

**Submission by Herbert Geer Lawyers on behalf of:**

**Adam Internet Pty Ltd,**

**iiNet Limited,**

**Internode Pty Ltd,**

**Primus Telecommunications Pty Ltd, and**

**TransACT Communications Pty Ltd**

**in response to the ACCC discussion paper of December  
2011 into whether wholesale ADSL services should be  
declared under Part XIC of the *Competition and Consumer  
Act 2010***

## **A. INTRODUCTION**

This submission is provided on behalf of Adam Internet Pty Ltd, iiNet Limited, Internode Pty Ltd, Primus Telecommunications Pty Ltd, and TransACT Communications Pty Ltd (collectively, **our Clients**) in response to the ACCC's December 2011 discussion paper into whether wholesale ADSL (**WDSL**) services should be declared under Part XIC of the *Competition and Consumer Act 2010* (**the Discussion Paper**). This submission responds to the specific questions set out in the Discussion Paper.

## **B. EXECUTIVE SUMMARY**

Our Clients firmly believe that it is appropriate to declare WDSL for the following reasons:

- It will restrict Telstra's current ability to engage in anti-competitive conduct.
- It will promote competition in relevant markets.
- A regulated WDSL price is likely to be significantly lower than the current WDSL rate available to access seekers. This rate is likely to be passed on to end-users as part of the competitive process.
- Consumers will gain increased access to diverse products.
- Stimulating broadband competition in areas without competitive infrastructure in the transition to the NBN will help promote competition on the NBN.
- It will enable Telstra's competitors to build scale, which is necessary to compete on the NBN.

## **C. QUESTIONS RAISED IN THE DISCUSSION PAPER**

### **1. What is the relevant market for the purpose of this Discussion Paper and the application of the LTIE test?**

Our Clients agree with the market view expressed in the Discussion Paper<sup>1</sup>. Functionally, the important focus for the ACCC's assessment includes the retail market for downstream services used and acquired by end-users of telecommunications services, rather than simply the wholesale market in which WDSL is supplied. As stated by the ACCC, the relevant retail and wholesale product market includes bundled fixed telephone and high speed broadband, which can be provided over copper, HFC, optic fibre, and to some degree, wireless services. It is important to note that Telstra is also dominant in the supply of services over most of the networks that can supply substitutable products.

Our Clients consider that the beneficial effect of declaration of WDSL in terms of promotion of competition and improvement of the LTIE, will be most clearly felt in rural and regional areas where there are few, if any, substitutable products. However, they agree with the ACCC's view that it is appropriate for this assessment to be undertaken on a national basis, particularly as RIMs and pair gain systems are common in many metro exchange service

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<sup>1</sup> Discussion Paper pp12-14.

areas (**ESAs**) and prevent the competitive provision of ADSL via the LSS or ULLS to significant numbers of end-users.

**2. Do you consider that Telstra's wholesale terms and conditions inhibit competition? If so, what have been the effects on the ability of access seekers to compete?**

**3. Do access seekers have data to indicate the effect of Telstra's access terms on their ability to compete? Please indicate the relevant market shares of customers on-net and off-net.**

### Questions 2 and 3

Our Clients firmly believe that Telstra's WDSL terms and conditions inhibit competition. In particular, Telstra has leveraged its dominant position as sole supplier of wholesale broadband services in many regional and rural areas in a manner that strongly favours its own retail business and is very detrimental to competition. Telstra's wholesale pricing structure, which attacks competitors that own infrastructure in metro and CBD exchange service areas (**ESAs**), has in regional and rural markets resulted in Telstra's infrastructure based competitors either providing retail ADSL services over Telstra's WDSL network at a loss or having retail rates higher than Telstra Retail and in effect itself pricing themselves out of the market.

Each of our Clients own their own infrastructure. In the geographic areas where our Clients own infrastructure, they have been able to actively compete with Telstra. However, in order to compete with Telstra Retail in areas where they do not have infrastructure, our Clients have sold retail services provided via Telstra WDSL at a loss. For example, Adam Internet has calculated that it is losing \$21/month per subscriber that is serviced via WDSL rather than its own network<sup>[1]</sup>.

This has not surprisingly has proved unsustainable. Despite many requests over the past several years, Telstra Wholesale has not made any pricing offers that alter this situation. This has limited our Clients' ability to compete with Telstra in areas where they can only provide off-net services to end-users. Details of our Clients on-net and off-net service numbers are attached in **Annexure 2**. The data in this annexure is commercially sensitive and confidential.

An example of the detrimental effect that Telstra's conduct has on competition was demonstrated in July 2011 when Internode implemented new retail plans in the ESAs where it does not have its own infrastructure and supplies retail services over Telstra WDSL. The new plans were priced at rates to recover Internode's costs of providing the service. The new rates were a substantial increase on Internode's previous retail rates and are significantly higher than Telstra's retail rates. The effect of this price rise has been that Internode's customers have and continue to churn away, most frequently to Telstra, with the result that Internode expects that it 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 resulted in Internode being unable to compete in these geographic markets without putting its ongoing viability at risk. Prior to Telstra's implementation of an ADSL price squeeze, Internode never experienced a net loss of end-user customers that were serviced via WDSL, however, this trend, which commenced in August 2010, is now entrenched and looks likely to continue or increase. Graphs of Internode's churn data are attached at **Annexure 3(a)**. Graphs of Adam Internet's churn data is attached at **Annexure**

<sup>[1]</sup> See the attached **Annexure 1** for a breakdown of the costs incurred by Adam Internet and the method that this loss is calculated. Annexure 1 contains commercially sensitive information and is confidential in its entirety

