



**Australian  
Competition &  
Consumer  
Commission**

# **Telstra's local carriage service and wholesale line rental exemption applications**

**Discussion paper**

**August 2007**

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# 1. Introduction

The Australian Competition and Consumer Commission (ACCC) has received an application from Telstra for individual exemptions from the standard access obligations under section 152AT of the *Trade Practices Act 1974* (TPA). The exemptions relate to the supply of two services:

- the local carriage service (LCS)
- the wholesale line rental service (WLR)

in 371 exchange service areas (ESAs) in metropolitan Australia (the exemption area).

The LCS is a wholesale local call service. It involves the carriage of a telephone call from one end-user to another end-user in the same standard zone.

The WLR service involves the provision of a basic line rental service that will allow the end-user to connect to the access provider's public switched telephone network (PSTN). It provides the end-user with:

- the ability to make and receive standard PSTN voice calls
- a telephone number.

The existing LCS and WLR declarations do not apply in the central business district areas of Sydney, Melbourne, Adelaide, Brisbane and Perth. This reflects an exemption previously granted for the LCS in July 2002.<sup>1</sup>

The ACCC has the power in sections 152AS and 152AT of the TPA to determine that a specified class of carriers or a particular carrier respectively are exempt from the standard access obligations (SAOs) for a declared service. The ACCC must not make such a determination unless it believes that granting the exemption order will promote the long-term interests of end-users (LTIE) as defined in section 152AB of the TPA. An exemption order may be unconditional or subject to such conditions or limitations as are specified in the order.<sup>2</sup>

Telstra has, under section 152AT, applied to the ACCC for individual exemptions from all SAOs for the LCS and WLR declared services in 371 ESAs. Telstra has chosen the ESAs in the proposed exemption area based on the presence of competing infrastructure and, in particular, the presence of DSLAM-based infrastructure by Telstra's competitors. Each ESA in the proposed exemption area has at least one DSLAM deployed by a competitor of Telstra.

## 1.1 Purpose

The purpose of this discussion paper is to seek comment on Telstra's exemption applications. In particular, this paper will:

- set out background material about, and discussion of, the issues which the ACCC thinks should be considered in deciding whether to grant Telstra's individual exemption applications

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<sup>1</sup> ACCC, *Future scope of the Local Carriage Service—final decision*, July 2002.

<sup>2</sup> TPA subsection 152AT(5)

- identify issues which are relevant to the decision about whether to grant Telstra's requested exemptions
- seek comment on the relevant issues from interested parties
- outline the process and timetable for the consideration of the exemptions.

## ***1.2 Background***

Both the LCS and WLR declared services were declared by the ACCC in July 2006. The LCS had previously been declared by the ACCC in July 1999. In making the declarations, the ACCC considered that declaration of the services was likely to promote the LTIE by both promoting competition and encouraging the economically efficient use of and investment in infrastructure.

Declaration means that an access provider supplying the LCS or WLR to itself or another person must comply with the SAOs. The SAOs are set out in section 152AR of the TPA. Among other things, they require the access provider to:

- supply the declared service to an access seeker on request
- take all reasonable steps to ensure that the technical and operational quality of the service provided to the access seeker is equivalent to that which the access provider supplies to itself
- permit interconnection of the access provider's facilities with the access seeker's facilities to enable the supply of the declared service.

Telstra submitted to the ACCC's 2006 declaration review that there was significant competitive infrastructure present in many other exchange areas in addition to the CBD areas of Sydney, Melbourne, Adelaide, Brisbane and Perth. It submitted that further geographic areas should be exempt from declaration. In that review, the ACCC decided to declare the service nationally other than the identified CBD areas. However, it noted the formal process to grant exemptions from the SAOs.

The ACCC is currently arbitrating two access disputes about the terms of access to the LCS and two access disputes about the terms of access to the WLR service.<sup>3</sup>

## ***1.3 The exemption applications***

Telstra's exemption applications were lodged with the ACCC on 9 July 2007.

If the ACCC is of the opinion that the making of an exemption order would be likely to have a material effect on the interests of a person, the ACCC must publish the application for an exemption and invite submissions from the public.<sup>4</sup> The ACCC must consider any submissions received within the time it has specified when it published the application.

In the present case, the ACCC is of the opinion that the making of the exemption orders would be likely to have a material effect on a person. The ACCC understands that the LCS and WLR are currently supplied in Telstra's proposed exemption area

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<sup>3</sup> A list of current access disputes is available on the ACCC's website at: <http://www.accc.gov.au/content/index.phtml?itemId=635059>

<sup>4</sup> TPA subsection 152AT(9)

and that exempting Telstra from the SAOs would be likely to have a material effect on both access seekers and end-users. Accordingly, the ACCC is publishing the application and inviting submissions by way of this discussion paper.

In support of its exemption applications, Telstra submits that facilities-based entry by its competitors “has made regulation of resale-based access in the form of LCS and WLR completely redundant.”<sup>5</sup> Telstra submits that continuing to regulate the services will result in unnecessary costs and inefficiencies, harm the competitive process and discourage efficient investment. It submits that, conversely, granting the requested exemptions will promote competition and the efficient use of and investment in infrastructure in the proposed exemption area. Accordingly Telstra contends that granting the exemptions will promote the LTIE.

Telstra’s exemption applications follow the ACCC’s release of a second position paper as part of its Fixed services review.<sup>6</sup> In that paper, the ACCC proposed to focus regulation on elements of the fixed-line network that continued to represent ‘enduring bottlenecks.’ The ACCC also stated that, where an enduring bottleneck does not persist, it will be inclined to progressively withdraw *ex ante* access regulation where it is confident that declaration is not required to promote the LTIE. The ACCC also stated in that report that it anticipated basing future market definition exercises at the exchange level.

#### ***1.4 Structure of this report***

The rest of this report is set out as follows:

- Section 2 outlines the timetable and process for the public inquiry.
- Section 3 provides background information on the LCS and WLR, and the developments leading up to Telstra's exemption applications.
- Section 4 provides a brief summary of Telstra’s submission supporting its exemption applications.
- Section 5 sets out key issues that submissions should address in responding to this discussion paper.
- Appendix A sets out the legislative background to the access regime that submissions should address when responding to this discussion paper.
- Appendix B attaches Telstra’s confidentiality undertaking for parties wishing to access Telstra’s confidential submissions.
- Appendix C collates the questions set out by the ACCC in section 5.

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<sup>5</sup> Telstra, *Telstra’s Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 3.

<sup>6</sup> ACCC, *Fixed services review—a second position paper*, April 2007.

## 2. Timetable and public inquiry process

After receiving and considering submissions from interested parties in response to this discussion paper, the ACCC expects that it will publish a draft report setting out its preliminary findings on Telstra's exemption applications. The ACCC will then provide an opportunity for comment to be made on the draft report before making its final decision. The ACCC's currently expected timetable for the inquiry is:

Release of discussion paper	31 August 2007
Deadline for submissions in response to the discussion paper	18 October 2007
Release of draft report	Late November 2007
Deadline for submissions in response to the draft report	January 2008
Release of final decision	February 2008

The ACCC encourages industry participants and the public to consider the issues raised in this discussion paper and to make submissions to the ACCC to assist it in considering the exemption applications. As set out in the above timetable, the ACCC is seeking submissions in response to the discussion paper by **Thursday 18 October 2007**.

The ACCC has a six month period in which to make the decision to accept or reject the exemption applications.<sup>7</sup> However the six month period does not include any period where the ACCC has published the application and invited people to make submissions within a specific time limit, or where there is an outstanding response to an information request.<sup>8</sup> The ACCC may also extend the six month period by a further three months in certain circumstances.<sup>9</sup>

The ACCC prefers to receive electronic copies of submissions. Electronic submissions should be in a PDF, Microsoft Word or (if appropriate) a Microsoft Excel format that contains searchable text and allows "copy-and-paste". Electronic submissions should be provided by email to:

**Robert Wright**  
General Manager  
Compliance and Regulatory Operations  
Communications Group  
Australian Competition and Consumer Commission  
robert.wright@acc.gov.au

The ACCC asks that any electronic submission is also copied to:

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<sup>7</sup> TPA subsection 152AT(10)

<sup>8</sup> TPA subsection 152AT(11)

<sup>9</sup> TPA subsection 152AT(12)

**Michael Eady**  
Compliance and Regulatory Operations  
Communications Group  
Australian Competition and Consumer Commission  
michael.eady@acc.gov.au

The ACCC also accepts hard copies of submissions. Any hard copy should be sent to the following address:

**Robert Wright**  
General Manager  
Compliance and Regulatory Operations  
Communications Group  
Australian Competition and Consumer Commission  
GPO Box 520  
Melbourne VIC 3001

To allow for an informed and open consultation, the ACCC will treat all submissions as non-confidential, unless the author of a submission requests that the submission be kept confidential. In such a case, the author of the submission must provide a non-confidential version of the submission.

Non-confidential submissions will be published by the ACCC on its website.

Telstra has provided a number of confidential documents in support of its application. It has stated that it will provide access to the confidential versions of its submission and attachments to agreed interested parties who have signed appropriate confidentiality undertakings. Telstra has provided the ACCC with the confidentiality undertaking it seeks to have parties sign. The undertaking is at Appendix B to this discussion paper and a Microsoft Word copy of the undertaking is available on the ACCC website. Parties wishing to gain access to Telstra's confidential documents should execute the undertaking and send it to Paul McLachlan of Telstra at Paul.McLachlan@team.telstra.com, copied to Michael Eady of the ACCC at michael.eady@acc.gov.au.

If Telstra does not agree to provide an interested party with Telstra's confidential submissions, that party should advise the ACCC that the party has been unable to gain access to the confidential submissions. The ACCC will then act to resolve the dispute.

Any questions about this discussion paper should firstly be directed to Michael Eady at michael.eady@acc.gov.au or 03 9290 1945.

### **3. Background – the declared services**

This section sets out relevant information about the declared LCS and WLR services, and the ACCC's approach to regulation.

#### ***3.1 The LCS and WLR services***

The LCS is a wholesale local call service that allows access seekers to resell local calls without deploying substantial alternative infrastructure. It involves the carriage of a telephone call from one end-user to another end-user in the same standard zone.

The service functions at the resale level. There is no access seeker equipment required in the provision of the service (although access seekers may seek to provide other elements or services in conjunction with the service). Telstra, as the access provider, provides the end-to-end call service between the called and calling party.

The WLR service involves the provision of a basic line rental service that will allow the end-user to connect to the access provider's PSTN. The end-user is provided with:

- the ability to make and receive standard PSTN voice calls such as local, national long distance, international, fixed-to-mobile or mobile-to-fixed calls
- a telephone number.

As with the LCS, access seeker equipment is not involved in the provision of the WLR service, although access seekers may again seek to provide other elements or services in conjunction with the service.

Historically, the LCS and WLR have typically been purchased from Telstra by access seekers as a bundle of products.

The detailed service descriptions of the declared services are contained in the ACCC's final decision on declaration in its Local services review.<sup>10</sup>

#### ***3.2 The ACCC's decision to declare the services***

The LCS and WLR services were declared by the ACCC in July 2006 as part of its Local services review.<sup>11</sup> The LCS had previously been declared by the ACCC in July 1999 as part of its inquiry into local telecommunications services.<sup>12</sup>

In the Local services review, the ACCC considered that declaration of both services would be likely to promote the LTIE by both promoting competition and encouraging the economically efficient use of and investment in infrastructure. In reaching this view, the ACCC noted that, outside of CBD areas, there were no widespread effective substitutes for either service, with implications at both the wholesale and retail level.<sup>13</sup>

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<sup>10</sup> ACCC, *Local services review—final decision*, July 2006, Appendix C and D.

<sup>11</sup> ACCC, *Local services review—final decision*, July 2006.

<sup>12</sup> ACCC, *Declaration of local telecommunications services*, July 1999.

<sup>13</sup> ACCC, *Local services review—final decision*, July 2006, pp. 30-31.



The ACCC considered that there was considerable uncertainty about the development of competitive infrastructure platforms, such as wireless access, fixed-to-mobile substitution, VoIP and the ULLS, that could act as supply substitutes to the LCS and WLR services. However it noted that it was difficult to be definitive about substitution trends beyond a two year period.<sup>14</sup>

The ACCC noted that, given the lack of widespread facilities-based competition to the LCS, service providers resupplying Telstra's services were likely to be the main source of retail market competition for local telephony services. It considered that declaration would mandate access to the LCS on reasonable terms, constrain Telstra's ability to influence competition in the retail local telephony market and promote competition in the long-distance telephony market because of bundling.<sup>15</sup>

The ACCC also considered that declaration would encourage efficient investment in infrastructure by facilitating market entry and reducing the risks associated with infrastructure deployment by access seekers and that Telstra's incentives to invest would not be unduly affected by declaration.<sup>16</sup>

The ACCC took into account that, while a line rental service had been implicitly declared as part of the pricing and access arrangements for the LCS, there were strong reasons for the independent, explicit and transparent declaration of a WLR as a separate service.

The ACCC considered that a separate declaration would provide greater certainty on the provision of and pricing for the service, thus promoting competition, and enable the WLR service to be used other than just as part of a bundle.<sup>17</sup> The ACCC also considered that the declaration would encourage service providers to find lower-cost ways of producing retail services and allow access seekers to obtain market information.<sup>18</sup>

The ACCC declared the services for three years, in the expectation that considerable uncertainty about the state of competition and infrastructure deployment might be resolved by the time of the ACCC's next review of the declarations.<sup>19</sup>

The ACCC also decided not to declare the LCS and WLR services in the CBD areas of Sydney, Melbourne, Adelaide, Brisbane and Perth, in recognition of the previous exemption granted in those regions for the LCS.<sup>20</sup> The ACCC noted the availability of legislative provisions that would allow parties to seek exemptions from obligations, and that an audit of competitive infrastructure may assist in informing the decision on exemptions.<sup>21</sup>

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<sup>14</sup> *ibid.*, p. 41.

