herbertgeer

Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan

Discussion Paper

Submission by Herbert Geer Lawyers on behalf of:

Adam Internet Pty Ltd,

iiNet Limited, and

Internode Pty Ltd

27 September 2011

1. INTRODUCTION

This submission is made on behalf of Adam Internet Pty Ltd, iiNet Limited and Internode Pty Ltd (collectively, **our Clients**) in response to the ACCC's discussion paper of 30 August 2011 entitled *Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan* (**the Discussion Paper**).

Our Clients believe that the ACCC's decision relating to Telstra's Structural Separation Undertaking (**SSU**) has the potential to be the single most important decision that the ACCC has made in respect of telecommunications since competition in telecommunications markets was opened up. At the outset, our Clients wish to commend the ACCC for seeking to fully consider the merits of the issues that arise rather than simply allowing the deal between Telstra and NBN Co to lead to a *fait accompli*. That said, the shortcomings in the public consultation (which our Client's acknowledge may be beyond the control of the ACCC) cannot pass without comment. Our Clients believe that the issues that arise in respect of the SSU are far more important than the issues that arose in respect of the following matters:

- Telstra's application for exemption in respect of the Wholesale Line Rental and Line Sharing Service in certain exchange service areas[1]; and
- Telstra's undertaking in respect of the price of the Unconditioned Local Loop Service in band 2[2].

However, before the ACCC made any decisions with regard to those matters, there was a two stage public consultation which involved a discussion paper and a draft decision. Given the importance of the SSU, our Clients are deeply concerned that the ACCC could make a decision to accept the SSU (after Telstra has tinkered with it) without providing the opportunity for public comment on a draft decision.

2. STRUCTURE OF THESE SUBMISSIONS

The SSU and Migration Plan are governed by Division 2 of Part 33 of the *Telecommunications Act 1997* (**TA**). Our Clients note that Division 2 of Part 33 of the TA:

- contemplates two distinct time periods as follows:
  - the period from when the SSU comes into force until the 'designated day' (the **Interim Period**)[3]; and
  - the period after the designated day[4] (i.e. the period after Telstra's structural separation has been completed);
- contains express prohibitions on the ACCC accepting the SSU, unless the SSU meets the requirements of:

[1] See: http://www.accc.gov.au/content/index.phtml/itemId/801246
[2] See: http://www.accc.gov.au/content/index.phtml/itemId/806792
[3] See s.577A(2)(c) and (d) of the TA.
[4] See s.577A(1)(a) of the TA.

  - s.577A(3) of the TA (i.e. transparency and equivalence during the Interim Period); and
  - the requirements of s.577A(5) of the TA (i.e. monitoring of Telstra's compliance with the SSU);
- provides a distinct test for the Migration Plan[5]; and
- prescribes matters that the ACCC must have regard to when it is considering whether to accept the SSU[6].

In light of the distinct legal tests that are contained in Division 2 of Part 33 of the TA, these submissions will address the following in turn:

- Issues relating to transparency and equivalence during the Interim Period (i.e. issues that go to s.577A(3) of the TA).
- Issues relating to the ACCC's monitoring of Telstra's compliance with the SSU (i.e. issues that go to s.577A(5) of the TA).
- Issues relating to the migration to the NBN, including issues that go to whether the Migration Plan complies with the Migration Plan Principles.
- Issues relating to the overall effect of the SSU, including issues that relate to matters that the ACCC is required to have regard to when considering whether to accept the SSU.

3. EXECUTIVE SUMMARY AND OVERVIEW

3.1 Transparency and Equivalence during the Interim Period

Our Clients submit that the ACCC cannot accept the SSU because it does not satisfy the requirements of s.577A(3) of the TA.

The SSU does not satisfy the requirements of s.577A(3)(a) of the TA because the scope of Telstra's commitment to equivalence is not wide enough. Telstra does not even purport to provide price equivalence in respect of:

- Future regulated services.
- Declared services to which the standard access obligations are inapplicable.
- Telstra Exchange Building Access (**TEBA**).

The SSU does not satisfy the requirements of s.577A(3)(b) of the TA because the purported transparency and equivalence provisions in the SSU are not fit for purpose for the following reasons:

[5] i.e. the test in s.577BDA(2) of the TA - the ACCC must accept the migration plan if it complies with the Migration Plan Principles.
[6] This requirement is imposed by s.577A(6) of the TA.

- The Independent Telecommunications Adjudicator scheme is fundamentally flawed.
- The ACCC is given insufficient power to oversee and enforce the SSU.
- Access seekers are expressly prevented from directly enforcing the SSU.
- The provisions relating to wholesale ADSL (**WDSL**) are limited and completely inadequate and do not come anywhere near what is required to address Telstra's anti-competitive behaviour relating to wholesale ADSL.
- The provisions relating to TEBA are inadequate.
- Wholesale customers may have difficulty obtaining the rate card prices.
- The Service Level Guarantee Scheme is flawed.
- The SSU adopts certain existing processes that do not meet the requirement of equivalence.
- The ring fencing provisions are weak and ineffective.

Further detail on each of these points is provided in section 4.2 below.

3.2 Monitoring of Telstra's compliance

Our clients submit that the ACCC cannot accept the SSU because it does not satisfy the requirements of s.577A(5) of the TA because the SSU fails to provide for monitoring of compliance after the designated day. Further detail is provided in section 5 below.

3.3 Issues relating to migration to the NBN

(a) The Migration Plan

Our Clients submit that the Migration Plan does not comply with the Migration Plan principles because:

- The fundamental flaws with the Independent Telecommunications Adjudicator scheme, as relevant to disputes arising under the Migration Plan, mean that the Migration Plan does not provide for an 'adequate' dispute resolution process, as required by Migration Plan Principle 33.
- Contrary to Migration Plan Principle 8(d), the Migration Plan does not prevent Telstra from charging disconnection charges to wholesale customers in respect of non declared services migrated to the NBN, in circumstances where Telstra Retail would not incur equivalent charges.

(b) Wider issues relating to the NBN

Our Clients have identified three NBN related issues that are related to the SSU which have the affect of adversely affecting competition. These are:

- The fact that Telstra is being compensated by NBN Co to decommission its copper infrastructure whereas NBN Co will not be compensating access

seekers for their copper based infrastructure (for example DSLAMs) that the NBN will make obsolete.

- NBN Co potentially being given preferential access to Telstra's ducts.
- The ability of Telstra and/or NBN Co to vary the Definitive Agreements between Telstra and NBN Co (**DAs**).

The ACCC must have regard to these issues[7], and the potential impacts of these issues on competition, when considering the SSU. Further detail is provided in section 6 below.

3.4 The overall effect of the SSU

An assessment based on a comparison of the 'future with / future without' is an extremely complicated exercise. This is for three reasons.

Firstly, if, as in this case, the SSU does not satisfy the requirements of s.577A(3) and s.577A(5) of the TA, there can be no 'future with' the particular SSU that is before the ACCC for consideration, because if the SSU does not satisfy .577A, it cannot be accepted.

Secondly, there are two distinct periods to consider:

- the Interim Period; and
- the period after the designated day.

Thirdly, it is not clear what the precise counterfactual will be. Although it can be concluded with relative certainty that if Telstra does not voluntarily structurally separate, it will be compelled to undertake functional separation in accordance with Part 9 of Schedule 1 to the TA, many of the provisions in Part 9 of Schedule 1 to the TA give the Minister and the ACCC considerable discretion. Therefore, the precise form that this functional separation might take is unknown.

As regards the effect on competition and consumers, our Clients submit that the following are fairly uncontroversial conclusions, all other things being equal:

1. Functional separation would be more desirable than transparency and equivalence during the Interim Period.
2. Structural separation would be more desirable than functional separation after the designated day.

Our Clients believe that the conclusion at 1 above has implications for how the ACCC goes about applying s.577A(3) of the TA. This is because, ultimately, what is 'appropriate and effective' transparency and equivalence involves a degree of subjectivity. This means that the ACCC has considerable discretion when applying s.577A(3) of the TA. Our Clients acknowledge that the transparency and equivalence provisions are not intended to go as far as functional separation. However, given the reasons underlying the need for structural reform, and the fact that the transparency and equivalence provisions in the SSU are intended to be a

[7] By virtue of clause 4(d) of *Telecommunications (Acceptance of Undertaking about Structural Separation - Matters) Instrument 2011.*

substitute for functional separation during the Interim Period, it is submitted that the ACCC should 'set a high bar' in terms of the requirements for transparency and equivalence. Otherwise, there is unlikely to be any significant benefit from structural reform until after the designated day.