**3(b).** Attached at **Annexure 4** is a table comparing Telstra's retail plans with the costs that Internode would incur to provide a similar retail service via Telstra WDSL and demonstrating the existence of a price squeeze. Attached at **Annexure 5** is a table from iiNet that compares the costs that it incurs in providing off-net and on-net retail bundles of voice, broadband and IPTV. The material in Annexures 3(a), 3(b), 4 and 5 is commercially sensitive and the annexures are confidential in their entirety

Our Clients have held back expansion into regional areas because WDSL costs are prohibitive. Internode stated that it would have deployed a DSLAM in Bordertown SA except that Bordertown has a very high RIM ratio which would mean the site would be unlikely to be profitable. Our Clients' WDSL agreements with Telstra specify very low download and upload limits for individual SIOs, which if exceeded permits Telstra to cancel the individual service.<sup>2</sup> Internode has instructed us that the Ordering and Provisioning Annex to CRA 71D contains a documented 30GB usage cap per service. Telstra can also impose speed restrictions on customers downstream of a RIM if they claim that the backhaul from the RIM is congested. Internode has checked customers on the list of speed restricted ports against its usage data and it appears that Telstra imposes such speed restrictions routinely as soon as a customer reaches 30GB in a month. We are not aware of any similar limitations being placed on Telstra's retail customers. Further, due to Telstra's exorbitant AGVC charge, it is simply not economically viable for our Clients to provide high quota plans on WDSL. Thus, Telstra has also effectively indirectly restricted access seekers from offering higher quota plans, which clearly makes access seekers less attractive to consumers..

A further example of the detrimental impact of Telstra's WDSL pricing structure on competition in rural areas was reported on 13 January 2012, when ClubTelco stated that it is reversing its national broadband retail pricing structure and implementing higher retail prices in regional and rural areas. ClubTelco is reported as stating that this is a result of a continuing discrepancy between metropolitan and rural Telstra wholesale pricing.<sup>3</sup>

**4. Are there any instances whereby delays in the negotiation of revised wholesale DSL charges following Telstra's retail price changes have affected the ability of access seekers to compete? If so, please specify the duration and impact of the delays.**

In response to the ACCC's 2010 consultation regarding the potential for an inquiry into declaration of WDSL, Telstra provided a submission dated 27 October 2010. Amongst other things, Telstra claimed that:

- it is impractical to signal proposed retail prices with competitors ahead of the disclosure of those prices to the market;
- it is incorrect to assume that wholesale customers are detrimentally affected by those delays;
- Telstra offered lower prices to its wholesale customers and invited them to negotiate further;
- finalisation of negotiations can take time; and
- most of Telstra's wholesale customers agreed to new pricing and most of the remainder were still involved in active negotiation with Telstra.

<sup>2</sup> Example: Adam Internet -Telstra CRA 71Gb, clauses 2.3 and 2.4 of Part B

<sup>3</sup> <http://www.itnews.com.au/News/286762,clubtelco-culls-national-price-scheme.aspx>

Delays in contract negotiation have resulted in access seekers paying higher rates for a longer period, but the revised WDSL rates after negotiation have not been sufficient to assist our Clients' ability to compete.

An example of the delays experienced occurred after Telstra released new retail ADSL plans on 26 July 2010 and 6 June 2011 that significantly changed its retail prices and quotas. Telstra's retail plans undercut its WDSL rates, representing a price squeeze that was most significant in rural and regional areas.

Following the release of new Telstra retail plans in July 2010, our Clients attempted to negotiate more reasonable wholesale rates with Telstra. Internode has advised that it took 12 months before a new WDSL agreement with Telstra was achieved, which still left Internode in the position of not having wholesale rates that enabled it to compete with Telstra. The inability to compete is caused by Telstra Wholesale's schedule of rising prices depending on SIO numbers and higher rates in regional and rural ESAs, its uncompetitive AGVC rates, and its continued refusal to offer a WDSL/Wholesale Line rental (**WLR**) bundling discount in regional and rural ESAs. Internode is currently mid-term in its WDSL contract. Telstra has signaled that it may consider providing a better WDSL/WLR bundle deal in Zones 2 and 3, via an option to add included calls with the WLR service at an additional cost. The offer gives with one hand and takes with the other and it could result in an unattractive retail product that remains uncompetitive .

**5. Do you consider that Telstra's wholesale terms and conditions restrict the nature of service offerings? For example, the provision of large data quotas and retail products such as IPTV and multimedia content.**

Yes. High AGVC charges and the inability to multicast means that retails products such as IPTV and multi-media content cannot be provided on an economically basis to end-users connected via WDSL.

Telstra demands that WDSL is only provided in association with a current PSTN service. There is no obligation for the WDSL service provider to also be the PSTN service provider but there are no exceptions to the forced bundle. By definition, Naked DSL is a broadband service without PSTN, so WDSL and Naked DSL are deemed mutually exclusive by Telstra. This results in end-users connected via WDSL having to acquire and pay for a PSTN voice service, even if they do not require one. It is technically feasible for Telstra to offer WDSL without an associated PSTN service, the existence of Naked DSL services from competitors using DSLAMs proves this point.

As discussed above in response to Questions 2 and 3, Telstra's WDSL terms impose quota limits that restrict the ability of its wholesale customers to sell high quota retail plans. Telstra's high AGVC costs also have the same result, as it financially unviable .to provide high quota plans over WDSL because of the high AGVC charges incurred.

**6. Are there any business cases that have been or could be frustrated as a result of the pricing of AGVC?**

THE AGVC charge is consumption based. As Telstra does not provide multicasting over its network, the same content must be carried multiple times over Telstra's network each time it is viewed by a different end-user customer. Delivering duplicated content attracts duplicated AGVC costs. Along with the quantum of the AGVC charge, this results in IPTV services being very uneconomic over WDSL, so much so that our Clients will not provide IPTV over WDSL.