<sup>15</sup> *ibid.*, pp. 8, 39-41.

<sup>16</sup> *ibid.*, pp. 43-46.

<sup>17</sup> *ibid.*, pp. 47-49.

<sup>18</sup> *ibid.*, pp. 49-51.

<sup>19</sup> *ibid.*, July 2006, p. 46.

<sup>20</sup> ACCC, *Future scope of the Local Carriage Service—final decision*, July 2002.

<sup>21</sup> ACCC, *Local services review—final decision*, July 2006, p. 9.

The ACCC's declaration of distinct LCS and WLR products allowed the two services to be priced independently by the ACCC.<sup>22</sup>

### ***3.3 Fixed services review second position paper and proposed audit of competitive infrastructure***

Since the ACCC's decision to declare the LCS and WLR services in July 2006, there have been two significant ACCC reports which will have implications for the assessment of these exemption applications.

#### **Fixed services review second position paper**

In April 2007, the ACCC released a second position paper in its ongoing Fixed services review.<sup>23</sup> The primary purpose of the position paper was to outline a robust framework for the review of existing service declarations.

In the second position paper, the ACCC considered that *ex ante* access regulation under Part XIC should focus on those elements of the fixed-line network that continue to represent 'enduring bottlenecks'. The ACCC considered that an enduring bottleneck would generally refer to a network element or facility that exhibits natural monopoly characteristics and is 'essential' to providing services to end-users in downstream markets in a way that promotes the LTIE.<sup>24</sup>

Where an enduring bottleneck does not persist, the ACCC stated that it will be inclined to progressively withdraw *ex ante* access regulation where it is confident that declaration is not required to promote the LTIE.

Particularly relevant to the exemption applications, the ACCC's stated approach was "based on the principle that, where it is economically efficient, facilities-based competition is more likely to promote the LTIE".<sup>25</sup> The ACCC further noted that its proposed approach was:<sup>26</sup>

... also based on the principle that, for services or network elements which are not enduring bottlenecks, competitors that do not wish to invest in their own infrastructure will, more than likely, have the opportunity to enter into commercially negotiated arrangements for access with third parties (or the incumbent) without the need for *ex ante* regulatory intervention. In this regard, the withdrawal of access regulation at certain network layers does not necessarily suggest that these forms of competition will cease, or that their price will necessarily be raised excessively by the access provider. Rather, it is recognition that *ex ante* regulation is no longer required to ensure that these services are competitively priced at or near their underlying costs.

The second position paper also considered the geographic dimension to market definition employed by the ACCC in the past and its future application. After considering a number of alternative options—defining markets at the household,

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<sup>22</sup> ACCC, *Pricing principles and indicative prices—local carriage service, wholesale line rental and PSTN originating and terminating access services—final determination and explanatory statement*, 29 November 2006.

<sup>23</sup> ACCC, *Fixed Services Review—a second position paper*, April 2007.

<sup>24</sup> *ibid.* pp. 16-17.

<sup>25</sup> *ibid.* p. ii.

<sup>26</sup> *ibid.* p. iii.

exchange, Telstra Band or by broad geographic area, the ACCC reached the conclusion that:<sup>27</sup>

... the most desirable and analytically meaningful approach in relation to the fixed-line sector would be to consider geographic units at the exchange level.

Essentially, the ACCC considers that analysis at the ESA level provides a useful tool to consider the growth of competition in different geographic regions, although each individual ESA may not be a distinct market.

In addition to this particular aspect of market definition, the ACCC considered more generally the approach to be taken to the assessment of competition.<sup>28</sup> The ACCC identified a number of structural and behavioural characteristics that it would examine in making a competition assessment:

- structural factors, including market concentration, the nature of competition and the underlying costs of service provision
- the potential for competition, including planned entry, the size of the addressable market, and the existence and height of barriers to entry, expansion and exit in the relevant markets
- the dynamic characteristics of markets, including growth, innovation and product differentiation, as well as changes in costs and prices over time
- the nature and extent of vertical integration in the market.

The second position paper also proposed to conduct a comprehensive review of fixed service declarations commencing in mid 2008.<sup>29</sup>

While the ACCC has sought and received submissions on the positions outlined in the second position paper, and is still considering those submissions, the paper clearly provides relevant guidance for the ACCC's consideration of Telstra's exemption applications.

### **Audit of competitive infrastructure**

The ACCC has recently issued a discussion paper proposing a new record keeping rule (RKR) which would require relevant telecommunications infrastructure owners to identify the key components and locations of their infrastructure assets.<sup>30</sup> The discussion paper sought the views of interested parties on the proposed approach.

The ACCC is considering submissions received in response to the discussion paper. If it decides to proceed with an RKR, that information would provide useful information to the ACCC about future declarations and also the exemption applications.

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<sup>27</sup> *ibid.* p. 40.

<sup>28</sup> *ibid.* pp. 40-49.

<sup>29</sup> *ibid.* pp. v, 30.

<sup>30</sup> ACCC, *Proposed audit of telecommunications infrastructure assets—discussion paper*, March 2007.

## 4. Summary of the exemption applications

This section provides a brief summary of Telstra's submission supporting its exemption applications.

Telstra has submitted two separate exemption applications to the ACCC on 9 July 2007 – one for the LCS and one for the WLR service. Both exemption applications cover an identical geographic region. Telstra provides only a single submission in support of both exemption applications.<sup>31</sup> The following summary accordingly applies equally to the two applications.

The ACCC considers at this stage that the relevant considerations for granting an exemption for the LCS are much the same as those for granting an exemption for the WLR service. Therefore, at this stage, the applications are considered jointly.

Telstra has annexed ten documents to its supporting submission. Annexure A to Telstra's supporting submission is an economic report prepared by Paul Paterson of CRAI. The remaining documents consist of Telstra staff witness statements, some Telstra internal cost modelling and another analyst report. Public versions of five of these documents have been provided by Telstra. As noted in section 2 of this discussion paper, Telstra has stated that it will provide confidential versions of all its supporting documents to agreed parties who sign confidentiality undertakings in Telstra's favour.

If Telstra does not agree to provide an interested party with the confidential versions of Telstra's submissions, that party should advise the ACCC that the party has been unable to gain access to the confidential versions. The ACCC will then act to resolve the dispute.

On 27 August 2007, Telstra also provided a supplementary submission in support of its exemption applications. That supplementary submission contained no confidential information.

### 4.1 Exemption area

Telstra has sought the exemptions for both applications in 371 ESAs in metropolitan (Band 2) Australia.<sup>32</sup> Telstra states that the ESAs contain just over 5.2 million PSTN services in operation (SIOs), which equals around 77 per cent of all metropolitan SIOs or 50 per cent of all PSTN SIOs.

Telstra has sought exemption from all of the SAOs for the LCS and WLR in its proposed exemption area.

Telstra cites the ACCC's conclusions from its Fixed services review second position paper, and the views of Telstra's consultant, Paul Paterson of CRAI, to support the use of an exchange by exchange basis for setting the exemption area.<sup>33</sup>

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<sup>31</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 6.

<sup>32</sup> *ibid.* p. 9.

<sup>33</sup> *ibid.* pp. 11-12.

## **4.2 Presence of competitor infrastructure**

Telstra's basis for choosing the 371 exchanges in its proposed exemption area is the presence of competing infrastructure including exchanges where at least one competitor DSLAM has been deployed in the exchange for that ESA.<sup>34</sup> Telstra's supplementary submission states that, between the time of lodging the applications and August 2007, the number of exchanges with at least one competitive exchange has grown to 387 exchanges.<sup>35</sup> However Telstra does not state that it is seeking to have its proposed exemption area widened. Telstra submits that there is also other significant infrastructure present in its proposed exemption area, pointing to cable networks, fixed wireless networks and (to a lesser extent) mobile networks as providing alternatives to Telstra's PSTN.<sup>36</sup>

Telstra submits that there are two or more competitor DSLAMs in around 77 per cent of ESAs in its proposed exemption area, three or more competitor DSLAMs in around 50 per cent of ESAs, and four or more competitor DSLAMs in around 29 per cent of ESAs.<sup>37</sup> Its supplementary submission states that, by August 2007, those numbers had increased to 87 per cent, 63 per cent and 40 per cent, respectively.<sup>38</sup> It also submits that cable networks are present in 205 of the ESAs in its proposed exemption area, and fixed wireless networks in 239 of the ESAs in its proposed exemption area.<sup>39</sup> Telstra further submits that there is rapid growth in the deployment of DSLAMs by Telstra's competitors.<sup>40</sup>

Telstra submits that it has only used publicly available data sources to estimate the presence of competitive infrastructure and that its estimates about the presence of competitive infrastructure are likely to be conservative.<sup>41</sup>

## **4.3 Extent of competition**

Telstra submits that there is evidence of significant competition throughout the exemption area, and that the markets in which the LCS and WLR are supplied are contestable and workably competitive. Telstra submits that a number of pieces of evidence support this position, namely:<sup>42</sup>

- a lower retail market share for Telstra in its proposed exemption area compared to the national average
- evidence of wholesale competition from companies such as Optus, AAPT-PowerTel, Nextep, Primus and Agile

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<sup>34</sup> *ibid.* pp. 23-4.

<sup>35</sup> Telstra, *Supplementary material in support of Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications*, August 2007, p. 2.

<sup>36</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 16.

<sup>37</sup> *ibid.* p. 18.

<sup>38</sup> Telstra, *Supplementary material in support of Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications*, August 2007, p. 3.

<sup>39</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, pp. 19-20.

<sup>40</sup> *ibid.* pp. 20-23.

<sup>41</sup> *ibid.* p. 16.

<sup>42</sup> *ibid.* pp. 25-30.

- the emergence of VoIP as a competitive substitute to traditional fixed voice services
- increased fixed-to-mobile substitution meaning that mobile originated voice calls are an effective substitute for fixed voice calls, particularly in the proposed exemption area
- low barriers to entry for DSLAM-based infrastructure.

On this last point, Telstra states there are a number of factors which indicate that there are low barriers to entry for DSLAM-based infrastructure.<sup>43</sup> Telstra submits that:

- a large part of DSLAM investment is unlikely to be a sunk cost as DSLAMs can be redeployed and have a relatively short life span, that switching and transmission infrastructure sunk costs can be avoided by access seekers and that sunk advertising costs would be minimal
- the minimum efficient scale (MES) requirements to be competitive in the market with DSLAM entry are low, due to technological developments and the fact that MES need not be reached in the voice market alone. It contends that the minimum number of retail SIOs at which ULLS entry becomes viable is no more than [c-i-c] SIOs in Band 2
- there are no technical constraints which would prevent DSLAM-based competitors from providing a standard telephone service of equal quality to that provided by Telstra
- backhaul costs are not a barrier to entry as the backhaul transmission market in Band 2 is mature and there are a number of providers
- there are no non-price impediments to entry due to Part XIB of the TPA, the SAOs for provision of the ULLS and LSS, and Telstra's operational separation requirements.

Telstra also argues that there has been considerable growth in the deployment of DSLAMs since September 2005.<sup>44</sup>

#### **4.4 Costs of regulation**

Telstra submits that there are a number of costs in continuing regulation. Telstra submits that, given what it describes as extensive alternative infrastructure within its proposed exemption area, competition is significant in the market for fixed-line voice services and that continued regulation would be harmful and costly.

Telstra points to, in particular, four potential adverse impacts of not granting the exemption applications. It submits that:<sup>45</sup>

- granting the exemptions will remove the possibility of the truncation of returns from regulated access prices

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<sup>43</sup> *ibid.* pp. 30-34.

<sup>44</sup> Telstra, *Supplementary material in support of Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications*, August 2007, pp. 5-8.

<sup>45</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, pp. 35-41.

- continuing to regulate the LCS and WLR in its proposed exemption area would “provide a crutch to passive competitors unwilling or unable to invest in infrastructure and to commit to the rigours of a competitive market”<sup>46</sup> and states that there is clear regulatory dependence in the market for fixed voice services
- the possibility for arbitrage by access seekers is high where access prices are set by regulators, and that such distortions are a persuasive reason why the ACCC should in particular reduce the regulation of resale services
- there is a likelihood that regulatory error is asymmetrical – i.e. regulated prices will tend to be lower than efficient, or that even if the risk of over-pricing is symmetrical, the impact of error is not.

Telstra submits that, overall, these impacts of regulation will tend to inefficiently distort investment incentives, because of transactions, compliance and administrative costs, and inevitable regulatory error.

#### ***4.5 Effect on the long-term interests of end-users***

The final part of Telstra’s submission sets out Telstra’s contentions on the effect of the exemptions on the LTIE.

#### **Promotion of competition**

Telstra submits that the resale based regulation of the LCS and WLR is likely to lead to a reduction in the intensity of competition. Comparatively, it states that facilities-based competition is preferable to regulated access as it leads to greater price competition, greater service innovation and competition over a wide range of markets.<sup>47</sup> Telstra contends that the stepping-stone model of regulation has now been called into question both in Australia and overseas and that in any case such a model was never meant to operate permanently. Telstra submits that the exemptions will actually promote facilities-based competition, given the extensive roll-out of alternative infrastructure in the proposed exemption area, the fact that efficient and workable competition already exists in the markets and the fact that competition will improve in the future.