As regards the conclusion at 2 above, given that we already know that the form of structural separation that will take place after the designated day would:

- not address Telstra's horizontal integration; and
- not fully address Telstra's vertical integration (i.e. Telstra will still own exchanges and backhaul infrastructure)[8],

it could be argued that, when consideration is given to the particular form of structural separation that is provided for under the legislation, functional separation might be more desirable in terms of the impact on consumers and competition. That said, our Clients acknowledge that the ACCC must consider all of the statutory criteria, and some of the matters that the ACCC is required to consider clearly favour a form of structural reform that would see Telstra migrate its customers to the NBN rather than potentially compete with the NBN. Further detail is provided in section 7 below.

4. TRANSPARENCY AND EQUIVALENCE

Section 577A(3) of the TA provides that the ACCC must not accept Telstra's SSU unless the ACCC is satisfied that:

- the SSU provides for transparency and equivalence in relation to Telstra's supply of regulated services to Telstra's wholesale customers and retail business units during the Interim Period; and
- the SSU does so in an appropriate and effective manner.

Our Clients believe that the SSU as currently drafted does not meet the requirements of s.577A(3) of the TA for the following reasons:

- the scope of Telstra's commitment to equivalence is not wide enough; and
- there are aspects of the SSU that result in a failure to provide for appropriate and effective transparency and equivalence during the Interim Period.

Each of these issues will be considered in turn.

4.1 The scope of Telstra's commitment to equivalence

Section 577A(3) of the TA provides as follows:

> *(3) The ACCC must not accept an undertaking under this section unless the ACCC is satisfied that:*

[8] These outcomes are the result of the carve outs contained in the *Telecommunications (Structural Separation Undertaking—Networks and Services Exemption) Instrument 2011*.

(a) the undertaking provides for transparency and equivalence in relation to the supply by Telstra of regulated services to:

(i) Telstra's wholesale customers; and
(ii) Telstra's retail business units;

during the period:

(iii) beginning when the undertaking comes into force; and
(iv) ending at the start of the designated day; and

(b) the undertaking does so in an appropriate and effective manner.

Section 577A(3) of the TA is part of a statutory mechanism for achieving transparency and equivalence during the Interim Period which works as follows:

- the ACCC must not accept the SSU unless satisfied that:
  - the SSU provides for transparency and equivalence (i.e. as per s.577A(3)(a)); and
  - that the manner in which the SSU provides for transparency and equivalence is appropriate and effective (i.e. as per s.577A(3)(b))

  (**the ACCC SSU Obligation**); and
- Telstra must comply with the SSU and, assuming the ACCC has complied with the ACCC SSU Obligation, the SSU will oblige Telstra to provide transparency and equivalence in relation to the supply by Telstra of regulated services during the Interim Period.

Note that for ease of expression the equivalence component of the requirement arising from s.577A(3)(a) will be referred to as **the Equivalence Obligation**.

It is important to note that s.577A(3) of the TA has two limbs[9] and each limb has distinct work to do. The work that the first limb of s.577A(3) of the TA does is to identify the obligations that the SSU must impose on Telstra. In other words, the first limb establishes the ‘what’. This ‘what’ consists of transparency and equivalence in relation to the supply of regulated services during the Interim Period. What is ‘equivalence’ and what is a ‘regulated service’ is defined by the legislation[10].

‘Equivalence’ is defined as:

equivalence in relation to terms and conditions relating to price or a method of ascertaining price; and equivalence in relation to other terms and conditions.

A ‘regulated service’ is defined as a declared service within the meaning of Part XIC of the *Competition and Consumer Act 2010* (**CCA**) or a service that is determined to be a regulated service by the Minister. It is important to note that these definitions are set by the legislation. They are not negotiable.

[9] i.e. s.577A(3)(a) is the first limb and section 577A(3)(b) is the second limb.
[10] See clause 69 of Division 1 of Part 9 of Schedule 1 to the TA.

The work that the second limb of s.577A(3) of the TA does is to dictate the manner in which the obligations that are identified in the first limb are complied with. In other words, the second limb establishes the 'how' (i.e. transparency and equivalence in respect of regulated services must be delivered by the SSU in a manner that is appropriate and effective). It is important to note that the first limb is not subject to the second limb. Therefore, it would be incorrect, and impermissible, for the ACCC to conflate the two limbs of s.577A(3) of the TA and read section 577A(3) of the TA as if it stated:

> *the undertaking must provide for effective transparency and equivalence in relation to the supply of regulated services to the extent that this is appropriate*.

It is important to note that the statutory definition of 'equivalence' means that the Equivalence Obligation is not satisfied if equivalence in relation to price terms is not provided for in the SSU. In other words, merely providing equivalence in respect of non price terms will not satisfy the Equivalence Obligation. Given this fact, it is submitted that the following omissions or carve outs in respect of price equivalence result in the SSU not providing for the full scope of the Equivalence Obligation, and thereby oblige the ACCC to reject the SSU by virtue of the first limb of s.577A(3) of the TA:

- There is no provision for price equivalence in respect of future regulated services.
- Price equivalence in respect of declared services to which the standard access obligations (**SAOs**) are inapplicable (**Exempt Services**) is expressly carved out[11].
- There is no provision for price equivalence in respect of TEBA.

Each of these issues will be considered in turn.

(a) **Price equivalence for future regulated services**

The SSU effectively locks in what purports to be price equivalence to those services which currently meet the definition of 'regulated service'[12]. To tie the price equivalence component of the Equivalence Obligation only to current regulated services may lead to a situation where Telstra has no obligation during the Interim Period to provide price equivalence in respect of a service that was not a regulated service at the time the SSU came into force but has subsequently become a regulated service. It is submitted that the potential existence of this situation would be contrary to the Equivalence Obligation because:

[11] Telstra originally attempted to carve out the entire Equivalence Obligation from applying to Exempt Services. However, Telstra has subsequently limited this carve out to price terms only, following concerns raised by the ACCC.

[12] This is due to the fact that the mechanism that Telstra uses to achieve price equivalence is reliant on a 'Rate Card' which only applies to 'Reference Services' (see clause 17.1 of the SSU and clauses 1.1 and 1.2 of Schedule 8 of the SSU). 'Reference Services' are exhaustively defined by reference only to current regulated services, thereby locking in the obligation to provide price equivalence to current regulated services.

- s.577A(3)(a) of the TA requires the Equivalence Obligation (including equivalence as to price) to apply to all regulated services throughout the Interim Period; and
- the definition of 'regulated services' contemplates that services that do not currently satisfy the definition may do so in the future (i.e. additional services may be declared by the ACCC or determined to be regulated services by the Minister).

(b) **Price equivalence in respect of Exempt Services**

It is important to note that notwithstanding that the SAOs may be inapplicable to Exempt Services, Exempt Services still have the status of declared services under Part XIC of the CCA[13]. Therefore, Exempt Services come within the definition of 'regulated service' for the purposes of the Equivalence Obligation. Given that the legislature has deliberately chosen to define 'equivalence' and 'regulated service' in the way that it has, there is no scope for the ACCC to 'read down' the scope of the Equivalence Obligation by accepting an SSU that clearly and expressly attempts to carve out price equivalence from applying to regulated services simply because the SAOs do not apply.

Furthermore, even if such 'reading down' of the Equivalence Obligation were permissible, it is not appropriate to do so. The only possible justification for not including the Exempt Services within the scope of the Equivalence Obligation is the fact that the SAOs are inapplicable to the Exempt Services. It is submitted that this fact is of no relevance to the Equivalence Obligation. The fact that the statutory definition of 'regulated service' includes two services to which the SAOs do not apply[14], clearly shows that it was not intended that the reach of the Equivalence Obligation should be determined by the extent to which the SAOs apply. In light of this, there is no justification for not applying the Equivalence Obligation to a regulated service, or a subset of that regulated service, simply on the basis that the SAOs are inapplicable. The Equivalence Obligation is a specific legislative measure that is part of a wider reform of the industry. Therefore, the Equivalence Obligation is an entirely separate obligation from the obligation to comply with the SAOs, and it should be treated as such.

