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Australian Competition and Consumer Commission

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Domestic Transmission Capacity Service - Declaration Inquiry

Your Reference

Our Reference IP 021403

Macquarie Telecom Pty Limited ("**Macquarie**") appreciates the opportunity to make this submission to the Australian Competition and Consumer Commission ("**ACCC**") in response to the ACCC's draft report concerning the above.¹ In addition to the Draft Report, Macquarie's submission is informed by the discussion at the stakeholder meeting concerning this matter convened by the ACCC on 4 February 2014 ("**Stakeholder Meeting**").

This submission is set out in two main parts. The first part provides Macquarie's broad views on the context in which the ACCC's declaration inquiry into the domestic transmission capacity service ("**DTCS**") takes place. This provides an essential setting for the second part in which Macquarie's comments on specific matters arising from the Draft Report are set out.

Context of DTCS Declaration Inquiry

The ACCC's DTCS declaration inquiry occurs at a time when Australia's communications sector is undergoing a period of substantial change which is being driven by a number of key forces. First, there is the Australian Government's national broadband network ("**NBN**") policy which was first announced by the previous Labor Government in 2009. While the Coalition Government is committed to the broad principle of a national, publicly funded NBN, it has scaled back the project from fibre to the premise to a "mix of technologies" for 93 *per cent* of premises. Further, the details of the form in which broadband services will be offered to end-users and to retail service providers ("**RSPs**") are yet to be settled pending the outcome of a cost-benefit analysis. This has inevitably created uncertainty in the sector as a major long-term industry policy is re-set.

Second, considerable consolidation has occurred in recent years within the industry as operators seek competitive advantage through scale and operational efficiency. Some key takeover activity which has recently occurred includes:

- TPG's takeover of Pipe Networks (2009) and AAPT (2013);
- iiNet's takeover of Netspace (2010), TransACT (2011), Internode (2011) and Adam

¹ ACCC, Domestic Transmission Capacity Service, An ACCC Draft Report on the review of the declaration for the Domestic Transmission Capacity Service, Public Version, December 2013 ("**Draft Report**")

Internet (2013); and

- M2's takeover of Primus (2012), Dodo / Eftel (2013) and Engin (2013).

Third, the industry continues to undergo substantial change through technological developments. Key among these developments is the growth in smart phones which together with the deployment of 4G spectrum has seen consumers shift toward mobile communications. In addition, there has been the emergence of cloud computing which has driven enormous efficiencies in the way that data is stored and managed and services are delivered to end-users.

The impact of these changes on the competitive structure of the Australian communications market has, in Macquarie's view, been disproportionate across RSPs. Telstra remains the dominant industry participant with commanding leadership positions in the fixed, mobile, pay TV and internet service segments of the industry. Telstra's financial strength, scale and scope of its operations provides it with enormous capacity to respond to, and take advantage from, industry changes. It is evident that Telstra:

- is surging ahead of its competitors in the mobile segment in terms of customers, revenue and network coverage;
- controls bottleneck fixed network infrastructure particularly in the customer access network; and
- because of its incumbency and market power is the major influencer of Government policy and holds the key to whether or not policy implementation will be successful.

Macquarie contends that in this environment effective competition is under threat and that there is now an acute need for competition to be protected through appropriate policy and regulatory settings. The inevitable outcome of inappropriate policy and regulatory settings will be detrimental to the LTIE and will effectively begin to wind back the end-user benefits of market liberalisation that have been achieved over the past 25 years.

Macquarie notes recent decisions by the ACCC which have been particularly supportive of competition in response to changing market conditions and failures to achieve intended market outcomes. Specifically, Macquarie notes the following recent decisions of the ACCC:

- declaring the wholesale ADSL service in 2012;²
- removing exemptions which applied to the supply of the wholesale line rental ("WLR") service, local carriage service ("LCS") and PSTN OA services in certain ESAs in 2011³ and to WLR services and LCS in CBD areas in 2013;⁴ and
- regulating the supply of SMS termination services in 2013.⁵

² ACCC, Declaration of the wholesale ADSL service under Part XIC of the Competition and Consumer Act 2010, Final Decision, February 2012

³ ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Final Report, December 2011

⁴ ACCC, Fixed Services Review - Declaration Inquiry, Public inquiry into the fixed line services declarations, Draft Report, December 2013

⁵ ACCC, Domestic Mobile Terminating Access Service Declaration Inquiry, Report of the ACCC's Draft Decision, 13 December 2013

Against this background, Macquarie is disappointed with the ACCC's draft decision in respect of the DTCS to the extent that it erodes the regulation of this service. The ACCC's draft decision weakens the framework which protects competition at a time when effective competition is under threat and Telstra's market position is arguably stronger than at any time since market liberalisation began.