Telstra submits that the exemptions will not compromise competition due to the presence of supply-side substitution and workable competition in alternatives to the LCS and WLR wholesale services.<sup>48</sup>

#### **Any-to-any connectivity**

Telstra submits that the granting of the exemptions is unlikely to have any effect on any-to-any connectivity.<sup>49</sup>

#### **Efficient use of and investment in infrastructure**

Telstra submits that granting the exemptions will promote facilities-based competition by encouraging greater investment in competing infrastructure, and will promote the

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<sup>46</sup> *ibid.* pp. 37-8.

<sup>47</sup> *ibid.* p. 43.

<sup>48</sup> *ibid.* p. 46.

<sup>49</sup> *ibid.* p. 48.

efficient use of and investment in infrastructure. In relation to the relevant legislative considerations in subsections 152AB(6) and (7), Telstra submits that:<sup>50</sup>

- the widespread deployments of DSLAMs and evidence of supply of services equivalent to the LCS and WLR demonstrate that alternative supply is technically feasible in the proposed exemption area
- its legitimate commercial interests will be enhanced by allowing it greater commercial freedom and flexibility
- the incentives for investment will be improved because the risks and potential market distortions of regulation will be removed.

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<sup>50</sup> *ibid.* pp. 48-9.



## 5. Questions about the exemption applications

In assessing the exemption applications, the ACCC will take particular account of, among others, two questions:

- Without the declared LCS and WLR, will competition be effective in downstream retail markets?
- How will granting the exemptions affect the incentives for rollout of infrastructure, such as DSLAMs, by telecommunications companies?

These questions will be informed by the findings on a number of key issues. This section sets out the particular issues the ACCC would like interested parties to focus on in providing submissions to assist in the ACCC's consideration of Telstra's exemption applications.

The ACCC will decide whether to grant the exemptions after having regard to the LTIE matters in the legislation (as discussed in Appendix A to this discussion paper). Submissions should, therefore, address the legislative matters, where possible, in responding to this discussion paper.

While the ACCC has grouped questions in categories reflecting the need to consider the review in the context of the legislative matters, the ACCC recognises that some issues may be relevant to more than one of the matters identified below. Similarly, some questions may overlap with each other or be subsets of other questions.

Parties may also wish to provide submissions on relevant issues not directly raised in the questions in this section.

### 5.1 *Enduring bottlenecks*

As noted above, the ACCC has expressed the view in its second position paper as part of its Fixed services review that *ex ante* access regulation should focus on elements or services that are enduring bottlenecks and be withdrawn from elements or services which are not 'enduring bottlenecks', provided that these declarations are not required to promote the LTIE.<sup>51</sup> The ACCC considered that an approach to regulation that encouraged competitors to invest in their own infrastructure, where it is economically efficient, is likely to promote the LTIE, but that there were likely to be enduring bottlenecks across particular elements of the fixed-line market.

The ACCC also stated that:<sup>52</sup>

- in areas where there is evidence of full-facilities based competition (either intra or inter-modal competition), or the potential for sustainable and efficient full-facilities-based competition, the main question for review is whether any form of *ex ante* access regulation promotes the LTIE
- in areas where there is evidence of quasi-facilities based competition, or the potential for sustainable and efficient quasi-facilities based competition, the main

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<sup>51</sup> ACCC, *Fixed services review—a second position paper*, April 2007, p. 15.

<sup>52</sup> *ibid*, p. 23.

question for review is whether regulated re-sale based services are required to promote the LTIE

- in areas where there is only evidence of regulated re-sale based competition, or no competition at all, the main question for review is whether mandated access at ‘deeper’ levels of the network (e.g. ULLS) is likely to promote the LTIE.

The second of these points is of particular relevance to the exemption applications. The ACCC noted that evidence of replicability of fixed-line network elements may provide guidance towards practically assessing whether it is likely to be economically efficient for competitors to duplicate infrastructure.<sup>53</sup>

In its supporting material for its exemption applications, Telstra has presented evidence which it submits demonstrates that the LCS and WLR are replicable, pointing towards the presence of DSLAMs, cable networks and fixed wireless networks that it says provide substitutable voice services. It also points towards mobile services as providing substitutable voice services<sup>54</sup> and states that there are a number of companies offering wholesale substitutes to the LCS and WLR. It also states that VoIP services offer an emerging competitive substitute to PSTN voice services.<sup>55</sup>

Telstra also provides statements from its consultant and employees to support its submissions that there are no technical constraints to supplying voice services in conjunction with the use of the ULLS or LSS, through either traditional voice switches or VoIP (with the inclusion of soft switches and various other equipment in the IP network).<sup>56</sup>

Consistent with Telstra’s submissions, the ACCC understands that voice services can be provided using a number of alternative technologies. However, it notes that the commercial case for the various alternatives may differ. In brief, the ACCC understands that the options available include:

- Traditional voice switches and the ULLS. In this case, the normal voice band of the copper line is used to connect a Plain Old Telephone Service (POTS) phone to a traditional voice switch and network. The switch could be provided by Telstra, the access seeker acquiring the ULLS, or a third party.
- Soft switching and the ULLS. In this case, the access seeker uses the normal voice band of the copper line to connect a POTS phone to a Multi-Service Access Node (MSAN) that can terminate both DSL and voice-band traffic. The voice service is either handled by a soft switch in an IP network or sent via a voice gateway to a traditional voice switch.
- Internet access device (IAD) and the ULLS/LSS. In this case, the end-user connects a POTS phone to an IAD that converts the voice call to VoIP at the end-user premises. The call is transferred to the exchange and the access seeker’s equipment over the broadband connection. The voice service can be handled by a

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<sup>53</sup>ibid, p. 27.

<sup>54</sup> Telstra, *Telstra’s Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 16.

<sup>55</sup>ibid, p. 26.

<sup>56</sup>ibid, Annexure A, pp. 19-22, 85-7; Annexure B, pp. 17-22; Annexure D.

soft switch in an IP network but will require a voice gateway to interconnect with the PSTN.

- VoIP and the ULLS/LSS. The access seeker provides a voice service through a full IP solution over the broadband connection, using either a VoIP handset or software on a computer to emulate a telephone. Again, the voice service can be handled by a soft switch in an IP network but will require a voice gateway to interconnect with the PSTN.

The use of VoIP-based solutions may have implications for access to emergency services, operator services and directory services.

The ACCC considers that evidence of the replicability of the LCS and WLR would help to determine whether the LCS and WLR could be considered an enduring bottleneck. There is some evidence to suggest that LCS and WLR services are replicable by access seekers using the ULLS. The ACCC understands, for example, that companies such as Optus and Primus currently supply their own PSTN voice services over the ULLS. The ACCC notes that the ULLS, LSS and PSTN OTA declared services are available to access seekers wishing to provide voice services.

#### **Questions for interested parties:**

- Should the LCS and WLR be considered enduring bottlenecks?
- Are PSTN voice services replicable through the use of:
  - DSLAMs?
  - traditional voice switching equipment?
  - soft switches?
  - VoIP?
  - alternative infrastructure such as fixed wireless or HFC?
- Are Telstra's statements about the ease of access to traditional voice switching and soft switches accurate?
- Does the fact that an access seeker has a DSLAM in an exchange mean that it is capable of providing a voice service to end-users?
- What are the technical and cost differences in DSLAMs that can be used to provide voice and those that can only be used to provide xDSL?
- What percentage of DSLAMs currently deployed would be capable of providing PSTN voice services?
- Are the upgrade costs (e.g. addition of line cards) to enable provision of PSTN voice services significant?

## **5.2 Market definition**

In considering an exemption application, the ACCC needs to define the relevant markets. This is a necessary first step in enabling the ACCC to determine whether granting an exemption would be likely to promote competition in the markets for listed services under section 152AB of the TPA. Typically, the ACCC considers the product, geographic, functional and temporal dimensions of a market. The relevant markets can include:

- the market or markets where the declared service is or can be supplied

- the market or markets in which competition may be promoted, including downstream and upstream markets.

Market boundaries incorporate all sources and potential sources of close substitution with which the firm supplying the service would compete. Section 4E of the TPA states that:

... ‘markets’ means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first mentioned goods or services.

The ACCC has previously noted the following statement of the High Court:<sup>57</sup>

...This process of defining a market by substitution involves both including products which compete with the defendant’s and excluding those which because of differentiated characteristics do not compete...

To identify services that are ‘substitutable for, or otherwise competitive with’ the services under consideration, the ACCC uses the “price elevation test” as a useful tool to assist market analysis. This test is premised on the idea that the availability of close substitutes (on both demand and supply sides) constrains the ability of suppliers to profitably divert prices or the quality of services from competitive levels. The resulting market is the smallest area over which a hypothetical profit maximising monopolist could impose a small but significant and non-transitory price increase.

As noted in its second position paper, the ACCC must consider both demand and supply-side substitutability constraints. From the demand-side, a relevant consideration is to what extent consumers can substitute to other services (or sources of supply) in the event of a significant price rise, or equivalent exercise of market power, by an incumbent firm. From the supply-side, a relevant consideration is the extent to which (and how quickly) firms could switch or expand supply in the event of a significant price rise, or equivalent exercise of market power, by an incumbent firm.

The ACCC is also guided by the ‘commercial realities’ of a particular industry (such as actual patterns of supply) to ensure that the market(s) identified accurately reflect the arena of competition. The ACCC will also take into account that declarations, exemptions and the overall telecommunications regulatory regime might affect the dimensions of particular markets.

The ACCC considers generally (and Telstra has submitted in its supporting documents)<sup>58</sup> that market definition is not necessarily a determinative exercise for processes under Part XIC.<sup>59</sup> Rather, market analysis provides an analytical framework to examine the likely effect of granting an exemption.

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<sup>57</sup> *Queensland Wire Industries Pty Ltd. BHP Co Ltd* (1989) 167 CLR 177 at p. 188, per Mason CJ and Wilson J.

<sup>58</sup> Telstra, *Telstra’s Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 12.

<sup>59</sup> ACCC, *Fixed services review—a second position paper*, April 2007, p. 32; ACCC, *Local services review—final decision*, July 2006, pp. 28-30.

In the ACCC's final decision to declare the LCS and WLR services, the ACCC came to the conclusion that the following wholesale markets were relevant markets for considering whether to declare the two services:<sup>60</sup>

- the national WLR market, with the exemption of the CBD areas of Adelaide, Brisbane, Melbourne, Perth and Sydney
- the national market for providing local calls to other carriers and carriage service providers via the LCS or other means, with the exemption of the CBD areas of Adelaide, Brisbane, Melbourne, Perth and Sydney.

This view on wholesale markets was informed by conclusions that:

- there were no widespread effective substitutes at that time for either Telstra's WLR or LCS
- line rental should be seen as a separate stage of the supply chain to local calls
- there was sufficient alternative local access infrastructure and declared services in CBD areas to constrain Telstra's prices for WLR and LCS
- there was considerable uncertainty about the development of competitive infrastructure platforms and services to WLR and LCS.

The ACCC considered that the relevant downstream markets at their narrowest could be defined as separate retail markets for line rental and local calls, or more widely as a market for retail fixed voice services which necessarily includes both retail line rental and local calls services. The ACCC did not consider that it had to form a precise view about the boundaries of relevant retail markets.<sup>61</sup> The relevant retail market might include more services than just line rental and local calls due in particular to the fact that line rental and local calls are typically consumed by end-users as part of a bundle of fixed-line services also including long-distance and fixed-to-mobile calls.

The other aspect of market definition that is particularly relevant to the exemption applications is the geographic dimension of the markets. The ACCC's second position paper reached the conclusion that:<sup>62</sup>

...the most desirable and analytically meaningful approach in relation to the fixed-line sector would be to consider geographic units at the exchange level. This is particularly because a main driver for a shift in competitive dynamics across discrete geographic regions is likely to be the take-up (and potential for take-up) of ULLS and/or LSS services, and that the strategies of access seekers in terms of the areas they target is likely to be heavily influenced by the characteristics of an exchange (i.e. no. of customers connected etc).

Accordingly, analysis at the ESA level provides a useful tool to consider the growth of competition in different geographic regions, although each individual ESA may not be a distinct market. The ACCC considered that another important consideration would be how different geographic areas would be aggregated together to form a 'class' of markets because they have 'similar' competitive conditions. Indicators which the ACCC considered could be used to aggregate geographic areas included structural factors such as the number of facilities-based competitors, population

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<sup>60</sup> ACCC, *Local services review—final decision*, July 2006, pp. 30-31.

<sup>61</sup> *ibid*, p. 31.

<sup>62</sup> ACCC, *Fixed services review—a second position paper*, April 2007, p. 39.

density thresholds, and evidence of price discrimination or price correlation.<sup>63</sup> Relevantly, in the present case, Telstra's rule for choosing ESAs to be part of the proposed exemption area is based on the presence of at least one quasi-facilities-based competitor with a DSLAM in the exchange.<sup>64</sup> As the ESAs selected by Telstra are all contained in Band 2, the ACCC understands that they will be loosely characterised by similar population density characteristics.<sup>65</sup>

A consideration relevant to the functional dimension of the markets is the relationship between the upstream ULLS and LSS, which are used to provide services in conjunction with access seeker infrastructure deployments, and the downstream resale-based LCS and WLR services.