Our Clients consider that Telstra's AGVC charge is uncompetitively high. Telstra has recently stated that the AGVC charge should be set at \$55 based on a RMRC methodology.<sup>4</sup> This is broadly comparable to the AGVC charge that some of our Clients pay to Telstra. We understand that the ACCC has obtained copies of WDSL access agreement via a direction to Telstra and expect that the ACCC will review them to ascertain the extent of variations in the AGVC price and other charges incurred by Telstra's wholesale customers.

The AGVC charge is a charge for backhaul that WDSL customers must buy. Telstra will not sell WDSL unless AGVC is also purchased. In effect, this forced bundling means that Telstra is refusing to sell WDSL to its wholesale customers if they buy backhaul off another carrier. Telstra's AGVC or backhaul costs are uncompetitively high. For example, Internode buys DSL access off Optus, which charges Internode a small fraction of the price that Telstra charges for AGVC. Internode considers that Optus's AGVC represents a direct 'apples for apples' comparison with Telstra's AGVC, i.e. both are wholesale backhaul products with similar technical specifications. The prices charged to Internode by Telstra and Optus for AGVC since June 2010 are graphed historically in the attached **Annexure 6**. As Annexure 6 contains commercially sensitive pricing information it is confidential in its entirety.

Further and importantly in regards to high bandwidth services, the per subscriber backhaul cost that is incurred from other carriers drops as our Clients' subscriber numbers increase, because they pay for large amounts of unutilised bandwidth that can be used for further customers without incurring extra charges. Having access to cheaper and more bandwidth also means that our Clients can provide greater quotas and more competitive plans to consumers at lower incremental cost.

Internode estimates that when it uses dark fibre backhaul, the effective costs averages out at about \$2 per megabit per month, which is a massive reduction from Telstra's AGVC rate. An obvious and important benchmark for Telstra's AGVC price is the CVC price of \$20 Mbps that NBN Co will charge. It is also clear that NBN Co recognises that a \$20 CVC rate is actually above its real cost, as NBN Co has promised to lower the charge as take-up and consumption increase on the network to maintain an effective fixed average total cost per customer of \$33/month for CVC and port costs, which includes voice port access as well as broadband. Further and relevantly, NBN Co's charges are set at rates to recover its costs of constructing and operating a new network, as opposed to Telstra's use of an existing network, for which substantial costs have already been recovered through many years of use. This demonstrates that Telstra's AGVC rate of \$55 is simply far too high when considered from a cost recovery basis.

In the submission to the ACCC that accompanied Telstra's December 2011 Structural Separation Undertaking, Telstra stated that its RMRC calculations estimate WDSL prices of \$30 in Zone 1, \$37 in Zone 2<sup>5</sup>. If these prices are added to WLR and the AGVC costs, it results in a wholesale cost of about \$60 per bundled customer, or almost twice the amount that NBN Co will charge for the wholesale bundle of data, voice and backhaul. Our Clients accordingly consider it very reasonable to argue that a fair cost for a bundle of WDSL, WLR and unlimited AGVC should be no more than \$33/month ex GST. On Telstra's current pricing schedule for a bundle of WLR and WDSL/AGVC, Telstra either does not provide any discount for bundling or any discount that it does provide is so minimal that Telstra is clearly double recovering any network costs incurred in providing the two wholesale services for the same end-user and on the same line.

<sup>4</sup> Telstra, *Submission in support of revised Structural Separation Undertaking*, 9 December 2011, p. 18

<sup>5</sup> Ibid

Telstra has made it clear that Telstra BigPond does not incur the same level of AGVC costs in providing retail ADSL2+ services. This strongly suggests that AGVC costs are used by Telstra to damage competitors through the imposition of higher charges for a less efficient service. An important example of this is that Telstra's AGVC is not able to support the multicasting required for IPTV.<sup>6</sup>

Telstra has publicly stated that BigPond has access to 147 aggregation points. This indicates that it can reach customers far deeper into the network than the access pickup points that are available to Telstra's WDSL customers, which have always been limited to capital city pickup points. 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'.<sup>7</sup> 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. It is clear that Telstra's internal costs are not linked to its wholesale charges.

The experience of our Clients in regards to the Fetch TV service has demonstrated that it requires 2.5 Mb bandwidth per active stream delivered to a subscriber. Fetch TV has announced that it will move to high definition, which will require 6 Mb per stream. Where 2 streams are required, e.g. watching one programme and recording another, 5 Mb will be required at standard definition and 12 Mb will be required at high definition. Internode has advised us that its current observed behaviour is that one in three Fetch TV subscribers has a stream active at any point, meaning that the average network consumption is 0.8 Mb per subscriber (i.e. 2.5 Mb divided by 3 = approximately 0.8Mb), with an average price of 0.8 x \$55 Mb AGVC = \$44 per month.

This trend in bandwidth consumption is increasing with time as the number of Fetch TV channels increases. The move to high definition will increase bandwidth consumption significantly, i.e. it will more than double it. Though the average network consumption for our Clients' Fetch IPTV subscribers is currently below 1Mb per subscriber, the service is only in its infancy and data requirements will rise significantly as the content becomes more attractive to consumers and end-users become more comfortable with IPTV in general.

