



Optus Submission

Telstra Structural Separation Undertaking and Draft Migration Plan

September 2011

Public Version

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Section 1. Introduction

- 1.1 This submission is provided in response to the ACCC’s Discussion paper on its “Assessment of Telstra’s Structural Separation Undertaking and Draft Migration Plan”.

Executive summary

- 1.2 The Government has implemented important policy measures aimed at achieving significant changes to the structure and competitive landscape of the fixed line telecommunications market.
- 1.3 Optus has been a strong advocate in favour of the policy approach, which has the potential to deliver a level playing in the fixed line sector thereby creating a platform to significantly lift competition.
- 1.4 However, whilst the high-level policy principles set out in the legislation are laudable the real test is whether they are carried through in practice. The detailed implementation measures will, therefore, ultimately be definitive in terms of whether the policy expectations will be met.
- 1.5 Telstra’s proposed Structural Separation Undertaking (SSU) represents one of the key policy deliverables. A central component of Telstra’s SSU is the additional equivalence and transparency measures Telstra proposes to implement in line with its obligations under the recent changes to the Telecommunications Act to advance competition in the transition period to the NBN. These measures are of critical importance to the industry. They will go to the heart of whether the recent regulatory reforms will in practice deliver a meaningful lift to competition in the transition to the NBN and beyond.
- 1.6 In this respect Optus submits that the SSU (without the amendments we propose below) not only fails to deliver on the reform objectives set out in the legislation, it actually risks reinforcing Telstra’s dominance in the next decade and beyond as the industry transitions to the NBN. There are three broad concerns with the SSU which create this risk;
- (a) It fundamentally fails to deliver an appropriate and effective set of equivalence and transparency arrangements in the transition period to the NBN;
 - (b) The form of the proposed structural separation is significantly limited; and
 - (c) The arrangements between Telstra and NBN Co will potentially give Telstra a systemic long-term advantage on the NBN.
- 1.7 Optus appreciates that it is not helpful to simply seek a rejection of the SSU. For this reason whilst our submission provides a detailed critique of each component of Telstra’s proposed equivalence arrangements it also sets out recommended amendments to address the concerns we raise. A summary of the more material changes we recommend is set out at the end of this section.

- 1.8 A critical question the ACCC has to address is the likely future state of the market and competition both with and without the SSU. This is a standard piece of competition analysis.
- 1.9 For the reasons outlined in the submission, in particular our concerns relating to Telstra's failure to deliver acceptable interim equivalence arrangements, Optus does not believe the SSU, in its present form, will pass the test. That is, Optus does not accept that the SSU will deliver a lift in competition that will advance the long-term interests of end-users versus other options and present arrangements.
- 1.10 Central to this conclusion are our concerns with Telstra's proposed equivalence arrangements. At its heart the SSU does not seek to deliver equivalence in terms of how Telstra treats its wholesale customers and Retail business units. What the SSU does is to put in place a series of processes that Telstra must comply with. Those processes at best only have a fleeting regard for whether there is equivalence between Telstra's wholesale customers and its Retail business units. In summary, the fundamental failings of the proposed equivalence arrangements are that they;
- (a) Place few if any obligations on Telstra;
 - (b) Set no incentive for Telstra to proactively implement equivalence in practice;
 - (c) Effectively rely on the ACCC and/or access seekers to catch Telstra out. Even in circumstances where a breach can be identified there are few if any meaningful penalties imposed on Telstra for a failure to implement equivalence or comply with its own processes;
 - (d) Include a plethora of limitations in terms of the obligations or arrangements that Telstra is prepared to commit to, which materially reduces their utility;
 - (e) Are limited to the services provided over the copper network; and
 - (f) Differ little from the existing discredited "Operational Separation" arrangements Telstra has been subject to since 2005. In some respects it represents a step backwards from those existing operational separation arrangements.
- 1.11 If these amendments are adopted and a revised SSU is put forward then the ACCC is likely to be able to accept it since it would pass the competition test. Such a revised undertaking would be consistent with the Government's reform objectives and would put the industry on a more competitive footing. This in turn would put the industry in the best position to transition to the NBN and ensure that the long-term objectives of the NBN are realised.

Next steps

- 1.12 The next steps in the process will be important to achieving an outcome that advances competition and the interests of consumers. Optus submits that it is important for the ACCC to take some control over the process, in particular to help broker a set of arrangements that all the industry are prepared to accepted.

1.13 As a first step it will be important for the ACCC to issue a guidance paper which sets out the concerns both the ACCC and the industry has raised with the current SSU and indicates the changes it expects to be made to address these concerns.

1.14 It would also be highly productive for the ACCC to facilitate a series of workshops involving both Telstra and representatives of its wholesale customers to seek to develop some detailed changes to the equivalence arrangements to address the industry's concerns.

Recommendations

Set out below are the more significant changes to the SSU that are recommended in this submission.

1. Over arching commitment to equivalence.

The SSU should:

- **Define the standard of equivalence to be met. This should be to put in place measures to enable wholesale customers and Telstra's Retail business units to gain access to key input services at "materially the same" quality and functionality for the "same" price.**
- **Impose a clear and legally binding non-discrimination obligation in line with the standard above, which should apply to all Telstra's employees, its operations and activities.**
- In addition, to ensure that there is full transparency and certainty that equivalence is being delivered in practice, the SSU should **commit Telstra to put in place an internal contract between the Telstra Network Services Unit and Retail Business Units that sets out each of the key price, non-price and operational terms that will be supplied to Telstra's Retail businesses.**
- **Any breach of the equivalence obligation should lead to swift and meaningful enforcement action by the ACCC with limited appeal rights. That action should be capable of being initiated by both the ACCC and access seekers.** Past experience has indicated that even with rules in place if the enforcement mechanisms are weak, Telstra is adept at using such weakness to avoid its obligations.

2. Scope of commitments

- **There should be no limits or constraints on the scope of any of Telstra's equivalence commitments.**

3. Price equivalence

- **The SSU should contain an explicit requirement for price equivalence, and a binding enforcement mechanism.**
- **Telstra should price internal access services on the basis of the ACCC's regulated access price.**

- **The wholesale ADSL service should be priced according to the actual cost of supply, rather than a retail minus construct.**
- **This cost based ADSL price should also be used as the price input for Telstra's Retail business units in setting retail prices for ADSL services.**

4. Organisational

The SSU should provide for more rigorous ring-fencing of wholesale staff and activities to ensure that:

- **Telstra Wholesale and Telstra's Network Services Unit (NSU) operate independently (budgets, financials, investment, and incentive arrangements etc).**
- **Telstra's NSU will treat the Telstra Wholesale Unit and the Telstra Retail Unit equivalently for price and non-price terms**
- **Decisions relating to wholesale services are made by Telstra Wholesale's Senior Management only.**
- **Decisions relating to Telstra's NSU are made by Telstra's NSU Senior Management only.**
- **The Telstra Wholesale unit and the NSU are physically separate from Telstra Retail premises (e.g. separate buildings).**
- **All incidents of non-compliance by Telstra should be enforceable by the ACCC, regardless of whether or not they form part of a demonstrable pattern of behaviour.**

5. Wholesale systems

Given that the current wholesale systems do not provide for an "equivalence of outcomes", Telstra should;

- **Commission an independent "gap" audit to identify the material differences in output between the existing wholesale and retail systems; and**
- **Develop a rectification plan to address these differences in a manner that is timely and minimises the cost of the changes to access seekers.**

6. Equivalence and transparency metrics

- **The proposed equivalence and transparency metrics should be fundamentally re-designed to ensure that they provide meaningful comparative statistics that would reveal the actual levels of service supplied to Telstra's Retail business units and its wholesale customers and the variances between them.**

7. Service Level Rebates

- **Telstra should not be able to buy its way out of its equivalence obligations. If there is non-equivalence then the only acceptable remedy will be for Telstra to fix the fundamental cause for the non-equivalence. The obligation on Telstra should be absolute and a process should be put in place to facilitate this.**

8. TEBA access

- **Telstra's Retail business units should be required to use exactly the same TEBA and External Interconnect Facilities processes as access seekers.**

9. Dispute resolution

To ensure it is fit for purpose and access seekers have the confidence to sign-up to the Independent Telecommunications Adjudicator (ITA) scheme, it must adhere to the following key principles:

- (a) The ITA should operate under the jurisdiction of the ACCC.**
- (b) The ITA should be appointed by the ACCC after consultation with the industry. Any person selected for this role should have the confidence of the industry and should be able to demonstrate an appropriate level of independence.**
- (c) The cost of the ITA should be met out of the ACCC's budget but with reimbursement of those costs from Telstra. An administrative fee could be imposed on access seekers (much like the fee for raising access disputes) to prevent frivolous or vexatious disputes from being raised.**
- (d) The ITA should focus solely on non-price related disputes relating to breaches of equivalence.**
- (e) The ITA to be able to make binding determination under the heads of power of the ACCC.**

Section 2. Assessing the impact of the Structural Separation Undertaking

Optus support for the Government's pro-competition policy

- 2.1 The Government has introduced important policy measures aimed at achieving significant changes to the structure and competitive landscape of the fixed line telecommunications market.
- 2.2 The critical elements of the reforms are;
 - (a) The planned roll-out of the NBN which the Government has committed to operate as a wholesale-only infrastructure with access provided on an open and equivalent basis; and
 - (b) Measures to address the problems associated with Telstra's vertically integrated structure, which has been recognised to have acted as a key impediment to the emergence of competition in the fixed line sector.
- 2.3 With respect to Telstra's level of vertical integration the Competition and Consumer Act 2010 (CCA) gave Telstra a clear choice, either;
 - (a) To implement structural separation of its Retail and fixed line Network businesses, so that fixed line services it provides to retail customers are not supplied over a network it controls; or
 - (b) To implement functional separation of its Retail and Network business and face the risk of being excluded from accessing future spectrum.
- 2.4 Consistent with the Government's twin objectives for structural reform and the roll-out of the NBN Telstra has agreed to implement a form of structural separation, which will involve Telstra decommissioning its copper network and migrating its retail customers to the NBN. Since this process is likely to take 10 years to be fully implemented, the CCA also included measures to advance competition and deliver improved outcomes for customers during this long transition period. Specifically, in this transition period Telstra is required to implement improved equivalence and transparency arrangements in relation to Telstra's supply of services to its wholesale customers and retail business units.
- 2.5 Optus has been a strong advocate in favour of this policy approach. Taken at face value this approach has the prospect of delivering a significant lift in competition versus both the status quo and the alternative option of Telstra being required to implement functional separation. In particular, we have previously argued in support of the CCA that these policy reforms have the potential to facilitate a paradigm shift in the regulatory framework that would deliver the necessary behavioural change and improvements to ensure there is genuine equality of access which is so vital for the development of sustainable competition in the fixed line services market. Such an outcome would not only enhance the prospects for competition and therefore consumer outcomes in the short term, it would also create a platform for the industry

to successfully transition to the new super fast technology of the National Broadband Network.

- 2.6 That said, Optus has always been mindful that the high-level policy principles need to be carried through in practice. The detail will therefore be definitive in terms of whether the policy approach is superior to other potential options or not.
- 2.7 In this respect Optus submits that the SSU not only fails to deliver on the reform objectives set out in the legislation, but actually risks reinforcing Telstra’s dominance in the next decade and beyond as the industry transitions to the NBN. There are three broad concerns with the SSU as presented by Telstra;
- (a) It fundamentally fails to deliver an appropriate and effective set of equivalence and transparency arrangements in the transition period to the NBN (this is discussed in section 3);
 - (b) The form of structural separation is significantly limited (see below); and
 - (c) The arrangements between Telstra and NBN Co will potentially give Telstra a systemic long-term advantage on the NBN (see below).
- 2.8 Each of these concerns is relevant to the broad question the ACCC must address about whether, taken as a whole, competition will be better served with or without the SSU in place (the “counter factual” test). Optus’ comments on the counter factual test are set out at the end of this section.

Telstra’s ongoing level of vertical integration

- 2.9 As indicated above, Optus has concerns both about the form of structural separation Telstra will be required to implement under the SSU and the likely ongoing advantage Telstra will derive from the nature of the agreement it has struck with NBN Co.

Form of Structural Separation

- 2.10 The form of “separation” that Telstra will be required to implement under the SSU is not one that is commonly contemplated by the concept of “structural separation”, which more routinely involves divestiture of assets or a demerger of parts of a business. In this case, Telstra has committed to de-commissioning its copper network and acquiring wholesale access services from the NBN for the purpose of servicing its residential and small business customers only. Consistent with the recent Ministerial Instruments¹ the scope of the “separation” to be implemented is highly limited. For example, the SSU will not apply to Telstra’s:
- (a) corporate fibre network;
 - (b) inter-exchange network;
 - (c) signalling, switching, transmission or routing infrastructure;
 - (d) exchange building and facilities; and

¹ Telecommunications (Structural Separation Network and Services Exemption) Instrument.

(e) conduits, ducts and pits

- 2.11 Put simply, Telstra is not implementing structural separation. In practice, Telstra will continue to act as a vertically integrated operation for a significant part of its business. Telstra will retain the ability to leverage its vertical integration to its advantage in certain markets and/or for certain customer segments.
- 2.12 As an example, whilst the NBN is expected to open up the corporate market to increased competition, because it will provide ubiquity of access, Telstra may retain an advantage through its ability to price access to its own retail business customers at marginal cost. This will enable it to set retail prices well below those capable of being offered by competitors who will have to set retail prices based on the long-run geographically averaged access prices set by NBN Co.