The ACCC considers that the various dimensions of markets—product, functional, geographic and temporal—are not discrete and that conclusions on one dimension may affect the consideration of other dimensions. For example, to the extent that wireless and fixed network voice and/or broadband services were considered part of the same product market, the consideration of the geographic dimension at the exchange level might be less significant. This would be because wireless and mobile network coverage is not particularly related to ESA-level deployment of infrastructure. Decisions to invest in mobile or wireless networks might be based on a larger geographic unit. Similarly, on the demand side, consumers would not be constrained to switching to services provided from their exchange.

#### **Questions for interested parties:**

- What are the relevant markets that would be affected by the granting of the exemption?
- How should these markets be defined? What evidence of demand and supply-side substitutability supports that market definition?
- The ACCC concluded in its Local services review that there were separate wholesale markets for the provision of wholesale line rental and the provision of wholesale local calls. It also concluded that retail markets at their narrowest could be defined as separate retail markets for line rental and local calls or more widely as a market for retail fixed voice services which necessarily includes both retail line rental and local calls services. Are the ACCC's conclusions still correct?
- Are there any other wholesale or retail markets that the ACCC should consider?
- Is Telstra's approach to defining its exemption area an appropriate one?
- Does Telstra's rule, based on the presence of competitor DSLAMs, represent an appropriate way of grouping together the ESAs in its exemption area?
- Is the data that Telstra uses, based on publicly available information, sufficiently robust to allow the ACCC to be confident about the deployment of DSLAMs in

<sup>63</sup> *ibid.*, p. 40.

<sup>64</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, Annexure A, p. 41-43.

<sup>65</sup> For example, Telstra's documentation as part of its Operational Separation obligations defines a Band 2 exchange area as "an area with more than 108.4 services in operation in a square kilometre area, which is not a Band 1 area." Accordingly all Band 2 exchanges would be expected to have a minimum level of teledensity. See: Telstra, *Service Quality Strategy, Annexure A: Key Performance Indicators Operational Document*, 23 June 2006, Clause 1.1, at [http://www.telstrawholesale.com.au/custsupp/docs/op\\_sep\\_quality\\_strategy.pdf](http://www.telstrawholesale.com.au/custsupp/docs/op_sep_quality_strategy.pdf),

the proposed exemption area?

- What further data, if any, would the ACCC need to determine the deployment of DSLAMs in the proposed exemption area?

### **5.3 Promotion of competition**

Once relevant markets have been defined, it will be necessary for the ACCC to assess the current state of competition in the relevant markets. This analysis should not merely be a static assessment but should also take into account dynamic factors such as the potential for sustainable competition to emerge and continue, and the extent to which the threat of entry or expansion constrains pricing and output decisions.<sup>66</sup> As noted above, the effect of granting the exemptions on competition in downstream retail markets is likely to be particularly relevant.

The ACCC noted in its second position paper that, where competition in relevant markets is determined to be ‘effective’, then continued declaration of a service is not likely to promote competition or the LTIE.<sup>67</sup> The ACCC considers that ‘effective’ competition is the appropriate benchmark for telecommunications markets and that perfect competition will not be found in fixed-line telecommunications markets. The ACCC considers that, where efficient, facilities-based competition is more likely to be effective competition and more likely to promote the LTIE. This is because rivals are able to differentiate their services and compete more vigorously across greater elements of the network and supply chain. The ACCC also considers that facilities-based competition is more likely to lead to enduring benefits.<sup>68</sup>

In this respect, the ACCC has noted in the past that the ongoing declaration of the resale-based LCS may prove a substitute for and impediment to investment in alternative infrastructure. In its Local services review, the ACCC noted that if the LCS provides the means to make easy, risk-free profits, access seekers may choose to postpone or cancel investment in new infrastructure.<sup>69</sup> This would stifle the development of facilities-based competition. Accordingly, not declaring the service (or, equally, the granting of exemptions), where facilities-based competition is feasible, would be likely to lead to more sustainable and innovative forms of competition. This view would equally apply to the resale WLR service.

However, the ACCC also noted that, in areas where there are few suppliers of an upstream service, a lack of competition may lead to a refusal to supply or inefficiently high upstream pricing. In such a case, a declared service allows for a minimal level of retail competition and allows a basic level of local calling providers.<sup>70</sup> There may also be a related effect from the fact that many telecommunications services are sold as a bundle and that the ability to supply low cost local calls will tend to increase competition in the markets for other services in the bundles.<sup>71</sup>

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<sup>66</sup> ACCC, *Fixed services review—a second position paper*, April 2007, p. 40.

<sup>67</sup> *ibid.*

<sup>68</sup> *ibid.*, p. 41.

<sup>69</sup> ACCC, *Local services review 2005—an ACCC discussion paper*, April 2005, p. 28-29.

<sup>70</sup> *ibid.*, pp. 27-28.

<sup>71</sup> *ibid.*, p. 29.

As noted above at 3.3, the ACCC considered in its second position paper that the following factors are relevant to a competition assessment:

- structural factors, including market concentration, the nature of competition and the underlying costs of service provision
- the potential for competition, including planned entry, the size of the addressable market, and the existence and height of barriers to entry, expansion and exit in the relevant markets
- the dynamic characteristics of markets, including growth, innovation and product differentiation, as well as changes in costs and prices over time
- the nature and extent of vertical integration in the market.

It is necessary to consider these issues at both the level of the wholesale market in which the LCS and WLR are supplied, and the level of the relevant downstream markets including retail line rental and local call services.

### **Structural factors**

Current market arrangements allow for three competitive models for the provision of basic access and local calls—the regulated resale LCS and WLR services, the use of ULLS, or stand-alone networks. The ACCC has noted in its competitive safeguards report that, in 2005-06, around 88 per cent of basic access lines were on Telstra’s network, with 19 per cent of total basic access lines sold by resellers of Telstra’s services and Telstra providing around 69 per cent of total lines as retail lines.<sup>72</sup> The remaining 12 per cent was largely accounted for by Optus supply on its HFC network, although other networks existed in discrete areas such as TransACT or Neighborhood Cable.

It would appear from this evidence that the market for the wholesale supply of LCS and WLR still relies largely on resale. However the ACCC understands that firms such as Optus and Primus are providing voice services using the ULLS that would be capable of being wholesaled to other telecommunications companies. Telstra’s supporting submission also points to wholesale alternatives from other carriers, such as Optus, AAPT-PowerTel and Nextep. However it is unclear from the Telstra submission to what extent these providers are providing wholesale PSTN voice services as compared to wholesale VoIP services.<sup>73</sup> Telstra has also submitted that there is evidence of a decrease in competitors using its resale services, pointing to a [c-i-c] decrease in WLR lines and a [c-i-c] decrease in LCS calls between May 2006 and May 2007.<sup>74</sup>

The competitive safeguards report figures also indicate that the retail level market is still dominated by Telstra, with more than two thirds of the retail basic access lines. Optus would appear to be the most significant retail competitor to Telstra. Resale competition, making up 19 per cent of the market, would appear to be a meaningful competitive presence. The ACCC notes that results from its Market indicators report (which only covers a subset of the providers in the market) indicate that, although

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<sup>72</sup> ACCC, *Telecommunications competitive safeguards for 2005-06*, April 2007, p. 14.

<sup>73</sup> Telstra, *Telstra’s Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 26.

<sup>74</sup> *ibid*, p. 79.



Telstra still represents more than two thirds of retail PSTN revenues, its market share in retail end-user access and local calls appears to be dropping over time.<sup>75</sup> The report also suggests that overall PSTN voice revenues are dropping over time across all services.<sup>76</sup> Telstra argues in its supplementary submissions that there is competitive tension coming from services supplied by ULLS-based operators, such as Optus' Fusion product and potential naked DSL offerings.<sup>77</sup>

Telstra also submits that cable-based networks and fixed wireless networks provide a competitive constraint on Telstra's pricing for the LCS and WLR and that "the presence of these alternative networks can only serve to reassure the Commission of the desirability of granting the exemptions."<sup>78</sup> The ACCC notes that the effectiveness of cable networks to provide a competitive constraint may be somewhat limited by ownership structures. In particular, Telstra and Optus each own a large cable network and are the largest Australian phone operators. Accordingly, the competition provided by cable networks for exchange-based voice services may be limited as the incentive to compete between the services may be reduced.

**Questions for interested parties:**

- In the absence of a declared LCS and WLR, would competition in downstream retail markets for relevant services be effective?
  - Is competition in downstream markets currently effective?
- What alternative providers to Telstra of LCS and WLR currently operate in the wholesale market?
  - Do these providers offer any significant competitive constraint on the pricing of the LCS and WLR?
- In the absence of access to a declared LCS and WLR in the proposed exemption area, would such firms provide a meaningful constraint on the pricing of the LCS and WLR or equivalent services?
- Would Telstra be likely to continue to supply the LCS and WLR if the exemption applications were granted?
- What infrastructure do alternative wholesale providers use?
- Are DSLAMs a significant competitive presence for the provision of wholesale and retail basic access and local calls?
- What percentage of DSLAMs currently would be capable of providing traditional voice services as opposed to only DSL broadband?
- Do cable and fixed wireless networks provide meaningful constraint on the pricing of the LCS and WLR?
- What are the relevant trends in retail markets for PSTN voice services?
- Is there evidence of end-users switching away from PSTN basic access, local calls and related services?

<sup>75</sup> ACCC, *Telecommunications market indicator report 2005-2006*, August 2007, p. 5.

<sup>76</sup> *ibid*, p. 6.

<sup>77</sup> Telstra, *Supplementary material in support of Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications*, August 2007, pp. 9-13.

<sup>78</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 26.

Telstra has submitted that, structurally, the presence of one competitive DSLAM is a sufficient signal of competitive strength in an exchange area.<sup>79</sup> It also submitted that there was evidence that, once a DSLAM was deployed by one competitor, additional competitors were also likely to deploy a DSLAM in the exchange.<sup>80</sup> The ACCC notes that it may also be relevant to consider the number of ULLS and LSS SIOs in an ESA in considering the competitive strength of an exchange area. Furthermore, the historical number of SIOs might also be relevant to assess the growth of competition.

Telstra also submitted that, were a particular competitor to exit the market, it is likely another DSLAM operator would replace the first competitor.

**Questions for interested parties:**

- Is there any significant difference in competitive conditions between an ESA with one competitive DSLAM and an ESA with two or more competitive DSLAMs?
- Does the ACCC also need information on the number of ULLS and LSS lines taken by access seekers to appropriately gauge competitive conditions in an ESA?
  - For the purpose of assessing the exemption applications, does it require historical data?
- Do access seekers tend to follow deployment of other DSLAM operators into ESAs?
- Are access seekers likely to purchase the infrastructure of a DSLAM operator that exits the market?
- What are the costs of installing a DSLAM?
  - Are these costs prohibitive or significant?
- What customer base is required to justify building a DSLAM in a particular ESA?

Telstra has submitted that VoIP should be considered an emerging competitive substitute to traditional PSTN telephony.<sup>81</sup> The ACCC has noted recently that the greater take-up of VoIP in conjunction with DSLAM rollouts is a development that could, in the future, test the dominance of Telstra in local telecommunications.<sup>82</sup> It has also noted that VoIP providers were a significant source of competition in the provision of domestic long-distance and international calls during 2005-06.

The ACCC has considered that it is premature to consider VoIP services as competitive substitutes to PSTN voice services.<sup>83</sup> There has been a rapid increase in VoIP providers. Market Clarity listed 270 Australian VoIP providers in August 2007, a significant increase in numbers from around 25 providers in May 2005.<sup>84</sup> However, despite this rapid increase in the number of VoIP service providers, in the period from January 2005 to June 2006, only 4.8 per cent of Australians were using VoIP for

<sup>79</sup> *ibid.*, p. 23; Annexure A, pp. 40-42.

<sup>80</sup> Telstra, *Supplementary material in support of Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications*, August 2007, pp. 8-10.

<sup>81</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 27.

<sup>82</sup> ACCC, *Telecommunications competitive safeguards for 2005-06*, April 2007, p. 20.

<sup>83</sup> ACCC, *Review of line sharing service declaration—draft decision*, August 2007, p. 39.

<sup>84</sup> Market Clarity, *Aussie VoIP list*, [www.marketclarity.com.au/voip](http://www.marketclarity.com.au/voip), accessed on 14 August 2007.

phone calls.<sup>85</sup> In particular, there would not be expected to be a large subscriber base of paying VoIP customers at the present time, with many consumer using free VoIP options instead.<sup>86</sup>

However a further 13 per cent of consumers said that they were ‘likely to use VoIP in the next 12 months’ (ie. the 2006-07 financial year).<sup>87</sup> This perhaps signals that there is some significant potential for growth in the use of VoIP services. That said, there are also consumer concerns about the universality, security and quality of VoIP that may need to be addressed for VoIP to be a more significant market presence.<sup>88</sup>

Telstra has similarly submitted that mobile originated voice calls provide an effective substitute for fixed voice calls, particularly in Telstra’s proposed exemption area.<sup>89</sup> In its Local services review, the ACCC considered that the scope for mobile services to act as effective substitutes for wholesale line rental appeared to be limited.<sup>90</sup> As noted above for cable services, the fact that Telstra and Optus operate both fixed line and mobile networks may limit the effectiveness of competition between mobile services and fixed voice services.

**Questions for interested parties:**

- Does VoIP have a significant effect in the wholesale and retail markets for basic access and local calls in the proposed exemption area?
- To what extent can mobile calls be considered a substitute for fixed line basic access and local calls, as suggested by Telstra?