In the geographic areas where there is no competitive infrastructure, fixed broadband competition can only exist if service providers buy wholesale access off Telstra. Fixed infrastructure based competition only exists in approximately 469 ESAs<sup>8</sup> where competitive DSLAMs and HFC networks are installed. In the medium and long terms, Telstra's competitors will remain in these uncompetitive areas only if they can match or beat Telstra's retail ADSL2+ prices. Our Clients cannot achieve this in areas where they do not have their own infrastructure, which means what competition that has previously existed in those areas is being rapidly rolled back. The result will be that the competitive access seekers that own DSLAMs in areas where competitive backhaul makes it viable to operate such infrastructure will be forced to exit other ESAs. The only competitors to Telstra that can operate in these ESAs will be Telstra resellers operating under margins that do not allow them to differentiate

<sup>6</sup> <http://www.itwire.com/business-it-news/networking/39558-telstra-gears-up-for-high-bandwidth-content-services> and <http://www.itnews.com.au/News/213885.telstra-reveals-homegrown-content-delivery-network.aspx>

<sup>7</sup> <http://www.bigpond.com/tv/tbox/>

<sup>8</sup> This figure is based on our Clients deployed DSLAMs and currently available wholesale sources in addition to publicly available information, such as the list of DSLAM activated exchanges on <http://www.adsl2exchanges.com.au/>

We do not know the exact number of exchanges in which competitive DSLAMs are installed. The ACCC may have access to this data via its infrastructure RKR's.

their products through innovation and good customer service, and who are unable to sell innovative products like Naked DSL or IPTV.

**7. Are there instances where access seekers provide DSL services on more competitive terms if they use their own DSL network or where supply of wholesale ADSL is available from another provider? If so, please detail the differences.**

Yes. Our Clients' on-net plans are cheaper and with larger download quotas than their off-net plans. This is the direct result of Telstra's WDSL terms and charges. Comparisons of our Clients' on-net and off-net retail plans are attached at **Annexures 7(a) to 7(b)**.

**8. Could early termination charges discourage access seekers from providing services over alternative networks?**

Our Clients have indicated that early termination charges (**ETCs**) are not regarded as a significant issue in regards to a decision whether to migrate a service from WDSL to an alternative network, particularly onto their own networks. The reason is that though an ETC may be incurred, this is usually quickly recovered via the lower charges on an alternative network. However, Telstra's ETCs should be cost based rather than a penalty. If WDSL is declared and cost based access fees made available, it is likely that vigorous competition will occur via WDSL in the lead up to the NBN. WDSL ETCs at that stage could prove unreasonable and anti-competitive.

**9. Are there any instances of price discrimination between access seekers? If so, what is the basis for the price discrimination?**

The ACCC is best placed to assess the level of price discrimination between access seekers as it has access to copies of Telstra's agreements. Our Clients do not have access to this data.

**10. Are there any instances of price discrimination on access seekers that choose to use their own infrastructure or an alternative wholesale supplier to the incumbent?**

**11. Are there any instances of access terms such as volume commitments and minimum spend restrictions? If so, do the set targets reflect ordinary growth rates or do they rely on migration on to the Telstra network?**

**Questions 10 and 11**

Our Clients' WDSL agreements with Telstra include a pricing structure that applies higher charges if their number of WDSL services in the rural or regional Zones 2 and 3 drop below set a set level. If our Clients install more DSLAMs and migrate WDSL services in operation (**SIOs**) to their own infrastructure or migrate the SIOs to another wholesale network, the result is that the remaining WDSL SIOs become more expensive. Given that Telstra's retail rates, particularly in Zones 2 and 3, are lower than the retail rates that Internode, for example, has been forced to implement in order to remove negative margins on Telstra WDSL, it is unlikely that our Clients will be able to win new retail customers to maintain or reach the WDSL SIO levels required to achieve Telstra's discount. Though Telstra argues that it is offering our Clients an incentive to increase their SIO numbers, it is in fact discouraging our Clients from investing in its own infrastructure or migrating to an alternative network and being able to compete with Telstra on a fair and regulated basis.



Telstra's submission to the ACCC dated 27 October 2010 stated the following:

- Resellers of Telstra's WDSL services who commit to acquiring services nationally are rewarded with better pricing in exchange for their commitment.
- Rewarding customer commitment and/or providing volume discounts are standard commercial practices, and this approach to pricing is both commercially rational and economically efficient.
- Telstra is forced to cross-subsidise regional and rural services from more profitable services supplied in CBD and metropolitan areas.
- Telstra's facilities-based competitors benefit from lower costs in areas where they have deployed DSLAM infrastructure, and they have the same ability to compete in rural and regional areas by cross-subsidising in the same way as Telstra does.
- Telstra's pricing policies and discount structure enable [resellers who do not engage in facilities based competition] to effectively compete on a national basis.

Though it is not perhaps a surprise that such a practice occurs, Telstra conceded that it charges wholesale customers that do not have DSLAMs lower amounts to acquire WDSL than its wholesale customers that own DSLAMs. We consider that these 'whole of business' arrangements have a chilling effect on competition and this has been Telstra's intention. Telstra is effectively leveraging its position to discourage the use of competitive infrastructure by new entrants or current resellers. For example:

- Resellers of Telstra's WDSL services will be reluctant to invest in their own infrastructure in the geographic areas where it would be financially viable to do so when it is clear that such action would negatively impact the WDSL rates that they obtain from Telstra and damage their business models.
- Access Seekers with current but limited amounts of DSLAM infrastructure may be placed in the position where they need to divest that infrastructure in order to obtain Telstra's preferable 'reseller' WDSL rates if they wish to be able to compete on a national basis. This is likely to become an increasing issue for smaller Access Seekers considering their future options and business plans for competing via the NBN.
- By imposing a pricing structure that differentiates between wholesale customers with and without infrastructure, Telstra is pushing infrastructure owners into only operating in those ESAs where it is viable to install such infrastructure. This has adverse effects on the quality of competition in other ESAs.