Structure of the deal will favour Telstra in an NBN environment

- 2.13 Under the terms of the agreements between Telstra, NBN Co and the Government, Telstra will continue to own certain network infrastructure used by NBN Co. In particular, NBN Co will lease, rather than acquire, certain of Telstra's network assets including exchange buildings and facilities and conduits, ducts and pits. Optus considers that this arrangement is likely to have a number of impacts which are likely to be detrimental to competition.
- 2.14 Firstly, Telstra's continuing ownership of the relevant network infrastructure raises subtle problems around agency and transparency which relate to the relationship between Telstra's management and its shareholders. Optus considers it likely that Telstra's management will have the opportunity and incentive to use the ongoing stream of revenue from the infrastructure lease payments to advantage its retail sales units at the expense of its competitors.
- 2.15 Given its age, the relevant infrastructure is likely to be completely written down and in any case is a sunk cost. Telstra's ongoing marginal cost of supply caused by the NBN Co's use of this infrastructure will be close to zero. There are practically no costs to offset against the ongoing stream of revenue, and Telstra will have significant discretion over its use. For example, Telstra could allocate a portion of the lease revenue to offset part of the access fee payments it will make to the NBN Co in order to supply its retail customers in the residential and small business segments. In that case Telstra would have the flexibility to set low retail prices in order to win market share in an effort to lock in a dominant market share in the early stages of NBN deployment (and would retain the ability to raise prices in the future to offset any short term discounting).
- 2.16 Secondly, these arrangements will give Telstra a level of control over the terms and conditions of access to infrastructure required to access the NBN. Critical in this regard is the fact that the Points of Interconnection to the NBN are likely to be located at Telstra exchanges, which means that access seekers will be dependent upon Telstra for accessing space in the exchanges to establish interconnection with the NBN. This will give Telstra scope to set terms and conditions of access that favour its downstream retail business in an NBN environment over other access seekers. In this respect we note that the SSU specifically gives Telstra beneficial queuing rights over other access seekers in respect of exchange access (refer section 3).

- 2.17 Thirdly, Telstra’s opportunity to renegotiate new compensation arrangements in the future creates a very significant ‘hold up problem’. That is, when the time comes for the renegotiation of terms, Telstra will have the opportunity and incentive to significantly increase the price which it requires NBN Co to pay for the use of the relevant infrastructure. This opportunity will arise because NBN Co will have made very substantial and irreversible (sunk) investments in infrastructure which are completely dependent upon access to Telstra’s infrastructure and thus highly vulnerable to hold up by Telstra. Provided NBN Co remains able to recover its (very low) ongoing costs, Telstra will be able to raise the price it charges NBN Co to a level where it can essentially extract all of the value sunk in NBN Co’s own infrastructure through those charges. These charges will then be passed on to access seekers through NBN Co’s wholesale access charges, and will ultimately be borne by end users through increased retail prices.
- 2.18 The most effective way to address the above risks include;
- (a) Ensuring that there is genuine equivalence of access in the transition to the NBN (refer section 3 for further detail); and
 - (b) Ensuring that the regulatory arrangements that apply to the NBN limit the ability for Telstra to utilise any advantage it might be able to leverage in an NBN environment from the lease of infrastructure to the NBN.

The ACCC’s “future with and without” analysis

- 2.19 As noted above, a critical question for the ACCC to address is the likely future state of the market both with and without the SSU. This is a standard piece of competition analysis that the ACCC uses in many contexts under the CCA.
- 2.20 For the reasons outlined in section 3 and above Optus does not believe the SSU, in its present form, will pass this standard competition analysis. That is, Optus does not accept that the SSU will deliver a lift in competition that will advance the long-term interests of end-users versus other options.
- 2.21 That said, we believe that the ACCC’s assessment of the “without scenario” is too narrow. The ACCC essentially considers two alternative options to this SSU. Each of these would involve Telstra seeking to compete with the NBN;
- (a) Telstra demerging or divesting parts of its business; or
 - (b) Telstra implementing functional separation and being subject to the “excluded spectrum regime”.
- 2.22 Optus considers that there is a third and much more viable option, namely that Telstra submits a revised plan that better meets the equivalence and transparency requirement set out in the legislation.
- 2.23 Specifically, Optus submits that a revised SSU, which addresses the concerns on equivalence we have outlined in section 3, would almost certainly pass the ACCC’s “with or without test”. Such an undertaking would be consistent with the Government’s reform objectives and would put the industry on a more competitive footing. This in

turn would put the industry in the best position to transition to the NBN and ensure that the long-term objectives of the NBN are realised.

- 2.24 However, to reiterate without such changes the case that competition will be advanced by accepting the SSU is not made out.

Section 3. Interim Equivalence and Transparency Arrangements

Lack of commitment to equivalence

- 3.1 A central component of Telstra’s SSU is the additional equivalence and transparency measures Telstra proposes to implement in line with its obligations under the recent changes to the Telecommunications Act to advance competition in the transition period to the NBN. As indicated earlier in this submission, this component of the SSU is critical. It will go to the heart of whether the regulatory reforms will deliver a meaningful lift to competition in the transition to the NBN.
- 3.2 In assessing the SSU Optus submits that the ACCC has to be satisfied that it meets two key tests in respect of the equivalence and transparency arrangements:
- (a) Whether the proposed arrangements deliver equivalence and transparency in an “appropriate and effective manner” (in line with section 577A (3) of the Telecommunications Act); and
 - (b) Whether the measures proposed in the SSU “provide for meaningful improvements to the current transparency and equivalence measures” (as set out in the Explanatory Memorandum to the Competition and Consumer Safeguards Bill 2010).
- 3.3 Optus’ assessment of the proposed equivalence and transparency arrangements is that they **fundamentally fail** to pass either of these tests. For this reason we consider that the SSU is incapable of being accepted by the ACCC in its present form.
- 3.4 Optus’ specific concerns with each of the elements of Telstra’s proposed arrangements are set out in detail in this section. In summary, Optus submits that at its heart the SSU does not seek to deliver equivalence in terms of how Telstra treats its wholesale customers and Retail businesses units. What the SUU seeks to do is to put in place a series of processes that Telstra must comply with. Those processes at best only have a fleeting regard for whether there is equivalence between Telstra’s wholesale customers and its Retail business units. At a high-level the fundamental failings of the proposed equivalence arrangements are that they;
- (a) Place few if any obligations on Telstra;
 - (b) Set no incentive for Telstra to proactively implement equivalence in practice;
 - (c) Effectively rely on the ACCC and/or access seekers to catch Telstra out. Even in circumstances where a breach can be identified there are few if any meaningful penalties imposed on Telstra for a failure to implement equivalence or comply with its own processes;
 - (d) Include a plethora of limitations in terms of the obligations or arrangements that Telstra is prepared to commit to, which materially reduces their utility;
 - (e) Are limited to the services provided over the copper network; and

- (f) Differ little from the existing discredited “Operational Separation” arrangements Telstra has been subject to since 2005. In some respects it represents a step backwards from those existing operational separation arrangements.
- 3.5 The most significant flaw with the proposed arrangements, which the ACCC has also identified, is that it fails to put in place *“a clear and enforceable commitment to an ‘equivalence of outcomes’ that will enable wholesale customers and Telstra’s retail business units to gain access to key input services of equivalent quality and functionality”*.
- 3.6 Without a very clear and legally binding commitment to deliver equivalence access seekers can have no confidence that Telstra will actually will deliver equivalence in practice. Such an obligation must be the foundation stone on which all of the other commitments and arrangements are built.
- 3.7 It is the absence of such a transparent and unambiguous rule that has obstructed past attempts to enforce real equity in Telstra’s terms of supply. But to be clear such a rule should not simply be seen as an attempt to strait jacket Telstra by the threat of legal action. What such a rule will do is to create a catalyst for Telstra to change its behaviour so that a culture of “what can we get away with” is replaced by a culture of “what do we need to do” to ensure equity of treatment to wholesale customers.

Recommendation

- 3.8 A pre-requisite for acceptance of an SSU is that it includes a very clear and legally binding commitment to deliver equivalence. Specifically, Optus recommends that to deliver on this an SSU should;
- (a) **Define the standard of equivalence to be met objective. This should be to put in place measures to enable wholesale customers and Telstra’s retail business units to gain access to key input services at the “materially same” quality and functionality for the “same” price;**²
 - (b) **Impose a clear and legally binding non-discrimination obligation in line with the standard above, which should apply to all Telstra’s employees, its operations and activities.**
 - (c) In addition, to ensure that there is full transparency and certainty that equivalence is being delivered in practice, the SSU should **commit Telstra to put in place an internal contract between Network unit and Retail Business Units that set out each of the key price, non-price and operational terms that will be supplied to Telstra’s Retail businesses.**
- 3.9 **Any breach of the equivalence obligation should lead to swift and meaningful enforcement action by the ACCC with limited appeal rights. That action should be capable of being initiated by both the ACCC and access seekers.** Past experience has

² For the avoidance of doubt this would not require Telstra to use the same systems/processes to serve retail and wholesale customers, but where it does use different processes these must deliver “materially the same” outcomes.

indicated that even with rules in place if the enforcement mechanisms are weak, Telstra is adept at using such weakness to avoid its obligations.

Scope of Telstra's commitments is limited

- 3.10 As indicated above, the arrangements set out in the SSU provide no binding obligation on Telstra to deliver equivalence.
- 3.11 Nevertheless, Optus notes that the commitments that are set out in the SSU are materially constrained by a number of limitations in terms of the circumstances in which these commitments apply or in respect of the ACCC's ability to enforce these obligations.
- 3.12 For example, a number of the commitments are conditional on access seekers contracting into Telstra's proposed processes. Examples include the Independent Telecommunications Adjudicator scheme and the Service Level Rebate scheme.
- 3.13 In respect of the ACCC's enforcement rights, almost all of the proposed commitments are subject to limitations of one form or another. Whilst the list of such limitations is broad, two examples can illustrate the point:
- (a) Telstra's failure to comply with organisational obligations is subject to safe harbour provision that a breach has to be material and represent a recurring pattern of non-compliance.
 - (b) Similarly, the ACCC can only take action for breaches relating to services and processes that are systemic in their nature.
- 3.14 It is wholly inappropriate for Telstra to restrict the scope of its equivalence obligations. Indeed, such limitations are inconsistent with Telstra's legal obligations.

Recommendation

- 3.15 **There should be no limits or constraints on the scope of any of Telstra's equivalence commitments.**
- 3.16 As indicated above the SSU should in any event include an over arching obligation to deliver equivalence which would remove any ambiguity about the scope of Telstra's commitment.

Price equivalence and transparency measures

- 3.17 Optus submits that Telstra's interim price measures are subject to a number of material deficiencies.
- 3.18 If properly constructed, the proposed rate card and TEM Reports might appear to promise increased transparency regarding the price of Telstra's internal wholesale services. However, transparency alone is insufficient, given that the proposed price equivalence measures fall substantially short of the 'appropriate and effective' benchmark. Further, there are significant shortcomings in the service definition and pricing approach proposed for the reference ADSL service, which if allowed to pass unchecked would allow Telstra wide scope to act to the detriment of competition in the sector.

- 3.19 In short, it is Optus' view that the SSU materially fails to provide for price equivalence. Instead, the arrangements in the SSU are more likely to institutionalise price discrimination.

There is no explicit requirement for price equivalence

- 3.20 A critical omission in the SSU is the lack of any mechanism to ensure price equivalence. That is, the SSU contains no requirement that the internal wholesale prices Telstra charges its retail business unit are *equivalent* to the listed external wholesale prices.
- 3.21 Optus notes that the SSU appears to set an expectation that the internal price will be different from the external price – given that the reporting mechanism allows for a difference of up to five per cent without triggering the preparation of a 'substantiation report'. Implicitly this allows Telstra to price its retail services at up to 5 per cent less than external wholesale prices without any consequence.
- 3.22 Whilst this feature of the SSU is a significant weakness, the 'consequence' of pricing differences which are greater than five per cent are even more serious. Pricing differences of above five per cent will trigger the preparation of a 'substantiation report' – and nothing further. There is no stated recourse for the ACCC or access seekers following the substantiation report. That is, the SSU allows any magnitude of difference between internal prices and external prices without *any* apparent consequence (except to damage wholesale competition). This is a fundamental flaw in the SSU which will render it completely without utility in terms of promoting appropriate and effective price equivalence. Indeed, the proposed arrangements almost certainly guarantee price discrimination.
- 3.23 Further, it is unclear how the proposed arrangements will assist in a "real life" example of price discrimination. In practice, Telstra will have very wide scope to price services to its Retail business units at prices well below those set out in the TEM (and well below the regulated prices to access seekers) on the basis that the TEM will set out highly aggregated and averaged internal costs.

Recommendation

- 3.24 **The SSU should contain an explicit requirement for price equivalence, and a binding enforcement mechanism.**
- 3.25 **Telstra should price internal access services on the basis of the ACCC's regulated access price.** This is the only way to provide access seekers with confidence that Telstra's retail prices will be based on access to equivalently priced access services.
- 3.26 **The TEM reports should be a tool to ensure compliance; with clear remedies in place should Telstra fail to comply with the price equivalence requirement.**

Retail minus pricing approach is inappropriate and will not promote competition

- 3.27 Optus is concerned about the proposed retail minus pricing approach, both in terms of the general pricing approach and also in terms of the specific application proposed by Telstra.

- 3.28 The proposed retail minus approach is based on narrowly defined costs that are subtracted from existing uncompetitive retail prices. This makes it extremely difficult for access seekers to offer retail prices which are significantly lower than the incumbent's retail prices. Given Telstra's sheer size, it has access to significant scale economies which are unavailable to its competitors. This has two main implications.
- 3.29 First, it is unlikely that access seekers will be able to earn a normal commercial return using a retail minus wholesale pricing construct. **Commercial –in-Confidence** Retail minus makes it very likely that Telstra's competitors will be unable to compete with Telstra in the relevant market(s). It is, therefore, unlikely that pricing the reference ADSL service at the existing retail price and subtracting the avoidable retail costs will result in vigorous competition in the resale ADSL market. Therefore it simply entrenches Telstra's existing market share under the guise of promoting competition.
- 3.30 Second, even if there are competitors taking resale services priced at retail minus, the retail minus pricing construct practically guarantees that there will be no improvement in retail pricing. This is because retail minus makes it extremely difficult for access seekers to offer retail prices which are significantly lower than the incumbent's retail prices, as explained above. In effect, an underlying assumption of retail minus as a pricing approach is that existing retail prices are assumed to be appropriate. This is a fundamental problem.
- 3.31 In fact, Telstra's existing retail prices are very far from appropriate. For example, as of 18 September 2011, Telstra's retail ADSL plans for new customers start from \$59.99 per month on a standalone basis (ie. its BigPond Elite ADSL 5GB plans on a 12-month term).³ However, Telstra's included data allowance significantly pales in comparison with other access seekers at a similar price point.⁴ There are a number of reasons as to why existing retail prices are likely to be too high, the most pertinent being Telstra's market power in the fixed-line market, specifically in regional areas – which has been highlighted by the ACCC in the past (in 2001 and 2004), notably in describing alleged contraventions by Telstra for vertical price squeeze conduct on two separate occasions.⁵
- 3.32 Whilst retail minus rules out pricing improvements for ADSL, at least it might (if properly constructed) potentially prevent further price squeezes by Telstra. However, it should be recognised that the prevention of illegal activity is not an appropriate benchmark for acceptance of the SSU. This would simply commit Telstra to avoidance of future contraventions of competition law. It is however difficult to see how the SSU could be said to result in a positive promotion of competition in this area. In Optus' view, the proposed ADSL retail minus pricing approach will simply create a shield against competition.