The ACCC would expect that the nature of competition for end-user customers would largely be price competition, given the significant use of resale services. The ACCC would consider that, in any case, there would be unlikely to be much differentiation possible in the provision of local calls and line rental, although it notes that there may be value-added services such as messaging services or call management facilities that could differentiate line rental services. The ACCC had regard to such value-added services in its Local services review but considered that it would not be necessary to include such services in the declared WLR service.<sup>91</sup>

<sup>85</sup> ACMA, Communications Report 2005–06, October 2006, p. 65

<sup>86</sup> Telstra submits that there are around 100,000 paid VoIP SIOs: Telstra, *Telstra’s Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 27. Engin has publicly estimated that it had 44 per cent revenue share of the Australian VoIP market with 52,500 paying subscriber lines at 31 December 2006, and 58,000 at 27 February 2007: Engin, *Engin revenue growth up 173% and 44% market share achieved*, ASX announcement, 28 Feb 2007.

<sup>87</sup> ACMA, Communications Report 2005–06, October 2006, p. 39

<sup>88</sup> For example, the ACCC notes that recently, on 16 August 2007, Skype voice services were unavailable for around two days: see, e.g. Communications Day, “Skype Out: World’s largest VoIP service down for two days” 20 August 2007, p. 1.

<sup>89</sup> Telstra, *Telstra’s Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 29.

<sup>90</sup> ACCC, *Local services review—final decision*, July 2006, p. 39.

<sup>91</sup> *ibid.*, pp. 53-54.

#### **Questions for interested parties:**

- Is competition in the market for wholesale and retail line rental and local call services largely driven by price?
- Is there any significant product differentiation and/or would significant product differentiation be likely to occur if the exemption was granted?

#### **Potential for competition**

While there is some overlap with the issues identified above in the discussion of structural factors, the ACCC considers that it is also important that it have regard to the potential for effective competition to develop. The ACCC identified three factors to be considered in its second position paper in its Fixed services review — planned entry, the size of the addressable market and the existence of barriers to entry or expansion.

While Telstra's exemption applications are based on the presence of at least one currently deployed competitor DSLAM in an ESA, Telstra also makes reference to planned entry by competitive access seekers.<sup>92</sup> In particular, it cites evidence from its consultant CRAI that, based on current planned infrastructure deployment, by the end of 2007, 97 per cent of ESAs in its proposed exemption area will have two or more DSLAMs present in the exchange and 76 per cent of ESAs in its proposed exemption area will have three or more DSLAMs.<sup>93</sup> In its supplementary submission, Telstra has also presented updated information on the number of DSLAMs in the exemption area in August 2007.<sup>94</sup> However, the ACCC noted in its second position paper that it is necessary to view prospective investment plans somewhat cautiously given the potential for exogenous factors to alter the likelihood of actual investment.<sup>95</sup>

#### **Questions for interested parties:**

- Should the ACCC regard these planned investments as being representative of the likely deployment of DSLAMs in the proposed exemption area by the end of 2007?
  - How cautiously should the ACCC regard these planned deployments?
- Would new DSLAMs all have the capacity to provide voice services, or would some of the DSLAMs only be capable of providing DSL broadband?

The ACCC also noted in its second position paper that the size of the addressable market is arguably one of the most important factors in determining whether effective competition is likely to be viable.<sup>96</sup> The size of the addressable market is closely linked to measures of population density or household density (or, more strictly,

<sup>92</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 20.

<sup>93</sup> *ibid*, Annexure A, p. 23.

<sup>94</sup> Telstra, *Supplementary material in support of Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications*, August 2007, p. 3.

<sup>95</sup> ACCC, *Fixed services review—a second position paper*, April 2007, p. 44.

<sup>96</sup> *ibid*, p. 44.

teledensity) within an ESA, with higher densities likely to lead to better prospects for infrastructure deployment and effective competition. For example, the CBD areas of Sydney, Melbourne, Adelaide, Perth and Brisbane, which are already exempt from the LCS and WLR exemptions, are characterised by high population densities.<sup>97</sup>

All ESAs in Telstra's proposed exemption area are located in Band 2. As noted above at 5.2, this implies that all of the ESAs meet a certain minimum teledensity, as Telstra's Bands are defined by reference to the number of SIOs per square kilometre. However, the ACCC notes that the teledensity within a Band can vary quite significantly.<sup>98</sup>

On this point, Telstra states in its submission that a relatively small number of services are necessary in an ESA for an access seeker to recover its costs. It contends that the minimum number of ULLS needed for profitability by an access seeker using the ULLS and DSLAMs to provide LCS and WLR in Band 2 is less than [c-i-c] SIOs.<sup>99</sup> If correct, these figures would suggest that issues of teledensity are not significant.

**Questions for interested parties:**

- Do the Band 2 ESAs in Telstra's proposed exemption area have a significant enough addressable market to allow access seekers to achieve sufficient economies of scale or density to provide effective competition?
- Is Telstra's internal estimation of the minimum efficient scale needed for competitive DSLAM entry accurate and realistic?
- Does an access seeker only need to have an amount less than [c-i-c] SIOs for ULLS and DSLAM-based entry to be viable?

The ACCC's second position paper states that, to be a relevant consideration, barriers to entry, expansion and exit simply need to represent an impediment for rivals which places rivals at a disadvantage.<sup>100</sup> The ACCC noted that barriers to entry and expansion can occur for a variety of reasons, such as technical supply-side constraints, sunk costs, economies of scale and scope, legal and regulatory barriers, product differentiation and brand loyalty, customer fixed-term contracts, the threat of retaliatory action and non-price factors.<sup>101</sup>

Telstra makes submissions on a number of barriers to entry to DSLAM infrastructure used to supply local calls and line rental. Firstly, Telstra submits that, based on the

<sup>97</sup> Australian Bureau of Statistics, *Regional population growth, Australia, 1996 to 2006*, Catalogue 3218.0, released 24 July 2007.

<sup>98</sup> The ACCC has published a comparison of the population density of selected metropolitan regions: ACCC, *Fixed services review—a second position paper*, April 2007, p. 45.

<sup>99</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 32; Annexure A, pp. 32-34; Annexure I.

<sup>100</sup> ACCC, *Fixed services review—a second position paper*, April 2007, p. 46.

<sup>101</sup> *ibid.* p. 47

views of its consultant CRAI, there is no material barrier to entry presented by sunk costs, for a number of reasons, namely:<sup>102</sup>

- DSLAMs are unlikely to be a sunk cost, as they can be redeployed and in any case have a relatively short life span and form a relatively small component of overall costs
- while switching and transmission infrastructure used to provide voice services could be sunk costs, these services can be acquired from existing network operators.
- in the alternative, ULLS-based access seekers could use emulation to provide a standard telephone service without acquiring telephone infrastructure
- sunk advertising and marketing costs at both the wholesale and retail level are likely to be minimal.

**Questions for interested parties:**

- Are Telstra's submissions about the level of sunk costs accurate?
- Are DSLAMs easily capable of redeployment?
- Are DSLAMs best characterised as a short-lived asset?
- Is it accurate to say that switching and transmission infrastructure for voice services can be readily acquired?
- The ACCC notes that CRAI says that it is 'technically feasible' to acquire this technology.<sup>103</sup> Is such acquisition commercially feasible?
- Does voice emulation and the use of soft-switching infrastructure provide a low sunk cost alternative to the use of traditional voice equipment?

As noted above, Telstra contends that the minimum efficient scale for access seekers using the ULLS and DSLAMs to provide voice is relatively low.<sup>104</sup> The ACCC repeats here the same question it asked in reference to tele-densities.

**Questions for interested parties:**

- Is Telstra's internal estimation of the minimum efficient scale needed for competitive DSLAM entry accurate and realistic?
- Does an access seeker only need to have somewhere less than [c-i-c] SIOs for ULLS and DSLAM-based entry to be viable?
- What is a sufficient customer base for a competitor to justify building a DSLAM in an ESA?

Telstra also submits that the provision of a standard telephone voice service is not a material barrier to entry and that there are no technical constraints that would prevent DSLAM-based competitors from providing a voice service equal to that of Telstra.<sup>105</sup>

<sup>102</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 31, Annexure B, Annexure D.

<sup>103</sup> *ibid*, Annexure A, p. 32.

<sup>104</sup> *ibid*, p. 32; Annexure A, pp. 32-34; Annexure I.

<sup>105</sup> *ibid*, p. 33.

It contends that this is true of legacy PSTN equipment, voice provided through softswitches and business-grade VoIP.<sup>106</sup>

**Questions for interested parties:**

- Would access seekers using DSLAMs and the ULLS, or providing VoIP services, be able to provide voice services of equivalent quality to Telstra's voice services?

Telstra submits that the backhaul transmission market in Band 2 ESAs are mature, that new entrants can purchase backhaul from a number of providers and that backhaul costs are accordingly not a material barrier to entry.<sup>107</sup> The ACCC has previously declared backhaul transmission services and concluded that transmission on certain routes is effectively competitive.<sup>108</sup>

**Questions for interested parties:**

- Would access seekers using DSLAMs and the ULLS, or providing VoIP services, be able to access competitively priced backhaul transmission in the Band 2 exchanges in the proposed exemption area?

Finally, Telstra submits that there are no non-price issues which constitute a material barrier to entry.<sup>109</sup> Telstra submits that Part XIB, the SAOs and Telstra's operational separation obligations would all prevent it from engaging in non-price conduct to impede roll-out.

The ACCC notes on this latter point that the Australian Competition Tribunal reached a conclusion that, at least in reference to certain aspects of Telstra's operational separation obligations, the operational separation regime may provide no enforceable protection for access seekers.<sup>110</sup>

The ACCC also notes that another non-price barrier to entry for the use of the ULLS to provide voice services may be the current absence of a LSS to ULLS transfer connection process. Currently, an access seeker using the LSS who wishes to transfer a particular end-user to the ULLS must pay for a disconnection of the LSS and reconnection of the ULLS. For access seekers who are currently using a combination of WLR and LSS to provide voice and broadband services to end-users, the absence of such a process might present a significant barrier to providing a PSTN voice service over the access line.

The ACCC also notes that the ULLS is typically used by access seekers to provide both a broadband service and a voice service to the end-user. The ACCC understands

<sup>106</sup> *ibid*, Annexure A, p. 34; Annexure B.

<sup>107</sup> *ibid*, p. 33.

<sup>108</sup> ACCC, *Transmission capacity service—review of the declaration for the domestic transmission capacity service—final report*, April 2004.

<sup>109</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 33.

<sup>110</sup> Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [322]

that, accordingly, service qualification testing for ULLS usually checks whether a line is capable of providing DSL. It would be relevant to know whether this places any limit on access seekers' ability to service voice customers outside of DSL range.

**Questions for interested parties:**

- What non-price barriers to entry exist for the use of DSLAMs to provide line rental and local call services?
- Does the absence of a LSS to ULLS transfer connection process provide a significant barrier to entry?
  - Is such a process likely to be made available in the near future?
- Are access seekers able to acquire the ULLS to provide voice services to customers who would not be capable of receiving xDSL?
  - Is this an issue in the Band 2 ESAs in the proposed exemption area?

The ACCC considers that there may be other barriers to entry, expansion and exit not addressed above.

**Questions for interested parties:**

- Are there any further barriers to entry, expansion and exit not already discussed above?

**Dynamic characteristics of markets**

The ACCC's second position paper notes that the structural features of relevant markets may change over time.<sup>111</sup> This can be due to factors such as market growth, technological development and the convergence of products and markets, and/or changes in prices and costs over time.

The ACCC notes that there are a number of possible changes or trends that could be identified as relevant to the exemption applications. These might include:

- technological change leading to cheaper or more capable DSLAM equipment
- improved reliability and prevalence of fixed wireless access
- growth in the use of VoIP services, and/or the quality of VoIP products
- fixed-to-mobile substitution by end-users for voice and broadband services.

These points have all been raised by the ACCC earlier in this discussion paper as relevant issues for consideration of the exemption applications.

More generally, the ACCC can look at changes in prices of services, profitability or product differentiation over time.

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<sup>111</sup> ACCC, *Fixed services review—a second position paper*, April 2007, p. 47.



The timeframe for dynamic changes to market characteristics is an important consideration. Relevantly, Telstra has sought exemption from the SAOs until the earlier of:

- the LCS and WLR ceasing to be declared
- a court finding that Part XIC of the TPA does not apply to the ULLS or LSS
- 30 December 2012.

The ACCC notes again that it currently intends to consider the declaration of all related fixed line services — the ULLS, LSS, PSTN OTA, LCS and WLR — in a comprehensive review of fixed-line regulation, commencing in mid 2008, before the expiry of the declaration of a number of services, including the LCS and WLR, in mid 2009.<sup>112</sup>

**Questions for interested parties:**

- What dynamic characteristics of the relevant markets should the ACCC consider?
- If the ACCC grants the exemption applications, for what period should the ACCC grant the exemptions?
  - Should the exemptions be granted until 2012, as sought by Telstra, or until the current expiry date of the LCS and WLR services?
- If the ACCC grants the exemption applications, should the exemptions take effect immediately, or should it be deferred?

**Nature and extent of vertical integration**

Telstra is a vertically integrated carrier, supplying at all levels of the supply chain. The ACCC has noted that vertical integration raises issues of price and non-price constraints on the ability of new entrants to compete effectively in specific downstream market segments.<sup>113</sup>

The ACCC considers that issues relating to vertical integration have largely been dealt with above.

**Questions for interested parties:**

- Are there any other issues relating to vertical integration relevant to the exemption applications that have not been raised above?

**Other issues**

There may be other issues that the ACCC should take account of in deciding whether to grant the exemptions. One issue is that it may be appropriate to place certain conditions on the granting of the exemption applications. For example, in granting Telstra's exemption application for the LCS in CBD areas, the ACCC granted the

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<sup>112</sup> *ibid*, p. 30.