Though Telstra has attempted to characterise this two-tiered wholesale pricing structure as reasonable and pro-competition, the reality is that it is a very effective attack against Telstra's largest and most effective competitors in fixed broadband markets, which assists in limiting their market share to CBD and metro areas. This may not put Telstra's largest competitors out of business as they can still operate viably in the CBD and metro ESAs, however it does severely limit the geographic competitive footprint and mean that Telstra is really the only service provider that can provide a range of diverse services over fixed broadband in the vast bulk of ESAs. For instance, Naked DSL is not available to consumers in ESAs where competitive DSLAMs are not installed, and the combination of Telstra's refusal to implement multi-casting and its high AGVC charges means that competitive IPTV and other value added products are also unavailable in those ESAs. The effect is that broadband competition in regional and rural markets is of low quality when compared to the standard of

services that are available to consumers in cities. Rural and regional consumers only have access to a limited product range for which they pay more,

In negotiations about WDSL terms in mid 2010, Telstra offered one of our Clients a significant discount on the standard WDSL port charge for any services that were migrated from LSS to WDSL. In this proposal, Telstra also offered to waive all connection and migration fees for services migrated to WDSL from LSS. This offer applied to LSS SIOs connected to our Client's infrastructure or to another access seeker's infrastructure. In our Client's view Telstra's offer was clearly designed to encourage WDSL resellers without competitive infrastructure to target end-users connected to access seekers' DSLAMs. Our Client considers it is likely that this offer is commonly made to Telstra Wholesale's reseller customers and probably not often made to other infrastructure owners. Telstra's offer suggests that resellers that obtain more favourable access terms than access seekers with infrastructure. Details of this offer are attached in **Annexure 8**. Annexure 8 is confidential in its entirety as it contains commercially sensitive pricing information.

**12. Do you consider that it is imperative to have a pre-existing subscriber base prior to the rollout of the NBN? If so, will an existing market share provide a material comparative advantage? If so, how?**

Our Clients consider that it is absolutely vital to have a pre-existing subscriber base prior to the roll-out of the NBN and that an existing share will provide a material competitive advantage. Connecting to the NBN will incur substantial initial and ongoing monthly fixed costs<sup>9</sup>. Having scale will allow an RSP to share these costs over a large subscriber base. It is our Clients' view that they need to be as large as possible in the markets that they operate in to successfully compete and survive on the slim margins that will be available in retailing services over the NBN. For example, Adam Internet operates predominantly in South Australia, with a small number of services in the Northern Territory. Increasing its subscriber base in the South Australian market in the lead up to the NBN will increase its competitiveness on the NBN in South Australia as it will be able to share fixed costs across its subscribers and operate on margins that are lower than margins on Adam Internet's own infrastructure. For the iiNet Group, which includes Internode and TransACT, and for Primus, the focus is on increasing their subscriber base nationally for the same reason.

There are significant costs involved in winning a customer. This cost varies depending on acquisition methods, but by dividing its marketing budget by acquired subscribers, iiNet has estimated this cost as between \$250 to \$300 per customer. The value of a customer to a service provider increases over time, and as such, customer retention is very important. Essentially, a customer becomes a lot more valuable over time due to lower support costs, lower usage, increased NPS<sup>10</sup>, and increased ARPU. The cost of retention depends on individual initiatives but generally it ranges from \$80 to \$120 per customer, with this spend only being targeted at customers who are considered a high churn risk. This is perceived to be a low percentage of the customer base, i.e. less than 5%. The graph attached at **Annexure 9** describes the increasing profitability of customers over time. It is therefore our Clients' view that having an existing subscriber base prior to the NBN roll-out that can be migrated to the NBN will result in far lower costs than having to win new customers. This is a considerable competitive advantage.

Further, though migration to the NBN will represent a significant opportunity for competing service providers to win new end-user customers, it is likely that a large number of consumers will decide to stay with their existing service provider as long as they are satisfied

<sup>9</sup> See the table in Question 15

<sup>10</sup> NPS = Net Promoter Score, which is a measure of customer satisfaction

with the level of service provided to date. Having this pre-existing customer base will enable an RSP on the NBN to offset migration and initial set up costs in a way that will not be available to start-ups.

**13. Are access seekers concerned about Telstra migrating its customers onto the NBN and contractually “locking in” customers by specifying a minimum term or imposing prohibitive switching fees?**

The reality is that any RSP could lock-in customers upon migration to the NBN by implementing honeymoon deals or other offers that provide end-user customers with an incentive not to churn to another provider. However, Telstra’s ability to lock in a significant market share is greater than other service providers as a result of its existing dominant market share. Further, Telstra has massive and ubiquitous brand awareness, unparalleled marketing resources, and in comparison to its competitors, a greater ability to carry the cost of loyalty discounts to lock customers in because of its network ownership, lower cost base, and vast financial resources, which will be bolstered by the large government payments that Telstra will obtain for migrating its customer base to the NBN.

Prohibitive switching or churn fees could be imposed as an early termination fee that negates an upfront discount that was given to the consumer as a sign-on or loyalty incentive at the time of NBN migration, sometimes known as a deferred establishment fee. Examples of this are delayed connection fees, delayed equipment fees, discounted monthly charges, or other incentive offers that have to be paid or repaid immediately if a customer terminates or churns a service within a specified period. All have the effect of locking customers in with a particular provider.