³ Telstra, Our customer terms: BigPond service section, Part C – ADSL, last updated 18 September 2011, available from <http://www.telstra.com.au/customer-terms/home-family/bigpond-services/adsl/?red=/customerterms/bigpond/adsl.htm>

⁴ Optus, Naked broadband plans, <http://optus.com.au/store/phone/Broadband>; iiNet, Broadband plans, <http://www.iinet.net.au/broadband/plans.html>; TPG, ADSL2+, http://www.tpg.com.au/products_services/adsl2plus_pricing.php?/pricing/adsl2plus

⁵ ACCC, *Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan*, Discussion Paper, 30 August 2011, p.80

Recommendation

- 3.33 **The wholesale ADSL service should be priced according to the actual cost of supply, rather than a retail minus construct.**
- 3.34 **Further, this cost based price should also be used as price input for Telstra's Retail business units in setting retail prices for ADSL services.**
- 3.35 This is the most appropriate approach to advance competition. It is consistent with the pricing principles applied by the ACCC in pricing the declared fixed line services supplied over the Telstra's copper access network.

*"Access prices that reflect efficient costs, and do not include any monopoly profits, will facilitate access to the infrastructure services required by access seekers to provide a range of communications services to end-users... [as such] Determining prices through a transparent and cost-based pricing model will provide regulatory certainty for both the access provider and access seekers about the way in which the ACCC will set prices. Such certainty promotes efficient investment and competition in the markets for carriage services."*⁶

- 3.36 A cost based approach would also avoid the many problems we have noted with retail minus approach, including the necessity for regular updates for retail price changes and potential gaming behaviour by Telstra and access seekers. More importantly, it would open up the ADSL market for genuine competition on the merits between Telstra and its competitors.

Retail Minus approach requires careful consideration

- 3.37 If the ACCC decides, despite Optus' objections, that the retail minus approach is appropriate for pricing an ADSL service, then Optus considers it must examine the details of the proposed method in detail.
- 3.38 First, in estimating a reference price, the ACCC should define the avoided costs more broadly to include *at least* corporate overhead costs, since it is likely that Telstra would be able to reduce its overheads to some degree should it cease to supply retail ADSL services. Further, Optus agrees with the ACCC that the costs that Telstra is proposing to utilise in the calculation of a reference ADSL service need to be determined and available for consultation prior to any SSU can be accepted.
- 3.39 Moreover, in a Retail Minus approach the ACCC would also need to recognise the ill effects of the proposed average pricing construct and the definition of the ADSL reference service (as discussed in the following two sections). To reiterate, a cost based price that would apply to both wholesale customers and Retail business units would avoid the complexities associated with setting a Retail Minus price.

Average pricing construct will facilitate anticompetitive ADSL pricing by Telstra

- 3.40 Optus is concerned about the specific application of retail minus pricing proposed by Telstra, in particular the average pricing construct.

⁶ ACCC, *Inquiry to make final access determinations for the declared fixed line services*, Final Report, July 2011, p.133

- 3.41 Under the arrangements proposed in the SSU, a single wholesale ADSL price will be set based upon an average of a number of different internal wholesale prices corresponding to a number of different Telstra retail prices. This is made clear in the SSU discussion paper, which notes that:

*“the wholesale ADSL price will generally be maintained at or below the average retail price...”*⁷

“... additional financial reporting ... will specify the effective internal wholesale prices (IWP) faced by Telstra’s retail business units...”

*“some IWPs could be higher while others lower.”*⁸

- 3.42 Whilst access seekers may be able to access the ADSL service on terms which are equivalent to the internal price faced by Telstra’s Retail business units *on average*, there is no guarantee that access seekers will be able to access the ADSL service on terms which are equivalent to all business units. Effectively, Telstra will be able to make offers of the ADSL service which no access seeker can match. It will have the ability to make these offers in selected geographies, at selected times, and in response to individual access seeker promotions. And – given that Telstra will have zero subscribers taking any new offer (at least at first) – the new price will have zero impact on the average ADSL price.
- 3.43 To be clear, the SSU will have no impact in constraining anticompetitive ADSL pricing by Telstra – as the direct consequence of the average pricing construct. Indeed, it will facilitate anticompetitive pricing by providing ‘cover’: Telstra will be able to point to its TEM reporting and claim that its retail pricing meets the test *on average*; even though any given retail ADSL price may be below the wholesale ADSL price (including for example pricing set at predatory levels in a limited geographic area for a limited time in response to a successful competitor offer).
- 3.44 Optus considers that in determining the construct for the retail price that is associated with the ADSL reference service, the ACCC should recognise the wide scope available to Telstra to take advantage of its existing position in the market, and recognise that the reference price will incorporate the existing customer base and may not change until there is take-up of a new offer. That is, with a nationally averaged retail price being the basis of the reference price, Telstra has wide scope to set aggressive win-back offers without affecting the wholesale price. In contrast, with a cost based reference price this type of problem would be avoided.

ADSL reference service is insufficiently defined

⁷ SSU DP p.79

⁸ SSU DP p.80

3.45 The definition of the ADSL reference service is critical for determining whether price equivalence will be possible. Indeed, before the question of price equivalence can be examined properly, first product equivalence needs to be established.

3.46 Optus agrees with the ACCC's apparent view that the reference service may not be sufficiently comprehensive. The ACCC has noted that:

"The proposed wholesale ADSL price measures do not appear to apply to wholesale ADSL service that is 'substantially different' from the Wholesale ADSL Reference Service. As a consequence, it is unclear whether these price measures will be available to 'premium services providers'".⁹

3.47 Optus considers that it is critical for competition that access seekers are not foreclosed from competing in particular market segments such as the business segment or the premium services segment.

3.48 As a general principle, Optus considers that the SSU should provide access seekers with the ability to match any ADSL service offerings made by Telstra. In the absence of a cost based price this would require a commitment that for every retail product there is a wholesale equivalent. That is, Telstra should be required to offer a separate wholesale price in respect of each Telstra retail price (that is, each Telstra retail product and each Telstra retail offer).

3.49 In this regard it will be important to consider the impact of bundling in retail plans. In particular, for the purposes of promoting competition in the market, it is essential that access seekers should have the ability to match Telstra offers of ADSL bundled with other products, such as combined ADSL, line rental and calling plans. As bundled plans become increasingly popular it will be of little use to access seekers to be able to match a standalone product if practically none of Telstra's retail customers take that product. It will be of relevance for the product construct to ensure that the costs associated with the relevant service are appropriately allocated to each service in the bundle and do not adversely affect the reference service price.

Recommendation

3.50 If in contrast to Optus' recommendation for a cost based price, the ACCC considers that a retail minus approach is valid, then such an approach must reflect the following key principles:

- (a) **Avoided costs should be broadly defined; and**
- (b) **A separate wholesale price should be available in respect of each Telstra retail price (that is, each Telstra retail product and each Telstra retail offer).**

The Telstra Economic Model requires more information and limited application

⁹ ACCC, *Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan*, Discussion Paper, 30 August 2011, p.83

3.51 Based on the high level descriptions of the TEM provided to date, it is reasonable to expect that the financial reporting might, if carried out rigorously, lead to an improvement in transparency. However, in this area the devil is very much in the detail. In this regard, it is concerning that the TEM has not yet been made available. It appears that the ACCC has to take it on trust that Telstra will offer something material and rigorous by way of financial reporting. Optus considers that the contents and full details of the TEM and financial reporting need to be specified in detail if the SSU is to be adequately understood prior to acceptance.

3.52 Further, Optus is concerned at the suggestion in the discussion paper that the TEM could be used to set fixed-line access prices. Optus does not support the ACCC's contention that:

[The TEM] reports would be of potential use at the time of the next regulatory review of fixed-line access prices, should the ACCC then reach the view that adopted the set of IWPs would better promote competition and encourage economic efficiency.¹⁰

3.53 Optus submits that it is inappropriate for Telstra's economic model to be used for any other purpose other than the reporting of internal and external wholesale prices. That is, it should most definitely *not* be used as an input for any future fixed line services reviews conducted by the ACCC. To set wholesale prices based upon a cost model developed by Telstra would leave the ACCC and access seekers vulnerable to substantial asymmetry of information. This is a very well understood problem in regulatory pricing: the incumbent always holds all the cards when it comes to reaching an accurate assessment of its own internal costs¹¹.

3.54 Put simply, Telstra would be able to submit claimed costs that are higher than its real costs, and the ACCC would be unable to disprove the contention. Telstra has a long track record of attempting to raise access prices by submitting inflated costs based on apparently respectable cost models – which have been rejected, repeatedly, by the ACCC and the Competition Tribunal (for example the PIE II and TEA models). To invite a repeat of this history would be a grave error.

Recommendation

3.55 **The contents and full details of the TEM and financial reporting need to be specified in detail prior to acceptance of the SSU.**

¹⁰ ACCC, *Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan*, Discussion Paper, 30 August 2011, p.82

¹¹ Laffont, J. And Tirole, J., (2000), *Competition in telecommunications*, Munich Lectures in Economics, The MIT Press: Cambridge, Massachusetts, p.141

Organisational measures

- 3.56 In order for access seekers to compete on a level playing field against Telstra's Retail businesses, Telstra must supply services to access seekers through external transactions on an equivalent basis to the way in which Telstra's Retail businesses are supplied with services through internal transactions; i.e., both Telstra Wholesale and Telstra's Retail businesses must procure services internally from Telstra's Network Services Unit (NSU) on an equivalent basis.
- 3.57 For this equivalence to be effective, a critical prerequisite is that a number of organisational measures are put in place in order to properly delineate the distinct parts of Telstra which are involved in these internal transactions. That is, effective ring fencing arrangements must be put in place between Telstra's relevant business units.
- 3.58 Further, as a vertically integrated operation many opportunities will arise through the normal course of Telstra's operations for its Retail businesses to gain a significant competitive advantage through the potential insights it will gain into its competitors' businesses through their relationship with Telstra Wholesale. Effective ring fencing arrangements between Telstra's relevant business units will also be useful in order to prevent this competitive imbalance.

Separate Business Units

- 3.59 The SSU proposes to ring-fence the separate business units by identifying 'required functions' of the separated business units, and some other requirements, including that the Wholesale business premises be physically separate from retail.
- 3.60 Optus considers that in this area the SSU does not go far enough. In order to effectively promote equivalence, it is necessary that not only should the Telstra Wholesale unit be physically separate from Telstra Retail premises (e.g. separate building), but also the Telstra Wholesale unit should operate independently, in terms of its budgets, its financial systems, its investment and all other aspects of its operations. These measures would provide access seekers and the ACCC with confidence that Telstra Wholesale is operating in a truly separate manner to the retail side of the business.
- 3.61 Further, in order to effectively promote equivalence, decisions relating to wholesale services should be made only by Telstra Wholesale's Senior Management. This would provide access seekers and the ACCC with confidence that Telstra Wholesale is not making its decisions in order to further the agenda of Telstra's retail business.
- 3.62 Moreover, Optus considers that the separation measures proposed for Telstra's NSU are inadequate. In order to effectively promote equivalence, the NSU should also be physically separate and be subject to strict guidelines to ensure that it manages relationships with both retail and wholesale divisions, and external parties, on equivalent terms.
- 3.63 The claim that these measures are unnecessary because the NSU's work is technical and process-oriented does not withstand scrutiny. Telstra's NSU is a critical component, indeed, **the** critical component of the entire edifice of separation. The wholesale services upon which access seekers depend in order to supply their customers are ultimately provided by Telstra's NSU. Not only is the internal wholesale price (IWP)

faced by Telstra's Retail business units a transfer to the NSU; but also, it is Telstra's NSU which supplies both access seekers (via Telstra Wholesale) and Telstra's Retail business units with service provisioning, network operations and maintenance and response and rectification of network faults. Equivalence demands that all of these functions of the NSU are performed equivalently, by the NSU, for both access seekers (via Telstra Wholesale) and for Telstra's Retail business units. Access seekers cannot have confidence that there will be equivalence in respect of these functions unless the NSU is fully separated, physically separate and subject to strict ring fencing rules.

- 3.64 Telstra's track record in this regard amply demonstrates that discrimination between retail and wholesale customers on the part of network services personnel is a likely outcome if firm measures are not in place to prevent it. Further, information security is of concern, as is the potential for marketing activities to be carried out by network staff.
- 3.65 Optus considers that it is imperative that pre-ordering, ordering, provisioning and service assurance activities are provided on equivalent terms. Without strict conduct guidelines and barriers to reduce the opportunity to discriminate, the SSU will not promote or achieve equivalence.