<sup>113</sup> *ibid*, p. 48.

exemption to apply one year from the making of the exemption order and subject to Telstra providing written notice of certain events relating to the sale of the LCS.<sup>114</sup>

**Questions for interested parties:**

- What conditions (if any) should be placed on the granting of the exemption applications?

#### **5.4 Any-to-any connectivity**

In its Local services review, the ACCC considered that the declaration of the LCS and WLR were unlikely to affect the objective of any-to-any connectivity.<sup>115</sup> It also concluded that, given the presence of alternative infrastructure and declared services, any-to-any connectivity was unlikely to be affected when granting Telstra's exemption application for the LCS in CBD areas.<sup>116</sup> Telstra similarly submitted in support of its present exemption applications that the exemptions would not have a bearing on any-to-any connectivity.

**Questions for interested parties:**

- Would granting the exemption applications have any effect on any-to-any connectivity?

#### **5.5 Efficient use of and investment in infrastructure**

As discussed in Appendix A, when deciding whether an exemption will be in the LTIE, the ACCC is required to consider whether exemption would be likely to encourage the:

- economically efficient use of infrastructure
- economically efficient investment in:
  - infrastructure by which listed services are supplied
  - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.

There is a strong relationship between the relevant factors when considering the promotion of competition and the relevant factors when considering the encouragement of economically efficient use of and investment in infrastructure. The ACCC's view on the likely effect of granting the exemption applications on competition will influence its view on the likely effect of granting the exemption applications on economic efficiency. As noted above, the ACCC considers that the effect of the exemptions on the incentives for investment is likely to be a significant factor in deciding whether to grant the applications.

<sup>114</sup> ACCC, *Future scope of the Local Carriage Service—final decision*, July 2002, pp. 66-9.

<sup>115</sup> ACCC, *Local services review—final decision*, July 2006, p. 41, 49.

<sup>116</sup> ACCC, *Future scope of the Local Carriage Service—final decision*, July 2002, p. 58.

Competition is generally only promoted by declaration of a service where there is market power in the upstream market. In other words, market power enables a firm to charge prices that differ from the efficient cost based price, leading to inefficient use of infrastructure. However, if a market for a wholesale service is effectively competitive, then prices should approach underlying costs and the declaration of a service is unlikely to promote the economically efficient use of and investment in infrastructure. Instead, there may be costs associated with regulation that actually discourage economically efficient use of and investment in infrastructure.

### **Economically efficient use of infrastructure**

As noted in Appendix A, the ACCC considers that efficiency has three major components — allocative, productive and dynamic. In general, each of these forms of efficiency is enhanced when the prices of given services reflect the underlying costs of providing these services. In more competitive markets, service providers have a greater incentive to lower prices in order to win market share. Accordingly, this incentive helps push prices towards their underlying costs, improving allocative efficiency. In turn, this incentive is also likely to improve the efficient use of infrastructure by which listed services are supplied.

Accordingly, whether economically efficient use of infrastructure is promoted by declaration is closely related to the price charged for a service. The comparison of the level of costs to prices, and the impact declaration will have on the difference between the two, is the main consideration in determining whether declaration leads to a more efficient use of infrastructure.

In its Local services review, the ACCC considered that declaration would be likely to promote the efficient use of infrastructure by leading to greater competition in downstream markets and giving service providers the incentives to find lower-cost means of producing the LCS and WLR.<sup>117</sup>

To the extent that there is effective competition now possible in the provision of alternatives to Telstra's LCS and WLR in the proposed exemption area, the granting of exemption applications would be unlikely to decrease the efficient use of infrastructure. The efficient use of infrastructure by which the LCS and WLR are provided would instead be ensured by the incentives on carriers to decrease their costs in order to obtain market share.

#### **Questions for interested parties:**

- Would granting the exemption applications have any effect on the efficient use of infrastructure by which listed services are provided?
- What impact would granting the exemptions have on the efficient use of infrastructure in upstream products such as the ULLS?

### **Economically efficient investment in infrastructure**

Efficient investment in infrastructure makes an important contribution to the promotion of the LTIE. It can lead to more efficient methods of production, foster

<sup>117</sup> ACCC, *Local services review—final decision*, July 2006, p. 44.

increased competition in lower prices, and enhance the level of diversity in the goods and services available to end-users.

The legislation states that, in considering the economically efficient use of and investment in infrastructure, regard must be had to the incentives for investment in infrastructure.<sup>118</sup> In examining the likely impacts of declaration or granting an exemption on economically efficient investment, the ACCC must look at the likely impact on economically efficient investment in:

- infrastructure by which listed services are supplied
- infrastructure by which listed services are likely to become capable of being supplied.

Central to the consideration of the incentives that ongoing declaration gives to service providers is the impact on their ‘build/buy’ decisions. That is, carriers operating in downstream markets will have a choice as to whether they should invest in their own upstream infrastructure (i.e. build) in order to provide services to end-users, or to seek access from an existing upstream provider of the listed service (i.e. buy).

The ACCC is particularly concerned to ensure declaration would not prevent efficient investment (such as efficient investment in upstream markets by potential service providers) or encourage inefficient investment (such as additional inefficient investment in downstream markets or the technically inefficient duplication of upstream network infrastructure). Creating the right incentive for service providers to make an efficient build/buy choice is closely related to the price of the service.

In the present case, it is necessary to consider three different types of infrastructure investment:

- infrastructure by which the LCS and WLR are currently supplied
- alternative infrastructure by which the LCS and WLR may be supplied
- alternative infrastructure by which other related services may be supplied.

In general, efficient investment in current LCS and WLR infrastructure will be supported as long as Telstra is able to gain a market return on its investment. This will depend largely on the price at which the LCS, WLR and their retail equivalents are sold. However, Telstra’s ownership of the customer access network (CAN) provides Telstra with a significant strategic advantage. Accordingly, it might be expected that granting the exemptions would not have a significant effect on Telstra’s investment incentives. However, Telstra has pointed to possible costs of regulation that it submits distorts investment incentives and lead to an inefficient level of investment, namely:<sup>119</sup>

- It contends that regulation tends to truncate the reward of successful investments without reducing losses from unsuccessful investments.
- Regulated resale access promotes arbitrage opportunities in the presence of a large number of declared services.

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<sup>118</sup> TPA paragraph 152AB(6)(c)

<sup>119</sup> Telstra, *Telstra’s Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, pp. 37-40.

- It also contends that it is likely that regulators are likely to set prices too low and that in any case the impact of under-pricing is greater than that of over-pricing.

Telstra submits that regulation is costly and when imposed on competitive markets it will inefficiently distort investment incentives because it imposes transaction, compliance and administrative costs and is prone to regulatory error.

**Questions for interested parties:**

- Would granting the exemptions significantly affect Telstra’s incentives to invest in its infrastructure?
- Would granting the exemptions affect Telstra’s plans to invest in maintenance, improvement and expansion of its fixed network infrastructure?
- How realistic are the costs of regulation identified by Telstra?
- Are regulators likely to set prices too low and are the impacts of doing so asymmetric?

The ACCC considers that the economically efficient investment in alternative infrastructure may be affected by the declaration of the LCS and WLR (and conversely by the granting of an exemption) in one of two ways.

Firstly, the ongoing declaration of the resale-based LCS and WLR may provide a substitute for and impediment to efficient investment in alternative infrastructure. If the declared service provides an easy means of entry into the market with minimal risk and investment, access seekers may choose to postpone or cancel investment in new infrastructure with which they could provide the LCS, WLR or equivalent services. Declaration would diminish the incentives for the deployment and activation of alternative infrastructure and stifle the development of facilities-based competition. Telstra submits that the current declaration of the LCS and WLR have led to such ‘regulatory dependence’.<sup>120</sup>

Accordingly, granting an exemption, if facilities-based competition is feasible, would be likely to lead to efficient investment by current access seekers and more sustainable and innovative forms of competition. As noted above, the ACCC is of the view that facilities-based competition is generally more desirable.

Comparatively, the ACCC was of the view in its Local services review that declaration of the LCS and WLR was likely to have a positive effect on investment for access seekers by allowing them to become familiar with the market and make more informed investment decisions. The ACCC considered that the declaration of the LCS and WLR was likely to promote incentives for efficient investment in both existing and new infrastructure.<sup>121</sup>

**Questions for interested parties:**

- Has declaration of the LCS and WLR discouraged investment in alternative voice infrastructure by access seekers?

<sup>120</sup> Telstra, *Telstra’s Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 37.

<sup>121</sup> ACCC, *Local services review—final decision*, July 2006, p. 45.

- Would granting the exemption applications be likely to encourage efficient investment in alternative infrastructure by removing the scope for reliance on the declared LCS and WLR?
- What implications would Telstra's exemption applications, and proposed rule for including ESAs in its exemption area, have on investment by access seekers in DSLAM infrastructure?
  - Would an alternative rule be preferable as a result?

### **Technical feasibility**

The TPA provides that, in considering an exemption application, regard must be had to whether it is or is likely to become, technically feasible for services to be supplied and charged for.<sup>122</sup>

Clearly, given the provision of both services over time, it is technically feasible for the LCS and WLR to be provided by Telstra. Telstra would be able to continue to supply the service if it wished whether or not the exemptions were granted. The ACCC considers that issues of the technical feasibility of providing equivalent services by other carriers are adequately dealt with in other sections of this report.

### **Legitimate commercial interests of access provider**

The TPA provides that, in considering an exemption application, regard must be had to the legitimate commercial interests of the access provider of a service, including the ability to exploit economies of scale and scope.<sup>123</sup>

The legitimate commercial interests of an access provider primarily consists of earning a commercial return on its assets, but also includes its interests in maintaining contractual commitments and in using its network for future requirements.

The ACCC considers that the main issue is whether granting the exemption applications will allow Telstra to recover more than is in its legitimate commercial interests. If there is sufficient competition in the relevant markets, then either allowing the declaration to stand or granting the exemption would be unlikely to allow recovery of more than is in Telstra's legitimate interests. Equally, the fact that Telstra has made the exemption applications suggests that granting the exemptions would be unlikely to be against Telstra's legitimate commercial interests. Telstra has submitted that its legitimate commercial interests would be enhanced by granting the exemptions as it will have greater commercial freedom and flexibility.<sup>124</sup>

### **Questions for interested parties:**

- Would granting the exemption applications be likely to allow Telstra to recover more than is in its legitimate commercial interests?

<sup>122</sup> TPA paragraph 152AB(6)(a)

<sup>123</sup> TPA paragraph 152AB(6)(b)

<sup>124</sup> Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, July 2007, p. 49.

## 5.6 Class exemption

In addition to granting individual exemptions from SAOs under section 152AT of the TPA, the ACCC is also able to grant exemptions to a class of carriers under section 152AS of the TPA.

In its consideration of Telstra's last application for an exemption from SAOs for the LCS in CBD areas, the ACCC also considered whether it would be appropriate to grant a class exemption.<sup>125</sup> The ACCC ultimately also made a class exemption in addition to granting Telstra's individual exemption.<sup>126</sup>

Under subsection 152AS(5) of the TPA, before making a class exemption, the ACCC must publish a draft of the exemption determination and invite submissions where the ACCC is of the view that the granting of the exemption is likely to have a material effect on the interests of a person. At the present time, the ACCC is seeking views on whether a class exemption should be made on terms similar to those expressed in Telstra's individual exemption applications. If the ACCC reaches a view that a class exemption should be made, it will publish a draft determination at the time of making its draft decision on Telstra's exemption applications.

### Questions for interested parties:

- Should the ACCC make a class exemption in similar terms to Telstra's individual exemption applications?
  - What would an appropriate class of carrier be?
- Are there any considerations for granting a class exemption that differ from those for Telstra's individual exemption applications?
- Should the conditions (if any) for a class exemption be different from those for the individual exemptions (if any)?

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<sup>125</sup> ACCC, *Future scope of the local carriage service declaration—discussion paper*, August 2000, p. 6.

<sup>126</sup> ACCC, *Future scope of the Local Carriage Service—final decision*, July 2002, pp. 64-65.

## Appendix A: Legislative background

Part XIC of the TPA sets out a telecommunications access regime. This section of the discussion paper outlines the provisions of the access regime relevant to the exemption applications.

### ***A.1 Declaration and the SAOs***

The ACCC may determine that particular carriage services and related services are declared services under section 152AL of the TPA. A carrier or carriage service provider that provides a declared service to itself or other persons is known as an access provider. Once a service is declared, access providers are subject to a number of SAOs pursuant to section 152AR of the TPA. Terms of access can be governed by the terms of an undertaking or, in the absence of an accepted undertaking, by ACCC determination in an access dispute.

In summary, the SAOs require that an access provider, if requested by a service provider, must:

- supply the declared service
- take all reasonable steps to ensure that the technical and operational quality of the service supplied to the service provider is equivalent to that which the access provider is supplying to itself
- take all reasonable steps to ensure that the fault detection, handling and rectification which the service provider receives in relation to the declared service is of equivalent technical and operational quality as that provided by the access provider to itself
- permit interconnection of its facilities with the facilities of the service provider
- take all reasonable steps to ensure that the technical operational quality and timing of the interconnection is equivalent to that which the access provider provides to itself
- take all reasonable steps to ensure that the service provider receives interconnection fault detection, handling and rectification of a technical and operational quality and timing that is equivalent to that which the access provider provides to itself
- if a standard is in force under section 384 of the *Telecommunications Act 1997*, take all reasonable steps to ensure that the interconnection complies with the standard
- if requested by the service provider, provide billing information in connection with matters, or incidental to, the supply of the declared services
- if an access provider supplies an active declared service by means of conditional-access customer equipment, the access provider must, if requested to do so by a service provider supply any service that is necessary to enable the service provider to supply carriage services and/or content services by means of the declared service and using the equipment.