(c) **Price Equivalence in respect of TEBA**

As TEBA is a regulated service, the Equivalence Obligation requires Telstra to provide price equivalence in respect of TEBA. As the SSU makes no provision for price equivalence in respect of TEBA, the ACCC SSU Obligation prevents the ACCC from accepting the SSU[15].

(d) **Conclusion on the scope of Telstra's commitment to equivalence**

It is submitted that the requirements of s.577A(3)(a) of the TA impose an obligation on the ACCC not to accept the SSU unless the SSU provides for equivalence (as defined in the legislation) in respect of regulated services (as defined in the

[13] Clause 5 of the Final Access Determinations Nos.1 to 6 of 2011 for Fixed Line Services provides the current basis for the exemptions in respect of Wholesale Line Rental, Local Call Service and PSTN OA.
[14] i.e. Wholesale ADSL Layer 2 and Telstra Exchange Building Access - see *Telecommunications (Regulated Services) Determination (No.1) 2011.*
[15] Consideration of the application of the Equivalence Obligation to TEBA is provided in section 4.2(e) below.

legislation). It is submitted that, given this obligation, the ACCC cannot accept an SSU that:

- Does not provide for price equivalence in respect of future regulated services.
- Carves out price equivalence in respect of Exempt Services.
- Does not provide for price equivalence in respect of TEBA.

It is submitted that the best way for the SSU to ensure that the Equivalence Obligation will be of sufficient scope is to include a generally applicable overriding commitment to equivalence.

4.2 The provision of appropriate and effective transparency and equivalence

This section of these submissions involves consideration of whether s.577A(3)(b) of the TA is satisfied. Our Clients note that s.4(g) of the *Telecommunications (Acceptance of Undertaking about Structural Separation - Matters) Instrument 2011* (**the SSU Instrument**) provides a non exhaustive check list of relevant matters for the ACCC to consider. While it is obviously appropriate for the ACCC to have regard to the check list specified in s.4(g) of the SSU Instrument, it is submitted that it is also important for the ACCC to have regard to:

- the ordinary meaning of the words 'appropriate' and 'effective'; and
- the relevant historical context which has led to the Government's decision to require structural reform of the telecommunications industry.

The ordinary meaning of the word 'appropriate' as taken from the Macquarie Dictionary is:

> *suitable or fitting for a particular purpose.*

The ordinary meaning of the word 'effective' as taken from the Macquarie Dictionary is:

> *producing the intended or expected result.*

It is submitted that applying the ordinary meaning of the words 'appropriate' and 'effective' results in s.577A(b) of the TA prescribing a 'fit for purpose' test.

Having regard to the relevant historical context, it is clear that the intended or expected purpose or result of the interim transparency and equivalence obligations is to address the issues that have arisen from Telstra's vertical integration[16]. It is submitted that consideration of the relevant historical context is not complete without having due regard to Telstra's past conduct. This past conduct includes:

---

[16] See Explanatory Memorandum to the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, at p.10.

- Engaging in anticompetitive conduct[17].

- A refusal to provide access seekers with ACCC indicative pricing voluntarily[18].

- Unmeritorious legal challenges to ACCC arbitration decisions[19].

- An unmeritorious legal challenge to the constitutionality of the telecommunications access regime[20].

Our Client's believe that Telstra's past conduct leads to the obvious conclusion that Telstra cannot be trusted to regulate itself, particularly when its ongoing horizontal and vertical integration and market dominance give it a clear ability and incentive to engage in anticompetitive conduct. Our Clients believe there is no evidence to suggest that Telstra has turned over a new leaf[21]. For example, Telstra has not offered the Rate Card prices in advance of the SSU coming into force (i.e. in circumstances where it is not obliged to do so). Therefore, as a matter of general principle, a situation where Telstra is simply trusted to 'do the right thing' as regards any aspect of transparency or equivalence, should be avoided. Accordingly, if the SSU results in Telstra being able to regulate itself as regards any aspect of transparency or equivalence, the SSU would not be fit for purpose.

As regards specific issues arising from the SSU, our Clients submit that for the following reasons the SSU is not fit for purpose:

- The Independent Telecommunications Adjudicator (**ITA**) scheme is fundamentally flawed.

- The ACCC is given insufficient power to oversee and enforce the SSU.

- Access seekers are expressly prevented from directly enforcing the SSU.

- The provisions relating to WDSL are limited and completely inadequate and do not come anywhere near what is required to address Telstra's anti-competitive behaviour relating to WDSL.

- The provisions relating to TEBA are inadequate.

- Wholesale customers may have difficulty obtaining the Rate Card prices.

- The Service Level Guarantee Scheme is flawed.

---

[17] This has resulted in the ACCC issuing eight competition notices to Telstra, and has also resulted in the ACCC taking Federal Court action against Telstra - see for example - *Australian Competition and Consumer Commission v Telstra Corporation Ltd* [2010] FCA 790.

[18] This contributed to the disproportionately high number of access disputes under the telecommunications access regime as compared to access regimes for other industries.

[19] See: *Telstra Corporation Limited v Australian Competition and Consumer Commission* (2008) 171 FCR 174; and *Telstra Corporation Limited v Australian Competition and Consumer Commission* (2009) 179 FCR 437.

[20] See *Telstra Corporation Limited v the Commonwealth* [2008] HCA 7.

[21] On the contrary Telstra's current ADSL pricing effects a price squeeze - see section 4.2(d) of these submissions.

- The SSU assumes that certain existing commitments meet the requirements of equivalence and transparency.
- The ring fencing provisions are weak and ineffective.

Each of these issues will be considered in turn.

(a) The ITA

There are obvious flaws in the ITA scheme as follows:

- Telstra is able to control the board of the ITA.
- The interim transparency and equivalence obligation under the SSU is an obligation imposed on Telstra. It is not an obligation imposed on access seekers. Therefore, while it is appropriate for the ITA to investigate equivalence complaints by access seekers, it is not appropriate that:
  - access seekers should have to pay for the ITA scheme; or
  - the ITA should be able to make non appealable decisions that are binding on access seekers[22].
- The ITA does not have the power to deal with pricing related disputes. Given that equivalence as to price is a core component of the Equivalence Obligation, this is unacceptable unless the ACCC is given power to deal with pricing related disputes.
- The ITA can only deal with systemic or process issues that have previously been raised with Telstra under the 'Telstra Accelerated Investigation Process'. This is an unnecessary and unjustified limitation on the jurisdiction of the ITA.
- The ITA's power to make a binding decision is subject to a monetary cap. This is unacceptable unless the ACCC is given power to deal with disputes above the monetary cap.

Given these serious flaws in the ITA scheme, it may be simpler for the SSU to provide that the ACCC exercise the dispute resolution function.

(b) The ACCC's powers

A number of provisions in the SSU provide for ACCC involvement but limit that involvement to 'reaching agreement' with Telstra[23]. Furthermore, before the ACCC is able to take direct enforcement action in respect of a failure by Telstra to meet the service quality and operational equivalence measures, Telstra's failure to comply must not be an 'isolated incident', must be 'material' and must form part of a 'demonstrated pattern of repeated non-compliance'[24]. It is submitted that these provisions are palpably ineffective enforcement measures. It is submitted that in

[22] Compare the Telecommunications Industry Ombudsman's Scheme which exists to investigate consumer complaints but is not funded by consumers and is not able to make binding non appealable decisions against consumers.
[23] See for example clauses 2.3, 2.4 and 4.1 of Schedule 8 of the SSU.
[24] See clause 10.7(c) of the SSU.

order to be fit for purpose, the SSU must give the ACCC full power to oversee and enforce all aspects of the SSU (including the power to fully review and make a binding determination in respect of any aspect of price setting by Telstra), and it should be for the ACCC, and not Telstra, to set the parameters under which the ACCC will exercise its powers in any given case.