Staffing of separate business units

- 3.66 Optus considers that the staffing arrangements in the SSU are too weak to effectively promote equivalence. The requirement that staff work 'principally' for their own business unit is weak enough, however the exceptions further limit the effect of the provisions.
- 3.67 Optus considers that the exceptions/exemptions in terms of staff with managerial responsibilities will definitely substantially weaken the effectiveness of the ring-fencing arrangements – particularly given that a very large number of Telstra staff may be defined as having such responsibilities. A key weakness of the existing Operational Separation arrangements is that have enabled the Head of Telstra's Retail Marketing to have oversight of Telstra Wholesale' pricing decisions. This situation could continue under the proposed SSU given that management is precluded from the scope of the ring fencing provisions.
- 3.68 Optus submits that at a minimum, staff in retail and wholesale should be completely separated without any overlap in management – wholesale should autonomously make pricing decisions and set budgets.
- 3.69 Further, the 'customer excellence' clause clearly has the potential to excuse a wide range of discriminatory behaviour which would otherwise violate the separation provisions. For example, it could allow staff from Telstra's NSU to provide relatively more "excellent" customer service to Telstra's retail business units in respect of faster service provisioning timeframes and/or quicker response and rectification of network faults compared to those which it provides access seekers (via Telstra Wholesale).

Incentives and employee benefits

- 3.70 Optus submits that the exceptions and exclusions to the Incentives and employee benefits provisions will substantially weaken their effectiveness, including the

exemption for staff with managerial responsibilities, the customer satisfaction bonus scheme and the exception for existing schemes.

- 3.71 Optus endorses the ACCC's assessment that these exceptions could weaken the broader arrangements. For example, they will provide staff including managers from Telstra's NSU with financial incentives which may consciously or unconsciously shape their behaviour and make it more likely that they will provide superior services (as noted above) to Telstra's retail business units compared to those which they provide access seekers (via Telstra Wholesale).

Enforcement

- 3.72 Optus considers that the SSU requires clear guidelines that entrench equivalence with strict repercussions for failures to comply. It is for this reason that Optus supports the ACCC's assessment that the SSU's proposed enforcement provisions are lacking:

*a failure by Telstra to comply with the proposed organisational ring-fencing arrangements is only enforceable by the ACCC if it is material and not an isolated incident and forms part of a demonstrable pattern of repeated non-compliance by Telstra. This **may weaken** assurance of Telstra's compliance with the proposed organisational measures.¹² [emphasis added]*

- 3.73 The SSU sets an extremely high threshold for enforcement action. The ACCC would face a very substantial task in establishing that a failure of compliance is part of "a demonstrable pattern of repeated non-compliance". This test, which is highly subjective and arguable, simply invites dispute and litigation, and will introduce a high level of uncertainty. Further, it is clearly conceivable that substantial and damaging violations of separation could harm competition, even if they do not form part of a "pattern". Optus contends that the proposed enforcement measures in the SSU substantially undermine Telstra's compliance with the proposed organisational measures. That is, there is no question that the lack of strict enforcement renders the proposed measures redundant.
- 3.74 Optus considers that all incidents of non-compliance by Telstra should be enforceable by the ACCC, regardless of whether or not they form part of a demonstrable pattern.

Comparison of ring-fencing provisions in SSU and OSP

- 3.75 In many respects, the ring-fencing provisions in the SSU are almost identical to the arrangements already in place under Telstra's existing Operational Separation plan (OSP); whilst the SSU might initially appear to go beyond the OSP in some areas, in practice it is significantly compromised by carve-outs. The table in Appendix A provides a high level comparison between the existing operational separation plan (OSP) and the SSU.
- 3.76 It is clear that any potential improvement in the SSU compared to the OSP is weakened by the presence of exceptions. For example, the localised incentive regime might appear to be an improvement, but we understand that it differs little from existing

¹² ACCC, ACCC, *Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan*, Discussion Paper, 30 August 2011, p.93

arrangements Telstra has had in place in the past. Further, it is significantly compromised by carve-outs such as the exception for staff with management responsibility. It also accords Telstra substantial discretion and flexibility in the definition of 'management responsibility' and what constitutes a 'substantial part' of overall management responsibilities. It is therefore clear that the SSU does not offer substantial change compared to existing arrangements.

Summary

3.77 Optus considers that the ring-fencing arrangements proposed in the SSU are not fit for purpose and will not effectively promote equivalence. In order to effectively promote equivalence, it is essential the SSU should be amended in order to provide for more rigorous ring-fencing of wholesale and NSU staff and activities.

Recommendations

3.78 Optus recommends that the SSU should be amended to ensure that:

- (a) **Telstra Wholesale and Telstra's NSU operate independently (budgets, financials, investment, and incentives arrangements etc).**
- (b) **Telstra's NSU will treat the Telstra Wholesale Unit and the Telstra Retail Unit equivalently for price and non-price terms**
- (c) **The Telstra Wholesale unit and the Decisions relating to wholesale services are made by Telstra Wholesale's Senior Management only.**
- (d) **Decisions relating to Telstra's NSU are made by Telstra's NSU Senior Management only.**
- (e) **NSU are physically separate from Telstra Retail premises (e.g. separate buildings).**
- (f) **All incidents of non-compliance by Telstra should be enforceable by the ACCC, regardless of whether or not they form part of a demonstrable pattern of behaviour.**

Non-price equivalence and transparency measures

3.79 The Ministerial Instrument places a very unambiguous obligation on Telstra to ensure that it delivers equivalence in respect of the non-price terms and conditions of supply. Specifically, the Instrument directs the ACCC to have regard to whether the SSU provides for appropriate and effective:

“(viii) measures to ensure that systems used for wholesale customers in relation to billing information, ordering, provisioning, fault reporting and fault rectification provide outcomes and functionality that are equivalent to the outcomes and functionality provided by systems used for those matters by Telstra's retail business units”.

3.80 Optus submits that the proposed interim non-price measures do not provide an appropriate assurance that known equivalence and transparency issues will be remedied.

- 3.81 As currently drafted, the SSU creates no incentive for Telstra to proactively implement equivalence measures. In fact, the SSU has been written by Telstra on the assumption that all existing processes for the Telstra Wholesale Business Unit are appropriate. Telstra has then adopted existing metrics (such as CSG), existing processes and existing systems around this assumption to maintain the status quo of inequity.
- 3.82 Optus has set out below a detailed examination of each of the key proposed non-price equivalence and transparency measures;
- (a) Wholesale customer systems;
 - (b) Equivalence and transparency metrics;
 - (c) SLA scheme;
 - (d) Information equivalence;
 - (e) TEBA access arrangements;
 - (f) DSL upgrades; and
 - (g) Information security arrangements.
- 3.83 As indicated earlier in this submission the commitments that Telstra makes in respect of non-price equivalence are materially undermined by a broad safe harbour provision. Specifically, at clause 10.7 c) Telstra notes that any breach of the non-price measures in the SSU has to be “*material*” and part of a “*demonstrable pattern of repeated non-compliance by Telstra*”.
- 3.84 Optus submits that this carve-out is inconsistent with Telstra’s legal obligations and is not permissible. Further, from a practical perspective it would totally undermine Telstra’s commitments to deliver non-price equivalence. Firstly, information asymmetries mean that it would be very difficult for access seekers to prove a pattern of repeated non-compliance. Secondly, there would be inevitable disputes about what constituted a “material’ breach.
- 3.85 More significantly Optus submits that a single event can be just as significant as a repeated non-compliance, especially if it results in a competitive imbalance in favour of Telstra’s Retail business units. If a customer is lost because of non-price discrimination then that is significant.

Recommendation

- 3.86 **There should be no threshold for breaches of non-price equivalence commitments.**

Wholesale customer systems

- 3.87 Under clause 10.2(c) and clause 10.3(c) Telstra submits that it should not be prevented from using separate business support systems or processes for its wholesale customers and retail customers. In this regard, in section 12 of the SSU, Telstra effectively provides a commitment to use the existing wholesale systems for servicing its wholesale customers.

- 3.88 Optus submits that this is a fundamental flaw in the SSU, since those existing wholesale systems and processes do not currently provide for an equivalence of outcomes in all respects. Where they differ from the relevant processes and systems applied to Telstra's Retail businesses, those differences can and do provide Telstra's Retail businesses with a significant competitive advantage.
- 3.89 The following three examples help to illustrate this point;
- (a) The connection processes for wholesale customers to order and connect a copper wire (through the ULLS ordering and provisioning process) puts wholesale customers at a distinct disadvantage to Telstra's Retail business units. In short, Telstra's Retail business units can connect a customer in 2 days whereas it takes some 5 to 7 days to connect a wholesale customer. This gives Telstra a clear competitive advantage in customer acquisition.
 - (b) Similarly, in placing an order for a ULL service, Optus experiences a high rejection rate across all orders and is charged a fee for each order rejection. While some of Optus' front end processes can control these rejection rates, other rejection codes have the effect of preventing Telstra's retail customers from seamlessly churning to other service providers. A common rejection reason relates to a "complex service" on the line. The existence of a "complex service" such as Spectrum Sharing Service requires the wholesale customer to ask its end customer to contact Telstra Retail to remove the service. That is, wholesale customers do not have the ability to remove the complex service. It is only after the complex service is removed that a wholesale customer can submit a new order. This may be several weeks after the initial rejected order on the assumption that the end user has not abandoned the process. In contrast Telstra's Retail business units can remove these complex services at Point of Sale.
 - (c) A third example of non-equivalence is the ability for the Retail business units to access the "correct address" for all end users. Another major reason for the rejection of ULLs orders is when an address mismatch occurs i.e. the address inputted in the ULLS request does not match the address in the Telstra systems and therefore the order is rejected (even if that address has been incorrectly entered into the Telstra systems). In short, the wholesale ordering system does not have direct access to Telstra's address database within Telstra's provisioning systems. This means that frequent address mismatches occur which leads to the rejection of customer orders. Again, Telstra's Retail business units do not face this issue as they have direct access to the address database.
- 3.90 Optus acknowledges that the "equivalence of outcome" requirement under the Ministerial Instrument stops short of creating an obligation for Telstra to re-engineer all its systems and processes to ensure that its retail and wholesale business units use identical systems and process. However, where different systems and processes are used Telstra should have an obligation to ensure that those systems and processes deliver an equivalent outcome. The SSU does not provide for this.

Recommendation

- 3.91 Given that the current wholesale systems do not provide for an “equivalence of outcomes”, Telstra should;
- (a) **Commission an independent “gap” audit to identify the material differences in output between the existing wholesale and retail systems; and**
 - (b) **Develop a rectification plan to address these differences in a manner that is timely and minimises the cost of the changes to access seekers.**
- 3.92 To ensure that the systems remain fit for purpose during the transition to the NBN, further measures will be required to be implemented. These are discussed in the sections below.

Equivalence and transparency metrics

- 3.93 For any equivalence regime to be effective it must be seen to deliver equivalence in practice. This necessitates the implementation of transparent and unambiguous reporting arrangements that measure actual service delivery. Without such arrangements access seekers can have no confidence in the equivalence regime. Further, without meaningful metrics enforcement of equivalence will be next to impossible.
- 3.94 Telstra’s proposed metrics in Schedule 3 are not appropriate as they do not properly measure equivalence and transparency. The metrics fundamentally lack the ability to show that quality, delivery and timeliness of services provided to Telstra’s wholesale customers are equivalent to those provided to Telstra’s Retail business Unit. They do not allow for a clear comparison of performance. Many of the metrics provide data that has little value or is meaningless. If adopted in their current form these metrics would allow for significant hidden or un-reported variations in operational quality both in systems and processes.
- 3.95 In essence Telstra’s proposed metrics are a direct cut and paste from the existing Operational Separation Plan (albeit with certain exclusions). These metrics not only disallow any meaningful analysis or explanation for any differences in, they further limit their analysis to the copper network when compared to those in the existing Operational Separation Plan.
- 3.96 The following examples demonstrate the inadequacy of Telstra’s proposed metrics:
- (a) Telstra has proposed a set of metrics for the Basic Telephone Service (Metrics 1 to 7) that are entirely based on the proportion of services that meet the minimum timeframes specified in the Customer Service Guarantee Standard (CSG). The use of the CSG timeframes as the target basis for the metrics is inappropriate as the CSG is a stand-alone obligation on all service providers which is wholly separate to the equivalence and transparency objectives of the SSU. Telstra’s metrics provide no meaningful analysis as whether the Telstra Retail business units are treated equivalently to wholesale customers. For example, reporting on the percentage of major rural Basic Telephone Services delivered *within 10 business days* does not allow for a comparison of equivalence between retail and wholesale delivery timeframes for those

services. While both Telstra Retail business units and wholesale customers may score a metric of 98%, Telstra Retail customers could still experience a significantly shorter provisioning time than wholesale customers.

- (b) Telstra's proposed metric 19 (TEBA) examines whether Telstra meets the requirement to inspect an installation completed by the Wholesale customer within 15 business days. This metric is entirely inappropriate as it ignores the 6-9 month lead time that is needed to establish a TEBA. Further, it provides no meaningful comparison of the time taken for either a wholesale customer or Telstra's Retail Business units to access an exchange.

3.97 In addition to these concerns, Optus notes that the utility of Telstra's proposed metrics are further undermined by a number of significant exclusions, which seek to assist Telstra in complying with its metrics. These include the following:

- (a) Under the General Conditions in Schedule 3, any services being migrated in a NBN Rollout Region would be excluded from the equivalence and transparency metrics. Optus strongly disagrees with this exclusion and considers that Telstra should specifically demonstrate that Wholesale and Retail Services are being treated equally immediately before and during NBN Migration activities i.e. both Retail and Wholesale metrics would be equally affected, if at all, by the NBN rollout.
- (b) Telstra has proposed that metrics would be adjusted when circumstances beyond its control cause delivery or fault rectification delays (such as 3rd party delays, natural disasters, emergencies, staff availability and legal access issues). This item highlights one of the key problems with Telstra's proposed metrics. By reporting only on performance against a minimum service level rather than on a comparative level, Telstra does not compare the actual provisioning or rectification timeframes that wholesale and retail customers are experiencing in any given quarter. Events such as natural disasters, staff availability etc ought to impact Telstra's Retail business units and wholesale customers on an equal basis and therefore the exclusion of these events is unnecessary and prone to subjective editing.
- (c) Similarly, under the Specific Conditions in Schedule 3 Telstra has sought to exclude the data from a number of scenarios in the reported metrics. Optus re-iterates that no exclusions should be included when a comparative performance metric is used as the both the Retail business units and the wholesale customers will be subject to the same general conditions. The exclusion of these Specific Conditions is unnecessary and prone to subjective editing.

