recent Final Exemption Decision."*[5]

This is out of step with the requirements of the TPA and very concerning given the compressed timetable and truncated nature of the declaration process. Not only has the Commission cast a "burden of proof" improperly onto others, but it has set out a timetable and process that makes it impossible for that burden to be satisfied.

The exemption process should not be used as a reason to bypass a critical assessment of the LTIE at the time of declaration or re-declaration. The Commission should not just "wave through" declaration, in the knowledge that a subsequent exemption application could protect the LTIE if the declaration happens to be unjustified. The Commission must form the view, following proper analysis, that the declaration of itself promotes the LTIE. Under the TPA, this process cannot be by-passed.

Telstra is deeply concerned with the following statement from the Draft Report:

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[5] Draft Report, page 15.

> "*The Commission remains committed to removing regulation from competitive transmission routes,* ***where it can be demonstrated*** *that doing so is in the long-term interest of end-users.* ***The statutory framework primarily provides for achieving this object through application of exemptions"***[6] (our emphasis added)

This quote suggests that the Commission does not consider that the declaration process has any meaningful role at all – in fact, it indicates that the Commission has not properly enquired as to whether the declaration of the DTCS would promote the LTIE. This is a departure from the past when, in the 2004 declaration inquiry the Commission decided it was in the LTIE to limit the declaration to exclude a nominated list of capital city to regional routes. Similarly, in 2001, the Commission of its own volition initiated a variation of the declaration to exclude inter-capital routes.

Instead, the draft decision suggests that the Commission has not properly applied the LTIE to the declaration process, and that it instead is proposing to rely on others to later apply for exemptions and trigger the "de-regulation" of the service. Under this approach, regulation becomes "given" while the Commission vacates its duty to assess whether the statutory test is actually met. This is unsatisfactory: the Commission needs to play an active role in the declaration process, and must properly assess the levels of competition that exist in all areas of the service, prior to determining whether continued regulation is required according to the LTIE.

A.4 The Commission has not considered the full scope of declaration

As part of the proper consideration of a service proposed for declaration, the Commission must consider the service in all of its dimensions. The Draft Report indicates this has not been done.

For example, by relying on its analysis in previous exemption processes,[7] the Commission has limited the scope of its consideration technically and geographically, because that exemption related to optical fibre only, and only in certain geographies. As a result, the Commission has failed to consider geographies outside the exemption application locations, and it has not critically evaluated technologies other than optical fibre. Further, any LTIE assessment of selected ESAs and routes in the exemption process is unsuitable for a national consideration of the LTIE in a declaration process.

The temporal dimension of the Commission's consideration presents further problems. The Commission's findings in 2004 are not relevant to the current state of competition in 2009. Moreover, considerable time has elapsed since the applications for exemptions were submitted to the Commission, and the market has become more competitive since then. Telstra's exemption application relied on data from 2006 and 2007, which is now 2 to 3 years old.

The Commission appears to have preferred a historical snapshot of narrowly-focussed data over currently available information such as the Commissions' Infrastructure RKR audit data. Telstra notes the Commission is already in possession of data collected from the first return of the information by industry under this RKR, and that further information will be available on the 1st of March 2009, allowing four weeks for

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[6] Draft Report, page 24.

[7] ACCC, Telstra's domestic transmission capacity service exemption applications – Final decision, November 2008

the Commission to consider the new 2009 data before confirming the scope of the declaration. There is no basis for the Commission ignoring this information in determining whether the DTCS ought to be re-declared.

A.5 Length of declaration

The Draft Report proposes that the re-declaration should expire in five years. As noted in Telstra's submission of 23 December 2008 (**December 2008 Submission**), Telstra considers that a five year declaration is too long and does not promote the LTIE. Telstra submits that the Commission has not considered the "long term" aspects of a five year re-declaration. Based on the reasoning provided in the Draft Report, the Commission has not engaged in the analysis necessary to conclude that the declaration of DCTS for the coming five years could be in the LTIE.

The Commission has acknowledged that investment is increasing, prices have fallen and that demand will change. In particular we note the following from the Draft Report:

> "*...the Commission is cognisant that markets for a significant number for inter-exchange transmission services are exhibiting increasing contestability*"[8]
>
> "*It is an encouraging sign that new transmission services are being deployed by competitors in response to increased demand. The Commission considers that this increased demand for transmission services will facilitate further investment and entry into all transmission service markets*"[9]
>
> "*...average industry prices for inter-exchange and tail-end transmission had fallen to some extent...Submissions to this inquiry tend to reconfirm that markets with multiple providers tend to exhibit greater competition and lower prices than those dominated by a single provider*"[10]

Telstra contests that if the Commission has sufficient evidence to acknowledge increased demand and likely further investment, it is inconsistent for the Commission to then declare the service for a five year period.

As argued in our December 2008 Submission, Telstra submits that a five year declaration period is too long for the Commission to predict key market and technological developments that will occur in the industry over that time. Evidence from the exemption process, limited as it is in terms of geography and the nature of substitute services, shows that competition has increased since 2004. By all accounts, it is very likely that demand for DTCS will continue to increase. Carriers that have completed investments in metropolitan areas are looking to expand the footprint of their fibre networks into regional towns and beyond. When the technological developments in wireless (or copper) are included in the market analysis, the likely level of competition currently experienced in the supply of the DTCS is even more intense. It is imperative that regulation of the DTCS acknowledges this and keeps apace with market developments. Regulatory rollback must occur in step with the emergence of competitive and technical developments, not years after the event.