Telstra’s current retail ADSL2+ plans are priced in schedules that encourage customers to bundle and to agree to a fixed term that is usually of 24 months, i.e. the cheapest plans are for bundling the highest number of services and for contractually agreed minimum time periods. This inhibits customers from moving to an alternative supplier for any of the bundled services and thereby inhibits future entry or expansion by a competitor into the market. We consider it likely that end-users that are transposed from copper to the NBN by Telstra Retail will be encouraged to enter into similar long term contracts, quite possibly through the offer of an incentive at that time.

**14. Are there any other potential risks to competition that may arise in the transition to the NBN if wholesale ADSL is not regulated? If so, what are they?**

It is likely that over the next several years the telecommunications industry will experience major efforts by service providers to increase market share leading up to the NBN rollout. Where this occurs as a result of vigorous competition, then it will be to the benefit of consumers. However, it should not be allowed to occur as a result of anti-competitive conduct such as Telstra’s current price squeeze and forced AGVC/WDSL bundling, which bodes badly for competition and consumers.

If Telstra has pushed competitors out of large numbers of ESAs or the standard of services able to be offered by competitors in those ESAs is of low quality, then rural consumers will have little knowledge about Telstra’s competitors and the services they offer. Though this could possibly be mitigated to a limited degree by an expansion of marketing efforts in the geographic areas where our Clients and other access seekers have few customers, the reality is that this is an expense that is very difficult to justify as in the short and medium term it provides no benefit unless our Clients are able to match Telstra’s retail prices in these ESAs. For this same reason, the long term benefit of such marketing is also very doubtful. It

is therefore likely that these consumers will simply be transposed from Telstra's copper ADSL service to Telstra's retail offering on NBN Co's fibre. This will further entrench Telstra's position and the lessening of competition in those markets as the NBN is rolled out.

The importance of competition at the wholesale level on the NBN also needs to be considered. Telstra Wholesale is currently the dominant supplier of fixed line wholesale broadband services and we expect that it will actively seek to retain that position on the NBN. We expect that the significant fixed costs involved in connecting to the NBN will result in a relatively small number of RSPs connecting directly via NBN Co and instead choosing to connect via a wholesaler. In the transition to the NBN, Telstra has the ability to lock-in wholesale customers by giving them a preferential WDSL rate in return for them agreeing to be Telstra Wholesale customers on the NBN. We consider that declaration of WDSL is an important step in avoiding this, as access to cost based WDSL prices will limit Telstra's ability to leverage its current market dominance in a manner that has potential to damage future wholesale competition on the NBN.

**15. Has the NBN changed the strategic importance/value of expanding during the transitional period leading up to the NBN? Why or why not?**

There are set costs involved in connecting nationally to the NBN. The more customers that an RSP has, the lower these costs will be per subscriber and accordingly, the greater an RSP's ability to compete. Simon Hackett of Internode has stated that these fixed costs will result in increasing consolidation of the telecommunications industry because RSPs with a customer base of less than 250,000 subscribers will not be viable as a national provider. This is demonstrated by considering the example of fixed costs that NBN Co has provided in its public pricing document, which are clearly substantial. NBN Co's example follows:

User Network Interface		Access Virtual Circuit		Connectivity Virtual Circuit		Network-Network Interface
<u>Product</u>	Data	TC_4	TC_1	TC_4	TC_1	1 Gbps short
		12 Mbps/ 1Mbps	150kbps	150 Mbps	20Mbps	
<u>Pricing</u>	Incl in Access Virtual Circuit	\$24		\$2150		\$200
<u>Quantity</u>	250,000 1 per customer	250,000 1 per customer		200 1 per Connectivity Serving Area		120 1 per Point of Interconnect
<u>Sub total</u>	N/a	\$6,000,000		\$430,000		\$24,000
<u>Total: MRC</u>	\$6,454,000 Monthly Recurring Charge (MRC) or \$25.82 averages across all customers					
<u>Total NRC</u>	\$1,000 Non-Recurring Charge (NRC) for each Network-Network Interface \$120,000 once off					

**16. On the NBN, do you anticipate increased competition to take place on value added retail services such as IPTV? Are access seekers considering deploying value-added services during the transition to NBN?**

It is likely that IPTV and other value added retail services will be important competitive differentiators to retail customers when choosing an RSP on the NBN. Given the NBN's greater capacity, it is perfectly suited to high bandwidth services such as IPTV. Adam Internet, Internode and iiNet each offer Fetch TV, though the service is still in nascence and can only be offered to on-net customers because of Telstra's high WDSL AGVC charges and limitations, as discussed earlier in this submission. The emergence of Fetch TV with its ability to aggregate demand amongst ISPs will promote competition, both in the market for subscription TV and in the market for broadband, as it enables Telstra's competitors to also offer a triple play bundle of voice, broadband and subscription TV.

The NBN will reduce barriers of entry in terms of access to the infrastructure needed to provide IPTV, however it is recognised that access to compelling content ultimately creates a more significant barrier to entry for subscription TV services than infrastructure. Foxtel

acquires a majority of the content distributed on subscription TV platforms in Australia.<sup>11</sup> Competitive subscription TV platforms are likely to have only limited access to content until existing content agreements expire or are renegotiated. As such, there will be a lead time before IPTV can effectively compete with Foxtel and Austar. This supports WDSL declaration, as improving access to the infrastructure necessary for competitive IPTV services to develop will assist competitive growth of the service in advance of widespread NBN rollout.

**17. Does investment in value-added retail services such as IPTV require greater customer scale, and if so, to what extent would a declaration of wholesale ADSL offer opportunities to obtain this scale?**

Our Clients have stated that they would not invest in value added products, such as the Fetch IPTV service, without a sufficient customer base to support it. If the WDSL price decreased as a result of declaration, access seekers would be able to compete for a larger market share and invest in further value-added retail services. It is our Clients' firm view that WDSL declaration will assist non-Telstra service providers to build customer scale. In the event that WDSL declaration results in considerably lower AGVC prices, our Clients would review the viability of providing previously unavailable value-added services to off-net customers, which could provide additional scale for further investment in such services.

