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By email

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

Dear Sean,

Macquarie Telecom Pty Limited ("**Macquarie**") appreciates the opportunity to make this submission to the Australian Competition and Consumer Commission ("**ACCC**") in relation to the ACCC's discussion paper concerning the above.¹ Telstra's structural separation undertaking is a key component of the Australian Government's regulatory reform agenda. The SSU is designed to establish Telstra's obligations and commitments to wholesale customers regarding transparency and equivalence in the period prior to Telstra's full structural separation.

Telstra has already submitted a SSU and draft migration plan to the ACCC.² The ACCC's acceptance of a SSU is necessary for the Telstra - NBN Co deal to proceed. The purpose of the ACCC's current review is to decide whether to accept Telstra's SSU and draft migration plan. As noted in the Discussion Paper, the ACCC has expressed the preliminary view that it cannot accept the SSU in its current form. Macquarie is of the view that the SSU does not satisfy the legislative requirements for the ACCC to accept an SSU. Accordingly, Macquarie agrees with, and supports, the ACCC's preliminary view that it cannot accept Telstra's SSU.

This submission notes the legislative requirements for the ACCC to accept an SSU and then addresses Macquarie's key concerns with Telstra's SSU. Finally, the submission sets out some key areas that can be addressed to improve the SSU with a view to making it acceptable to the ACCC.

¹ ACCC, Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan, Discussion Paper, 30 August 2011, ("**Discussion Paper**")

² Telstra, Structural Separation Undertaking, 29 July 2011 ("**SSU**")

Legislative Requirements for SSU Acceptance

Section 577A of the *Telecommunications Act 1997*, provides that the ACCC must not accept a SSU unless the ACCC is satisfied that the SSU provides for:

- transparency and equivalence in relation to the supply by Telstra of regulated services to its wholesale customers and Telstra's retail business units during the period prior to Telstra's full structural separation;
- the ACCC to monitor Telstra's compliance with the SSU; and
- Telstra to have systems, procedures and processes that promote and facilitate the ACCC's monitoring of Telstra's compliance with the SSU.

In addition, the SSU must do all of the above "in an appropriate manner".

Macquarie's Concerns with the SSU

Macquarie believes that the SSU fails to provide for transparency and equivalence in an appropriate manner between Telstra's wholesale customers and Telstra's retail business units. On this basis, Macquarie is of the view that the ACCC must not accept Telstra's SSU. Macquarie's key concerns with the SSU which support this view relate to the following:

- the absence of consequences for Telstra in the case of its non-compliance with the SSU;
- the exclusion of transparency and equivalence commitments in exempt geographic areas;
- inadequate dispute resolution arrangements;
- inadequate ring fencing arrangements;
- an ineffective service level rebate regime;
- the retail minus pricing of ADSL2+; and
- Telstra's privileged access to exchange capacity and interconnect facilities.

Each of these concerns is discussed below.

Absence of Consequences for Non-compliance

Macquarie is concerned that the SSU does not adequately balance Telstra's incentives to supply wholesale services on equivalent terms with the consequences of it failing to do so. In the transition to the NBN environment, Telstra will continue to be a wholesale supplier of services to the retail service suppliers that it competes with in retail markets. Arguably, Telstra has an even greater incentive to harm competition in this period to enable it to protect and build its customer base for eventual migration to the NBN.

While Telstra has a strong incentive to harm competition, the SSU does not provide adequate consequences should Telstra not comply with the SSU. Even if the SSU committed Telstra to robust processes and procedures to ensure the supply of services on equivalent terms, Telstra can deliberately choose not to comply with the SSU because there is little of consequence that follows if Telstra does not fulfil its commitments. For example, there is no financial penalty or regulatory discipline such as loss of licence or exclusion from a spectrum auction or an additional reporting obligation that would be triggered if Telstra fails to comply with the SSU.



Carve out of Exempt Areas

Under the provisions of section 577A of the *Telecommunications Act 1997*, the ACCC must not accept a SSU unless it provides for the transparency and equivalence in relation to the supply by Telstra of “regulated services”. WLR, LCS and PSTN OA services are regulated services as they have been “declared” by the ACCC. Under the ACCC’s fixed service final access determinations (“**Fixed FADs**”) the supply of these services in certain geographic areas are exempt from the standard access obligations (“**SAOs**”). As such, Telstra is not obligated to supply these services in the exempt areas.

