



**Australian
Competition &
Consumer
Commission**

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

Discussion paper

October 2007

Contents

1. Introduction.....	3
1.1 Purpose.....	4
1.2 Timetable and public inquiry process	4
1.3 Background	6
2. Summary of the exemption applications.....	7
2.1 Exemption area	8
2.2 Telstra’s submissions in support of its exemption applications.....	8
3. Questions about the exemption applications.....	8
Appendix A: List of ACCC discussion questions.....	10

1. Introduction

On 12 October 2007, the Australian Competition and Consumer Commission (ACCC) received applications from Telstra for individual exemptions from the standard access obligations (SAOs) under section 152AT of the *Trade Practices Act 1974* (TPA). The exemptions relate to the supply of two services:

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

in 16 exchange service areas (ESAs) in metropolitan Australia (the exemption area).

These exemption applications have been made in addition to Telstra's application of 9 July 2007 for exemptions from the SAOs for the supply of the WLR and LCS declared services in 371 ESAs.

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

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

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

The existing LCS and WLR declarations do not apply in the central business district areas of Sydney, Melbourne, Adelaide, Brisbane and Perth. This reflects an exemption previously granted for the LCS in July 2002.¹

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

Telstra submits that these exemption applications have been made in view of the additional investment in alternative infrastructure, by its competitors, since the time of its exemption applications of 9 July 2007.³ Telstra submits that its additional exemption applications rely on all the materials lodged by it in relation to its 9 July 2007 exemption applications.⁴

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

² TPA subsection 152AT(5)

³ Telstra, *Local Carriage Service and Wholesale Line Rental Exemption Applications- Supporting Submission*, 12 October 2007, p. 1

⁴ *ibid.*

1.1 Purpose

The purpose of this discussion paper is to seek comment from interested parties on Telstra's exemption applications lodged with the ACCC on 12 October 2007. This paper sets out the background to the lodgement of these exemption applications; outlines the ACCC's proposed process for assessing the applications; and provides a summary of Telstra's submissions supporting its exemption applications. Appendix A of this discussion paper sets out the questions which the ACCC would like interested parties to focus on in making submissions on these exemption applications. These questions have been taken from chapter 5 and Appendix C of the ACCC's August 2007 discussion paper in relation to Telstra's 9 July 2007 exemption applications.⁵ The ACCC's August 2007 discussion paper can be accessed on the ACCC's website at www.accc.gov.au.

1.2 Timetable and public inquiry process

The ACCC is seeking submissions in response to this discussion paper by **Friday 14 December 2007**. After receiving and considering submissions from interested parties in response to this discussion paper, the ACCC expects that it will publish a draft report setting out its preliminary findings on Telstra's exemption applications. The ACCC will then provide an opportunity for comment to be made on the draft report before making its final decision.

The ACCC has a six month period in which to make the decision to accept or reject the exemption applications.⁶ However the six month period does not include any period where the ACCC has published the application and invited people to make submissions within a specific time limit, or where there is an outstanding response to an information request.⁷ The ACCC may also extend the six month period by a further three months in certain circumstances.⁸

The ACCC's currently expected timetable for the inquiry is:

Deadline for submissions in response to this discussion paper	14 December 2007
Release of draft report	February 2008
Deadline for submissions in response to the draft report	March 2008
Release of final decision	May 2008

The ACCC encourages industry participants and other interested parties to consider the issues raised in this discussion paper and to make submissions to the ACCC to assist it in considering the exemption applications. Given the commonality of issues between Telstra's exemption applications of 9 July 2007 and 12 October 2007 and the similar supporting materials relied upon by Telstra in support of both applications,

⁵ ACCC, *Telstra's local carriage service and wholesale line rental exemption applications- Discussion Paper*, August 2007

⁶ TPA subsection 152AT(10)

⁷ TPA subsection 152AT(11)

⁸ TPA subsection 152AT(12)

interested parties are encouraged to cross reference any submission with the issues raised in chapters 3, 4, and 5 of the ACCC's discussion paper in relation to Telstra's 9 July 2007 exemption applications. Parties may also wish to reference their submissions to the ACCC's discussion paper in relation to Telstra's 9 July 2007 exemption applications in responding to this discussion paper.⁹

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

Richard Home
General Manager
Strategic Analysis and Development Branch
Communications Group
Australian Competition and Consumer Commission
richard.home@acc.gov.au

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

Ali Rahman
Strategic Analysis and Development Branch
Communications Group
Australian Competition and Consumer Commission
ali.rahman@acc.gov.au