(c) **Enforcement of the SSU by access seekers**

Clause 7.4 of the SSU prevents access seekers from directly enforcing Telstra's transparency and equivalence obligations under the SSU. Given that the transparency and equivalence obligations have a direct impact on access seekers and may be crucial to allow access seekers to compete with Telstra, it is inappropriate to deny access seekers the right to enforce these obligations.

(d) **WDSL**

In order to be fit for purpose, the provisions in the SSU relating to WDSL would have to ensure that wholesale customers and Telstra business units acquiring WDSL operated on the same costs basis and the same terms. The SSU does not do this, but rather provides Telstra's retail business units with a clear competitive advantage. As the ACCC is aware, our Clients have for several years sought regulatory intervention as a result of their considerable concerns about the anti-competitive effect of Telstra's retail and WDSL pricing structures. It is our Clients' view that Telstra's conduct has caused and continues to cause serious anti-competitive effects in regional and rural markets for broadband services. In its current form, the SSU would cement this conduct and its resulting detrimental impact on competition. In addition to being relevant to s.577A(b) of the TA, this is also relevant to the ACCC's consideration of s.577A(6)(ab) of the TA. It remains our Clients' firm view that the anti-competitive problems associated with WDSL must be addressed through the ACCC issuing a Competition Notice regarding Telstra's conduct in the market for wholesale broadband services in rural and regional markets; and in parallel, the ACCC commencing an inquiry into declaring WDSL and setting regulated pricing. Though acceptance of the SSU does not necessarily prevent other regulatory action, it would suggest that the ACCC considers the SSU would provide an acceptable level of competition in all geographic fixed broadband markets. Our Clients consider that this is not correct. With this in mind we agree with the ACCC's comment that there is potential for WDSL to be declared and subject to an access determination[25]. Therefore, at the very least the WDSL reference price should provide that it is overridden by an access determination, in the event that the ACCC declares a WDSL service.

Telstra's proposed price equivalence and transparency measures in regards to WDSL would allow Telstra to continue to leverage its dominant position as sole supplier of WDSL services in many regional and rural areas in a manner that strongly favours its own retail business and is very detrimental to competition. Telstra has conceded that the proposed pricing[26] is actually higher than some instances of current pricing[27]. We consider it very unlikely that Telstra is selling WDSL to any competitor, including favoured resellers without DSLAMs, at below cost rates, i.e. below the price its own retail business units would pay. We are not aware of any instance ever where Telstra has willingly offered a reasonable cost

[25] Discussion Paper, p.83.

[26] A guide to Telstra's price-related interim equivalence and transparency obligations – 5 September 2011, p.4.

[27] See Telstra's submission to the ACCC dated 5 September 2011 in which it refers to some wholesale customers negotiating lower prices than the WDSL reference price.

based price to its wholesale customers. Rather, in every instance, Telstra has only lowered its wholesale prices when forced to do so by the ACCC after years of expensive disputes instigated by access seekers. There are many repeated instances of this conduct by Telstra in regards to declared services. For this reason, we consider that Telstra's concession that some wholesale customers already receive WDSL at rates below its proposed reference price is cogent circumstantial evidence that the reference price does not reflect Telstra's underlying costs and cannot be regarded as providing price equivalency. In light of this, the WDSL and AGVC pricing proposed by Telstra cannot improve the current situation, and may actually worsen it.

As reported in the media, in July 2011 Internode significantly increased its retail rates for off-net retail DSL services. This was necessary in order to limit its ongoing financial loss. These new rates were a substantial increase on Internode's previous retail rates and are significantly higher than Telstra's retail rates. There is little doubt that the effect of this price rise will be that Internode's customers will churn away, most likely to Telstra, with the result that Internode will gradually exit the regional and rural markets for broadband services. Internode has absolutely no wish to 'exit the bush' but Telstra's anti-competitive conduct and the ACCC's decision to postpone regulatory action have resulted in Internode simply being unable to compete in this market without putting its ongoing viability at risk. Acceptance of the SSU and Telstra's proposed WDSL pricing will entrench this trend.

There has already been substantial churn of WDSL end-users from Internode to Telstra in regional and rural markets. Prior to Telstra's ADSL price squeeze, which commenced in mid 2010, Internode never experienced a net loss of its WDSL customers, however, this trend is now entrenched and looks likely to continue or increase. Telstra's SSU does not address this anti-competitive situation in any way whatsoever, but rather actually potentially worsens the situation. As pointed out by the ACCC[28], s.152ER(3) of the CCA prohibits the ACCC from performing a function or power under Part XIC of the CCA that would prevent Telstra from complying with its undertaking. If WDSL is declared, as our Clients submit it should be, then the ACCC would be limited in its ability to make an access determination that is contrary to the WDSL reference price set by Telstra as part of its SSU. This is an unacceptable situation.

Attached as a confidential annexure to this submission is an imputation test table, that is based upon Telstra's retail ADSL and phone plans, its proposed WDSL port charges, AGVC charge, and WLR charges. The table contains Internode's internal cost data, which is the reason for its confidentiality.

When Telstra's proposed WDSL pricing is compared against its retail plans a price squeeze is shown to exist, i.e. the wholesale rate is too high to allow a competitor to match Telstra's retail rates.

The price squeeze is particularly apparent in regards to:

- Bundled phone/broadband plans – as a result of Telstra's retail discount for bundles.
- Higher data usage plans - as a result of the greater allocation of AGVC and other network costs to those plans.

[28] Discussion Paper, p.17.

Our Clients believe that Telstra's conduct in regards to WDSL amounts to anti-competitive conduct in breach of the competition rule set out in s.151AK of the CCA and that contrary to s.151AJ(2) of the CCA, Telstra is taking advantage of its substantial degree of power in the markets for wholesale and retail broadband services with the likely effect of substantially lessening competition in the regional and rural markets for:

- retail broadband services;
- subscription TV services; and
- backhaul services.

This anti-competitive conduct is having, and will continue to have, a most detrimental effect in the large number of exchange service areas (**ESAs**) without competitive infrastructure, which are in regional and rural areas and commonly referred to as Zones 2 and 3 by Telstra. To put this in context, there are about 2340 ESAs where Telstra is the only infrastructure owner and where broadband can only be provided to consumers via Telstra retail or a reseller using Telstra's WDSL.

In all of these ESAs, our Clients cannot match Telstra's retail fixed broadband prices because Telstra's wholesale charges are too high, both currently and in the SSU's proposed pricing. Competitors that are unable to match Telstra's prices are being pushed out of large geographic areas of the market for broadband services. This has, and will continue to, substantially lessen competition in these markets. We submit that for the following reasons, this results in the ACCC being unable to accept Telstra's SSU for the following reasons:

- s.577A(3)(b) of the TA: the SSU does not provide for pricing that results in appropriate and effective equivalence in relation to Telstra's supply of WDSL, particularly when bundled with WLR.

- s.577(6)(a) of the TA and s.4(a) of the SSU Instrument: by failing to provide reasonable WDSL pricing, the SSU is detrimental to broadband competition in regional, rural and remote areas, which militates against achievement of the Government's policy objective of improving the accessibility and quality of broadband for consumers in those areas.

- s.577(6)(a) of the TA and s.4(c) of the SSU Instrument: by failing to provide reasonable WDSL pricing, the SSU will restrict the economic benefits that could flow to consumers in regional, rural and remote areas as a result of increased competition.

In assessing the SSU's WDSL proposals against s.577A(b) of the TA and s.4 of the SSU Instrument, we request the ACCC to consider the following points:

- Our Clients estimate that about 46% of the Australian population live in areas that are not served by any competitive fixed line infrastructure as a result of being in ESAs without competitive infrastructure or being connected via RIMs, making it impossible to connect to the Internet except via Telstra retail or WDSL. This emphasises the importance of competitive WDSL pricing for the benefits of competition to reach significant parts of the country.

- The initial Wholesale ADSL Reference Price will be published by Telstra three months after the Commencement Date. It is not clear when the Commencement Date will actually occur, but it is definitely at least still some months away. Further, it is not reasonable for Telstra to wait a further three months after that time to put the regulated pricing in place. This extended time period (three months, plus the time it takes an ISP to reprice its products and update its 'back-end' IT systems and websites) allows Telstra the opportunity to keep using its dominance to damage fixed broadband competition in rural and regional markets.

