

# **TELSTRA CORPORATION LIMITED**

## **Fixed Services Review**

**Response to other parties' submissions to the Commission's Discussion paper on the Declaration Inquiry**

**Response to the Commission's request for market information on 9 October 2013**

**Public version**

25 October 2013

## 1. Introduction

Telstra welcomes the opportunity to make this further submission to the Australian Competition and Consumer Commission (**Commission**) Fixed Services Review. The main purpose of this submission is to respond to the Commission's letter of 9 October 2013 *Fixed Services Review – Request for market information (Information Request)*.

In the Information Request, the Commission has sought detail relevant to the current state of competition in Central Business District (**CBD**) areas to assist it in analysing the implications of maintaining or removing the CBD exemptions for Wholesale Line Rental (**WLR**) and the Local Carriage Service (**LCS**). Section 3 responds to this request as well as addressing specific claims made by access seekers in support of removing the CBD exemptions which apply for WLR and LCS.

CBD areas have unique characteristics which differentiate them from all other areas of the country. End users in CBD areas enjoy the benefits of extensive competition which manifests in multiple choices as regards competitive service providers, network technologies, and product and service differentiation to meet their needs. The relatively high proportion of business premises in CBD ESAs (as opposed to other areas) has encouraged network operators to invest extensively in deploying their own infrastructure in order to compete for these high value business customers in the provision of voice and data services. This competitive infrastructure in turn benefits all end users through extensive choice.

Retention of the longstanding voice resale exemptions in CBD areas will continue to promote the high levels of infrastructure based competition and investment which has occurred in CBD areas for more than a decade. This will also facilitate further product innovation, better services, and differentiated choices for consumers.

Telstra's further submissions in respect of exemptions in CBD areas are set out in section 3 below. Detailed responses to the Commission's Information Request are contained in Appendix 1.

Telstra also wishes to take this opportunity to address some statements made by other parties in their submissions to the Commission's *Fixed Services Review Discussion Paper on the Declaration Inquiry*, July 2013 (**Discussion Paper**). Telstra wishes to ensure that the current consultation process is as fact-based as possible and any conclusions drawn are based on the most up-to-date, relevant and accurate information. Telstra's responses to other parties' submissions are addressed in section 2.

Telstra would welcome the opportunity to provide further detail on any of the matters that it raises in this submission.

## 2. Specific responses to other parties' submissions

### 2.1 WLR is not essential for the supply of Wholesale ADSL

In its submission, Optus argued that the "ACCC has mandated that the WLR must be purchased for a working WADSL to be supplied"<sup>1</sup> and that therefore "the ACCC is in effect removing the regulation of WADSL from CBD areas."<sup>2</sup> Telstra does not consider this to be correct.

Throughout the Wholesale ADSL (**WDSL**) Final Access Determination inquiry, Telstra consistently pointed out that the only requirement for a WDSL service to be provisioned is a working PSTN service. This PSTN service can be provided through Telstra's retail business units, or by any Telstra wholesale customer acquiring WLR. Telstra does not force its wholesale customers to bundle WLR and WDSL.<sup>3</sup>

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<sup>1</sup> Optus, *Submission in response to ACCC Discussion Paper on the Declaration Inquiry, Fixed Services Review, Confidential version*, August 2013, p7.

<sup>2</sup> Ibid.

<sup>3</sup> See for example, Telstra Corporation Limited, *Submission in response to Wholesale ADSL FAD discussion paper*, April 2012, p.23 and Telstra Corporation Limited,

## 2.2 Telstra's facilities access agreements

Telstra observes that some respondents to the discussion paper comment upon restrictions in their agreements pertaining to TEBA and state that those restrictions are either [c-i-c] or state that such restrictions may allow Telstra to discriminate against other mobile providers<sup>4</sup>.

Telstra considers that these statements are misleading in that they only tell part of the story.

[c-i-c]

If an access seeker wishes to access Telstra's Equipment Buildings for other purposes not covered by the standard terms, it can request such access in accordance with Schedule 1 to the *Telecommunications Act* and – subject to the provisions of that Act – Telstra and the access seeker can then agree relevant access terms. [c-i-c]

## 3 CBD exemptions

Telstra believes that there is ample evidence available for the Commission to make a decision to re-confirm the longstanding CBD exemptions that apply to WLR / LCS. This section therefore, has two purposes; first, to reiterate and expand upon data previously supplied, and second, to respond to specific claims raised by some access seekers in their arguments for the removal of the CBD exemptions.