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[8] Draft Report, page 19.
[9] Draft Report, page 19.
[10] Draft Report, page 21.

The only argument presented by the Commission in favour of a five year declaration is that it would promote certainty for access seekers investments by way of guaranteed access to both IEN and tails DTCS where they haven't yet invested.[11] Yet apart from the narrow inquiry undertaken by the Commission in response to Telstra's exemption applications, the Commission has not positively determined where that investment has not occurred. The Commission has advised that it does not propose to inquire into the information it will receive from industry each year in order to assess the need for continued regulation[12]. Telstra has twice provided the Commission with information on existing competitive infrastructure in relation to the provision of IEN DTCS in exchange service areas located in Victoria and Queensland, and the Commission has so far declined to consider this information in determining whether, in accordance with the LTIE, regulation of the DTCS in those areas is required. It is incumbent upon the Commission to make proper inquiries and to properly consider this information, particularly where it is proposing to re-declare the DTCS for a lengthy five year period.

While certainty of access to use Telstra's assets might be convenient and desirable for access seekers, there is insufficient explanation by the Commission as to how these private benefits generate social gains that are consistent with the LTIE. Indeed, continued access for five more years appears more likely to incent non-investment – thus delaying the benefits of infrastructure competition by perhaps half a decade.

Access seekers' IEN investments have already enjoyed two five year declaration periods during which certainty of access should have enabled investment plans to be made. The Commission does not appear to have had any regard to the time of construction of competitors' networks, the period of certainty access seekers have already enjoyed, or what declaration period is reasonable for investment to occur. Many infrastructure owners installed their networks prior to 2004 and therefore have benefited from over 10 years of declaration in areas where they have chosen not to build. This is substantial time in which to build their customer base. The Commission should now be encouraging competitors to invest in their own tail transmission links by removing the DTCS declaration for tail end services in CBDs and for low bandwidths in metropolitan ESAs.

De-regulation will incentivise investment by access seekers by removing uncertainty over the future of their investment. The case for competition in tail markets is strongest for CBD ESAs where the Commission has already agreed that the IEN markets are competitive with between two and twelve alternative IEN fibre owners. The presence of IEN fibre improves the business case for tail end fibre investment because the tails can be configured as spurs from the cables carrying IEN DTCS. The fact that competitors have invested in numerous fibre tails in CBDs is evidence that it is economically and technically feasible for competitors to build tail links. Deregulation of tail DTCS will encourage further investment in tail infrastructure.

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[11] Draft Report, page 30.

[12] Draft Report, page 24.

B Proper application of the long-term interests of end-users test

While Telstra is pleased the Commission is proposing to exclude from the definition of the declared service those areas where the Commission has found competition exists, the shortcomings in the Commission's re-declaration inquiry (as described in the section above) mean the Commission is proposing to continue regulation in respect of certain DTCS services that ought not be declared, and indeed, where a proper application of the LTIE would require its removal.

Telstra submits a proper analysis and application of the LTIE criteria demonstrates the Commission should be proposing a much narrower scope for future regulation of the DTCS, as outlined below.

1. The LTIE requires an assessment of not just the existence of competitive infrastructure today, but also where competition will foreseeably emerge within a few years time. This ensures the right regulatory environment is in place upfront and that competition emerges as it should, and indeed is promoted where it is efficient. The scope of the declaration should be targeted to the areas where competition is unlikely to occur over the course of the declaration and beyond which requires a forward-looking assessment of prospective competition.

2. The Commission's proposed decision to continue regulation of all DTCS tail services is not in the LTIE for two reasons. First, ShDSL is currently being delivered by access seekers via the ULLS as a substitute to DTCS. The market in which tail transmission up to 8Mbps is supplied is therefore broader than just Telstra's fibre. Business customers are receptive to ShDSL as an alternative to Telstra's tail DTCS and competitor's tail DTCS because the quality of service is high and the bandwidth speed is comparable to DTCS. We refer you to **Attachment 1** which contains advertisements from Primus, Soul TPG and XYZed for data services to business customers over Telstra's rented copper.

   Access seekers rent Telstra's access copper between the exchange and end users premises using ULLS for a price of about $16/month and then sell various business grade symmetric ShDSL services over the copper. This allows access seekers to compete with Telstra's tail end DTCS to serve end-user premises. When combined with access seekers extensive IEN networks in metropolitan areas, access seekers can now supply end to end transmission services to business customers at prices that are extremely competitive with Telstra services. It is in the LTIE for the Commission to roll back the declaration of DTCS tails, at least in locations where ULLS is available to access seekers.