- Telstra's undertaking relates only to wholesale ADSL2+ services. Telstra will not be required to provide access to lower speed wholesale ADSL services on regulated terms. Currently ADSL2+ is available in about 1,979 ESAs, leaving 807 ESAs where only ADSL is available to provide fixed broadband services. Telstra's SSU ADSL2+ proposal does not cover these services, which will remain unregulated.

- Telstra is offering different prices for metro and regional/rural ESAs. Higher prices in regional/rural ESAs will hinder the growth of competition in those areas. The unfavourable position for rural/regional consumers is further emphasised by the fact that there is very limited DSLAM based competition in those areas. The WDSL pricing proposed by Telstra will hinder competitors creating sufficient customer base to warrant the establishment of infrastructure based competition.

- Telstra is not offering a regulated price that is based upon a bundle of WLR and ADSL2+. A significant percentage of iiNet's and Internode's retail customers that do not buy a naked DSL service instead buy a bundled DSL and WLR product. Bundling is a common and cost effective option that consumers prefer due to lower price and the convenience of a single bill. If the regulated WDSL price is only for a standalone ADSL2+ product, it will remain unviable to compete with Telstra, as Telstra's retail prices for bundled WLR/ADSL2+ products are discounted significantly compared to its retail prices for the standalone ADSL2+ product. In these circumstances, where competitors only have access to a wholesale charge that is based upon the far more expensive standalone ADSL2+ plans, the current situation, where they simply cannot compete with Telstra, will remain unchanged. A clear indication of this is gained by simply comparing Telstra's retail ADSL2+ standalone plans with its retail ADSL2+/WLR bundled plans. Telstra's standalone ADSL2+ retail plans are far more expensive than its bundled plans. As a result, if Telstra's SSU proposal is accepted and WDSL prices are based on Telstra's retail ADSL2+ standalone plans, WDSL prices will remain unreasonably high and competition will suffer. To provide equivalence, there must also be a reasonable and regulated price for a WLR/ADSL2+ bundle in order for Telstra's undertaking to have a beneficial effect on competition.

- The importance of this is further emphasised when the NBN is taken into consideration, where basically the mantra will be 'whoever bundles, wins'. Firstly, bundled consumers will most likely simply be transposed to the NBN by the same service provider. However, if the consumer uses different service providers for broadband and phone, the consumer will choose between the service providers when their services are transposed to the NBN. Secondly, the NBN pricing structure is such that all services will be a broadband/voice bundle. It will be prohibitively expensive for a consumer

to have a different service provider for each product. In the lead up to the NBN, it is vitally important that service providers can compete for the voice and broadband bundle on reasonable terms. At present, Adam Internet does not offer a retail voice product via WLR, though it has been in negotiations with Telstra to acquire this product so that it can provide a bundled product.

- Telstra does currently offer a WDSL/WLR bundle, though, to the knowledge of our Clients, only in limited geographic areas where there is or likely to be DSLAM based competition. The SSU does not include this bundling offer, meaning that acceptance of the SSU would result in an even worse environment for competition than already exists.

- Telstra is offering a regulated price based on RMRC, which the ACCC has previously decided to be an unsatisfactory costing methodology[29]. Given that the ACCC has only recently developed a model to estimate reasonable charges for fixed line services, WDSL prices should be based upon the same modelling and without the raft of exemptions included in Telstra's offer.

- It is not reasonable for the regulated price to only apply after the expiry of existing contractual terms between Telstra and wholesale customers, particularly as access seekers have been seeking reasonable WDSL access charges for years but have had no choice except to accept what Telstra puts on the table. Telstra should offer to implement the new charges immediately upon the access seeker's request. Though, given that the SSU prices are so unreasonable, this is unlikely to be an issue as we expect that most access seekers will not seek the SSU prices.

- The AGVC charges are calculated at an artificially low utilisation rate that does not take into account the likely exponential growth in internet usage that will be stimulated as people increasingly use high data websites and applications during the decade long migration to the NBN. It is not clear why BigPond's usage should bear any resemblance or have any connection to wholesale usage. Schedule 10 of the SSU is so vague that it is extremely unclear what the average charge will be based upon. For example, the wording allows T-Box and Foxtel content to be ignored and not taken into account in this measurement.

- The proposed $65 AGVC is uncompetitively high. This high AGVC rate, which we believe is not charged to BigPond, will allow Telstra to damage competition. This is particularly relevant in regards to the provision of IPTV, which is likely to become a major competitive differentiator in broadband markets. Telstra's BigPond TV is unmetered when supplied via Telstra's 'T-Box'.[30] As a result of the significant amounts of bandwidth that an IPTV service consumes, which would result in a service provider incurring incredibly high AGVC charges, no competitor providing broadband via Telstra WDSL ports could even consider offering a comparable service where IPTV is unmetered.

- The SSU does not remove Telstra's forced WDSL/AGVC bundling, which prevents WDSL acquirers buying backhaul off anybody but Telstra.

---

[29] With regards to WLR pricing.
[30] See http://www.bigpond.com/tv/tbox/

- The Wholesale ADSL Reference Price only applies in relation to wholesale services similar to the Wholesale ADSL Reference Service. This limits the ability of wholesale customers to compete by providing diverse services and products to the market.

- The Wholesale ADSL Reference Price will not be subject to any change where a Telstra retail ADSL price change results in a change of 5% or less of the headline monthly charge. There is no indication in the SSU as to whether the 5% is a cumulative or once off alteration. If this allows cumulative changes, then Telstra has the ability to reduce its retail charge several times but still not have to alter the Wholesale Reference Price. Even in the event that Telstra's intention is not to allow cumulative variations to its retail price to avoid corresponding variations in the wholesale price, a 5% variation gives Telstra an unreasonable and significant market advantage that should not be ignored if price equivalence is mandated.

- The Wholesale ADSL Reference Price will not be subject to change where a retail ADSL change only relates to products or plans targeting government and enterprise customers. Wholesale customers should be able to compete with Telstra in this valuable market on reasonable terms. By avoiding this, the SSU is not providing equivalence.

- The Wholesale ADSL Reference Price will not be subject to change where it relates to customised or other specialised pricing that is not mass marketed. Wholesale customers should be able to compete with and test new products on an equivalent basis to Telstra. Further the scope of this exception is very vague and has potential to allow Telstra to act anti-competitively but still be operating within the terms of its undertaking. For instance, the time period of a 'trial' and the size of a 'small group of customers' is not defined, unreasonably leaving both terms open to Telstra's interpretation.

- The Wholesale ADSL Reference Price will not be subject to change where it relates to 'bona fide short term discounts or promotional offers' that do not continue for over six months and are not the same as a promotional offer in the last six months. Again, wholesale customers should be able to compete with and test new products in the same manner as Telstra. This option should not be solely in Telstra's camp, as it will result in competitors appearing to lack innovation, which is not a good position in the ICT industry. The six month time lag between promotional offers also provides Telstra the opportunity to ramp up its marketing in bursts prior to and during 'promotional offers', which is a practice that is quite common in various industries. Where a pattern of regular promotional offers or sales exists, consumers can simply wait for the next 'promotional' offer to come along before purchasing a new service or product.

- The process in clause 4 of Schedule 8 of the SSU that provides for review of the Wholesale ADSL Reference Price should allow for the ACCC to make a final decision that is backdated to the date of notification referred to in sub clause 4.1 of Schedule 8 of the SSU. This would bring it into line with the process where Telstra requests a review.

- In correspondence to the ACCC dated 27 October 2010, Telstra conceded that it charges wholesale customers without DSLAMs (**resellers**) lower amounts to acquire WDSL than its wholesale customers with DSLAMs (**infrastructure owners**). As rightly pointed out by the ACCC, this has the potential to lessen competition in downstream markets as service providers with DSLAMs and higher WDSL costs will be at a competitive disadvantage and over time will be excluded from the market[31]. Telstra's WDSL reference price, and its supplementary submission of 5 September 2011, indicate that Telstra intends continuing to give resellers better WDSL terms than infrastructure owners. Telstra stated 'many wholesale customers have commercially negotiated different and in some case lower price points' than its rate card prices[32]. We do not accept that Telstra is selling WDSL to any wholesale customer below cost, therefore, the WDSL reference price must be in excess of its cost, demonstrating that the reference price will not provide price equivalence.