In its September submission, Telstra provided the following data on competition in CBD areas:

- on average, there are [c-i-c] DSLAM-based competitors in CBD ESAs, compared to an average of [c-i-c] DSLAM-based competitors in the 466 Band 2 ESAs;
- access seekers have installed more interconnect pairs in CBD ESAs than there are active SIOs within CBD ESAs;
- Telstra's retail market share for basic access services is [c-i-c] lower in CBD ESAs compared to its national share [c-i-c]. Similarly, Telstra's retail market share for broadband services is [c-i-c] lower in CBD ESAs compared to the national share [c-i-c]; and
- the level of competition throughout CBD ESAs is also less varied than for metropolitan ESAs. The standard deviation in Telstra's retail market share across the 16 Band 1 ESAs is only five per cent for basic access services and four per cent for DSL services. In comparison, the standard deviation in Telstra's retail market share across Band 2 ESAs is nine per cent for basic access services and 17 per cent for DSL services.

In addition to the data already provided to the Commission on this issue, and to assist the Commission in its assessment of competition with respect to fixed line services in CBD areas, Telstra has provided answers to the questions posed by the Commission in its information request of 9 October 2013. Telstra's answers are set out in Appendix 1.

### 3.1 The CBD exemptions for WLR and LCS should be maintained

Telstra firmly believes that it is in the long term interests of end users (LTIE) for the CBD exemptions for WLR and LCS to be maintained. Innovation and investment in CBD areas to the benefit of end users has occurred in the absence of regulation. Introducing regulation, where effective competition exists, risks distorting the market and would not be in the LTIE.

Access to LCS has not been regulated in CBD areas for more than a decade and WLR has never been regulated in CBD areas. As early as 2002, the ACCC recognised the presence of multiple alternative fibre networks and emergent ULLS-based competition as drivers of effective competition in the market for fixed line services in CBD areas.

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<sup>4</sup> Optus, August 2013, p55

Underpinning the Commission's previous decisions to exempt CBD areas from access regulation with respect to WLR and LCS is the clear fact that within these areas WLR and LCS cannot reasonably be considered an essential facility or an enduring bottleneck.

From a first principles perspective, ex-ante access regulation is only likely to be in the LTIE where there is an enduring bottleneck. A facility or service is only a bottleneck if it is a necessary natural monopoly input into the production process of a firm to compete in a downstream market. Strictly, a bottleneck service exists only if it passes two economic tests:<sup>5</sup>

1. it is used to manufacture a specific good or service and there must be **no alternative input or process** which enables a competitor to produce an equivalent final good or service at a comparable cost; and
2. there must be **no alternative, substitutable final good or service** that can be manufactured and sold at a comparable price without using that input.

If both tests are met,<sup>6</sup> then an economic problem that may justify access regulation exists. If one or both of the tests are not met, then there is no structural impediment to competition and no economic basis justifying the imposition of regulation. This is because, if one or both of the tests are not met, *"the owner of the essential facility (bottleneck) is constrained from exercising monopoly power due to direct competition from substitutes or indirect competition because substitutes exist to products that use its input."*<sup>7</sup>

In practice, this means that the two economic tests, which focus on the existence of substitutes, determine the circumstances in which regulation will or will not enhance competition and the LTIE.

In the context of WLR and LCS services supplied in CBD areas, it is clear that neither of the two tests is met. With regard to wholesale inputs, access seekers have a choice of multiple alternative wholesale inputs within CBD areas including ULLS (and resale services supplied through ULLS) and services supplied through alternative fibre networks (either self-supplied, or via wholesale services supplied through those networks). With regard to the second test, there are a wide range of alternative end user services that are available and competing in the market alongside WLR-based services. The tests are examined in detail below.