   AAPT submits that CBDs and inner metropolitan ESAs are competitive.[13] AAPT also confirm that in their experience non-Telstra providers supply tail end DTCS using fibre and/or ULLS.[14] Optus changes its view from submissions in the exemption process and now agrees with Telstra that alternative wholesale

[13] AAPT, Submission by AAPT to the ACCC in response to DTCS- a discussion paper reviewing the declaration for DTCS page 8

[14] Ibid, page 6

services and technology platforms (presumably this includes ULLS) could be an acceptable substitute to DTCS for customers other than high demand corporate customers.[15]

Second, the competitive nature of the market for DTCS tails is also evidenced by the fact that competitors have already invested in optical fibre to the premise, particularly in CBDs. The case for exemption for tail end services is strongest in CBDs where tail distances are significantly shortened by the proximity of competitive IEN optical fibre which is present in most city streets. This means that a fibre spur can be run relatively cheaply from IEN cables already in the street into the buildings, rather than running fibre all the way from the exchange into buildings. In addition, investment in fibre tails is likely to pay dividends within a very short period of time. The potential revenue from connecting fibre to CBD buildings can be substantial especially for buildings with multiple tenants and multi-storey buildings which are likely to have higher levels of demand due to the number of occupants. The possibility of gaining further customers after an initial customer is obtained in a building improves the business case for access seekers to lay fibres to CBD buildings because one fibre cable has many fibre strands enabling multiple customers to have their own dedicated fibre path.

Telstra's exemption application presented data on the business case for deploying optical fibre tails using Telstra's ducts and for building new ducts.[16] The business cases presented were very conservative in that they assumed the tail fibre was run between Telstra exchanges and end users' buildings from the in each CBD ESA, rather than an off-shoot from nearby cables carrying IEN traffic into the end users' buildings. In addition the business cases assumed that only one tail service was sold over the dedicated fibre and the installed fibre cable was not used for any other services. Despite the many conservative assumptions, the analysis showed the pay back period for a competitor to install their own tail fibre in CBDs is relatively short; between 6-8 ½ months for Sydney, Melbourne and Brisbane for a single 34 Mbps service in a typical CBD ESA. Clearly a single 2 Mbps service has a longer payback period, however if a competitor sells five services of 2 Mbps each at average market prices, the payback period is in the order of 1 to 2½ years in an average ESA depending on the city. The expected monthly rental revenue from investment in transmission tails provides sufficient return to justify the investment cost, especially given the long expected life of duct fibre.

The fact that Telstra has invested in fibre tails to some CBD buildings in the past does not remove the positive nature of the business case for competitors –as demonstrated by the fact that competitors have over-built fibre tails to many buildings in CBDs.

When the ready availability of substitutes to DTCS sold over ULLS and the relatively short payback period for investing in fibre tails are taken into account, there is no justification for continuing to declare DTCS tails in all mainland CBD areas.

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[15] Optus, Optus Submission to ACCC on Reviewing the Declaration of DTCS page 8 2008

[16] Mike Smart, Statement of Michael Smart of CRA international on the Economic Considerations for Metro and CBD domestic transmission capacity service exemptions, 2007. page.22

3. The Commission's proposal to remove from regulation only those IEN DTCS services in ESAs where two access seekers' POIs are located at the Telstra exchange, and to exclude ESAs where the access seekers POIs are not located in Telstra's exchanges, is too narrow, as it ignores the competitive constraint that the latter access seekers place on the supply of the service. Interconnection between access seekers' optical fibre networks and Telstra's optical fibre and copper network must in all situations still occur if not in Telstra's exchange then generally close to the exchange via a high capacity optical fibre cable, either owned by the access seeker or rented from Telstra. As long as the two networks interconnect somewhere within the metropolitan conurbation or ESA then access seekers can sell end to end DTCS. Competitors with POIs outside Telstra's exchanges still participate in the relevant ESA thereby subjecting Telstra to competitive constraint in the relevant market.

   The logic to dis-allow ESAs where the access seekers interconnect with Telstra outside t he Telstra exchanges appears inconsistent with the regional decision where the Commission took the view that it was feasible for an access seeker to build a spur from IEN links for up to 1 km in regional towns[17]. In metropolitan ESAs, access seekers' POIs are almost always less than 1 km from Telstra's exchange. There is no reason why, in metropolitan areas, access seekers would be any less capable of building their own cable link between their POI and the Telstra exchange to supply their own interconnection services.

4. The Commission's decision to exclude optical fibre owners from being counted as participants in the regional telecoms markets if their fibre is located more than 1 km from the regional post office is arbitrary. The Commission refers to no evidence to suggest that a 1km investment in optical fibre represents the limit of economic viability. In Telstra's view, the distance from which a competitor imposes a competitive constraint is approximately 5 per cent of the length of the initial cable from the capital city (ie investment cost already made).This conclusion is derived from the well accepted SSNIP theory used in market definition. Telstra considers that there are more capital city to regional routes, as listed in the exemption application, that are competitive and should be removed from the declaration than the Commission has proposed.

5. In its December 2008 Submission, Telstra provided the Commission with data collated by Market Clarity for the Band 2 Exchange Service Areas (**ESAs**) in Victoria and Queensland showing the number of optical fibre owners in Telstra's exchanges. The data showed that there are [c-ic], yet the Commission has not proposed to remove regulation from those geographic areas.[18] In its Draft Report the Commission stated that it was not currently satisfied that the additional ESAs should be excluded the declaration. Telstra believes that this is unsatisfactory. This data, together with the data the Commission has gathered, and will collect, from the industry Infrastructure RKR, should be used to inform it in this process as to where competition for the

[17] ACCC, Final Decision 2008 page 51
[18] Telstra, Submission 2008,,page 10

DTCS exists, and therefore where it is (or is not) in the LTIE for the service to be re-declared.