Macquarie's preferred position with respect to the declaration of the DTCS is that there should be no exemptions. That is, the supply of DTCS should be subject to regulation across the board. The rationale for reaching this view is as follows:

- Telstra is the dominant ubiquitous provider of the DTCS and has dominance across all sectors of Australia's communications sector and also has an incentive to supply the DTCS on unreasonable terms;
- the considerable effort of the ACCC and industry players in debating which DTCS should and should not be regulated is costly *per se* and is a major distraction from the more important role of regulation which is in this situation to ensure efficient pricing for the DTCS; and
- the claims that the cost of regulation in situations that are competitive are high are (in the case of the DTCS) difficult to accept, i.e., it would seem that it would be more efficient to regulate all DTCS rather than carving out regulation in often difficult to identify situations across the range of DTCS.

Comments on Specific Matters

In this section Macquarie comments on a range of specific matters arising from the Draft Report. These matters concern the following:

- decision to re-declare the DTCS;
- decision to revise the methodology for assessing competition;
- decision to de-regulate certain routes;
- regulation of tail-end services;
- special linkage charges;
- facilities access services; and
- the five year term of the re-declaration.

Each of these matters is addressed in turn in the discussion that follows.

Decision to Re-declare the DTCS

The ACCC has made the draft decision that it will re-declare the DTCS. This means that Telstra is obliged to provide the DTCS if requested by an access seeker on terms (including price) that will be set by the ACCC except in respect of certain routes which are considered competitive and are not subject to regulation. Re-declaration of the DTCS is a threshold decision which Macquarie supports. It is a (draft) decision that recognises that the DTCS is an important input for access seekers which enables them to offer services to end-users and thereby compete with Telstra. Moreover, it recognises that Telstra has market power in the supply of these services and there is a risk that it can set unreasonable terms of supply.



Decision to Revise the Methodology for Assessing Competition

Macquarie welcomes the ACCC's draft decision to revise its methodology for assessing competition. Competition on a given route will be assessed on the basis of a threshold test that there is three independent major fibre providers within very close proximity of a Telstra exchange in a given ESA, i.e., T +2. If this threshold is met, the ACCC will apply various additional quantitative and qualitative assessments to reach a final view on whether the ESA is considered competitive. If the ESA is considered to be competitive, services from capital cities to that ESA and, if the ESA is a metropolitan ESA, services from other ESAs in the same metropolitan area to that ESA will not be subject to regulation. Such additional quantitative and qualitative assessments include:

- whether there is direct connectivity between the exchange to a CBD ESA;
- an assessment of the likely demand for transmission services from that ESA; and
- the level of price competition in that ESA.

Macquarie welcomes the ACCC's revised methodology because *prima facie* it provides a more rigorous test of competition. In particular, it provides scope for the ACCC to take into account other relevant qualifying factors that would be overlooked if the test of competition was purely based on the number of independent major fibre providers that are present at the Telstra exchange in a given ESA. As such, Macquarie would expect that there is genuine competition on the routes that are to be de-regulated as a result of applying the revised competition assessment.

Decision to De-regulate Certain Routes

While Macquarie welcomes the ACCC's revised methodology for assessing competition, it is disappointed that the methodology actually results in less routes being subject to regulation. That is, based on Macquarie's experience in acquiring DTCS it believes that a higher competitive threshold would provide evidence that competition is generally not effective which would mean that more routes would become subject to regulation.

Macquarie is particularly concerned with ineffective competition on various metropolitan routes. Specifically, Macquarie has identified five metropolitan routes which are already de-regulated and yet two of the largest non-Telstra wholesale service providers are unable to offer services to Macquarie using their own infrastructure. These routes are:

- Melbourne - Caulfield;
- Melbourne - Elsternwick;
- Sydney - Coogee;
- Sydney - East; and
- Sydney - Undercliffe.