Recommendation

3.98 **The proposed equivalence and transparency metrics should be fundamentally re-designed to ensure that they provide meaningful comparative statistics that would reveal the actual levels of service for the Retail Business Units and the Wholesale Business Units and the variances between them.**

- 3.99 Optus proposes a number of metrics which are detailed in the Attachment to this SSU. These include:
- (a) service qualification;
 - (b) rejection rates for orders;
 - (c) ordering and delivery timeframes;
 - (d) fault timeframes for different classes of service;
 - (e) administrative timeframes for TEBA build;
 - (f) Wholesale system availability; and
 - (g) billing timeframes.
- 3.100 To demonstrate equivalence, Optus proposes that the metrics provide a direct comparison of provisioning times separated into residential and business customers and by category (urban/rural/regional).
- 3.101 In addition fault repair times should be clearly separated for different service assurance levels that Telstra offers to its retail end customers and its wholesale customers. These metrics reflect instances where customers (both Wholesale and Retail) pay a premium for guaranteed faster fault rectification and maintenance.
- 3.102 Both provisioning and service assurance metrics should also measure whether appointment times are met.
- 3.103 Pre-ordering processes should be monitored for equivalence if Telstra continues to use different support systems and processes for wholesale customers and Retail business units. Therefore, Optus believes it is appropriate to include metrics which try to measure any significant differences in the ordering procedures which include could include order rejection rates, feasibility study timeframes and service qualification (SQ) timeframes.
- 3.104 Timely access to Telstra Exchange Building Access (TEBA) is crucial to allow interconnection to regulated services. Optus believes a metric should be included to measure the time to complete a TEBA installation at a Telstra exchange as this is a key input to the supply of regulated services such as ULLS, LSS and Domestic Transmission Capacity Service.
- 3.105 All systems associated with the supply and maintenance of services should be benchmarked. Systems such as Linx Online Service, ebill, LOLIG and ULL-CIS should be explicitly listed and metrics on their availability should be included in the Equivalence and Transparency Metrics. The revised metrics listed in the Attachment to this submission focus on full and partial availability, and no availability, of each of these systems for each quarter.
- 3.106 To reiterate, properly constructed reporting arrangements that measure actual service delivery and performance are an essential component of an effective equivalence regime.

Service Level Rebates

- 3.107 Another essential component of an effective equivalence regime is to ensure that appropriate measures are put in place to deal with instances where equivalence is breached and discrimination arises. These measures should operate both as a deterrent and a means to provide clear and remedial action in the event of a breach.
- 3.108 In this respect Telstra has proposed a Regulated Services SLA Agreement in Schedule 7 of the SSU. Effectively this scheme will provide an automatic rebate (given certain limitations) if there is a breach of the proposed equivalence metrics. There are, however, two significant conditions to this scheme; access seekers must contract-in to the scheme; and in doing so access seekers must waive all other rights to compensation (that is the rebate will be their sole remedy).
- 3.109 Optus submits that the scheme is ill-conceived and ill-designed
- (a) It fundamentally fails to provide any meaningful incentive for Telstra to provide equivalence. In fact it actually encourages Telstra to discriminate given the meagre level of the rebates; and
 - (b) It provides no meaningful compensation to access seekers.
- 3.110 The inadequacy of the Equivalence and Transparency Metrics has already been discussed in the section above. Even if it could be assumed that the metrics were robust and correctly defined, it is clear that the penalties that are to Telstra are inconsequential if there was a breach.
- 3.111 The following example demonstrates the inadequacy of the proposed SLA rebates;
- (a) Under Metric 20 (Schedule 7 paragraph 8) for ULLS CIS availability, the target availability for the ULL-CIS system is 98%, or 1248hrs per quarter. If the system is only available for 95% of the available hours between 6:00am-10:00pm. i.e. the metric is not met and this will result in 4 business days of unavailability.
 - (b) Optus submits approximately **commercial-in-confidence** If ULLS –CIS was not available for 4 business days, Optus would be able to claim approximately \$240 in rebates.
- 3.112 Clearly this amount is no reflection of the actual loss to Optus from such an outage, given that Optus may have lost the ability to process several thousand customer orders. Similarly the other SLRs do not reflect the loss suffered by Wholesale Customers nor do they incentivise Telstra to implement equivalence.
- 3.113 Telstra further limits its liability by excluding the Wholesale Customer right to claim a “rights of CSG contribution” under section 118A of the Consumer Protection Act if a Regulated Services SLA Agreement is entered into.

Recommendation

- 3.114 Telstra should not be able to buy its way out of its equivalence obligations. **If there is non-equivalence then the only acceptable remedy will be for Telstra to fix the fundamental cause for the non-equivalence. The obligation on Telstra should be absolute and a process should be put in place to facilitate this.**
- 3.115 Telstra must publically publish the Operational Equivalence Report setting out its achievements against the equivalence metrics for a Quarter within 60 days of the end of the relevant Quarter. **In circumstances where there is a difference in service delivery it should provide to the ACCC for approval;**
- (a) **Detailed information or data clearly identifying the causes/s of the non-equivalence;**
 - (b) **A detailed plan of actions to rectify the cause of the non-equivalence; and**
 - (c) **Timeframes to implement the remedy.**
- 3.116 **Telstra should provide sufficient detail to the ACCC and the Adjudicator to enable them to further query Telstra’s suggested steps for rectification.**
- 3.117 **The ACCC should have the right to consult with wholesale customers as to the suitability of the remedy.**
- 3.118 **If the ACCC, upon investigation of the data provided by Telstra and any other requested data, reasonably consider that the Rectification Plan is inadequate, the ACCC should be able to direct Telstra to modify the proposed rectification plan.**
- 3.119 **The proposed remedy should be implemented within 3 months after the report has been tabled with the ACCC unless otherwise agreed. The ACCC should have rights to enforce any changes it proposes.**

Information Equivalence

- 3.120 Access to information can be a key source of competitive advantage. An essential component of an effective equivalence regime is to ensure that wholesale customers receive access to relevant information at the same time as Telstra’s Retail business units.
- 3.121 While the objective of Clause 13 and Schedule 4 of the SSU is to ensure that the quality and timeliness of information provided by Telstra to wholesale customers in respect of network activities amongst other things is equivalent to that provided to the Retail Business Unit, Optus does not believe this objective is met.
- 3.122 Optus has the following concerns with the proposed information equivalence arrangements as set out in the SSU;
- (a) Under Schedule 4, Telstra should not be able to “carve out” any notifications related to the Migration to NBN. To do so, would deprive Wholesale Customers of the ability to manage its own network availability, take

- appropriate actions to mitigate outages and manage the expectations of its end customers;
- (b) Telstra restricts Network Notifications to services provided over the copper network only, which means that a number of fixed line regulated services are not captured. Further, the Notifications that are provided under Schedule 4 appear to be only a subset of the existing notifications provided to Wholesale Customers;
 - (c) Under paragraph 10 of Schedule 4, Telstra has excluded NBN related activities from the scope of the Network Modernisations. This is not appropriate since it will be critical for equivalence that access seekers receive sufficient advance notification of the withdrawal of copper based services;
 - (d) Under the Major Network Modernisation and Upgrade notifications in paragraph 10 Schedule 4, the suggested information to be provided in the General Notification is not sufficient to ensure equivalence between Telstra's Retail business units and Wholesale Customers and is of little value unless it provides key information about the ongoing availability of existing services and replacement services; and
 - (e) Under paragraph 11 of Schedule 4, Telstra defines Co-ordinated Capital Works Programs as a major network and modernisation activity that extends across more than one Exchange Service Area. In order for this forecast and schedule to have any value this definition needs to be extended to include activities in a single Exchange Service Area. Telstra's decommissioning of the copper network in South Brisbane is a major network upgrade activity that is affecting every address in five suburbs of central Brisbane and thousands of consumers. However, under the SSU this activity would not be classified as Co-ordinated Capital Works Program because it only covers a single exchange service area.

Recommendations

3.123 To address the above concerns, Optus recommends that the following changes are made to the information equivalence arrangements.

- (a) **Paragraph 2 of Schedule 4 should be deleted** (consistent with paragraph 3.122 (b) above);
- (b) **The obligation to provide Network Notifications should extend to all regulated fixed line services and not be limited to those supplied using the copper network;**
- (c) **In addition to the proposed Network Notifications detailed in Schedule 4, Telstra must be required to provide six monthly notifications for the forward two year period that detail proposed changes. These notifications should cover anything change that will affect Regulated Service, DSL or TEBA and Duct Access and include;**
 - (i) **Product withdrawals;**
 - (ii) **New products or feature changes;**

- (iii) **System changes (such as LOLO, LOLIG, ULL-CIS etc);**
 - (iv) **Network Changes; and**
 - (v) **Process Changes (such as transfer of services, churn of services etc);**
- (d) **In respect of Major Network Modernisations, Optus proposes that Telstra must provide the following information to Wholesale Customers when it initially sends a General Notification advice about the network upgrade:**
- (i) **The alternative services available;**
 - (ii) **The date of supply, pricing, interconnection requirements and technical specifications of the alternative services available;**
 - (iii) **The planned migration process including the migration dates for individual services and the costs involved;**
 - (iv) **The extent of the network upgrade;**
 - (v) **The exact services that will be affected;**
 - (vi) **The exact manner in which the services will be affected, including whether the service will be affected, in whole or, in part; and**
 - (vii) **The “cease sale date” for any new services.**
- (e) **The definition of Co-ordinated Capital Works Programs should be changed to include major network and modernisation activity that extends across a single Exchange Service Area.**

Access to Telstra Exchange Buildings (TEBA) & External Interconnect Facilities

- 3.124 Timely access to Telstra Exchange Buildings and External Interconnect Facilities ducts is a key input to a wholesale customer’s ability to interconnect with Regulated Services. Therefore it is essential that terms of access do not act as an obstruction.
- 3.125 Telstra’s proposals under Section 11 are inappropriate. They effectively adopt the existing processes which will necessarily entrench discrimination. A fundamental concern with the arrangements is that whilst Telstra on the one hand commits to use the same queuing process as access seekers on the other hand it allows itself the ability to reserve Exchange Capacity and External Interconnect Facilities for a 36 month period. This will enable it to by-pass the queuing process and access space in a manner that is not equivalent to access seekers who will be required to queue for any “leftover” facilities.
- 3.126 In some cases, the effect of Telstra’s forecasts may be to cap the Exchange Capacity or the External Interconnect Facilities even before a Wholesale Customer submits a request for access.

3.127 In addition, while Telstra states that it will treat internal requests (if any) in an equivalent manner to wholesale customer requests, Telstra is not obliged to establish a common ordering process for internal retail and wholesale requests (cl 11.2 (c)). Therefore it is not possible to determine if the limited requests received by internal retail customers are treated equivalently to wholesale requests.

3.128 Finally, Telstra's governance arrangements (clause 11.5) are inappropriate as they simply ensure that Wholesale Customers are being equally treated unfairly. It does not address the fundamental issues of Telstra reserving facilities without scrutiny and ensures that unilateral policy or process changes can be imposed on wholesale customers regardless of their commercial impact. These should provide for an independent oversight to ensure that the TBA processes operate in an equivalent manner.

Recommendation

3.129 To address the above concerns, Optus recommends the following obligations are placed on Telstra.

- (a) **Telstra's Retail business units should be required to use exactly the same TEBA and External Interconnect Facilities processes as access seekers.** In respect of future space requirements, a more equitable regime would be the collation of the forecast requirements of both wholesale customer's and Telstra's Retail business units for the same period of time (say 18 months) and the relevant facility reserved.
- (b) **Under Schedule 3, Optus proposes that metrics should be put in place to measure the comparative timeframes for TEBA access and External Interconnect Facilities processes for both retail and wholesale requests.**
- (c) **Governance arrangements should allow for an independent oversight determine whether the appropriate equivalence measures are being followed.**

DSL Upgrades

3.130 In section 14 of the SSU, Telstra undertakes that if it develops DSL Upgrade or develops mass market "Naked DSL" consumer product, it will offer the relevant comparable wholesale DSL service to Wholesale Customers.

3.131 Whilst Telstra's intention is welcomed the proposed arrangements do not actually deliver on the objective of putting access seekers in an equivalent position to Telstra's Retail business units.

3.132 Firstly, Optus submits that the "Naked DSL" product should not be limited to a mass market consumer product but any "Naked DSL" product for any market segment. Secondly and more importantly, Telstra should not be able to launch the Telstra Retail version of a DSL Upgrade or a Naked DSL product simultaneously with the Wholesale version. Access seekers will need to undertake product development to implement a new or upgraded wholesale DSL service. This is likely to take a minimum of six months on the assumption that the commercial terms for the product are acceptable to access

seekers. During this time, Telstra's Retail business units will have a significant "first movers" advantage in the market.

Recommendation

- 3.133 **Telstra must be obliged to provide the Wholesale customer details of the Wholesale DSL Product (technical specs, price and non-price terms, geographic availability, draft commercial agreement) at least six months prior to the commercial launch date of the DSL Upgrade or the Naked DSL Product.** This would ensure that wholesale customers can commercially launch their services at a similar time to Telstra's Retail business units
- 3.134 **Additionally under paragraph 14(d), any product testing undertaken must be offered to all Wholesale Customers rather than select Wholesale Customers who are "handpicked" by Telstra.** These trials must also occur at the same time as the Telstra's Retail business units. Optus believes this is essential as product trials for new services allow service providers to refine the product and enable the development of a "fit for market" product launch. To adopt Telstra's proposed process would entrench non-equivalence.

Information Security Arrangements

- 3.135 At a high level the proposed information security arrangement appear to go some way towards protecting confidential and commercially sensitive information. That said there are a number of gaps in these arrangements, which necessitate a number of additional safeguards to be incorporated into a revised SSU.
- 3.136 A significant issue relates to the clear implication that Telstra's Retail business units are able to access information provided to Telstra by wholesale customers, albeit in an aggregated form (so long as the identity of the wholesale customers is not disclosed). Optus submits that this is not reasonable. It would enable Telstra Wholesale to prepare "market share" reports and to use these to win back customers, thereby repeating the problems identified in Optus ongoing Federal Court action against Telstra for breach of confidentiality obligations. This is fundamentally inconsistent with Telstra's equivalence obligation. Telstra Retail should not be able to gain advantage by virtue of the commercial relationship between Telstra Wholesale and its customers.