- It is not appropriate for WDSL reference prices to 'act as a ceiling for commercial negotiations' as stated by Telstra[33]. If the price is a ceiling then it is too high because it must by definition be more than Telstra's internal charge and therefore not equivalent.

- In addition to providing an equivalent price for WDSL, the SSU must provide a mechanism for that price to be immediately acquired as soon as the SSU comes into force. Without such a mechanism, the SSU does not comply with s.577A(3)(a)(iii) by providing equivalence during the period beginning when the undertaking comes into force.

(e) **TEBA**

As indicated by the ACCC[34], access seekers to the NBN will require:

- Access to space within Telstra exchanges in order to interconnect with the NBN. Access seekers will be able to obtain access to this space from NBN Co or from Telstra.

- Access to ducts or external interconnection cables in order to interconnect transmission facilities at Telstra exchanges. Access seekers will be required to seek either regulated or commercial access to this facility directly from Telstra.

Consequentially, there is potential for Telstra to continue to engage in discrimination in relation to access to exchange facilities. Telstra may also retain a competitive advantage in relation to its ongoing ownership of facilities. For instance, Telstra would self-supply exchange space rather than use the same processes as other access seekers in order to interconnect to the NBN.

Telstra's past and current practices strongly suggest that Telstra will use its control of this infrastructure to impede competition. The clear incentive remains for Telstra

[31] Discussion paper, p.81.
[32] Telstra, A guide to Telstra's price related interim equivalence and transparency obligations - 5 September 2011, p.1
[33] Telstra, A guide to Telstra's price related interim equivalence and transparency obligations - 5 September 2011, p.2
[34] Discussion paper, p.40

to use its control of necessary infrastructure in a manner that favours its retail business units. Relevant past practices include Telstra's exchange capping and queuing policies, which impeded and delayed the rollout of competitive DSLAM infrastructure into Telstra's exchanges for several years despite frequent complaints from access seekers. This was an effective means for Telstra to limit growth of competitive LSS and ULLS services. The ACCC is well aware of this issue, given that it successfully instigated Federal Court proceedings against Telstra in regards to this conduct. Telstra could attempt to argue that this issue has been resolved, but nonetheless it demonstrates Telstra's willingness and ability to engage in conduct designed solely to hinder competition, and further to vigorously defend its position when bought to task by the regulator.

Further anti-competitive practices relating to Telstra's infrastructure ownership have been raised in the 13 access disputes lodged by seven access seekers currently being arbitrated by the ACCC. These disputes relate to the charge that Telstra imposes for housing internal interconnection cables (**IIC**) in Telstra exchange buildings. The IIC is a cable that links competitive DSLAMs with Telstra's MDF in an exchange building and is necessary to acquire the LSS and ULLS. Though access seekers pay for the cable, its installation and it maintenance, they have to pay Telstra millions of dollars per annum to house the IIC. Our Clients consider that any costs that Telstra incurs because of IICs are already recovered through charges that include a network costs component, such as the ULLS and WLR, or alternatively via TEBA rack charges, which recover TEBA costs on a floor space allocation (though a review of Telstra's RAF data may reveal that all TEBA costs including rack costs are already recovered via Telstra charges attributed towards network costs).

Telstra's rate card does not address TEBA charges. In considering this point, the ACCC stated that competition concerns relating to TEBA have traditionally centred on non-price issues[35]. Traditionally, perhaps, this is true as Telstra has actively used non-price conduct to restrict TEBA access to the point that access seekers simply felt relieved to gain access at all so that they could get on with running their businesses. However, the lack of past disputes about TEBA charges should not be regarded as any indication that TEBA charges are reasonable, let alone equivalent. Rather, it is a symptom of the lack of information available to Telstra's competitors and the difficulty in obtaining information of a sufficient standard to assess the extent that TEBA charges are cost based. The fact that the ACCC is currently arbitrating 13 disputes about a TEBA charge that is necessary to access declared services clearly shows that TEBA price equivalence and transparency is a very important issue. Ensuring that TEBA terms are equivalent and transparent is an issue that the SSU must provide for in order to comply with s.577A(3)(a) and (b). If it does not do so, then the ACCC must not accept the SSU.

Our Clients consider it likely that both before and after the designated day, Telstra will continue such anti-competitive practices and continue to extract excessive monopoly rent from access seekers using its infrastructure. Accordingly, access seekers will operate on a higher cost basis to Telstra, which will impede the competitive benefits that structural reform is supposed to promote.

The ACCC correctly pointed out that Telstra's ability to reserve TEBA space is an example of where access seekers are not given equivalent rights[36]. We note the ACCC's concerns that if access seekers were given an equivalent right then they could abuse it by inflating their forecasts. Our Clients submit that this is not

[35] Discussion Paper, p.79.
[36] Discussion Paper, p.111.

particularly likely and our Clients are not aware of any evidence of past practices that support such a concern. In the event that such conduct was occurring, it could be addressed by ACCC intervention. Our Clients also agree with the ACCC's suggestion that equivalence in queuing is required to incentivise Telstra to minimise delays to accessing TEBA space. It is important that these issues are also considered in the context of the DAs and the conduct that would be authorised by s.577BA(3)(f)(iv) of the TA. It would be unreasonable and anti-competitive if either Telstra or NBN Co had any priority in accessing or reserving TEBA space.

(f) **Obtaining Rate Card prices**

The prices in the SSU do not automatically amend or override the CRA prices[37] and so wholesale customers may have to wait for the CRA to expire before getting the benefit of the SSU prices. This could significantly delay a wholesale customer from obtaining the benefit of the Rate Card prices. This is unacceptable.

(g) **The Service Level Guarantee Scheme**

The Service Level Guarantee Scheme is flawed for the following reasons:

- The rebates are too low to amount to an effective incentive for Telstra to comply with the Equivalence Obligation. Given that the rebates would be the wholesale customer's sole and exclusive remedy in respect of 'matters to be measured by the Equivalence and Transparency Metrics', this issue is significant.

- There are too many unnecessarily wide and unjustified carve outs to the Equivalence and Transparency Metrics[38]. For example, clause 11(a) of Schedule 3 of the SSU contains a carve out in respect of any Rollout Region which was in the course of being migrated to the NBN. Although it is acknowledged that migration to the NBN may affect Telstra's ability to meet some of the performance metrics, the carve out should not apply where the NBN rollout was not the cause of Telstra's failure to meet that performance metric.

(h) **Existing commitments**

Many of the provisions in the SSU are based on the assumption that, where the ACCC has set regulated terms of access, those terms of access will be sufficient to satisfy the requirements of transparency and equivalence. This is particularly evident as regards price equivalence. It is submitted that this approach is dangerous for two reasons:

- the specific criteria applied by the ACCC in setting particular terms may not have been based on the specific requirements of transparency and equivalence; and

- the regulated terms may not 'cover the field'.

Therefore, simply because the ACCC may have set some regulated terms in respect of a particular service, does not mean that the Equivalence Obligation has no work to do in respect of that service. This issue is of particular importance as regards the

[37] See clause 17.2(d) of the SSU.
[38] For example see, clause 15.1(e), Schedule 3 clause 11(a),(b) and Schedule 7 clauses 2 and 7.

ULLS. As the ACCC rightly points out, the Transparency and Equivalence Metrics as they relate to ULLS do not provide any improvements on current practice[39]. In light of this, it would appear that the Transparency and Equivalence Metrics that relate to ULLS are based on the assumption that current practice promotes effective equivalence. Given that the ACCC has recognised that the delay in activating ULLS services, as compared to other services (including those used by Telstra Retail), can put ULLS access seekers at a competitive disadvantage, this assumption must be wrong.

Furthermore, it should not be assumed that any improvement on current practice would necessarily meet the requirement of equivalence. For example, although Telstra commits to give wholesale customers 28 days notice in relation to DSL upgrades[40], this will not result in equivalence if Telstra Retail is given more than 28 days notice.