The ACCC must only declare a service if, following a public inquiry, it considers that declaration would promote the LTIE. Section 152AB of the TPA states that, in determining whether declaration promotes the LTIE, regard must be had only to the extent to which declaration is likely to result in the achievement of the following objectives:

- promoting competition in markets for listed services
- achieving any-to-any connectivity in relation to carriage services that involve communication between end-users
- encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which telecommunications services are supplied or are, or are likely to become, capable of being supplied.

Section 152AB also provides guidance in interpreting these objectives. The three objectives are discussed further below.

## ***A.2 Exemptions from SAOs***

Exemptions can be granted from the SAOs. This can occur in two ways:

- a class exemption under section 152AS of the TPA
- an individual exemption under section 152AT of the TPA.

In the case of an individual exemption application, a carrier or carriage service provider may apply to the ACCC for a written order exempting it from any or all of the SAOs that apply to a declared service.<sup>127</sup>

If the ACCC is of the opinion that the making of an exemption order would be likely to have a material effect on the interests of a person, the ACCC must publish the application for an exemption and invite submissions from the public.<sup>128</sup> The ACCC must consider any submissions received within the time specified.

The ACCC must not grant an exemption order unless the ACCC is satisfied that the making of the order will promote the LTIE.<sup>129</sup> An exemption order can be unconditional or subject to such conditions or limitations as are specified in the order.<sup>130</sup>

The ACCC has a six month period in which to make the decision to accept or reject the exemption order.<sup>131</sup> However the six month period does not include any period where the ACCC has published the application and invited people to make submissions within a specific time limit, or where there is an outstanding response to an information request.<sup>132</sup> The ACCC may also extend the six month period by a further three months in certain circumstances.<sup>133</sup>

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<sup>127</sup> TPA subsection 152AT(1)

<sup>128</sup> TPA subsection 152AT(9)

<sup>129</sup> TPA subsection 152AT(4)

<sup>130</sup> TPA subsection 152AT(5)

<sup>131</sup> TPA subsection 152AT(10)

<sup>132</sup> TPA subsection 152AT(11)

<sup>133</sup> TPA subsection 152AT(12)

After considering the application, the ACCC must either make a written exemption order or refuse the application.<sup>134</sup>

A class exemption under section 152AS of the TPA similarly can only be made if the ACCC believes that the exemption will be in the LTIE. However the exemption applies to a specified class of carrier or carriage service provider, and there is no six month time limit on consideration of a class exemption.

### ***A.3 Long-term interests of end-users***

Both a decision to declare a service and, more relevantly for the present purposes, a decision to grant an exemption from the SAOs for a declared service can only be made if the ACCC considers that making the declaration or granting the exemption will be likely to promote the LTIE.

As noted above, section 152AB of the TPA states that, in determining whether declaration promotes the LTIE, regard must be had only to the extent to which the exemption is likely to result in the achievement of the following objectives:

- promoting competition in markets for listed services
- achieving any-to-any connectivity in relation to carriage services that involve communication between end-users
- encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which telecommunications services are supplied or are, or are likely to become, capable of being supplied.

The objectives are interrelated. In many cases, the LTIE may be promoted through the achievement of two or all of these matters simultaneously. In other cases, the achievement of one of these matters may involve some trade-off in terms of another of the matters, and the ACCC will need to weigh up the different effects to determine whether the exemption promotes the LTIE. In this regard, the ACCC will interpret long-term to mean the period of time necessary for the substantive effects of the exemption to unfold.

The following discussion provides an overview of what the ACCC must consider in assessing each of these objectives.

### **Promotion of competition**

Subsections 152AB(4) and (5) of the TPA provide that, in interpreting this objective, regard must be had to, but is not limited to, the extent to which the arrangements will remove obstacles to end-users gaining access to listed services. The Explanatory Memorandum to Part XIC of the TPA states that:<sup>135</sup>

...it is intended that particular regard be had to the extent to which the...[declaration]... would enable end-users to gain access to an increased range or choice of services.

This requires the ACCC to make an assessment of whether or not exemption would be likely to promote competition in the markets for listed services.

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<sup>134</sup> TPA s. 152AT(3)

<sup>135</sup> Trade Practices Amendment (Telecommunications) Act 1997 (Cth) Explanatory memorandum

The concept of competition is of fundamental importance to the TPA and has been discussed many times in connection with the operation of Part IIIA, Part IV, Part XIB and Part XIC of the TPA.

In general terms, competition is the process of rivalry between firms, where each market participant is constrained in its price and output decisions by the activity of other market participants. The Trade Practices Tribunal (now the Australian Competition Tribunal) stated that:<sup>136</sup>

In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.

Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate.

Competition can provide benefits to end-users including lower prices, better quality and a better range of services over time. Competition may be inhibited where the structure of the market gives rise to market power. Market power is the ability of a firm or firms profitably to constrain or manipulate the supply of products from the levels and quality that would be observed in a competitive market for a significant period of time.

The establishment of a right for third parties to negotiate access to certain services on reasonable terms and conditions can operate to constrain the use of market power that could be derived from the control of these services. Accordingly, an access regime such as Part IIIA or Part XIC addresses the structure of a market, to limit or reduce the sources of market power and consequent anti-competitive conduct, rather than directly regulating conduct which may flow from its use, which is the role of Part IV and Part XIB of the TPA. Nonetheless, in any given challenge to competition, both Parts XIB (or IV) and XIC may be necessary to address anti-competitive behaviour.

To assist in determining the impact of potential exemption on downstream markets, the ACCC will first need to identify the relevant market(s) and assess the likely effect of exemption on competition in each market.

Section 4E of the TPA provides that the term 'market' includes a market for the goods or services under consideration and any other goods or services that are substitutable for, or otherwise competitive with, those goods or services. The ACCC's approach to market definition is discussed in its *Merger Guidelines*, June 1999 and is also canvassed in its information paper, *Anti-competitive conduct in telecommunications markets*, August 1999.

The second step is to assess the likely effect of exemption on competition in each relevant market. As noted above, subsection 152AB(4) requires that regard must be had to the extent to which a particular thing will remove obstacles to end-users gaining access to listed services.

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<sup>136</sup> *Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd*, (1976) ATPR 40-012, 17,245.

The ACCC considers that denial to service providers of access to necessary upstream services on reasonable terms is a significant obstacle to end users gaining access to services. In this regard, declaration can remove such obstacles by facilitating entry by service providers, thereby providing end users with additional services from which to choose. For example, access to a mobile termination service may enable more service providers to provide fixed to mobile calls to end-users. This gives end-users more choice of service providers.

Where existing market conditions already provide for the competitive supply of services, the access regime should not impose regulated access, and granting an exemption would generally be appropriate in such circumstances. This recognises the costs of providing access, such as administration and compliance, as well as potential disincentives to investment. 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.

In the context of considering whether an exemption will promote competition, it is therefore appropriate to examine the impact of the existing declaration on each relevant market, the likely effect of reduced access obligations on the relevant market, and compare the state of competition in that market with and without the exemption. In examining the market structure, the ACCC considers that competition is promoted when market structures are altered such that the exercise of market power becomes more difficult; for example, because barriers to entry have been lowered (permitting more efficient competitors to enter a market and thereby constrain the pricing behaviour of the incumbents) or because the ability of firms to raise rivals' costs is restricted.

### **Any-to-any connectivity**

Subsection 152AB(8) of the TPA provides that the objective of any-to-any connectivity is achieved if, and only if, each end-user who is supplied with a carriage service that involves communication between end-users is able to communicate, by means of that service, or a similar service, with other end-users whether or not they are connected to the same network. The reference to 'similar' services in the TPA enables this objective to apply to services with analogous, but not identical, functional characteristics, such as fixed and mobile voice telephony services or Internet services which may have differing characteristics.

The any-to-any connectivity requirement is particularly relevant when considering services that involve communications between end-users. When considering other types of services (such as carriage services that are inputs to an end-to-end service or distribution services such as the carriage of pay television), the ACCC generally considers that this criterion will be given less weight compared to the other two criteria.

### **Efficient use of, and investment in, infrastructure**

Subsections 152AB(6) and (7A) of the TPA provide that, in interpreting this objective, regard must be had to, but is not limited to, the following:

- whether it is technically feasible for the services to be supplied and charged for, having regard to:
  - the technology that is in use or available
  - whether the costs that would be involved in supplying, and charging for, the services are reasonable
  - the effects, or likely effects, that supplying, and charging for, the services would have on the operation or performance of telecommunications networks
- the legitimate commercial interests of the supplier or suppliers of the service, including the ability of the supplier or suppliers to exploit economies of scale and scope
- the incentives for investment in:
  - the infrastructure by which the services are supplied; and
  - any other infrastructure by which the services are, or are likely to become, capable of being supplied.

In determining the extent to which a particular thing is likely to encourage the efficient investment in other infrastructure, the ACCC must have regard to the risks involved in making the investment.

Economic efficiency has three components.

- Productive efficiency refers to the efficient use of resources within each firm such that all goods and services are produced using the least cost combination of inputs.
- Allocative efficiency refers to the efficient allocation of resources across the economy such that the goods and services that are produced in the economy are the ones most valued by consumers. It also refers to the distribution of production costs amongst firms within an industry to minimise industry-wide costs.
- Dynamic efficiency refers to the efficient deployment of resources between present and future uses such that the welfare of society is maximised over time. Dynamic efficiency incorporates efficiencies flowing from innovation leading to the development of new services, or improvements in production techniques.

The ACCC will need to ensure that the access regime does not discourage investment in networks or network elements where such investment is efficient. The access regime also plays an important role in ensuring that existing infrastructure is used efficiently where it is inefficient to duplicate investment in existing networks or network elements.

***The technical feasibility of supplying and charging for particular services***

This incorporates a number of elements, including the technology that is in use or available, the costs of supplying, and charging for, the services and the effects on the operation of telecommunications networks.

In many cases, the technical feasibility of supplying and charging for particular services given the current state of technology may be clear, particularly where (as in the present case) the service is already declared and there is a history of providing access. The question may be more difficult where there is no prior access, or where

conditions have changed. Experience in other jurisdictions, taking account of relevant differences in technology or network configuration, will be helpful. Generally the ACCC will look to an access provider to demonstrate that supply is not technically feasible.

***The legitimate commercial interests of the supplier or suppliers, including the ability of the supplier to exploit economies of scale and scope***

A supplier's legitimate commercial interests encompass its obligations to the owners of the firm, including the need to recover the cost of providing services and to earn a normal commercial return on the investment in infrastructure. The ACCC considers that allowing for a normal commercial return on investment will provide an appropriate incentive for the access provider to maintain, improve and invest in the efficient provision of the service.

A significant issue relates to whether or not capacity should be made available to an access seeker. Where there is spare capacity within the network, not assigned to current or planned services, allocative efficiency would be promoted by obliging the owner to release capacity for competitors.

Paragraph 152AB(6)(b) of the TPA also requires the ACCC to have regard to whether the access arrangement may affect the owner's ability to realise economies of scale or scope. Economies of scale arise from a production process in which the average (or per unit) cost of production decreases as the firm's output increases. Economies of scope arise from a production process in which it is less costly in total for one firm to produce two (or more) products than it is for two (or more) firms to each separately produce each of the products.

Potential effects from access on economies of scope are likely to be greater than on economies of scale. A limit in the capacity available to the owner may constrain the number of services that the owner is able to provide using the infrastructure and thus prevent the realisation of economies of scope associated with the production of multiple services. In contrast, economies of scale may simply result from the use of the capacity of the network and be able to be realised regardless of whether that capacity is being used by the owner or by other carriers and service providers. Nonetheless, the ACCC will assess the effects of the supplier's ability to exploit both economies of scale and scope on a case-by-case basis.

***The impact on incentives for investment in infrastructure***

Firms should have the incentive to invest efficiently in infrastructure. Various aspects of efficiency have been discussed already. It is also important to note that while access regulation may have the potential to diminish incentives for some businesses to invest in infrastructure, it may also ensure that investment is efficient and reduces the barriers to entry for other (competing) businesses or the barriers to expansion by competing businesses.

There is also a need to consider the effects of any expected disincentive to investment from anticipated increases in competition to determine the overall effect of granting an exemption on the LTIE. The ACCC is careful to ensure that services are not declared where there is a risk that incentives to invest may be dampened, such that there is little subsequent benefit to end users from the access arrangements.

## **Appendix B: Telstra’s confidentiality undertaking**

This Telstra confidentiality undertaking will also be made available on the ACCC’s website in Microsoft Word format.