Recommendation

- 3.137 To address this issue and to ensure that information security arrangements are fit for purpose Optus recommends that the following changes need to be made to the SSU.
- (a) **Delete clause 9.5.**
 - (b) **Delete clause 9.2(b)(i), 9.2(b)(ii) and removing reference to clause 9.2(b) in clause 9.5(b).**
 - (i) Protected Information should not be restricted to information disclosed to Telstra from Wholesale Customers. It should include other sources as well (clause 9.2(b)(i)). For example, confidential information of the Wholesale Customer may be disclosed to Telstra by NBN Co.

- (ii) Information may be provided by a customer of a Wholesale Customer but this may still be confidential to the Wholesale Customer. (9.2(b)(ii))
- (c) As well as ensuring that any information relating to a Wholesale Customer provided to the Network Services Business Unit is not to be disclosed to any Retail Business Unit (cl. 9.4(a)(ii)), the Network Services Business Unit should not use that data for the advantage of the Retail Business Unit. For example, the Network Services Business Unit may be requested to provide quotes for Retail Business Unit and a Telstra Wholesale Customer (via the Wholesale Business Unit) for a corporate customer bid (e.g. a major bank's national data and transmission facilities). In these instances, **the Network Services Business must not use Protected Information for the advantage of the Retail Business Unit.**
- (d) Similarly under clause 9.4(b), **any Employee of the Network Services Business Unit may use Protected Information for performing his/her duties but must not use that information for the advantage of the Retail Business Unit.**
- (e) **Appropriate punitive actions should be imposed on any member of staff who deliberately disclose or use Protected Information of a Wholesale Customer for the benefit of Telstra's Retail business units.**

Dispute Resolution Arrangements

- 3.138 A central component of the proposed dispute resolution arrangements under the SSU is Telstra's proposed Independent Telecommunications Adjudicator (ITA).
- 3.139 Optus notes that this is a concept that Telstra has been pursuing since 2008, i.e. from the time it was actually seeking to roll-back regulation and challenge any attempts at pro-competitive regulatory reform. We have always, therefore, been sceptical about Telstra's motives in pursuing the establishment of an ITA, since it has appeared more of an attempt to step around the ACCC on some key competition issues. This would involve those issues being determined by an adjudicator with a more narrow technical focus than the ACCC, which is likely to deliver outcomes more consistent with Telstra's interests.
- 3.140 Optus has consistently argued that the industry already benefits from an independent adjudicator, it is the ACCC. The ACCC remains best placed to deal with all disputes, including those focused on non-price terms of access and equivalence of access, which involve issues of a more technical and operational nature. Optus' experience to date with non-price disputes is that whilst these deal with technical matters they also typically involve key threshold questions about the nature of the dispute and whether there is a case to be heard. A good example is provided by Optus' Access Dispute relating to the provisioning process for connecting the ULLS service in Multi-Dwelling Units. Before proceeding to examine the case in detail the ACCC had to address Telstra's claim that the ACCC did not have jurisdiction because the dispute fell outside the scope of the declared service and that since Telstra did not use ULLS there could be no breach of standard access obligations. The ACCC rejected these claims and heard the dispute.

3.141 This demonstrates that the ACCC is properly placed to deal with these questions because these threshold questions often come down to interpretations about the Telstra's obligations under existing law. Optus notes that there is nothing to stop the ACCC seeking external technical expertise to assist it in any particular dispute. Such an approach could effectively take on elements of the proposed ITA scheme. Properly constructed there might be some merit in having an ITA to assist the ACCC in its role.

3.142 However, the arrangements proposed by Telstra are deeply flawed and Optus would not sign-up to this scheme. The ACCC should assume that Telstra's scheme is not fit for purpose if access seekers are unwilling to sign-up to it. Our concerns with Telstra's proposed scheme are set out in more detail below.

Independence

3.143 Optus is not satisfied that the current arrangements guarantee the independent operation of the ITA. These arrangements stipulate that the Board of Directors will be appointed by Telstra, which will clearly give Telstra significant scope to influence the operation of the ITA over time.

3.144 We recognise that Telstra has argued that the activities of the Board of the ITA will be constrained by the proposed draft constitution and "charter of Independence", both of which will be subject to ACCC approval.

3.145 However, since neither of these documents has been provided to the ACCC, it should assume that these will not address access seeker concerns about the independence of the ITA. In any event, our experience with Telstra's documented policies is that they can and will be broken so a "constitution" or "charter" will offer no tangible guarantee of independence.

Jurisdiction and Ability to make decisions

3.146 Optus notes that there appears to be some significant constraints on the ITA's ability to take on disputes and to make decisions. These limitations include:

- (a) Disputes can only be referred if they have gone through Telstra's "accelerated investigation" process as a first step and this has failed to resolve the issue. This adds an element of bureaucracy and delay to the process of resolving disputes. It also introduces scope for disagreements as to whether a matter has passed the necessary hurdles for referral to the ITA. This process places significant time constraints on access seekers that are likely to operate to make the process fall over and prevent escalation through to the ITA.
- (b) There is a burden of proof for an access seeker to demonstrate that it has been "materially or detrimentally affected" by the issue. This provides significant scope for disagreement as to whether a complaint is valid.
- (c) Disputes cannot be referred to the ITA that do not relate to a failure of a system or process, so a complaint regarding repeated non-delivery or breach of SLA's could not be referred to the ITA.
- (d) The ITA can only require Telstra to change a process or system if there is evidence of systemic breach of "equivalence". This places an undue burden of

proof on access seekers to demonstrate a repeated pattern of behaviour, which they may not be in a position to prove. Further, it is a wholly unreasonable limitation. A breach is a breach regardless of how often it occurs. A single breach could be just as material if not more so than a repeated breach. For example, a single breach that leads to the loss of a customer is significant.

- (e) The ITA cannot make a ruling that either prescribes or proscribes a specific system or process, design or technology. It is left to Telstra to proscribe such systems or processes in response to a ruling by the ITA. This provides access seekers with no level of confidence that such a change would be fit for purpose and that it would appropriately resolve the dispute.
- (f) The directions of the ITA are subject to monetary caps, of \$1 million per event and \$10 million per annum. This is simply unreasonable. Telstra has an obligation to provide equivalence. The legislation places no limit on the cost of achieving that equivalence – so nor should Telstra. The reality is that the greater the cost of any change to Telstra the more significant the likely breach of equivalence and the more important it will be for that breach to be addressed by whatever means are necessary. Further, in practical terms our experience is that process and/or systems changes in telecommunications are usually costly and the proposed caps will be easily breached.

3.147 In addition Optus notes that the proposed arrangements enable the ITA to make orders against access seekers. This is completely unacceptable and is at odds with the intent of the legislation which is directed at Telstra's behaviour not access seekers.

Funding and cost orders

3.148 Telstra proposes that whilst it will fund the ITA for one year, thereafter access seekers will contribute to funding by way of an annual fee, specific investigation fees and cost orders issued from time to time.

3.149 Further, there appears to be a suggestion that the ITA can make a cost awards against access seekers, which may require them to pay Telstra's fees in connection with the investigation of a complaint.

3.150 These proposed funding arrangements are wholly unreasonable. The purpose of the proposed "equivalence and transparency" arrangements that are to address Telstra's continued abuse of its monopoly position and existing equivalence obligations. To require access seekers to contribute to Telstra's cost of compliance with its obligation, which is what the proposed funding arrangements imply, demonstrates breath taking arrogance by Telstra. It would also turn on its head the normal practice were the perpetrator of an offence should pay the penalty not the victim.

Recommendation

3.151 As indicated above, Optus considers that there might be some merit in a properly constructed ITA scheme as a means of assisting the ACCC in its various roles under the CCA. To ensure it is fit for purpose and access seekers have the confidence to sign-up to the ITA scheme, it must adhere to the following key principles:

- (a) **The ITA should operate under the jurisdiction of the ACCC.**
- (b) **The ITA should be appointed by the ACCC after consultation with the industry. Any person selected for this role should have the confidence of the industry and should be able to demonstrate an appropriate level of independence.**
- (c) **The cost of the ITA should be met out of the ACCC's budget but with reimbursement of those costs from Telstra. An administrative fee could be imposed on access seekers (much like the fee for raising access disputes) to prevent frivolous or vexatious disputes from being raised.**
- (d) **The ITA should focus solely on non-price related disputes relating to breaches of equivalence.**
- (e) **The ITA to be able to make binding determination under the heads of power of the ACCC.**

Section 4. Case Study – The Scope for discrimination and why the SSU will not prevent it

4.1 In this section we seek to bring to life the concerns raised in section 3 relating to the numerous and significant failings of Telstra’s proposed equivalence and transparency arrangements in the SSU. We do this by providing a hypothetical (albeit all too common) example of a customer putting its business out to tender between Telstra and Optus.

The scenario

4.2 SmartCo, a leading retail Small Medium Enterprise business with branches in several metropolitan and regional locations, has put out a request for tenders from providers of telecommunications services, with the following requirements;

- (a) Ubiquitous coverage across its facilities;
- (b) Whole of business (WOB);
- (c) Comprehensive scope (fixed, mobile, voice, broadband, managed services);
- (d) Service continuity and prompt response to faults;
- (e) Minimum disruption to business;
- (f) Value for money; and
- (g) A hard deadline for lodgement of tenders.

4.3 Optus and Telstra are competing to win SmartCo’s business.

Opportunities for discrimination

4.4 Optus will supply some of the services required by SmartCo using its own infrastructure (primarily mobile services), and will rely on Telstra Wholesale for other services (primarily fixed services). In order to supply Optus with the required services, Telstra Wholesale will need to procure services internally from Telstra’s Network Services Unit (NSU). The relevant Telstra Retail business unit, Telstra Business, will also need to procure the same services internally from Telstra’s NSU.

4.5 Given Telstra’s goal of winning the SmartCo tender, Telstra’s NSU will have an incentive to provide superior service (or a lower “price”) to Telstra Business than the service (or price) it provides to Optus (via Telstra Wholesale). If appropriate controls are not in place, there will be opportunities for Telstra’s NSU to discriminate in the way it supplies its services. For example, it could discriminate across the following dimensions;

- (a) Quoting timeframes;
- (b) Service Levels;
- (c) Provisioning timeframes; and
- (d) Pricing.

- 4.6 In order for Optus to compete on a level playing field against Telstra Business for the SmartCo contract, it is critical that Telstra be prevented from discriminating in these ways. This is a reasonable test for the SSU. If it is to effectively promote equivalence, then it must prevent discrimination across all of these dimensions.
- 4.7 The SSU's likely performance in preventing discrimination in respect of each of the above opportunities is considered below.

Quoting timeframes

How Telstra can discriminate

- 4.8 SmartCo will choose its supplier of telecommunications services from amongst those providers that are able to make accurate, reliable tenders by the deadline. Equivalence requires that Optus is able to obtain accurate quotations from Telstra Wholesale on the same timeframe as Telstra Business is able to obtain the required information on the cost of service provision from Telstra's NSU.
- 4.9 Currently, Telstra's retail units are able to obtain the required cost information promptly; whereas access seekers are frequently forced to wait for lengthy periods before receiving a quote.
- 4.10 Alternatively, the initial quote received may be unrealistic and further negotiation is required, which pushes the timeframe out. If Telstra Wholesale does not provide an acceptable quote before the RFT deadline, then Optus could be forced to "estimate" the cost, which could compromise the accuracy and competitiveness of its tender.

Will the SSU prevent discrimination?

- 4.11 The SSU does not attempt to address this issue, because metrics are provided only for services ordered. Pre-order steps including quoting timeframes are not covered in the SSU.
- 4.12 So if the SSU is finalised in its current form, Telstra's NSU will still be able to provide Telstra Business with cost information on a shorter timeframe than Optus. It follows that the SSU cannot prevent Telstra from discriminating against Optus and in favour of Telstra Business in the area of quoting timeframes.
- 4.13 As the result of this discrimination, Optus' tender to SmartCo may be late, inaccurate or noncompliant; whereas Telstra Business's tender will be timely, accurate and fully compliant.

Service Levels

How Telstra can discriminate

- 4.14 Service continuity and prompt response to faults are critical to many SME's that operate in a competitive retail market place. Accordingly, SmartCo will choose its supplier of telecommunications services based, in part, on the service levels (SLAs) that the supplier is able to offer, for example on timeframes for technician availability and fault rectification. Equivalence requires that Telstra's NSU makes the same SLAs available to Optus as those it makes available to Telstra Business.

4.15 Currently, Telstra Business is able to offer superior SLAs which are unavailable to access seekers. For example, technicians can be made available 24/7 to address faults for Telstra's retail customers; whereas technicians are available to address ULLS faults experienced by access seekers only by the next business day for Band 1 and Band 2 services (by the end of 2 full business days for Band 3, by the end of 3 business days for Band 4).

Will the SSU prevent discrimination?

4.16 The SSU does not attempt to address this issue, because metrics are measured against percentages of services that are repaired within CSG timeframes which is the next business day for Band 1 and Band 2 services. (by the end of 2 full business days for Band 3, by the end of 3 business days for Band 4).

4.17 This measure is not effective, because it is based on CSG timeframes, which are an obligation on all service providers, rather than a direct comparative measure. So, despite this provision, Telstra's NSU will still be able to provide service levels to Telstra Business which are superior to those it provides to Optus. That is, the SSU cannot prevent Telstra from discriminating against Optus and in favour of Telstra Business in the area of service levels.

4.18 As the result of this discrimination, Telstra Business will be able to offer SmartCo superior SLAs in its tender compared to the SLAs Optus is able to offer (in respect of services which it sources from Telstra Wholesale).