(i) **The ring fencing provisions**

Although our Clients acknowledge that the transparency and equivalence obligations do not require full functional separation, the transparency and equivalence obligations do clearly require that 'effective' measures be introduced. Our Clients believe that the ring fencing provisions in the SSU are likely to be only of cosmetic effect and will not be effective. Many of the provisions are either:

- subject to such wide exceptions as to make them of little value; or
- unlikely to be enforced.

Two examples are as follows:

- Although clause 8.10 of the SSU appears under the heading 'senior management' it contains a carve out in respect of those Telstra employees that have 'management responsibilities'. Given the size of Telstra, this carve out is likely to apply to a vast number of Telstra employees.
- The SSU prohibits staff of Telstra's Network Business Unit from engaging in 'Marketing Activity' on behalf of Telstra in circumstances where the relevant retail service is provided by a wholesale customer[41]. It is highly likely that Telstra will be either unwilling or unable to enforce this prohibition.

It is submitted that, in the absence of effective ring fencing measures in the SSU as currently drafted, the ACCC's approach in order to comply with s.577A(3)(b) should be to reject the SSU as currently drafted and then focus on:

1. identifying additional measures which would effectively promote transparency and equivalence; and
2. requiring Telstra to include those measures unless there is a good reason for not doing so (for example because the measures would lead to functional separation).

---

[39] Discussion Paper, at p.101.
[40] See clause 14(c)(ii).
[41] See clause 2 of Schedule 2 to the SSU.

Our Clients submit that an appropriate and effective measure that would promote equivalence would be for Telstra to allow access seekers to directly avail themselves of the services of Telstra's Network Business Unit for work that has a nexus to the supply or use of a regulated service[42], on a fee for service basis, with such fees being equivalent to the amount Telstra charges itself. Our Clients believe that this is an effective measure that is related to the ring fencing provisions but which does not require functional separation.

5. MONITORING OF COMPLIANCE

Our Client's agree with the ACCC's view[43] that the SSU's failure to provide for monitoring of compliance after the designated day requires the ACCC to reject the SSU in order for the ACCC to comply with s.577A(5) of the TA.

As regards the provisions for monitoring of compliance prior to the designated day, there is little point in Telstra being required to report to the ACCC if the ACCC does not have the power to do anything to address any non compliance identified in the Telstra reports. That said, our Clients acknowledge that s.577(A)(5) of the TA is a freestanding statutory test and therefore requires separate consideration. However, the fact that monitoring of compliance is given such important treatment adds weight to the conclusion that the SSU will not provide for appropriate and effective transparency and equivalence unless the ACCC has sufficient power to deal properly with non compliance that is identified as a result of the reports issued by Telstra in order to comply with the compliance requirements that s.577A(5) of the TA requires.

6. MIGRATION TO THE NBN

It is important to note that the Migration Plan does not deal with all aspects of migration to the NBN. It only deals with the disconnection of services from Telstra's network. In light of this, it is appropriate to distinguish between:

- issues that are relevant to whether the ACCC should accept the Migration Plan (**Migration Plan Issues**); and
- issues that are relevant to the migration to the NBN but which are beyond the scope of the Migration Plan (**Wider NBN Issues**).

6.1 Migration Plan Issues

The effect of s.577BDA(2) of the TA is that consideration of Migration Plan Issues is limited to considering whether the Migration Plan complies with the Migration Plan Principles. Our Clients submit that the Migration Plan does not comply with Principle 33 of the Migration Plan Principles because the fundamental flaws with the ITA referred to above, as relevant to disputes arising under the Migration Plan, mean that the Migration Plan does not provide for an 'adequate' dispute resolution process, as required by Migration Plan Principle 33.

Our Clients are concerned that migration to the NBN may involve Telstra charging for disconnection of services from its network in circumstances where Telstra Retail does not incur a similar charge. This situation would clearly be contrary to Migration Plan Principle 8(d) which requires equivalent treatment in respect of the disconnection from Telstra's network. However, this issue is complicated by clause

[42] For example, work related to the installation of a regulated service.
[43] Set out in section 11 of the Discussion Paper.

5 of the *Telecommunications (Migration Plan - Specified Matters) Instrument 2011* which expressly precludes the Migration Plan from dealing with (emphasis added):

> *The imposition of charges, either in the form of one-off or ongoing charges, with respect to the provision of access to **a declared service** supplied by Telstra*
>
> (**the Migration Plan Prohibition**).

It is submitted that even if the Migration Plan Prohibition prevents the Migration Plan from dealing with disconnection charges in respect of declared services[44], it does not, and should not, prevent the Migration Plan from providing a commitment, consistent with Migration Plan Principle 8(d), that Telstra will not charge a disconnection fee to wholesale customers in respect of non declared services in circumstances where Telstra retail does not incur a cost which is equivalent to the disconnection charge.

6.2 Wider NBN Issues

Section 4(d) of the SSU Instrument provides that for the purposes of s.577A(6)(a) of the TA, in deciding whether to accept Telstra's SSU, the ACCC must have regard to the conduct that would, as a consequence of acceptance of the SSU, be authorised under s.577BA of the TA. Section 577BA(3)(f)(iv) of the TA provides that once the SSU is accepted, conduct engaged in by Telstra or NBN Co to give effect to a provision of the DAs is authorised for the purposes of s.51(1) of the CCA and will be disregarded in deciding whether the parties have breached the provisions in Part IV of the CCA prohibiting restrictive trade practices. Accordingly, in considering the SSU, the ACCC must have regard to the DAs.

Details of the DAs have not been made public. Though summaries of the DAs have been published on the website of each company, the reality is that the brief overview provided is totally insufficient to explain details of all aspects of the arrangements. NBN Co has rejected a Freedom of Information request from one of our Clients asking for access to the agreement documents, relying on the FOI exemption for commercial sensitivity. Given that our Clients have been unable to review the DAs in full, it is not possible for our Clients to comment exhaustively on the DAs, and our Clients' comments are limited to identification of the following three issues which have the potential to adversely affect competition:

- The fact that Telstra is being compensated by NBN Co to decommission its copper infrastructure whereas NBN Co will not be compensating access seekers for their copper based infrastructure (for example DSLAMs) that the NBN will make obsolete.
- NBN Co potentially being given preferential access to Telstra's ducts.
- The ability of Telstra and/or NBN Co to vary the DAs.

These issues will be considered in turn.

(a) Compensation provided by NBN Co

[44] This is appropriate because any issues relating to charging for declared services can be dealt with in an access determination or binding rule of conduct.

Our Clients believe that a fact that the ACCC should not overlook is that Telstra is being compensated by NBN Co to decommission its copper infrastructure whereas NBN Co will not be compensating access seekers for their copper based infrastructure (for example DSLAMs) that the NBN will make obsolete. As a matter of principle, this is obviously unfair to access seekers. The provision of this 'war chest' to an already dominant player in retail markets gives Telstra a significant competitive advantage over access seekers.

(b) **Use of Telstra's ducts**

The size and reach of Telstra's underground duct network is such that the few alternative duct networks owned by other carriers are extremely insignificant in comparison. To our knowledge, all carriers with underground cables utilise Telstra ducts. Though Schedule 1 of the TA requires Telstra to provide other carriers with access to its ducts, its ownership of the network gives Telstra a considerable competitive advantage. We are aware that carriers consider Telstra's duct charges are excessive and not based upon Telstra's costs in providing the service, particularly as the cost of the duct network has been depreciated over many years. However, there is, of course, no alternative unless a carrier installs its own ducts, which is inefficient when space is available in Telstra's existing ducts. Access seekers are also required to sub-duct when using Telstra ducts, i.e. the access seeker installs a 32mm sub-duct into the Telstra duct and places its cable into the subduct. This adds to the access seeker's costs and takes up a lot more duct space. Telstra cables are not commonly sub-ducted, giving Telstra the ability to utilise its own network at far lower costs.

As stated above, details of all aspects of the arrangements between Telstra and NBN Co, including those relating to NBN Co's use of Telstra's ducts, have not been made public. There is a real concern that NBN Co will be given priority of duct space over other carriers, including those currently using Telstra ducts for competitive networks.