While both such wholesale service providers can provide a service to Macquarie on these routes they do so using Telstra's infrastructure - not their own. Clearly, this is a re-bill situation which puts no competitive pressure whatsoever on Telstra's ability to set prices. Macquarie submits that the ACCC's assessment of competition must ensure that there is genuine infrastructure based competition. That is, a service provider that offers a service through re-billing Telstra's infrastructure must not be counted in the T +2 competition assessment. Macquarie urges the ACCC to revisit its assessment of competition on all routes that it proposes to de-regulate to ensure that competition is genuine infrastructure

based competition.

Macquarie stands by its view that competition on the above metropolitan routes is not effective and as such they should be regulated as opposed to the ACCC's preliminary view that they continue to be de-regulated. Macquarie also notes that of the five exchanges only Caulfield is an NBN Co POI. Macquarie submits that this suggests that it is unlikely that any wholesale service provider would make any investment in infrastructure for serving the other four exchanges which are not NBN Co POIs. That is, traffic will be driven to the NBN Co POIs and this is where new investment will occur.

Regulation of Tail-end Services

Prima facie, Macquarie welcomes the ACCC's draft decision that tail-end services will continue to be regulated. Tail-end services are effectively only supplied by Telstra which means that Telstra can set unreasonable terms of access. However, Macquarie is concerned that there is some ambiguity about the regulation of tail-end services and that there are some implications for competition concerning such services which need to be addressed by the ACCC.

Macquarie understands that Telstra only supplies a tail-end service to a given access seeker when the service is bundled with a link to the access seeker's POP located in the same exchange or bundled with an inter-exchange link where the access seeker's POP is located in another exchange. That is, the tail-end service is never actually provided on a stand-alone basis. This is despite the tail-end being priced within the ACCC's DTCS pricing model. In this latter situation, Macquarie is concerned that the availability of non-Telstra infrastructure on the inter-exchange link is undermined because the Telstra tail-end service is effectively prevented from being linked with competing inter-exchange infrastructure. This means that an access seeker has no choice other than to use Telstra's infrastructure when a tail-end service is required on an inter-exchange link.

Macquarie understands that the inability to link Telstra's tail-end service with competing inter-exchange infrastructure is more behavioural than technical. That is, this situation is primarily the result of Telstra exercising its market power rather than the existence of insurmountable technical hurdles.

Macquarie believes that the effective remedy to this situation is the unbundling of the tail-end service. This would mean that Telstra would provide the tail-end service on a stand-alone basis, i.e., not bundled with other links. This would also mean that access seekers would have the genuine opportunity to utilise non-Telstra inter-exchange infrastructure when required in combination with a Telstra tail-end service. In turn, this would flush out Telstra-imposed impediments such as TEBA rules which are used to prevent access to non-Telstra inter-exchange infrastructure.

In expressing its view that Telstra's tail-end services should be unbundled, Macquarie notes the ACCC's dismissal of this proposition in the Draft Report. Macquarie is concerned that the ACCC's grounds for reaching this preliminary view appear to be no more than simply that no-one other than SingTel Optus advocated tail-end service unbundling. Macquarie submits that on the basis of the following factors, it is incumbent on the ACCC to reach a considered view if it chooses to confirm its dismissal of the proposition to unbundle tail-end services in its final view on this matter:



- tail-end service unbundling is evidently practiced in other jurisdictions;
- Telstra is effectively the only supplier of tail-end services and has the market power and incentive to provide them on terms that it alone chooses; and
- investment in non-Telstra inter-exchange infrastructure will remain constrained while tail-end services remain bundled.

Should the ACCC persist with its view that it will not unbundle tail-end services, Macquarie believes that the DTCS service description needs further clarification to remove an ambiguity. That is, while accepting that a tail-end service is, for example, bundled with a regional service, if that regional service is de-regulated, it is not clear if the tail-end component would also be de-regulated. Macquarie submits that the tail-end service should be regulated irrespective of whether it is provided as part of any other service and whether any such service is de-regulated. Accordingly, the service description needs to reflect this.