To assist the Commission, Telstra attaches a list identifying the individual ESAs in Victoria and Queensland in which there are two competitors plus Telstra who have optical fibre transmission, and which therefore meet the criteria the Commission has established in its previous decisions to remove regulation of the service. At the very least, the "Telstra plus two" criterion is an appropriate filtering device to identify areas where no regulatory intervention is required. These ESAs are set out in **Attachment 2**. Telstra previously provided the Market Clarity data to the Commission but did not specify the ESAs that should be exempt. In the exemption process the Commission stated that it relied on the RKR infrastructure audit data to identify the number of competitors in each ESA in preference to using the Market Clarity data supplied by Telstra. It's open to the Commission use this RKR infrastructure audit data again.

6. There is no evidence in the Draft Report that the Commission has given due regard to alternative technologies, such as microwave, and their role in the supply of competitive services to the DTCS. The admission by Vodafone that microwave has, to date, served most of its transmission needs demonstrates that microwave has had a significant role to play within the industry in the supply of transmission services. The Commission should be inquiring further into the role other technologies have in the supply of transmission services, and should take this into account prior to determining whether the proposed broad-ranging regulation of DTCS is warranted.

C The importance of infrastructure investment in assessing the LTIE

It is vital that the Commission gives proper weight to the infrastructure limb of the LTIE test in considering whether to re-declare the DTCS. In particular, regulating access to services which are already provided in a competitive environment will stifle investment, and will lead to underinvestment in the future, right at a time when investment in the telecommunications sector could enhance Australia's productivity.

Telstra's head of Public Policy and Communications, Mr David Quilty, recently addressed the National Press Club about the investment imperative in ICT.

> "*Telecoms is fundamental to virtually everything we do, but capital investment in communications infrastructure lags the wider economy. Since 1997, annual growth in comms capex has averaged 4.7% compared with non-comms capex of 7%. Conversely during the decade up to 1997, average annual growth in comms capex was 10.2% compared to non-comms capex of 3.1%. …*
>
> *Hence, one must ask if current policy settings are working as well as they should in encouraging investment in telecoms infrastructure. It (Global Access Partners 2008*

paper[19]) makes clear that efficient investment and innovation must be the primary objects of the competition regime. The paper also focuses on the need to reduce regulatory overreach, which impedes investment. Merits review at the critical service declaration stage and an assumption that regulations will be revoked or at least reviewed, are important ways of discouraging overreach……

Investment in ICT is an essential and core ingredient of Australia's economic recovery and future prospects. If we are to grasp the productivity-enhancing opportunities from the ICT –enabled economy, we must find new ways to stimulate commercial investment in essential infrastructure. We need to look to building win-win partnerships, with all the key commercial and government levers working in unison to drive this investment."[20]

The concern about the harm which over-regulation can cause industries has been raised by others. For example, the European Regulators Group warns against regulating access where replication of the infrastructure is feasible:

"There is general agreement that a great potential harm to welfare occurs when replication is feasible but not promoted. This will delay the roll out of new and innovative services and, particularly in relation to broadband, may have large negative consequences on the general economy."[21]

Clearly the availability of alternative infrastructure and transmission services from others has already occurred in many ESAs and on many capital city to regional routes, as evidenced by the Commission's decision to grant, at least in part, Telstra's exemption applications. But as mentioned earlier, the analysis undertaken by the Commission in those applications is not sufficient for the purposes of this inquiry.

The Draft Report does not sufficiently consider whether and how the efficient use of infrastructure, and investment in it, will be promoted by declaring the DTCS. It is vital the Commission not just consider the totality of where alternative services are available, and over what infrastructure, but also takes a forward-looking approach, and considers where competition is likely to develop. This is particularly important if the Commission is proposing to re-declare the DTCS for a period of five years. Significant harm could occur within the industry if the Commission does not set the appropriate groundwork to allow for the withdrawal of regulation to ensure investment in infrastructure continues within this country, and indeed is promoted as a valuable aim.

As detailed in Telstra's December 2008 Submission, economic theory points to a close relationship between regulation and investment incentives. Professor Martin Cave has stated "*while regulation properly responds to structure it also shapes it in the sense that regulating an asset as a bottleneck will probably keep it one – even if it could be*

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19 Global Access Partners , Regulating in Technology Rich Environments; Task Force Report 2008 page 14

20 David Quilty, "The Investment Imperative" (Speech delivered to the National Press Club, 24 February 2008. see: http://www.nowwearetalking.com.au/library/pdf/speech-presentation/transcript_dq-pressclub.pdf

21 ERG, ERG Common position on the approach to appropriate remedies in the new regulatory framework page 2004 page 68

replicated".[22] Telstra's December 2008 Submission also provided practical evidence from Australia and Hong Kong indicating that incumbents and new entrants invested more once regulation was lifted.[23]

The Commission repeats Telstra's argument that deregulation leads to investment and potential competition but then it does not properly consider the implications of that for the re-declaration process. As previously indicated Telstra does not believe the Commission has considered all competitive or prospectively competitive markets in the Final Decision. The proposed declaration in this Draft Report is likely to represent regulatory overreach and could seriously harm investment in transmission infrastructure.