**18. Do you consider that declaration of wholesale ADSL will promote competition in the transition to the NBN? Why or why not?**

Yes. Where access seekers have a reasonable cost based price in which to service end-users, they can compete with Telstra on their own merits. Our Clients consider that high levels of customer service result in customer loyalty but retail price is vitally important. If the WDSL price decreased as a result of declaration, then our Clients would be able to implement lower and more attractive retail prices in turn. This would undoubtedly lead to increased competition in currently competitively stagnant markets serviced solely by WDSL. The benefits of this increased competition will be clear to consumers that are connected via RIMs and pair gain systems or living in rural and regional areas without competitive infrastructure.

It is our firm view that declaration of WDSL will lead to considerably lower access charges once the charges are based upon a cost-based methodology. Once these access charges are available, access seekers will be able to pass them on to consumers through lower retail charges and improved service offerings. We expect that this will lead to vigorous competition in the ESAs where there was very little competitive options.

**19. What impact would declaration have on the objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users?**

Our Clients have commented on the need for the proposed service description to be amended to ensure connectivity with access seekers' existing facilities in response to Question 25. As long as this is achieved, we do not consider declaration would have an impact on the existing level of any-to-any connectivity.

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<sup>11</sup> NBN Implementation Study, pages 164 and 165, [http://www.dbcde.gov.au/broadband/national\\_broadband\\_network/national\\_broadband\\_network\\_implementation\\_study](http://www.dbcde.gov.au/broadband/national_broadband_network/national_broadband_network_implementation_study)

**20. If the ACCC were to declare a wholesale ADSL services, is it likely that access seekers would continue to invest in DSLAMs where it is efficient to do so?**

Yes, where it is economic and efficient to do so. The question of whether our Clients would continue to invest in DSLAMs is based predominantly upon anticipated financial return. This policy will not change as a result of a regulated WDSL price, though the pricing triggers in the investment decision will change with a lower WDSL price. The primary basis for a DSLAM investment decision considers the gap between the cost of providing a retail broadband service using WDSL against the costs of installing and utilising their own infrastructure. This includes consideration of backhaul costs and TEBA costs. Secondary issues relate to the greater ability to differentiate the product set delivered to consumers. For example, WDSL is restrictive and inflexible, it involves high AGVC costs and a mandatory PSTN service. Utilising their own infrastructure allows our Clients to define their product and add value in a way that is not possible with WDSL.

Where lower WDSL prices allow our Clients to efficiently compete with Telstra and build an ESA customer base to sufficient scale, then it is likely that they will invest in DSLAMs as long as there is competitive backhaul. Our Clients also consider that despite the AGVC requirement and the inability to provide Naked DSL, if the determined price for declared WDSL is attractive, they would increase their investment in rural and regional areas to win customers on Telstra WDSL, for example this would result in an increased marketing spend in these areas.

**21. Does investment in DSLAM infrastructure enhance the ability of access seekers to differentiate products, through increased functionality and service quality?**

Yes. For example, providing services over DSLAMs enables an access seeker to add value added products to service offerings, often at a low cost. This has proved very attractive to consumers. An example of this is iiNet's 'Freezone'. Adam Internet provides a local free zone called 'CommunityNet', where on-net customers connected at the same exchange can transfer data between each other at no cost and with no quota allocation. Our Clients could not provide these products over WDSL because they use high levels of bandwidth and would therefore be prohibitively expensive.

**22. Are there significant opportunities for efficient investment in competing DSL networks – in terms of either expansion of the existing DSLAM footprint or increased investment in areas that have already attracted ULLS/LSS based competition? Is this likely to change over time?**

The fibre cable backbone installed by Nextgen under the Government's Regional Backbone Blackspots Programme (**RBBP**) provides competitive backhaul to 78 ESAs on 5 geographic routes. As a result of the cheaper backhaul this network provides, Adam Internet, iiNet and Internode have installed DSLAMs in several of the ESAs that the RBBP services. Internode has installed DSLAMs in Victor Harbour, Alice Springs, Darwin, Nightcliff and Palmerston. iiNet has or proposes to install DSLAMs in 19 of the RBBP ESAs. Adam Internet has installed a DSLAM at Mt Barker. The RBBP made it economically viable to install infrastructure in ESAs serviced by the network where our Clients have an existing customer base connected via Telstra WDSL that can migrated onto our Clients' own networks. Our Clients do not have a business case to install DSLAMs in the bulk of the ESAs that will be serviced via the RBBP due to low current market share or lack of addressable market in those ESAs. Our Clients will continue to address this if their market share increases in these ESAs.

As the ACCC pointed out in its open letter of 18 April 2011, Nextep has or intends installing DSLAMs in 62 of the ESAs served by the RBBP. Nextep has also announced that it will provide wholesale services via its DSLAMs. This is a positive step for competition but it remains the fact that the vast bulk of ESAs in rural and regional ESAs are only serviced by Telstra with virtually no hope of ever receiving competitive DSLAMs. Internode is considering the viability of Nextep's wholesale offer, which would require Internode to implement new IT systems. Even if DSLAMs were installed in all of the 78 ESAs served by the RBBP, there would still be approximately 2285 ESAs where Telstra is the only infrastructure owner and freely able to impose a WDSL/AGVC bundling requirement and set WDSL charges at levels where competitors cannot match Telstra's retail rates.