### **COMMONWEALTH OF AUSTRALIA**

#### *Trade Practices Act 1974*

### **IN THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION**

<b>APPLICATION FOR EXEMPTION FROM STANDARD ACCESS OBLIGATIONS MADE BY:</b>	<b>Telstra Corporation Limited</b>
<b>UNDER:</b>	<b>Trade Practices Act 1974 (Cth) section 152AT(1)</b>
<b>DATE OF APPLICATION FOR EXEMPTION:</b>	<b>9 July 2007</b>
<b>DECLARED SERVICES:</b>	<b>Local Carriage Service (LCS) and Wholesale Line Rental Service (WLR)</b>

### **CONFIDENTIALITY UNDERTAKING**

I, \_\_\_\_\_ of \_\_\_\_\_, undertake to Telstra Corporation Limited (“**Telstra**”) that:

- 1 Subject to the terms of this Undertaking, I will keep confidential at all times the information listed in Attachment 1 to this Undertaking (“**Confidential Information**”) that is in my possession, custody, power or control.
- 2 I acknowledge that:
  - (a) this Undertaking is given by me to Telstra in consideration for Telstra making the Confidential Information available to me for the Approved Purposes (as defined below);
  - (b) all intellectual property in or to any part of the Confidential Information is and will remain owned by Telstra; and

- (c) by reason of this Undertaking, no licence or right is granted to me, or any other employee, agent or representative of [PARTY] in relation to the Confidential Information except as expressly provided in this Undertaking.

3 I will:

- (a) only use the Confidential Information for:
    - (i) the purposes of the consultation process(es) (including making submissions or otherwise) of the ACCC in relation to the applications for exemption from the standard access obligations in respect of the declared Local Carriage Service and the Wholesale Line Rental Service lodged by Telstra on 9 July 2007 (“**Exemptions**”);
    - (ii) the purposes of any application made to the Australian Competition Tribunal (the “**Tribunal**”) under section 152AV of the *Trade Practices Act 1974* for a review of a decision made by the ACCC in respect of the Exemptions; or
    - (iii) any other purpose approved by Telstra in writing;
- (“**the Approved Purposes**”);
- (b) comply with any reasonable request or direction from Telstra regarding the Confidential Information.

4 Subject to paragraph 5 below, I will not disclose any of the Confidential Information to any other person without the prior written consent of Telstra.

5 I acknowledge that I may disclose the Confidential Information to which I have access to:

- (a) ACCC employees for the Approved Purposes; and
- (b) any external legal advisors, independent experts, internal legal or regulatory staff of [PARTY], for the Approved Purposes provided that:



- (i) the person to whom disclosure is proposed to be made (“**the person**”) is notified in writing to Telstra and Telstra has approved the person as a person who may receive the Confidential Information, which approval shall not be unreasonably withheld;
  - (ii) the person has signed a confidentiality undertaking in the form of this Undertaking or in a form otherwise acceptable to Telstra; and
  - (iii) a signed undertaking of the person has already been served on Telstra; and
- (c) if required to do so by law; and
- (d) to any secretarial, administrative and support staff, who perform purely administrative tasks, and who assist me or any person referred to in paragraph 5(b) for the Approved Purpose.

6 I will establish and maintain security measures to safeguard the Confidential Information that is in my possession from unauthorised access, use, copying, reproduction or disclosure and use the same degree of care as a prudent person in my position would use to protect that person’s confidential information.

7 Except as required by law and subject to paragraph 11 below, within a reasonable time after whichever of the following first occurs:

- (a) a decision is made to accept or reject the Exemptions;
- (b) my ceasing to be employed or retained by [PARTY] (provided that I continue to have access to the Confidential Information at that time); or
- (c) my ceasing to be working for [PARTY] in respect of the Approved Purposes (other than as a result of ceasing to be employed by [PARTY]),

I will destroy or deliver to Telstra the Confidential Information and any documents or things (or parts of documents or things), constituting, recording or containing any of the Confidential Information in my possession, custody, power or control.

Note: For the purpose of paragraph 7(a) above, a decision is made to accept or reject the Exemptions where 21 days has expired after a decision has been made by the ACCC or the

Tribunal to accept or reject the Exemptions and there are no outstanding applications, appeals or other legal proceedings in relation to the Exemptions or the decision.

8 Nothing in this Undertaking shall impose an obligation upon me in respect of information:

(a) which is in the public domain; or

(b) which has been obtained by me otherwise than in relation to the Exemptions;

provided that the information is in the public domain and/or has been obtained by me by reason of, or in circumstances which do not involve any breach of a confidentiality undertaking or a breach of any other obligation of confidence in favour of Telstra or by any other unlawful means, of which I am aware.

9 I acknowledge that damages may not be a sufficient remedy for any breach of this Undertaking and that Telstra may be entitled to specific performance or injunctive relief (as appropriate) as a remedy for any breach or threatened breach of this Undertaking, in addition to any other remedies available to Telstra at law or in equity.

10 The obligations of confidentiality imposed by this Undertaking survive the destruction or delivery to Telstra of the Confidential Information pursuant to paragraph 7 above.

11 I acknowledge that this Undertaking is governed by the law in force in the State of New South Wales and I agree to submit to the non-exclusive jurisdiction of the court of that place.

Signed: \_\_\_\_\_ Dated: \_\_\_\_\_

Print name: \_\_\_\_\_

## **ATTACHMENT 1**

Any document, or information in any document provided by Telstra to [PARTY] which Telstra asserts is confidential information for the purposes of this Undertaking or is otherwise marked as confidential, including, but not limited to, the confidential version of supporting submission (and any attachments) to the exemption applications in respect of the Local Carriage Service and the Wholesale Line Rental Service.

## Appendix C: List of ACCC discussion questions

This appendix gathers together for reference the questions contained in chapter 5 of this paper.

### 5.1 Enduring bottlenecks

- Should the LCS and WLR be considered enduring bottlenecks?
- Are PSTN voice services replicable through the use of:
  - DSLAMs?
  - traditional voice switching equipment?
  - soft switches?
  - VoIP?
  - alternative infrastructure such as fixed wireless or HFC?
- Are Telstra's statements about the ease of access to traditional voice switching and soft switches accurate?
- Does the fact that an access seeker has a DSLAM in an exchange mean that it is capable of providing a voice service to end-users?
- What are the technical and cost differences in DSLAMs that can be used to provide voice and those that can only be used to provide xDSL?
- What percentage of DSLAMs currently deployed would be capable of providing PSTN voice services?
- Are the upgrade costs (e.g. addition of line cards) to enable provision of PSTN voice services significant?

### 5.2 Market definition

- What are the relevant markets that would be affected by the granting of the exemption?
- How should these markets be defined? What evidence of demand and supply-side substitutability supports that market definition?
- The ACCC concluded in its Local services review that there were separate wholesale markets for the provision of wholesale line rental and the provision of wholesale local calls. It also concluded that retail markets at their narrowest could be defined as separate retail markets for line rental and local calls or more widely as a market for retail fixed voice services which necessarily includes both retail line rental and local calls services. Are the ACCC's conclusions still correct?
- Are there any other wholesale or retail markets that the ACCC should consider?
- Is Telstra's approach to defining its exemption area an appropriate one?
- Does Telstra's rule, based on the presence of competitor DSLAMs, represent an appropriate way of grouping together the ESAs in its exemption area?
- Is the data that Telstra uses, based on publicly available information, sufficiently robust to allow the ACCC to be confident about the deployment of DSLAMs in the proposed exemption area?
- What further data, if any, would the ACCC need to determine the deployment of DSLAMs in the proposed exemption area?

### 5.3 Promotion of competition

*Structural factors*

- In the absence of a declared LCS and WLR, would competition in downstream retail markets for relevant services be effective?
  - Is competition in downstream markets currently effective?
- What alternative providers to Telstra of LCS and WLR currently operate in the wholesale market?
  - Do these providers offer any significant competitive constraint on the pricing of the LCS and WLR?
- In the absence of access to a declared LCS and WLR in the proposed exemption area, would such firms provide a meaningful constraint on the pricing of the LCS and WLR or equivalent services?
- Would Telstra be likely to continue to supply the LCS and WLR if the exemption applications were granted?
- What infrastructure do alternative wholesale providers use?
- Are DSLAMs a significant competitive presence for the provision of wholesale and retail basic access and local calls?
- What percentage of DSLAMs currently would be capable of providing traditional voice services as opposed to only DSL broadband?
- Do cable and fixed wireless networks provide meaningful constraint on the pricing of the LCS and WLR?
- What are the relevant trends in retail markets for PSTN voice services?
- Is there evidence of end-users switching away from PSTN basic access, local calls and related services?

- Is there any significant difference in competitive conditions between an ESA with one competitive DSLAM and an ESA with two or more competitive DSLAMs?
- Does the ACCC also need information on the number of ULLS and LSS lines taken by access seekers to appropriately gauge competitive conditions in an ESA?
  - For the purpose of assessing the exemption applications, does it require historical data?
- Do access seekers tend to follow deployment by other DSLAM operators into ESAs?
- Are access seekers likely to purchase the infrastructure of a DSLAM operator that exits the market?
- What are the costs of installing a DSLAM?
  - Are these costs prohibitive or significant?
- What customer base is required to justify building a DSLAM in a particular ESA?

- Does VoIP have a significant effect in the wholesale and retail markets for basic access and local calls in the proposed exemption area?
- To what extent can mobile calls be considered a substitute for fixed line basic access and local calls, as suggested by Telstra?

- Is competition in the market for wholesale and retail line rental and local call services largely driven by price?
- Is there any significant product differentiation and/or would significant product differentiation be likely to occur if the exemption was granted?

*Potential for competition*

- Should the ACCC regard these planned investments as being representative of the likely deployment of DSLAMs in the proposed exemption area by the end of 2007?
  - How cautiously should the ACCC regard these planned deployments?
- Would new DSLAMs all have the capacity to provide voice services, or would some of the DSLAMs only be capable of providing DSL broadband?

- Do the Band 2 ESAs in Telstra's proposed exemption area have a significant enough addressable market to allow access seekers to achieve sufficient economies of scale or density to provide effective competition?
- Is Telstra's internal estimation of the minimum efficient scale needed for competitive DSLAM entry accurate and realistic?
- Does an access seeker only need to have an amount less than [c-i-c] SIOs for ULLS and DSLAM-based entry to be viable?

- Are Telstra's submissions about the level of sunk costs accurate?
- Are DSLAMs easily capable of redeployment?
- Are DSLAMs best characterised as a short-lived asset?
- Is it accurate to say that switching and transmission infrastructure for voice services can be readily acquired?
- The ACCC notes that CRAI says that it is 'technically feasible' to acquire this technology.<sup>137</sup> Is such acquisition commercially feasible?
- Does voice emulation and the use of soft-switching infrastructure provide a low sunk cost alternative to the use of traditional voice equipment?

- Is Telstra's internal estimation of the minimum efficient scale needed for competitive DSLAM entry accurate and realistic?
- Does an access seeker only need to have somewhere less than [c-i-c] SIOs for ULLS and DSLAM-based entry to be viable?
- What is a sufficient customer base for a competitor to justify building a DSLAM in an ESA?

- Would access seekers using DSLAMs and the ULLS, or providing VoIP services, be able to provide voice services of equivalent quality to Telstra's voice services?

- Would access seekers using DSLAMs and the ULLS, or providing VoIP services, be able to access competitively priced backhaul transmission in the Band 2 exchanges in the proposed exemption area?

- What non-price barriers to entry exist for the use of DSLAMs to provide line rental and local call services?
- Does the absence of a LSS to ULLS transfer connection process provide a significant barrier to entry?
  - Is such a process likely to be made available in the near future?
- Are access seekers able to acquire the ULLS to provide voice services to customers who would not be capable of receiving xDSL?

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<sup>137</sup> *ibid*, Annexure A, p. 32.

- Is this an issue in the Band 2 ESAs in the proposed exemption area?

- Are there any further barriers to entry, expansion and exit not already discussed above?

#### *Dynamic characteristics of markets*

- What dynamic characteristics of the relevant markets should the ACCC consider?
- If the ACCC grants the exemption applications, for what period should the ACCC grant the exemptions?
  - Should the exemptions be granted until 2012, as sought by Telstra, or until the current expiry date of the LCS and WLR services?
- If the ACCC grants the exemption applications, should the exemptions take effect immediately, or should it be deferred?

#### *Nature and extent of vertical integration*

- Are there any other issues relating to vertical integration relevant to the exemption applications that have not been raised above?

#### *Other issues*

- What conditions (if any) should be placed on the granting of the exemption applications?

### **5.4 Any-to-any connectivity**

- Would granting the exemption applications have any effect on any-to-any connectivity?

### **5.5 Efficient use of and investment in infrastructure**

#### *Economically efficient use of infrastructure*

- Would granting the exemption applications have any effect on the efficient use of infrastructure by which listed services are provided?
- What impact would granting the exemptions have on the efficient use of infrastructure in upstream products such as the ULLS?

#### *Economically efficient investment in infrastructure*

- Would granting the exemptions significantly affect Telstra's incentives to invest in its infrastructure?
- Would granting the exemptions affect Telstra's plans to invest in maintenance, improvement and expansion of its fixed network infrastructure?
- How realistic are the costs of regulation identified by Telstra?
- Are regulators likely to set prices too low and are the impacts of doing so asymmetric?

- Has declaration of the LCS and WLR discouraged investment in alternative voice infrastructure by access seekers?

- Would granting the exemption applications be likely to encourage efficient investment in alternative infrastructure by removing the scope for reliance on the declared LCS and WLR?
- What implications would Telstra's exemption applications, and proposed rule for including ESAs in its exemption area, have on investment by access seekers in DSLAM infrastructure?
  - Would an alternative rule be preferable as a result?

*Legitimate commercial interests of access provider*

- Would granting the exemption applications be likely to allow Telstra to recover more than is in its legitimate commercial interests?

**5.6 Class exemption**

- Should the ACCC make a class exemption in similar terms to Telstra's individual exemption applications?
  - What would an appropriate class of carrier be?
- Are there any considerations for granting a class exemption that differ from those for Telstra's individual exemption applications?
- Should the conditions (if any) for a class exemption be different from those for the individual exemptions (if any)?