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

Richard Home
General Manager
Strategic Analysis and Development Branch
Communications Group
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001

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

As stated above, Telstra's exemption applications of 12 October 2007 rely on all the supporting materials provided by Telstra to the ACCC in relation to its exemption applications of 9 July 2007. Telstra provided a number of confidential documents in support of its exemption applications of 9 July 2007. Telstra states that it will provide

⁹ ACCC, *Telstra's local carriage service and wholesale line rental exemption applications- Discussion Paper*, August 2007

access to the confidential versions of its submission and attachments to agreed interested parties who have signed appropriate confidentiality undertakings.¹⁰ Telstra has provided the ACCC with the confidentiality undertaking it seeks to have parties sign. The undertaking is provided in Appendix B of the ACCC's discussion paper of August 2007.¹¹ A Microsoft Word copy of the undertaking is available on the ACCC website. Parties wishing to gain access to Telstra's confidential documents should execute the undertaking and send it to Paul McLachlan of Telstra at Paul.McLachlan@team.telstra.com, copied to Ali Rahman of the ACCC at ali.rahman@acc.gov.au.

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

Any questions about this discussion paper should firstly be directed to Arek Gulbenkoglou at arek.gulbenkoglou@acc.gov.au or 03 9290 1892, or to Ali Rahman at ali.rahman@acc.gov.au or 03 9290 1815.

1.3 Background

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

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

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

Telstra lodged an application with the ACCC on 9 July 2007 under section 152AT of the TPA seeking individual exemptions from the SAOs for the LCS and WLR declared services in 371 ESAs. Telstra made a single submission in support of both its exemption applications. Telstra annexed ten documents to its submission in support of its exemption applications. Annexure A to Telstra's supporting submission is an economic report prepared by Paul Paterson of CRA International. The remaining documents consist of Telstra staff witness statements, some Telstra cost modelling and another analyst report. Public versions of five of these documents have been provided by Telstra. Telstra has stated that it will provide confidential versions of all

¹⁰ Telstra, *Local Carriage Service and Wholesale Line Rental Exemption Applications- Supporting Submission*, 12 October 2007

¹¹ ACCC, *Telstra's local carriage service and wholesale line rental exemption applications- Discussion Paper*, August 2007

its supporting documents to agreed parties who sign confidentiality undertakings in Telstra's favour.

On 27 August 2007, Telstra provided a supplementary submission in support of its 9 July 2007 exemption applications, which contained no confidential information.

On 31 August 2007, the ACCC issued a discussion paper on Telstra's 9 July 2007 exemption applications.¹²

On 11 October 2007, Telstra provided a confidential and public version of a further supplementary statement by Paul Paterson; an explanatory statement in relation to Annexure I of its submission and confidential witness statements by three staff members.

On 11 October 2007, Telstra also requested an extension of a further two weeks in relation to its submission in response to the ACCC's August 2007 discussion paper. In its request Telstra stated that the extra time would be desirable, since it would enable Telstra to provide further information directly relevant to the ACCC's assessment of its 9 July 2007 exemption applications. The ACCC has granted Telstra an extension of two weeks, until 1 November 2007, to make its submissions. This extension also applies to all other interested parties.

2. Summary of the exemption applications

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

Telstra submitted two separate exemption applications to the ACCC on 12 October 2007 – one for the LCS and one for the WLR service. Both exemption applications cover an identical geographic region. Telstra provides a single submission in support of both exemption applications.¹³

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

Telstra submits that its exemption applications rely on all the material provided by it in relation to its 9 July 2007 exemption applications. Interested parties are advised to refer to the public versions of the documents submitted by Telstra in its exemption applications of 9 July 2007 and provide Telstra with the relevant confidentiality undertakings, as discussed in section 1.2 of this paper, if they wish to access the confidential versions of Telstra's submissions.

¹² *ibid.*

¹³ Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service Exemption Applications—Supporting submission*, October 2007

2.1 Exemption area

Telstra has sought exemptions from all of the SAOs for the LCS and WLR applications in 16 ESAs in metropolitan (Band 2) Australia.¹⁴ These exemption applications are in addition to Telstra's exemption applications of 9 July 2007 in relation to 371 ESAs.