### **Test 1: Diverse alternative inputs exist**

Competition in CBD ESAs has intensified since the LCS exemptions were originally granted in 2002. As noted in Telstra's September submission, end user demand in CBD areas is more likely to reflect the needs of business, government and enterprise customers than for the market as a whole. These customers typically have more sophisticated telecommunications needs than the typical residential consumer. As such, the range of services that effectively compete against WLR and LCS based services in the CBD market segment is broad. This is evidenced by the following:

#### *Copper based alternatives*

DSLAM based competition in CBD ESAs has increased. As outlined in Telstra's September submission,<sup>8</sup> CBD ESAs contain on average **[c-i-c]** DSLAM-based competitors, compared to an average of **[c-i-c]** DSLAM-based competitors in Band 2 ESAs. Further, access seekers have installed more interconnect pairs in CBD ESAs than there are active SIOs. Notably, the CBD ESAs have virtually no lines (less than 1%) constrained by the presence of 'line blockers' such as large pair gain

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<sup>5</sup> See King. S., (1997), "National competition policy", *Economic Record*, 73, 270-284, p.273.

<sup>6</sup> A third relevant test is that the relevant market is **not** perfectly contestable. See Chapter 11 in S. Martin (1993) *Advanced Industrial Economics*, Blackwell.

<sup>7</sup> See King. S., (2013), "Report on essential facilities, access regulation and value-added wholesale services on the NBN", p.7.

<sup>8</sup> Telstra Corporation Limited, *Fixed Services Review: Response to the Commission's Discussion paper on the Declaration Inquiry*, September 2013, Appendix 2, p.17

systems. This is far less than in other bands, which average between [c-i-c]. This was set out in greater detail in Telstra's previous submission.<sup>9</sup>

In its December 2011 decision to remove the exemptions in metropolitan areas, the Commission stated that *"the Service Level Agreements offered by Telstra for the ULLS are inferior to those provided for the WLR service, particularly in terms of fault rectification times,..."*<sup>10</sup> This reasoning does not apply in the CBD ESAs, where, with respect to fault rectification guarantees, Telstra offers better levels of service for the ULLS than WLR.<sup>11</sup> In the CBD ESAs, the highest level of fault rectification that is offered for WLR is 'Express 6 Plus', which has a target restoration time of 6 hours, whereas for ULLS, the highest level of fault rectification that is offered is 'Express ULLS', which has a target restoration of 4 hours. As such, it cannot be argued that wholesale customers need to rely on resale services to achieve higher service levels in the CBD ESAs.

Voice services are also supplied using alternative copper based technologies such as ISDN. These substitute services are available in CBD areas from a range of suppliers (including Telstra) in both retail and wholesale markets.

#### *Alternative infrastructure*

Competitive alternative infrastructure has expanded. As outlined in Telstra's September submission,<sup>12</sup> there are substantial numbers of fibre operators in CBD areas, a fact that has previously been acknowledged by the Commission.<sup>13</sup> Even more so than for DSLAM-based infrastructure, competitive fibre networks facilitate end-to-end infrastructure based competition across the complete range of fixed line telecommunication services and provide the maximum opportunity for competition through price, service offering and product differentiation. As far back as 2002, the Commission recognised that local call services provided over fibre optic (and HFC) networks are technological substitutes for the LCS.<sup>14</sup>

In addition to competitive fibre suppliers, Telstra supplies fibre-based, declared DTCS tails to CBD premises. Starting at 2Mbps, these services can supply multiple voice channels using protocols ranging from SIP trunks through to ISDN emulation. This means that as well as the regulated copper services in CBD ESAs (ULLS) there are also regulated fibre alternatives (DTCS) in those areas.

As well as fibre-based networks, fixed wireless has become a viable alternative for the supply of voice services. For example BigAir markets its wireless Ethernet service as being superior to ADSL for supporting VoIP and video applications (including 'telepresence' applications)

#### **Test 2: Alternative substitutable final services exist**

In its submission in response to the Discussion Paper, Optus argued that *"C&G customers have large premises within the CBD areas that require Access Seekers to utilise Telstra resale services."*<sup>15</sup> However, Telstra notes that, in June 2013, business WLR SIOs comprised less than [c-i-c] of total SIOs within CBD ESAs<sup>16</sup>. In any case, large enterprise and government premises within CBD areas

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<sup>9</sup> Ibid.

<sup>10</sup> ACCC, *Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Final Report*, December 2011, p8

<sup>11</sup> [c-i-c]

<sup>12</sup> Telstra, September 2013, Appendix 2, p.18

<sup>13</sup> Australian Competition & Consumer Commission, *Fixed Services Review Declaration Inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR – Final Decision*, July 2009, p 98.