D The Commission should stay on an active de-regulatory path

In recent years, the Commission has progressively de-regulated the supply of the DTCS. In 2001 the Commission initiated a public inquiry for a variation to the service description to roll back regulation of inter-capital routes "on the basis that increasing and impending entry was stimulating competition on these routes"[24]. The re-declaration process in 2004 resulted in the removal of regulation on 14 capital city to regional routes. More recently, it has occurred as a result of exemption applications by Telstra. This deregulatory path is essential to promote competition in the DTCS and ultimately serve the LTIE. Throughout all of these processes, there has been recognition from the Commission that it is in the LTIE for declaration of DTCS to be removed in areas where competition is apparent.

While the Commission has started on this important path, its task is by no means complete. As detailed in Telstra's December 2008 Submission, the past four years have seen the Commission only de-regulate when prompted by Telstra's exemption applications, which have been limited to certain geographies and technologies. Over the same period, the level of compulsory reporting of competitive infrastructure rollout has significantly increased through the Industry RKRs.

Telstra considers that while the exemption application process is a framework for industry players to alert the Commission to competition that has already developed, there are inherent information difficulties using this process to alert the Commission to competition that is developing.

First, the Commission is the only party that is in possession of the most complete and up to date database of information about alternative infrastructure from the information gathered in response to the Infrastructure Audit RKR. Identification of the locations where competition is present, or likely to be present, is a task that is therefore best undertaken by the Commission. Industry participants such as Telstra cannot obtain the same level of detailed information. The best Telstra can do is to second-guess where competitive infrastructure might be, or to contract a third party to provide market-based information in a subset of ESAs.

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[22] Professor Martin Cave, Public Submission on the roll-out and operation of a National Broadband Network for Australia, June 2008, page 6.

[23] Telstra, December 2008 Submission, pages 7-8.

[24] ACCC, Transmission Capacity Service; Review of the declaration for the DTSC Final Report, 2004

Second, even if Telstra or other industry participants are able to gather information regarding competitive infrastructure rollout, this information is necessarily backward-looking. For example, the exemption applications made by Telstra in 2007 relied upon information regarding competitive build that was obtained by Telstra in August 2007 after which it took the Commission over 12 months to make its decision, and a further 12 months before the exemptions come into effect. The infrastructure was in place well before Telstra began looking for evidence of it. Thus, competitive build will have been deployed two to five years before regulation will be removed. Given the Commission's acknowledgement from previous processes that regulation should be removed where competition already exists, it cannot be in the LTIE for the Commission to continue to promote the application of the exemption process as a satisfactory means of determining whether regulation ought to continue in respect of certain elements of the DTCS.

The declaration process requires the Commission to start rolling back regulation in competitive locations because to do so is in the LTIE. The Commission has an obligation to review the information it has before it about the level of infrastructure build. In 2004, the Commission undertook a thorough inquiry on DTCS infrastructure by using data from its report "Telecommunications Infrastructure of Australia 2002". This information was already at hand as the Commission had made separate inquiries of individual infrastructure owners. There is no reason that the Commission should shy away from taking a similar approach in this process, including using the RKR Infrastructure audit data to ascertain the locations of competitive infrastructure, and where therefore continued regulation of the DTCS is not warranted. If for some reason the Commission believes this information is not complete, then as suggested by Telstra in its December 2008 submission, the Commission could commence the necessary inquiries by instituting a class exemption process to ensure that information is gathered in a timely manner. For instance there may be more market participants than the Commission initially sought responses from and participants may enter or leave the markets over time.[25]

Given this, Telstra strongly disagrees with the following assertion in the Draft Review:

> "*As such, while the Commission has not reached a concluded view it does not consider that a monitoring programme to review the declaration on an annual basis would be appropriate in relation to the DTCS*"[26]

Telstra is not asking the Commission to institute a new monitoring programme. Instead Telstra is asking the Commission to make use of the infrastructure audit data that it already collects through the RKR process to wind back regulation in areas where the Commission knows that competition exists. The Commission has previously rolled back regulation of DTCS on the basis of industry data that showed competition was increasing on inter-capital routes via a variation to the declaration. It is not beyond the Commission to vary the declaration to roll back regulation in locations where the RKR Infrastructure data shows that competition exists on an annual basis. In the 2001 Variation to DTCS, the Commission acknowledged that: [27]

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[25] New information has become available from Market Clarity depicting the extensive nature of competitive infrastructure investment in various technologies in map presentation. http://www.marketclarity.com.au/research/telecom-atlas-2009.cfm

[26] Draft Report, page 24.