2.2 Telstra's submissions in support of its exemption applications

Telstra's submissions in support of its exemption applications of 12 October 2007 which include, by reference, submissions lodged in its exemption applications of 9 July 2007 are provided below. Chapter 4 of the ACCC's August 2007 discussion paper provides a detailed outline of these arguments.¹⁵ In summary, Telstra submits that:

- its choice of 371 ESAs in its exemption applications of 9 July 2007 and 16 ESAs in its exemption applications of 12 October 2007 is based on the presence of competing infrastructure, including exchanges where at least one competitor DSLAM has been deployed in the exchange for that ESA;
- there is evidence of significant competition throughout the proposed exemption areas, and that the markets in which the LCS and WLR are supplied are contestable and workably competitive;
- given the extensive alternative infrastructure within its proposed exemption areas, competition is significant in the market for fixed-line voice services and that continued regulation would be harmful and costly; and
- the LTIE would be adversely affected by the existing resale based regulation of the LCS and WLR by leading to a reduction in the intensity of competition, while the granting of the exemption applications will promote facilities based competition by encouraging greater investment in competing infrastructure.

3. Questions about the exemption applications

Telstra's additional exemption applications incorporate, by reference, all the material provided in support of its 9 July 2007 exemption applications. This material and the questions emerging from it are all relevant for the assessment of these additional exemption applications. The ACCC will therefore adopt the analytical framework set out in its August 2007 discussion paper for assessing these further exemption applications.¹⁶ Parties should refer to the August 2007 discussion paper, to apprise themselves of this framework. In assessing these applications for exemption, the ACCC will give consideration to two key questions:

¹⁴ Telstra, *Application for exemption from standard access obligations – Local Carriage Service*, 12 October 2007, p. 4 and Telstra, *Application for exemption from standard access obligations – Line Rental Service*, 12 October 2007 p. 4

¹⁵ ACCC, *Telstra's local carriage service and wholesale line rental exemption applications- Discussion Paper*, August 2007

¹⁶ *ibid.*

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

These questions will be informed by the ACCC's findings on a number of key issues. Interested parties are advised to refer to chapter 5 of the August 2007 discussion paper for the key issues and questions the ACCC would like them to focus on in providing submissions to this discussion paper. A list of questions for consideration, are also set out in Appendix A to this discussion paper.

The ACCC will decide whether to grant the exemptions after having regard to the LTIE matters in the legislation, which are set out in Appendix A of the August 2007 discussion paper. Submissions should therefore address the legislative matters, where possible, in responding to the questions raised in this discussion paper.

Parties may also wish to provide submissions on relevant issues not directly raised in the questions in Appendix A. As noted above, parties may wish to reference their submissions to the ACCC's discussion paper in relation to Telstra's 9 July 2007 exemption applications in responding to this discussion paper.

Appendix A: List of ACCC discussion questions

This appendix gathers together for reference the questions contained in chapter 5 and Appendix C of the ACCC's August 2007 discussion paper.¹⁷

Enduring bottlenecks

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

Market definition

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

¹⁷ ACCC, *Telstra's local carriage service and wholesale line rental exemption applications- Discussion Paper*, August 2007

Promotion of competition

Structural factors

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

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

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

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

Potential for competition

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

- Do the Band 2 ESAs in Telstra's proposed exemption area have a significant enough addressable market to allow access seekers to achieve sufficient economies of scale or density to provide effective competition?
- Is Telstra's internal estimation of the minimum efficient scale needed for competitive DSLAM entry accurate and realistic?

- Are Telstra's submissions about the level of sunk costs accurate?
- Are DSLAMs easily capable of redeployment?
- Are DSLAMs best characterised as a short-lived asset?
- Is it accurate to say that switching and transmission infrastructure for voice services can be readily acquired?
- The ACCC notes that CRAI says that it is 'technically feasible' to acquire this technology.¹⁸ Is such acquisition commercially feasible?
- Does voice emulation and the use of soft-switching infrastructure provide a low sunk cost alternative to the use of traditional voice equipment?

- Is Telstra's internal estimation of the minimum efficient scale needed for competitive DSLAM entry accurate and realistic?
- What is a sufficient customer base for a competitor to justify building a DSLAM in an ESA?

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

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

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

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

Dynamic characteristics of markets

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

Nature and extent of vertical integration

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

Other issues

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

Any-to-any connectivity

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

Efficient use of and investment in infrastructure

Economically efficient use of infrastructure

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

Economically efficient investment in infrastructure

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

- Has declaration of the LCS and WLR discouraged investment in alternative voice infrastructure by access seekers?
- Would granting the exemption applications be likely to encourage efficient investment in alternative infrastructure by removing the scope for reliance on the declared LCS and WLR?

- What implications would Telstra's exemption applications, and proposed rule for including ESAs in its exemption area, have on investment by access seekers in DSLAM infrastructure?
 - Would an alternative rule be preferable as a result?

Legitimate commercial interests of access provider

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

Class exemption

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