Pursuant to Part 5 of Schedule 1 to the TA, Telstra continues to have a statutory obligation to provide other carriers with access to its ducts. All carriers have a similar obligation in relation to a wide range of facilities. Schedule 1 provides that access will be on terms agreed between the carriers. Use of the ducts is commonly effected by a duct access agreement between Telstra and the second carrier, which is of course drafted by Telstra in a manner that protects its interests. Where the duct access agreement provides that Telstra can continue to deal with the licensed duct and the second carrier's occupation can be terminated upon notice by Telstra, then the second carrier's continued tenancy in Telstra's ducts is subject to Telstra requiring the duct for its own use or leasing the duct to somebody else, such as NBN Co.

Telstra's duct lease to NBN Co is clearly relevant to assessing the likelihood of whether existing carriers will be evicted from Telstra's ducts, though as we are not given access to the DAs we are uncertain to what extent. Any negative impact on other carriers whereby Telstra demands that a carrier remove its cables to make way for the NBN will depend on the amount of free space in the relevant ducts. We understand from discussions with carriers that in some areas there is very limited capacity in Telstra's ducts. Verifying the availability of space would most likely require physical inspection of the ducts, which would be a vast undertaking. We understand that Telstra's records of duct utilisation are often incomplete and further, will not always explain if ducts are blocked or otherwise unusable. News reports regarding NBN Co's rollout in the inner city Melbourne suburb of Brunswick said that

a lot of the underground duct in that location was blocked and unusable. If this is widespread, then there appears to be a reasonable likelihood that there will be areas where there is insufficient space in the ducts for NBN Co's cables unless other cables are removed. We consider it unlikely that Telstra will be removing any of its own cables where they can remain in use.

NBN Co has not publicly indicated that it will force other carriers to vacate Telstra's ducts when its lease takes effect, though such a result does seem entirely plausible if NBN Co deems that it needs to use the duct space that another carrier is using. Currently, proposed amendments to the *Telecommunications (Low-impact facilities) Determination 1997* will give NBN Co the right to install aerial cables. However, we expect that NBN Co will only install aerial cables as a matter of last resort as they are visually ugly and broadly disliked by residents and local councils. NBN Co is unlikely to take on such public outcry unless it has no other option.

The summary of the DAs on NBN Co's website says that Telstra will suffer monetary consequences for failing to make infrastructure available, clearly suggesting that it is in Telstra's financial interests to give NBN Co priority of access to ducts over other carriers. This in turn suggests that Telstra will be inclined to exercise any contractual right it has to terminate the access rights of other carriers in its ducts.

The $4 billion that NBN Co is reportedly paying to lease Telstra's ducts over 30 years is clearly not related to the value of the ducts or Telstra's costs in providing the service. In 2009, an ACCC report stated that the 2007-08 depreciated historic value of Telstra's ducts was about $3.9 billion. If NBN Co wanted to exercise its right as a carrier and to obtain duct access at reasonable rates, then failing agreement with Telstra, it could seek that the ACCC determine access rates via arbitration under Schedule 1 of the TA. It is hard to believe that the ACCC would determine that a reasonable charge for using part of Telstra's ducts would be more than the total depreciated historic value of the duct network. Clearly the political imperatives of rapid NBN rollout and getting Telstra on board outweighed the need for a reasonable commercial deal. Again, this suggests that NBN Co will be given priority in duct space as the financial benefit to Telstra is vast. Though access seekers pay Telstra for duct use, it is chicken feed compared to NBN Co.

There are also competitive advantages to Telstra in evicting wholesale customers, which are also its competitors, from its ducts. Telstra will still be able to provide services such as backhaul. Many users of Telstra's ducts also provide such services, but can't do so without access to the ducts. Other access seekers in Telstra's ducts provide dark fibre or managed services to government and corporate clients. If these access seekers are evicted from Telstra's ducts, Telstra has the opportunity to take over the business via the NBN, its wireless network, or its own backhaul network.

If the SSU is accepted and the DAs give NBN Co priority access, it will be difficult for affected access seekers to seek redress for conduct that would clearly affect their ability to compete. The ACCC has stated in its discussion paper that the acquisition of assets and rights of use of Telstra's infrastructure by NBN Co will have the benefit of the legislative authorisation[45]. This could be very detrimental to existing and future competition that relies on duct access. Accordingly, we ask that the ACCC give this issue serious consideration.

[45] ACCC, Acceptance of Telstra's Structural Separation Undertaking and draft Migration Plan - Discussion Paper, 30 August 2011, p.29, p.43.

(c) The ability of Telstra and/or NBN Co to vary the DAs

Our Clients agree with the ACCC's view that the absence of a mechanism in the DAs for regulatory assessment of variations to the DAs is a factor that militates against acceptance of the SSU[46].

7. THE OVERALL EFFECT OF THE SSU

Section 577A(6) of the TA requires the ACCC to have regard to a number of different matters (**Relevant Matters**). Our Clients are in broad agreement as regards the ACCC's approach in identifying issues that are relevant to s.577A(6) of the TA. However, an assessment based on a comparison of the 'future with / future without' is an extremely complicated exercise. This is for three reasons.

Firstly, if, as in this case, the SSU does not satisfy the requirements of s.577A(3) and s.577A(5) of the TA, there can be no 'future with' the particular SSU that is before the ACCC for consideration. In this situation the ACCC can:

- apply the 'future with / future without' analysis to a hypothetical SSU that meets the requirements of s.577A(3) and s.577A(5); or
- postpone its consideration of the Relevant Matters until it has an SSU before it that meets the requirements of s.577A(3) and s.577A(5); or
- not undertake a 'future with / future without' analysis.

Secondly, there are two distinct periods to consider:

- the Interim Period; and
- the period after the designated day.

Thirdly, it is not clear what the precise counterfactual will be. Although it can be concluded with relative certainty that if Telstra does not voluntarily structurally separate, it will be compelled to undertake functional separation in accordance with Part 9 of Schedule 1 to the TA, many of the provisions in Part 9 of Schedule 1 to the TA give the Minister and the ACCC considerable discretion. Therefore, the precise form that this functional separation might take is unknown.

In light of the above observations, it appears that the furthest a 'future with / future without' analysis can go is to consider the following high level questions in general terms:

- Whether transparency and equivalence is more desirable than functional separation during the Interim Period?
- Whether structural separation is more desirable than functional separation during the period after the designated day?

As regards the effect on competition and consumers, our Clients submit that the following are fairly uncontroversial conclusions to these general questions, all other things being equal:

---

[46] Discussion Paper at p.61.

1. Functional separation would be more desirable than transparency and equivalence during the Interim Period.

2. Structural separation would be more desirable than functional separation after the designated day.

Our Clients believe that the conclusion at 1 above has implications for how the ACCC goes about applying s.577A(3) of the TA. This is because, ultimately, what is 'appropriate and effective' transparency and equivalence involves a degree of subjectivity. This means that the ACCC has considerable discretion when applying s.577A(3) of the TA. Our Clients acknowledge that the transparency and equivalence provisions are not intended to go as far as functional separation. However, given the reasons underlying the need for structural reform, and the fact that the transparency and equivalence provisions in the SSU are intended to be a substitute for functional separation during the Interim Period, it is submitted that the ACCC should 'set a high bar' in terms of the requirements for transparency and equivalence. Otherwise, there is unlikely to be any significant benefit from structural reform until after the designated day.

As regards the conclusion at 2 above, given that we already know that the form of structural separation that will take place after the designated day would:

- not address Telstra's horizontal integration; and

- not fully address Telstra's vertical integration (i.e. Telstra will still own exchanges and backhaul infrastructure)[47],

it could be argued that, when consideration is given to the particular form of structural separation that is provided for under the legislation, functional separation might be more desirable in terms of the impact on consumers and competition. That said, our Clients acknowledge that the ACCC must consider all of the Relevant Matters, and some of these matters clearly favour a form of structural reform that would see Telstra migrate its customers to the NBN rather than potentially compete with the NBN.

Herbert Geer Lawyers on behalf of:

Adam Internet Pty Ltd,
iiNet Limited, and
Internode Pty Ltd.

27 September 2011

[47] These outcomes are the result of the carve outs contained in the *Telecommunications (Structural Separation Undertaking—Networks and Services Exemption) Instrument 2011*.