Special Linkage Charges

Macquarie notes the ACCC's draft decision concerning Telstra's special linkage charges ("SLCs") that is, that SLCs are primarily a pricing matter and are best addressed in the upcoming DTCS FAD inquiry. The ACCC also considers that it is not necessary to specify SLCs in the DTCS service description for SLCs to be considered in this inquiry. Macquarie would prefer that there was at least an acknowledgment in the DTCS service description that an access seeker may be required to acquire from an access provider additional ancillary services such as special linkage services in order for the DTCS to function. Alternatively, the ACCC should commit to reviewing the DTCS service description should addressing SLCs in the DTCS FAD inquiry turn out to be problematic.

Macquarie also notes the views of Telstra which were expressed at the Stakeholder Meeting to the effect that it recognised that its process for determining SLCs lacked transparency and that it was working on making improvements. While Macquarie welcomes these views this should in no way supplant the ACCC's role in addressing SLCs in the DTCS FAD inquiry. Macquarie looks forward to setting out its views on how SLCs should be addressed by the ACCC in the course of this upcoming inquiry.

Facilities Access Services

Macquarie notes that the ACCC has made a draft decision to give further consideration on whether to commence an inquiry into the declaration of facilities access services. The Draft Report states that if the ACCC considers it necessary to set access terms and conditions for facilities access services, the ACCC will seek submissions during the relevant DTCS FAD inquiry. Macquarie also notes that the ACCC has expressed much the same view in its draft decision concerning its inquiry into the declaration of fixed-line services.⁶

Prima facie, Macquarie is encouraged by this. However, Macquarie is concerned that the failure to commence an inquiry into the declaration of facilities access services at this time may further delay the appropriate regulation of such services to the detriment of access services and their customers. Macquarie considers that the ACCC does not need any further submissions on this matter and should make the decision to commence an inquiry into the declaration of facilities access services and commence such an inquiry as soon as possible.

⁶ ACCC, Fixed Services Review - Declaration Inquiry, Public inquiry into the fixed line services declarations, Draft Report, December 2013

Five year Term of the Re-declaration

The ACCC has made the draft decision that it will extend the declaration of the DTCS for a period of five years. Macquarie supports this draft decision on the basis that it provides access seekers with a more certain operating environment which is thereby less risky. While the duration of terms (including price) for the DTCS is subject to a separate FAD inquiry, Macquarie submits that a five year service declaration sits comfortably with a FAD of two years. That is, a two year FAD reflects the period of commercial agreements and different end dates for the FAD and the service declaration eases the workload for the ACCC and the industry alike.

Closing

Macquarie welcomes the opportunity to make this submission in response to the Draft Report. Macquarie reiterates the following key points arising from its review of the Draft Report:

- Macquarie supports the declaration of the DTCS but would prefer that the declaration had no route exemptions given Telstra's market dominance and the enormous effort involved in deciding which particular services should be exempt from regulation.
- Macquarie welcomes the ACCC's draft decision to revise its methodology for assessing competition as it *prima facie* provides a more rigorous test of competition.
- While Macquarie welcomes the ACCC's revised methodology for assessing competition, it is disappointed that the methodology actually results in less routes being subject to regulation. As such, the ACCC is urged to re-visit the application of its revised methodology to ensure that competition is genuine infrastructure based competition.
- Macquarie stands by its view that competition on at least five specified metropolitan routes is not effective and as such they should be regulated as opposed to the ACCC's preliminary view that they continue to be de-regulated.
- Macquarie believes that tail-end services should be unbundled in order to ensure that access seekers have a genuine opportunity to utilise non-Telstra inter-exchange infrastructure and to expose Telstra-imposed impediments to competition.
- Macquarie looks forward to setting out its views on how SLCs should be addressed by the ACCC in the course of its upcoming DTCS FAD inquiry.
- Macquarie considers that the ACCC should make the decision to commence an inquiry into the declaration of facilities access services and commence such an inquiry as soon as possible.
- Macquarie supports the ACCC's draft decision that it will extend the declaration of the DTCS for a period of five years.

Please do not hesitate to contact me should you have any queries in relation to this matter.

Yours sincerely



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