[27] ACCC, A final Report examining possible variation of the service declaration of the DTCS, May 2001, pages 1-2

> *"Significant rights and obligations flow from a decision to declare a particular service, and which exist while the declaration continues (subject to any variations to the service description and granted exemptions to the standard access obligations). It is, therefore, important for the Commission to maintain a scope of regulation consistent with the promotion of the LTIE. The Commission noted in its guide to the declaration provisions that:*
>
> > *'A foundation principle of competition policy is the need to* ***continually reconsider the case for regulation****. This is particularly important in a dynamic environment such as telecommunications. It ensures that the regulation continues to achieve its goals and does not lock the industry into particular technologies or modes of operation that may result in higher costs to market participants and detriment to end-users'.*[28] *"*
> >
> > *[emphasis added]*

If the Commission decides against this course of action, then the alternative is to scale back the frequency of the Infrastructure RKRs to align with a time period that the Commission is willing to consider. If the Commission re-declares the DTCS for five years, and does not propose to vary the service within that timeframe, then the industry should not be burdened with having to provide the detailed data under the industry Infrastructure RKR for that period of time. Then, if the Commission is faced with an exemption application during that time period, the Commission could make the necessary inquiries at that time in order to obtain the necessary data. This, of course, would not be an outcome that would best promote the LTIE, for as outlined above, it is likely that this process would result in the regulation of elements of the DTCS which are already highly competitive. Instead, the Commission should use the tools and information available to it, in order to properly assess the LTIE and to ensure that regulation of the DTCS only occurs where it is warranted. The cost and intrusion incurred from the imposing the RKR on industry participants cannot be justified if the data sits unused and ignored by the Commission.

In deciding to impose the Infrastructure audit RKR, the Commission stated that

> *"Appropriately targeted access regulation promotes the LTIE. The purpose of this Record-Keeping and Reporting Rule, in a highly dynamic and evolving market, is to provide the ACCC with a consistent and coherent database to inform regulatory decisions."*[29]

Yet the Commission seems to be proposing to make the regulatory decision of whether to declare the DTCS without considering this data. The Commission cannot compulsorily collect data, which was designed to inform declaration processes to

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[28] ACCC, Telecommunications services – Declaration provisions, July 1999, page 67

[29] ACCC, Infrastructure 2007 RKR; Regulatory impact Statement, 2007, page.4

allow for targeted de-regulation, while avoiding its duties to actively consider it in statutory proceedings.

Telstra submits that it is a less than optimal use of the Commission's and industry's resources to require Telstra to file individual exemption applications to cover those areas and routes that have not already been the subject of an exemption application, but which are competitive. Issuing a declaration that more accurately reflects the state of competition is a more efficient and timely process than exemptions.

E The use of "Rules of Thumb"

E.1 Context

In its Draft Report the Commission has referenced the Tribunal's decision in relation to 'rules of thumb' in its review of the Commission's decision to grant Telstra exemptions from the SAOs for the local call service (**LCS**) and wholesale line rental (**WLR**). In particular, the Commission has noted the Tribunal was critical of the different 'rules of thumb' it said were adopted by the Commission itself and proposed by Telstra in relation to LCS and WLR.

Telstra maintains that the Tribunal mischaracterised both its and the Commission's approach in this regard. Telstra (and the Commission) did not simply adopt a rule of thumb which in itself was said to justify exemption (or, as the Tribunal put it, "deregulation"). Rather, evidence of significant and deepening entry, together with evidence concerning the costs of entry, minimum efficient scale, the ability to surmount any barriers to entry, the substitutability of WLR/LCS for ULLS (and also LSS) and various competitive offerings was said to justify exemption in certain circumstances. Having arrived at that conclusion of the basis of conventional analysis of market structures, conditions and barriers to entry, the application of that conclusion to particular ESAs was to be achieved through the adoption of a practical entry-based rule. Telstra understood that this was also the approach which the Commission maintained it had adopted.

That aside, and as the Commission is aware, Telstra is appealing this decision, as it believes the Tribunal has made errors of law/erred in reaching its decision to refuse Telstra's exemption applications. In particular, Telstra has challenged the Tribunal's decision on grounds which include the following:

- the Tribunal imposed evidentiary requirements which are not supported by the relevant language of section 152AT of the TPA or section 152AB of the TPA. Telstra contends that the Tribunal applied the wrong test or misconstrued relevant legislative concepts;

- there was a substantial body of relevant material before the Tribunal which it failed to take into consideration;

- the Tribunal misconstrued the promotion of competition objective. It directed its consideration to the promotion and protection of individual competitors and whether competition would be, or has been, actually advanced or increased;

- the Tribunal made an error of law by misconstruing and misapplying section 152AB in adopting a short-term, rather than a long-term view;

- the Tribunal misconceived the nature of its jurisdiction and the scope of its powers thereby disabling itself from considering whether the making of individual exemption orders would promote the LTIE;

- the Tribunal failed to consider all aspects of efficient use and investment in infrastructure;

- the Tribunal made an error of law by concluding that section 152AT(4) did not impose a duty to make an individual exemption order in circumstances where the making of the order would promote LTIE; and

- the Tribunal made an error of law in failing to consider whether the test was satisfied in light of the conditions imposed by the Commission.

E.2 Nature of transmission is different to WLR/LCS

Without prejudice and notwithstanding the arguments detailed above, Telstra notes the following on the Tribunal's criticism of a 'rule of thumb' approach.