Internode is considering using Nextep's wholesale services where available, though the internal costs of developing IT systems to enable Internode to use an alternative wholesaler and concerns that have been raised about the performance and capacity of Nextep's network raise questions about the viability of this option. Adam Internet wanted to migrate its regional customers to Nextep, however, following Nextep's installation and announcement of its wholesale intentions, Telstra announced that the ESAs served by Nextep via the RBBP network would be re-zoned to Zone 1. This places the ESAs on a lower WDSL pricing schedule and significantly diminished any financial benefit that Adam Internet would obtain in migrating its services from Telstra's WDSL to Nextep.

Telstra's rezoning of these ESAs demonstrates the policy behind Telstra's WDSL zoning criteria. Zone 1 is where there is infrastructure based competition as a result of competitive DSLAM installations. Though still not particularly competitive, Telstra's WDSL rates in Zone 1 are significantly lower than Zones 2 and 3 in order to limit the threat to its retail business. Zones 2 and 3 represent ESAs where there is no competitive DSLAMs and rarely likely to be any. Telstra's WDSL rates in Zones 2 and 3 are significantly higher, clearly because Telstra has no concerns about competition impacting its retail business. Telstra's rezoning of the RBBP ESAs also demonstrates the incredible inefficiencies that result from Telstra's anti-competitive conduct and dominance. If WDSL was regulated and fair access terms put in place, the need for such a large federally funded construction project would have been doubtful. By waiting until the project was completed before implementing price improvements, Telstra demonstrated that it won't institute such competitive improvements until it is to it feels financially threatened or it is otherwise forced to do so by regulation.

The reduced ULLS price for regional and rural Band 3 ESAs in the ACCC's Final Access Determination makes it more viable to provide ULLS in Band 3, but it remains the case that it is not economically viable to do so without competitive backhaul to the ESAs. Telstra's high backhaul charges in areas where it is the only backhaul provider mean that it is simply not viable to invest in DSLAMs in these areas, so unfortunately a lower regulated ULLS price does not in itself have the ability to improve competition in regional and rural markets.

Beyond these points, our Clients consider that there are no further significant opportunities for efficient investment in competing DSL networks.



### 23. What impact does the NBN have on incentives to invest in DSLAM infrastructure?

Our Clients want to be in a position where they can maximise the number of end-users that they can migrate to the NBN as it is progressively rolled out in different geographic locations. The best way for our Clients to hold a customer is by maximising the customer's level of satisfaction with their ISP. This is best achieved by providing services over a DSLAM rather than TWDSL. As such, the NBN does provide an incentive for DSLAM investment. The ability to viably invest in DSLAMs includes consideration of existing customer numbers in an ESA. Where an access seeker has been able to build up customers through access to regulated WDSL, then DSLAM investment is more likely to occur.

However, if NBN Co indicates that rollout in a particular area is imminent or likely to happen in a term that is insufficient to allow for a reasonable return on investment, it is less likely that our Clients would choose to install a DSLAM in that area. Our Clients have stated that not currently knowing the NBN rollout beyond a 12-month time frame makes this assessment difficult.

### 24. Could declaration of wholesale ADSL promote efficient investment in infrastructure that will be used to interconnect on the NBN or provide value-added retail services?

Lower WDSL rates will promote retail ADSL competition and lead to Telstra's competitors having larger footprints and more ADSL SIOs. This will result in increased revenue streams that in turn can be utilised for greater investment in infrastructure, staff, value added retail services and other resources required for transition to and interconnection on to the NBN.

### 25. If the ACCC declares a wholesale ADSL service:

#### (a) What is an appropriate service description?

Our Clients consider that the ACCC's proposed service description is generally acceptable, except in regards to the level of discretion it allows to Telstra in regards to where access seekers can interconnect.

The definition of 'network-network interface that is a point of interconnection' appears to mean that Telstra has discretion to choose exactly where in a State or Territory the POI with an access seeker will be located. Giving Telstra this discretion is problematic. For example, if an access seeker acquired WDSL in a regional NSW town, Telstra could say the network-network interface POI is the exchange at that town rather than a hand-off point where the access seeker actually has existing equipment. In the likely event that the regional town was not serviced by competitive backhaul, Telstra could then charge the access seeker an exorbitant and unregulated rate for backhaul, as the backhaul component would not fit within the declared WDSL service description. This needs to be addressed by amending the second limb of the definition as follows:

*(b) in a location agreed to between the access seeker and access provider in the same state/territory that the access provider associates with the exchange service area in which the **user-network interface** is located. If agreement is not reached the location will be at the access seeker's discretion either the Telstra exchange in the exchange service area in which the **user-network interface** is located or the capital city point of interconnection that was utilised for services from the exchange service area at the date of declaration.*

**(b) Should the service description cover wholesale ADSL services nationally, or be limited in geographic scope?**

The benefits of WDSL declaration will be greatest to consumers in rural and regional areas, and for any SIOs that are connected via RIMs, pair gains, or other technologies that limit the ability of Telstra's competitors to provide a service via their own infrastructure. As RIMS and pair gains are installed widely throughout all geographic areas, it appears that the LTIE would be best achieved by national declaration. It remains open to the Access Provider to seek geographic exemptions.

**(c) What is the appropriate duration of the declaration?**

Our Clients agree with the ACCC's view that there is a benefit in providing certainty that WDSL declaration will remain in place during the transition to the NBN. Accordingly, the duration of the declaration should reflect the estimated NBN construction timetable available at the time of declaring WDSL, with added time to allow for construction delays.

**Adam Internet  
Internode  
iiNet  
Primus  
TransACT Communications**

**19 January 2012**