Telstra proposes that the SSU will not apply to the provision of WLR, LCS and PSTN OA services in the exempt areas. In Macquarie’s view, while there is a relaxation of the SAOs in the provision of such services in the exempt areas, the services themselves do not cease to be regulated or declared services. Moreover, the relaxation of the SAOs does not relax the requirement of equivalence. As such, the ACCC should not accept the SSU because the SSU should provide for equivalence in relation to WLR, LCS and PSTN OA in the exempt areas.

Inadequate Dispute Resolution Arrangements

The SSU proposes a fast track dispute resolution process through the establishment of the independent telecommunications adjudicator (“**ITA**”). The requirement for the ITA is, in Macquarie’s view, questionable given that dispute resolution is not a problem that needs to be fixed. In any case, the ITA arrangement as set out in the SSU suffers many deficiencies which, in Macquarie’s view, fail the legislative requirement of being “in an appropriate manner”. Such deficiencies include:

- the absence of independence as Telstra appoints the directors of the ITA;
- the inability of the ITA to impose penalties or awards of compensation;
- the limitations on the jurisdiction of the ITA to “systemic” breaches;
- the cost burden imposed on access seekers wishing to take disputes to the ITA; and
- the requirement for access seekers to enter into a binding ITA agreement.

Inadequate Ring Fencing Arrangements

The SSU sets out provisions for the organisational arrangements for Telstra’s network, wholesale and retail business units. Such arrangements include setting out the required functions of separated business units, restrictions on staff undertaking work for other business units and the confinement of staff incentive remuneration to the performance of the business units to which staff belong.

Macquarie is concerned that the ring fencing arrangements are not sufficiently robust to ensure that equivalence will be fulfilled. Of particular concern is:

- the ability of staff from one business unit to permanently move to another business unit such that the head of Telstra Wholesale could conceivably become the head of Telstra Retail;
- the general carve out of requirements which applies to employees who have “management responsibilities”; and
- that only material failures which form part a “demonstrable pattern of repeated non-compliance” constitute a breach of the ring fencing arrangements.

Macquarie is of the view that the ring fencing arrangements provided in the SSU fail the legislative requirement of being “in an appropriate manner”.

Ineffective Service Level Rebate Scheme

The SSU provides for a service level rebate scheme under which wholesale customers will be compensated if the service level provided by Telstra falls below an allowed margin. Under the scheme, Telstra will automatically pay rebates to wholesale customers without the necessity of making a claim.

Macquarie is concerned that the rebates are particularly low such that Telstra has little incentive to actually reach acceptable performance level targets. Moreover, participation in the scheme requires the wholesale customer to sign on to the scheme and accept that the rebate is the sole performance remedy. Macquarie is of the view that the service level rebate scheme provided in the SSU fails the legislative requirement of being “in an appropriate manner”.

Retail Minus ADSL2+ Pricing

The SSU proposes that the ADSL2+ service will be supplied by Telstra on the basis of a “retail minus” pricing approach. Retail minus is widely regarded as an inappropriate pricing approach. Moreover, the proposed use of retail minus is inconsistent with the regulated asset based pricing approach that the ACCC has adopted for fixed services and is now embodied in the Fixed FADs. Macquarie contends that the use of retail minus for ADSL2+ pricing in the SSU fails the legislative requirement of being “in an appropriate manner”.

Telstra’s Privileged Access to Exchange Capacity and External Interconnect Facilities

The SSU provides that Telstra - and only Telstra - may reserve exchange capacity in Telstra exchange buildings and reserve space for external interconnect facilities where it has plans to use such capacity and facilities within 36 months. This means that Telstra provides itself with privileged access to such capacity and facilities. Macquarie considers that this blatantly fails the legislative test of equivalence.

Improvements to the SSU

The previous section has noted Macquarie’s various concerns with the SSU. Macquarie is of the view that many of these concerns can be overcome such that the SSU would be in a form that it would be acceptable to the ACCC. The key improvements that could be made are the following:

- the SSU must expose Telstra to material penalties if it fails to comply with the requirements of the SSU, otherwise Telstra has no incentive to fulfil its requirements;
- the carve out in respect of exempt areas is removed;
- the independence of the ITA and its powers to investigate and impose penalties on Telstra are addressed;
- the tightening of ring fencing arrangements;
- the service level rebate scheme provides genuine compensation to access seekers

- for sub-standard service quality and provides Telstra with an incentive to provide an acceptable level of service performance; and access to exchange capacity in Telstra exchange buildings and access to space for external interconnect facilities is genuinely equivalent.

Closing

Macquarie would be pleased to elaborate on its views expressed in this submission. Should you have any queries concerning this submission please feel free to contact me.

Yours sincerely



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