Telstra considers that the application of the 'rule of thumb' developed by Telstra and the Commission as a practical screening device following appropriate analysis for transmission is different to the application of such a screening device for LCS and WLR.

The nature of the investment for transmission is very different to that in respect of WLR/LCS. An investor in transmission capacity will invest with a significant amount of scalable capacity. Additionally, their existence and potential existence in the market does actually provide a significant competitive constraint on other players in the market, including because an entrant that supplies transmission services using fibre generally holds capacity to supply significant market requirements and has a low variable cost structure.

E.3 Necessary but not sufficient condition

Failing the "rule of thumb" should be considered as a *necessary but not sufficient condition* before regulation is considered. That is, it is a filtering device. The Tribunal itself acknowledged (in reference to rules of thumb) that:

> "*certain rules may be useful as screening devices, to be ultimately determinative of a regulatory process that seeks to minimise regulatory distortions and to promote productive, allocative and dynamic efficiencies, any rule must be carefully researched and justified (if capable of being justified) on grounds of sound economic knowledge.*"[30]

Similarly, it is our intention that the "Telstra plus two" threshold test operate as a screening device to indicate whether or not the relevant service type should fall within the ambit of regulation *at all*. Telstra is not proposing that the "Telstra plus two" test be a substitute for proper analysis, but rather that it is a reliable indicator that a service type should fall entirely outside the scope of regulation. Indeed, as Telstra has made clear in numerous submissions, it is likely the Commission's test is

[30] Application by *Chine Communications Pty Ltd* [2008] ACompT 4 at paragraph 60

highly conservative, and that competition exists where there is only one fibre competitor to Telstra, or indeed where Telstra's competitors use infrastructure other than optical fibre, such as microwave, over which to deploy their transmission services. For this reason, Telstra sees no basis for the Commission's reticence to allow for the further application of the "Telstra plus two" threshold test to ensure that regulation does not occur in areas which are already sufficiently competitive.

F Pricing principles

Telstra considers that current industry developments and the multi-faceted nature of the transmission service mean that a simple pricing approach will not cover all the dimensions of the declared service.

As detailed in our December 2008 Submission, given the lack of disputes that have occurred in the DTCS, we consider there is no need for the Commission to commit to a single methodology to determine cost reflective pricing at this stage. TSLRIC+ is one of several accepted regulatory approaches to cost-based pricing.

Applying the constraints of TSLRIC+ pricing now increases the risk that an incorrect regulatory approach will stifle the investment that is likely to be needed in the near future, and potentially harm efficiency for current providers of the service, who may suffer significant changes in demand for existing services.

However, given that the Commission is contemplating the pricing principle of TSLRIC we would propose, at the very least, that sections 1 and 2 of Schedule 1 to the Pricing Principles Determination should be amended as follows:

1. Wherever it is reasonably practicable to do so and where it would be reasonable to do so, the price of the DTCS should be set equal to the total service long run incremental cost, including a contribution to common costs, (i.e. TSLRIC+) of the service.
2. Wherever it is not reasonably practicable or where it would not be reasonable to set the prices on the basis of TSLRIC+, the price for the DTCS should be set having regard to the price of an appropriate benchmark.

Telstra considers that the addition of "where it would/not be reasonable" will ensure that the strict pricing principle of TSLRIC only applies on a case-by-case basis where it has a reasonable application. We would propose that the standard of reasonableness is judged by reference to the statutory criteria in the TPA, ensuring consistency of approach.

G Other issues still to be considered

G.1 Mobile services

In the Draft Report, the Commission concludes that mobile services, including voice and data, are relevant downstream markets to the DTCS.[31] Telstra considers that it is premature to draw any conclusions about upstream supply without an analysis of

[31] Draft Report, pages 11-12.

whether mobile operators can self-supply their own transmission (by, for example, use of microwave).

Telstra notes that Vodafone stated the following in their public submission:

> "*Vodafone has an extensive mobile transmission network. To date microwave technology has provided a useful solution in some circumstances for Vodafone, particularly in short distance, low capacity situations where line of sight and environmental approvals are available.* "[32]

Additionally, Optus stated the following:

> "*Optus and other carriers (including Telstra) use a significant amount of microwave technology, particularly in the mobile network for connecting base stations to the network*"[33]

As we detailed in our December 2008 Submission, significant transmission demand is already met through self-supply, with larger carriers with extensive demand able to meet that demand by installing many kilometres of high-capacity fibre or using microwave to serve their transmission needs. It is not apparent from the Draft Report if the Commission has considered the nature and extent of this self-supply, which evidences the competitive environment in which transmission services are supplied. Any consideration of the re-declaration of the DTCS must take this into account, otherwise again the Commission risks regulating a service which is already competitive. This cannot satisfy the LTIE. [34]

G.2 Alternative technologies

DTCS is a multi-dimensional service which requires the use of a range of technologies to meet the demand for all aspects of the service. Indeed the transport of one data package may travel over several different technologies between origination and destination. Telstra currently supplies DTCS over optical fibre, copper, radio microwave, satellite and submarine cable. Other carriers also use all or some of these technologies to deliver DTCS, for both self supply and resale.