Provisioning timeframes

How Telstra can discriminate

4.19 A high priority for SME customers is that the disruption to their business on changing service provider is minimised. Accordingly, SmartCo will choose its supplier of telecommunications services based, in part, on the date by which the supplier will commit to beginning to provide services. Equivalence requires that Telstra Wholesale services are provisioned by Telstra's NSU on the same timeframe as Telstra Business services.

4.20 Currently, Telstra's NSU only offers access seekers indicative provisioning times based on whether minimal internal work or extensive external work is required. If a commitment date is given, it may be extended by Telstra at any time. In contrast, Telstra's retail units could experience expedited provisioning timeframes (compared to those available to access seekers).

Will the SSU prevent discrimination?

4.21 The SSU does not attempt to address this issue, because metrics are measured against percentages of services meeting the indicative provisioning time.

4.22 This measure is not effective, because it is based on an indicative service level rather than a direct comparative measure. So, despite this provision, Telstra's NSU will still be able to provide shorter provisioning timeframes to Telstra Business compared to those it provides to Optus. That is, the SSU cannot prevent Telstra from discriminating against Optus and in favour of Telstra Business in the area of provisioning timeframes.

- 4.23 Due to this lack of equivalence, in its tender Telstra Business will be able to offer SmartCo a more rapid and efficient transition, and minimal disruption to SmartCo's business compared to the offer Optus is able to make in its tender (in respect of services which it sources from Telstra Wholesale).

Pricing

How Telstra can discriminate

- 4.24 Pricing levels will clearly be a key determinant of SmartCo's ultimate choice of service provider. Equivalence requires that, for any wholesale service required by Optus for the contract (e.g. a transmission capacity service), Telstra Business faces an internal wholesale price (IWP) which is the same as the external wholesale price (EWP) paid by Optus (via Telstra Wholesale). For true price equivalence, the IWP must be a real, direct cost input which is borne by the relevant Telstra retail unit and demonstrably forms a component of retail prices charged by that unit.
- 4.25 Further, equivalence requires that any ancillary charges applied to Optus, such as the special linkage charge (SLC) levied to cover build costs for new infrastructure, apply equally to Telstra's retail units.
- 4.26 Currently, there are no clear guidelines around the IWP which Telstra Business faces in order to provide transmission capacity services. This means that, if Telstra Business wanted to offer SmartCo a lower price for certain data services than Optus was able to offer, then Telstra's NSU is able to lower the IWP faced by Telstra Business for transmission capacity. Under the proposed organisational arrangements Telstra's Business management would have an opportunity to see the wholesale price offered to Optus.
- 4.27 Further, SLCs are levied on access seekers, but may not form part of the internal wholesale price applied to Telstra's retail units.

Will the SSU prevent discrimination?

- 4.28 The SSU attempts to address this issue by requiring Telstra to publish its IWPs and compare them to EWPs. Pricing differences of above 5% will trigger the preparation of a 'substantiation report'. However, there is no stated consequence for the ACCC or access seekers following the substantiation report. The SSU does not address ancillary charges such as SLCs.
- 4.29 Consequently, notwithstanding the price equivalence provisions, Telstra's NSU will still be able to set the IWP faced by Telstra Business for transmission capacity services at a level significantly lower than the EWP faced by Optus. And it will be able to levy SLCs on Optus that are not faced by Telstra Business. That is, the SSU cannot prevent Telstra from discriminating against Optus and in favour of Telstra Business in the area of pricing.
- 4.30 As the result of this discrimination, Telstra Business' tender to SmartCo could contain prices in respect of fixed services that are lower than those Optus is able to charge (without making negative returns).

Outcome of the scenario

- 4.31 Since the SSU cannot prevent Telstra from discriminating against Optus and in favour of Telstra Business in any of the potential dimensions identified, it is highly likely that Telstra Business' tender to SmartCo will be superior to Optus' tender in terms of;
- (a) Quoting timeframes;
 - (b) Service Levels;
 - (c) Provisioning timeframes; and/or
 - (d) Pricing.
- 4.32 In this scenario Telstra Business wins the SmartCo tender as the direct result of discrimination by Telstra.

Conclusion

- 4.33 Whilst this is a hypothetical example, similar cases have been played out many times in the last decade. The reality is that Telstra has won many contracts by virtue of an unfair advantage and by taking opportunities for discrimination against competitors which are also its wholesale customers. Whilst Telstra does face competition, the playing field is tilted in its favour and Telstra does not play fair. The market for fixed line telecommunications services in Australia is far from effectively competitive.
- 4.34 Telstra's SSU provides a last real opportunity to solve these problems and allow Optus to compete for SmartCo's business on a level footing. However, this opportunity risks being lost. As the hypothetical example demonstrates, the SSU does not effectively promote equivalence and is not fit for purpose in its current form.
- 4.35 In order to effectively promote equivalence and to ensure that the scenarios highlighted in this case study do not occur the key changes to the equivalence arrangements we have proposed need to be made. These will ensure that;
- (a) Quotations supplied by Telstra Wholesale to access seekers are given in the same timeframe as Telstra's NSU provides the required information on the cost of service provision to Telstra's Retail business units;
 - (b) SLAs made available by Telstra's NSU to access seekers are equivalent to those it makes available to Telstra's Retail business units;
 - (c) Telstra Wholesale services are provisioned by Telstra's NSU on the same timeframe as services required by Telstra's Retail business units; and
 - (d) The internal wholesale prices faced by Telstra's Retail business units must be identical to the prices faced by Telstra's wholesale customers; and further, the internal wholesale prices must be a real, direct cost input which is borne by the relevant Telstra Retail business unit and demonstrably forms a component of retail prices charged by that unit.

Section 5. Consolidation of fixed line access networks

- 5.1 The ACCC has sought input on the potential competition impacts from the industry consolidation that will inevitably occur if the SSU is accepted.
- 5.2 Optus has previously argued in favour of such consolidation if the correct regulatory settings are put in place. For a country of Australia's geographic scale and population size upgrading the existing fixed line infrastructure to support the delivery of a highspeed broadband service on a national basis is economically challenging.
- (a) Firstly, the costs of rolling out the proposed NBN, which will cover 100% of the population, are likely to be substantial.
 - (b) Secondly and consistent with the Government's commitment to fund the NBN, there is little or no commercial case to deploy this infrastructure outside the most densely populated metropolitan areas without a high-level of Government support.
 - (c) Thirdly, to ensure such infrastructure is viable and services remain affordable it will have to carry a substantial proposition of all Australia's fixed line voice and data traffic. In practical terms only a single national network will be viable.
- 5.3 To roll-out the NBN will, therefore, necessitate a policy shift from infrastructure based competition to an approach which looks to maximise competition over a single national network infrastructure. Optus submits that such an approach can produce a number of efficiency benefits compared to an approach where competing networks are encouraged.
- 5.4 Telstra's decision to overbuild Optus' HFC cable network in the 1990's provides an obvious case study of the difficulties in Australia of supporting multiple last mile fixed line infrastructure. Neither network has achieved the level of penetration to deliver an adequate return on the investment with the result that both Optus and Telstra have been forced to make significant write downs totalling some \$2.4 billion on the carrying value of those networks. Such an outcome is socially wasteful and harms consumers because it necessarily results in higher prices for services on these networks.
- 5.5 The potential diseconomies of scale from having competing last mile networks running side by side are likely to be considerable and will ultimately place in jeopardy the anticipated social and economic benefits of the proposed highspeed broadband infrastructure. Specifically the risks include;
- (a) One or both of the competing networks either failing to deliver to their full potential or indeed failing altogether;
 - (b) Prices on the competing networks being higher than they ought to be because of the lower economies of scale; and
 - (c) Leading to lower levels of service take-up and less innovation.

- 5.6 Acceptance of Telstra's SSU by the ACCC and its approval by Telstra shareholders will clearly lead to consolidation of the fixed line networks. It will almost certainly support the roll-out of the NBN both by ensuring that take-up of services on the NBN will be maximised and by enabling NBN Co to utilise existing infrastructure to assist with the deployment of the network.
- 5.7 However, to compensate for this loss of competitive intensity at the infrastructure level it is vital that regulatory arrangements are put in place to facilitate intense competition in downstream retail markets. Optus has consistently argued that any regulatory arrangements need to be focused on two key objectives;
- (a) Effective measures to address Telstra's vertical integration so that it cannot simply carry its dominance across to the NBN; and
 - (b) Effective regulation of the NBN, which will be a licensed monopoly.
- 5.8 For the reasons outlined in Section 2 we are not convinced that the SSU in its present form will help to deliver a level playing field in the transition to the NBN. There remains a real risk that rather than advance competitive intensity the proposed arrangements will actually enable Telstra to carry its dominance through to an NBN environment.
- 5.9 Further, at the present time there is considerable uncertainty as to the long-term access conditions that will apply to the NBN given that NBN Co has yet to lodge its long awaited Special Access Undertaking (SAU). What detail has been made available to date on the terms NBN Co proposes to include in its SAU suggest that the conditions for network consolidation may not be met since those terms would provide NBN Co with the scope to exploit its monopoly position. That said, we note that the terms of NBN Co's SAU are likely to change through a constructive industry engagement process.
- 5.10 Optus notes that the ACCC has the ability to address each of these concerns. Firstly, the ACCC can ensure that significant changes are made to Telstra's SSU in line with the recommendations outlined in this submission. Secondly, the ACCC can ensure that NBN Co's SAU is consistent with the long term interests of end-users and does not provide NBN Co with any scope to abuse its markets position.

Section 6. Telstra's horizontal integration

- 6.1 This section sets out Optus' comments in response to the ACCC's questions about the potential implications of Telstra's ongoing ownership stake in Foxtel.
- 6.2 Telstra's fifty per cent ownership in Foxtel has been recognised to have caused significant distortions in the development of the Pay TV market within Australia, with associated impacts on the telecommunications fixed line services market. As long ago as 2003, the ACCC specifically noted that:

"Telstra's partial ownership of Foxtel provides it with the incentive to:

- foreclose supply of pay TV channels by Foxtel to other networks competing with Telstra for the supply of telecommunications services
- prevent other pay TV businesses or channels from gaining access to Telstra's HFC network".¹³

- 6.3 Optus submits that this problem will be significantly magnified with the migration to higher speed broadband services such as those to be offered on the NBN since IPTV and the associated content are likely to be key drivers for the take-up of those services. That is, control of content will become increasingly critical, since it will become a crucial factor in customer's purchasing decisions. There are two important aspects to this.

- (a) Firstly, content will create the customer demand for higher speed broadband services; and
- (b) Secondly, it will also be an important means by which carriers will seek to differentiate themselves and generate incremental revenue.

- 6.4 The importance of content as driver of subscription over Next Generation Networks (NGN) access networks and, indeed in underpinning the economics of the roll-out of NGN infrastructure, is well recognised. For example BT has noted that;

*"Pay TV is the primary source of additional revenue per user necessary to pay for such [fiber] investments"*¹⁴

- 6.5 Triple play is likely to become the most important driver of subscription in the emerging NBN fixed environment. For example, Ofcom has recognised that in the UK market:

"Most bundles include fixed-line broadband as one of the components... However, the greatest growth has been in the take-up of triple-play services including fixed voice, broadband and pay-TV, particularly since Sky launched its triple-play service in the summer of 2006".¹⁵

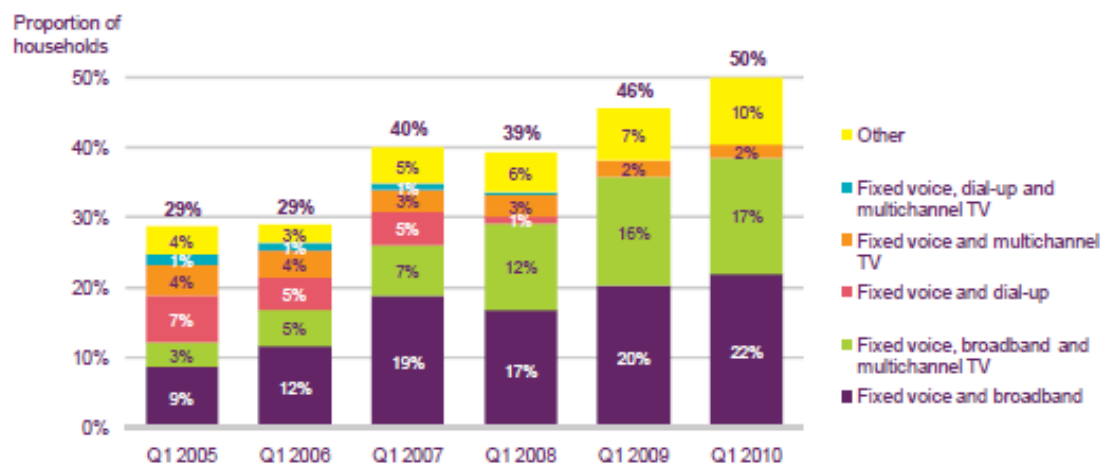
¹³ ACCC "Emerging markets structures for the communications sector" page 39

¹⁴ BT submission to Ofcom Third Pay Tv Consultation

¹⁵ Ofcom, *Communications Market Report*, Research Document, 19 August 2010, p.57

- 6.6 The strong take up of triple-play offerings is clearly demonstrated in the following graph, in which Ofcom further notes that “In Q1 2010, 17% of all households took a triple-play bundle of fixed voice, fixed broadband and pay-TV, compared to just 3% five years ago.”¹⁶

Figure 1.40 Take-up of bundled services over time



- 6.7 Further, Triple play and Quad play customers are substantially more valuable customers than those who take only one or two services. According to Virgin Media, for example, monthly Average Revenue Per User (ARPU) for quad play customers is over GBP80 compared to around GBP46 for single, double and triple play customers (see Appendix C).¹⁷ They also have significantly lower churn rates compared to customers who take only one or two services. According to Virgin Media, for example, the churn rate of triple play customers is half that of single service customers; for quad play customers the churn rate is less than a quarter that of single service customers.¹⁸
- 6.8 Optus submits that Telstra’s 50% ownership of Foxtel gives it the ability to access Foxtel’s content on terms and conditions that will provide it with a distinct advantage over its rivals. Specifically, this relationship will give Telstra a unique ability to offer the increasingly important Triple and Quad play bundles that will help to drive customer take-up on the NBN. That is, access to Foxtel’s content on favourable terms will give Telstra the ability to recreate a dominant position on the NBN regardless of its level of vertical separation. Indeed, it would be possible for Telstra to use its influence with Foxtel to ensure that only it has access to certain types of content.
- 6.9 In summary, Optus submits that Control of exclusive content rights will significantly increase Telstra’s ability to gain a dominant market position on the NBN.
- 6.10 We note that we are not alone in these views. The Government recognised the competition issues associated with exclusive content and bundling in the explanatory memorandum to the Competition and Consumer Safeguards Bill:

¹⁶ i.b.i.d

¹⁷ Virgin Media Investor Day, December 2010, Slide 28.