The Commission states "*optical fibre is the dominant technology for the provision of DTCS. Although other technologies can have a role to play, the Commission does not consider that they possess the technological attributes or customer acceptance to exert competitive constraint on an incumbent utilising optical fibre*".[35] Different technologies need to be assessed separately in each of the DTCS markets to ascertain their importance in either supplying DTCS or as effective substitutes. The fact that different technologies are not perfect technological substitutes for all forms of DTCS does not preclude them from placing a competitive constraint upon Telstra and other parties in relation to the supply of certain classes of transmission services.

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[32] Vodafone, *Submission to the ACCC, Discussion paper reviewing the declaration for the domestic transmission capacity service (DTCS)*, public version, 23 December 2008, at paragraph 2.3.

[33] Optus, *Optus Submission to the Australian Competition and Consumer Commission on Reviewing the declaration of the Domestic Transmission Capacity Service*, public version, December 2008, at paragraph 4.8.

[34] Telstra December 2008 Submission, page 7

[35] ACCC 2008 Op Cit p.22 and p.15

To continue to ignore non- fibre services in assessing the state of competition for DTCS and the LTIE is plainly wrong. The widespread use of alternative technologies to provide backhaul and tail end DTCS should be acknowledged by the Commission as part of this declaration process. Inclusion of microwave, copper and satellite in the assessment of the state of competition will reveal that competition in DTCS markets is far more prevalent than is apparent when only optical fibre is considered. It is this analysis that the Commission should be undertaking in assessing whether re-declaration of the DTCS is warranted.

The argument that non-fibre technologies are not accepted by wholesale customers is inconsistent with Telstra's experience in the market. Alternative technologies to optical fibre do have customer acceptance because they are currently used to deliver DTCS. For example, there are often several different ways to transport services at the speed and quality of service required by end-users: in some cases the technology platforms used to deliver the service may vary from day to day, with no discernable difference to the service delivered to the end-user. Similarly, technologies such as microwave may be used for transmission where, for example, the services being transported uses lower bandwidth. Ignoring this aspect of the market, and how services are delivered in practice, results in a misunderstanding of how the market works, and the context in which transmission services are delivered, which in turn leads to a misunderstanding of the competitive nature of the marketplace. It is imperative that the Commission develops this understanding, and makes the appropriate inquiries, before seeking to regulate the service.

Further, observations of the market place demonstrate how some carriers specialise in different DTCS technologies and build their business and reputation around specific requirements that their DTCS technology is perfectly suited to. Other carriers have decided to keep a hand in a range of DTCS technologies. Both strategies are proving to be successful business approaches. The Commission must turn to the various sources of information available to it and ascertain the correct state of competition for DTCS by looking much broader than simply alternative optical fibre build before it can properly determine the state of competition for the DTCS, and accordingly, whether there is a need for regulation of the service in order for the LTIE to be satisfied.

G.3 CONCLUSION

The Australian economy, and the LTIE, would benefit from a regulatory decision that encourages and promotes investment in transmission infrastructure. The Commission has before it an opportunity to use its regulatory tools to align the scope of the DTCS declaration to the realities of existing competitive conditions and prospectively competitive markets. Deregulation will promote the LTIE by creating a favourable regulatory setting that encourages potential investors to risk their capital in telecommunications infrastructure.

The Commission has gone some way to varying the DTCS service description to account for deregulatory decisions it has made in the past. However, this result is based on only a partial analysis of the relevant geographies and technologies that compete in the DTCS markets.

Appropriate consideration of existing and potential competition, taking into account:

- the evidence the Commission has at hand (such as the RKR data); and
- the alternative DTCS technologies that have been deployed,

will enable the Commission to de-regulate more areas of DTCS in this declaration process and in future variations within the five year declaration period.

Attachment 1 List of ShDSL providers

1 Primus offers ShDSL and HDSL over the capital city CBDs and some surrounding areas. Primus is rapidly expanding their coverage of ShDSL. Data speeds advertised are 2.3 Mbps up and download speeds. See the links http://www.primus.com.au/PrimusWeb/BusinessSolutions/InternetAndData/Broadband+DSL/

http://www.primus.com.au/PrimusWeb/BusinessSolutions/InternetAndData/Broadband+DSL/Pricing.htm

2 Soul TPG is advertising 10 Mbps symmetric business data transport over copper. See attached advertisement in The Sun Herald15 February 2009.

Soul TPG also offer Platinum ShDSL up to 4 Mbps.

http://soulaustralia.com.au/pdf/SC0002_AccessPlatinumSHDSL.pdf

Soul TPG also offer 2 Mbps ethernet which is built upon Soul's x163 access transmission services.

http://soulaustralia.com.au/pdf/SC0002_DigitalIPonEthernetDDE.pdf

3. XYZed offers ShDSL services over copper to business customers. They define SHDSL/ HDSL-2 as a Symmetric DSL. A more advanced form of HDSL that allows for symmetric transmission supporting speeds up to 2Mbps over a single copper pair.

http://www.optus.com.au/dafiles/OCA/Wholesale/ProductAndServices/DataSolutions/TransmissionSolutions/StaticFiles/Documents/WholesaleEthernetE-LinkOffer0408.pdf

Attachment 2 List of ESAs