¹⁸ Virgin Media Investor Day, December 2010, Slide 28.

“Exclusive access to content creates an effective means of locking customers in. Further lock-in can be achieved through the bundling of services (i.e. selling two or more types of services together at a discount rate). Access to content on an exclusive basis limits the opportunities available to competitors, in both the carriage and content sectors.”¹⁹

- 6.11 These risks were also recently identified by the former Chairman of the ACCC, Graeme Samuel, in a recent address to the National Press Club, in which he highlighted challenges surrounding the distribution of content:

“Content control is paramount. We might have a series of pipes to distribute content to consumers, but if the compelling content is controlled by too few media players, they will have a stranglehold over the competitive landscape in this important area.”²⁰

Recommendation

- 6.12 Optus recognises that the ACCC has limited if any ability to address these concerns in the context of its review of the SSU.
- 6.13 However, it is open to the Government and the ACCC to seek address concerns about Telstra’s ability to leverage control of exclusive content owned by Foxtel as part of the broader policy considerations of the appropriate regulatory setting for the NBN environment. This could take the form of an inquiry into the need for a content access regime, of the sort proposed in the UK, to ensure that control of content cannot be used to undermine competition in an NBN environment.

¹⁹ Explanatory Memorandum to Competition and Consumer Safeguards Bill

²⁰ ACCC, *Collins Street sleeper agent or Castro’s right-hand man?*, Graeme Samuel, ACCC Chairman, Speech

Section 7. Other Issues

Substantial Adverse Events

- 7.1 Optus shares the ACCC's concerns about the proposed substantial adverse events provision in the Telstra/NBN Co Definitive Agreement (DA).
- 7.2 We submit that any variation to the DA should be subject to ACCC scrutiny and approval on the basis that such a variation could alter the nature and impact of the agreement entered into. More importantly, such changes may impact competition both in the transition period to the NBN and the period after the NBN is operational.
- 7.3 This is a material oversight and absent changes which enable ACCC scrutiny of any changes to the DA would necessitate rejection of the SSU alone.

Section 8. Migration Plan

Maximising the end-user experience

- 8.1 The disconnection of Telstra services from the copper network and the migration of customers to the NBN will be an extremely complex process. It is unprecedented in its scope and scale and will represent a huge logistical challenge for our industry.
- 8.2 The process will inevitably involve close interaction between multiple parties, often with different priorities. Whilst the industry has a good history of working in cooperation, the fact is that many of the existing inter-operability arrangements will not be fit for purpose for this process.
- 8.3 Optus acknowledges that the Migration Plan is necessarily aimed at high level. It sets out key principles and processes that will be followed. However, much of the detail will need to be filled in at a later date as detailed plans for de-commissioning and migration are developed.
- 8.4 Optus submits that access seekers should have a central role in assisting with the determination of this detail to ensure that all end-users receive a seamless transition to the NBN. It should not be left solely to Telstra and NBN Co to work out this detail.
- 8.5 Optus considers that the complexities of the process are such that these ought to be tested out through a trial of the migration plan arrangements in a least one fibre roll-out region. This would provide the industry with an opportunity to test the detailed processes and identify and address any issues.

Recommendation

- 8.6 **Optus recommends that the processes set out in the Migration Plan should be trialled at a fibre roll-out region.**

Special services

- 8.7 The Migration Plan sets out arrangements to maintain the copper network for a defined list of “Special Services”, until there is a suitable NBN Co product available to support the service. To ensure that equity is provided to access seeker services (supplied over the ULLS/LSS service) can also qualify to be remain on the copper network until a suitable NBN product is available.
- 8.8 However, Optus notes that the equitable treatment afforded to access seekers only goes so far and in a number of respects access seekers are not afforded the same rights as Telstra Retail. Optus has a number of concerns with the process.
- 8.9 Firstly, it appears that the disconnection date for services supplied over ULL is tied to the disconnection date for Telstra Products. Optus submits that this principle is unreasonable and unnecessary. It should not be assumed that access seekers services will be comparable in all respects to Telstra’s services. Therefore, the fact that an NBN Co product is sufficient for Telstra’s requirements does not mean it will be sufficient to meet an access seeker’s requirements.

- 8.10 Secondly, the NBN Co White Paper process which will be used to determine whether a “fit for purpose” NBN Co product is available is Telstra centric. That is it appears that only Telstra has an ability to “dispute” whether a proposed NBN Co product is equivalent to an existing Special Service. There appears to be no ability for access seekers to engage in an equitable process with NBN Co relating to services provided over ULLS.
- 8.11 Thirdly, access seekers are required to go through a pre-certification process to determine whether a service provided over the ULLS can be classified as a “Special Service”. This process is to be managed by Telstra. This gives rise to a number of separate concerns;
- (a) The verification process seeks to define access seekers service by reference to a list of Telstra services. This creates an artificial hurdle since it means access seeker services can only be certified if there is an equivalent Telstra product. This is unreasonable since a number of existing access seeker services may not have a comparable Telstra product.
 - (b) The certification process is not subject to independent oversight. Optus submits that Telstra would have a commercial incentive not to certify its competitor services; and
 - (c) The process will potentially reduce the scope for innovation by placing a constraint on access seekers to ensure that the services they supply over ULLS are in lock-step with Telstra’s products and services.
- 8.12 Fourthly, the arrangements for “Contracted Special Services”, which provides for separate migration arrangements for services provided under existing contracts only apply to Telstra. This is inequitable, since access seekers will also have contractual commitments to customers.
- 8.13 Fifthly, the exceptions relating to the handling of double ended services only apply to Telstra services and not access seeker services.

Recommendation

- 8.14 Optus recommends that the following changes are made in respect of the proposed migration plan arrangements for Special Service:
- (a) **Access Seeker Special Services supplied over the ULLS and LSS should be defined separately.**
 - (b) **The process for certifying these services should be overseen by an independent expert, not Telstra.**
 - (c) **The process for determining the disconnection date for access seeker services should be determined by the NBN Co White paper process with access seekers afforded the same dispute rights in that process as Telstra.**
 - (d) **The arrangements for “Contracted Special Services” should also apply to access seeker services supplied under contract.**

- (e) **The exception handling arrangements for double ended services should also apply to access seekers.**

Information Security in relation to NBN Co Information

- 8.15 It is likely that under its agreement with NBN Co Telstra will gain access to commercially sensitive information in respect of the NBN roll-out which, if misused, could give Telstra a commercial advantage over other access seekers.
- 8.16 In this respect, the Migration Plan sets out a commitment for Telstra to develop confidentiality/information ring fencing procedures for approval by the ACCC which will help to prevent Telstra's misuse of such information. Indeed, this is a specific requirement of the Ministerial Instrument.
- 8.17 However, Optus notes that this plan will only be prepared after the Migration Plan has been accepted by the ACCC. This is not reasonable. Access Seekers are entitled to surety that Telstra will not be able to gain any competitive advantage in the transition to the NBN by virtue of its agreement with NBN Co. This is a material issue and should be addressed prior to acceptance of the Migration Plan.
- 8.18 Further, we note that there is a significant carve-out to the proposed ring fencing arrangements. At clause 24.1 (e) Telstra indicates that *"any information which has been made available to Telstra by NBN co under an agreement which is not a Definitive Agreement"* is excluded. This is not acceptable.

Recommendation

- 8.19 **The Migration Plan should not be approved until Telstra has provided a set of confidentiality/information ring fencing procedures that are acceptable to the ACCC.**
- 8.20 **Those procedures should cover information gained under the terms of any agreement between Telstra and NBN Co.**

Restrictions on Telstra field staff undertaking marketing activities

- 8.21 Optus notes that the Migration Plan imposes restrictions on the ability of Telstra field staff to undertake retail marketing activities whilst performing migration related activities. However, this restriction does not apply to Telstra's retail customers, that is field staff are not restricted from marketing to Telstra Retail customers.
- 8.22 This raises a real concern as to how this policy is to be "policed". An obvious issue arises where an end-customer has a service with both Telstra and another service provider (as would occur under the LSS service).
- 8.23 Further, this issue seems to be a direct breach of Telstra's equivalence obligations which ought to prevent Telstra field staff (who are likely to be employed in the Network unit) from undertaking retail activities.

Recommendation

- 8.24 **Telstra field staff undertaking activities under the Migration Plan should not be permitted to perform marketing related activities.**

Other Comments

8.25 Optus has set out other concerns on the Migration Plan in the attached Appendix 2.

Section 9. Appendices

Appendix 1

Comparison of Organisational Measures in Structural Separation Undertaking versus Operation Separation Plan

Component	Structural Separation Undertaking	Operational Separation Plan
Operational and organisational separation	One or more business units for: wholesale, retail and key network services	One or more business units for: wholesale, retail and key network services
	Each unit is <i>separate</i> from the others	Each unit is <i>substantially separate</i> from the others
	Required function of network services: fault detection, handling and rectification and service activation and provisioning	Key network services supplies fault detection, handling and rectification and service activation and provisioning
	Required function of wholesale: sales, managing service delivery and negotiating access agreements with wholesale customers	Is responsible for marketing, managing service delivery and negotiating supply contracts with wholesale customers.
	Required function of retail: sales and negotiating supply contracts with retail customers	
	Wholesale and networks cannot perform a required function of retail	
	Retail business unit cannot perform a required function of wholesale or network	
Staffing	Employee who is engaged to work for either wholesale or networks undertakes work <i>principally</i> for that unit and is prohibited for undertaking any work for retail.	Employee who is engaged to work for either Wholesale or Key Network Services undertakes work <i>principally</i> for that unit
	Employee who is engaged to work for retail works <i>principally</i> for retail and is <i>prohibited</i> from undertaking any work for wholes and network.	Employee who is engaged to work for retail undertakes work <i>principally</i> for the retail unit and is <i>not permitted</i> to undertake any work for wholesale
	Does not prevent or restrict short-term secondments, transfers, meeting requirements for natural disasters, emergencies, by law, etc.	Does not prevent wholesale and key network staff from doing work for a business unit of a different kind where only small part of role, prevent short-term secondments or transfers and does not apply to any employee who undertakes work for a corporate business unit
	Restrictions do not apply to global business, disability, emergency services, payphones, etc.	
Wholesale Business Unit	Direct responsibility for management of unit same level of seniority as person responsible for retail	Direct responsibility for management of unit same level of seniority as person responsible for retail
	Located in premise that is physically separate from retail	Located in premise that is physically separate from retail
	Required function of wholesale: sales, managing service	Is responsible for marketing, managing service delivery and

Component	Structural Separation Undertaking	Operational Separation Plan
	delivery and negotiating access agreements with wholesale customers	negotiating supply contracts with wholesale customers.
Incentives and employee benefits	All incentives and remuneration for the wholesale and networks unit will reflect the objectives and performance of those individual units (or can also include other non-separated units)	
Customer excellence	Nothing is intended to be a disincentive to Telstra's efforts to encourage customer-oriented, problem solving service culture to the benefit of retail and wholesale customers. Will not be regarded as having breached if the bona fide efforts of an employee to resolve a customer issue raised by retail or wholesale customer provided not breach of protected information and any reward is provided as part of a Telstra policy of rewarding employees who show similar initiative and excellence in customer service across retail and wholesale customers.	
Senior Management	Where employee has management responsibilities in relation to a separated business unit that employee is not required to work principally for that separated business unit. The incentive scheme will not apply if the management responsibilities in relation to the relevant wholesale or network do not comprise a substantial part of the overall management responsibilities.	

Detailed comments on the draft Migration Plan

Page	Issue	Comment
5.3 (v)	Engagement Strategy	The Migration Plan (MP) should include timeframes for consultation with Wholesale customers.
6.3 c and 6.3 (d) (i)	Establishment of new industry code	Consideration should be given to the need for a new industry code.
10.1 (c)	Pull Through Activities	There should be a proactive mechanism to seek the consent of one or all wholesale customers to agree to using pull through rather than the default position of leaving wholesale customers on the Telstra network.
12.2 (a)	Notification to Wholesale Customers of automatic disconnection	Telstra should clarify the notice period? This should be within 24 hours of Telstra receiving retail order.
13.2 (g) (ii)	Good faith	This is open to interpretation and ambiguous. There needs to be specific timeframes and commitments
18.1 (c) (ii)	Good faith	This is open to interpretation and ambiguous. There needs to be specific timeframes and commitments.
18.2 (b) (ii)	Good faith	This is open to interpretation and ambiguous. There needs to be specific timeframes and commitments.
21.12	Telstra contracted services	There needs to be a reasonable time limit of no more than 3 years.
25.1	Reporting	Include/ add to report both Telstra Special Service numbers and Wholesale Customer Special Service numbers for transparency
25.2 (a)	Reporting	Change reporting timeframe to monthly and provide 10 business days after month end
28.2 (iii)	Limits on ACCC and Adjudicator	Refer Optus' comments on the proposed ITA scheme in main submission
28.3 (e)	Modification proposals	Change 60 days to 20 days
Schedule 1	Standard process for disconnection of copper services	Optus queries whether "Standard Processes" are really suitable for large scale migrations. There are some obvious complications <ul style="list-style-type: none"> • The schedule 1 process appears to cater to single disconnections - are these appropriate for disconnections on the scale contemplated by the migration plan? • How does this process cater to a situation where a street has a mix of SDUs and MDUs and the MDUs cannot be served by NBN Fibre?

2.1 (b) pg 87	ULL FNN	Why should the FNN be handed back to Telstra?