<sup>14</sup> Australian Competition & Consumer Commission, *Future Scope of the Local Carriage Service – final decision*, July 2002, p.23

<sup>15</sup> Optus, August 2013, p46.

<sup>16</sup> Telstra expects that this percentage is actually significantly lower; however, this estimate is based upon the SIOs provided on Telstra's copper network only in the CBD ESAs. That is, the estimate of [c-i-c] does not include SIOs on other providers' fibre networks. Further, the number of SIOs on Telstra's network is also likely to be understated because each ISDN service is counted as one service, whereas in reality, an ISDN30 service could have up to 30 voice channels.

typically require more than just basic resale voice services. As such, an increasing number of buildings which house these types of tenants are already connected to alternative fibre networks over which access seekers can provide the full range of voice and data services. Even where buildings are not currently connected to alternative fibre, barriers to entry are low (as previously recognised by the Commission).<sup>17</sup> Additionally, there is a range of other services that can be used to deliver voice services to end users, including for example, ISDN, which is provided by both Telstra and other service providers.

Further, with respect to the enterprise and government segment, there are an increasing range of substitutable services that can be, and are being, selected in preference to PSTN based voice services. As corporate and government customers' demands move towards Unified Communications, PSTN voice is increasingly being replaced with IP connectivity and a full range of voice, data and video services.

Telstra's competitors are actively marketing and selling equivalent SIP trunking services in the enterprise and government market segment to support enterprise grade telephony services. Optus<sup>18</sup>, AAPT<sup>19</sup> and Macquarie Telecom<sup>20</sup> all supply SIP trunking services which allow for multiple voice lines to be provided over copper, fibre and even wireless access technologies. AAPT also make SIP trunking available through its wholesale channel and has published a whitepaper outlining the benefits it offers over ISDN.<sup>21</sup>

In the residential segment – which makes up a smaller proportion of SIOs in CBD ESAs than other ESAs – consumers also have a range of alternative options for voice service supply. These are not only limited to copper and fibre based voice services, but include wireless provision through fixed wireless suppliers such as BigAir and Vivid Wireless. These suppliers both offer services in the CBD ESAs currently exempt from WLR / LCS regulation, and in fact cover large parts of metro areas and major regional centres.

### 3.2 CBD exemptions are well established

The Commission has long recognised the existence of effective competition for LCS and WLR in CBD areas. Exemption from the standard access obligations (**SAOs**) in relation to supply of the LCS was first granted by the Commission in 2002. The presence of sufficient alternative local access infrastructure and other declared services (e.g. ULLS) within the five mainland capital cities was recognised as allowing alternative carriers and carriage service providers to provide a substitute to the LCS and to act as a constraint on the LCS price that Telstra could charge. The Commission expected that the exemptions would encourage the use of alternative infrastructure for the origination of local calls.

In July 2006, the Commission reaffirmed the CBD exemptions in the WLR declaration inquiry:

*"[T]here are sufficient alternatives to the LCS and WLR local services in certain CBD areas to provide a constraint on Telstra's prices for those two services in those areas. These alternatives include competing infrastructure and the unconditioned local loop service (ULLS)."*<sup>22</sup>

The most recent fixed services declaration review in 2009 once again confirmed the decision to maintain exemptions in the CBD ESAs for WLR and LCS.

As such, LCS has been exempt from regulation in CBD areas for over 10 years, and WLR has never been regulated at all in those CBD ESAs. Given the evidence of how infrastructure-based competition has developed and continues to develop in the CBD ESAs and applying the rationale underpinning

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<sup>17</sup> ACCC, *Future Scope of the Local Carriage Service – final decision*, July 2002, p.26

<sup>18</sup> <http://www.optus.com.au/business/Products+%26+services/Contact+and+collaborate/Calling+and+conferencing/Using+SIP+trunking>

<sup>19</sup> <https://www.aapt.com.au/enterprise/products/sip-voice-trunking>

<sup>20</sup> <http://www.macquarietelecom.com/products/data-voice/sip-trunking/>

<sup>21</sup> <https://aapt.com.au/ws-sip-trunking-isdn-voice-replacement-aapt-white-paper>

<sup>22</sup> ACCC, *Local Services Review: Final Decision*, July 2006, p.7

previous CBD exemptions decisions, Telstra believes that nothing has changed that would support the removal of those exemptions at this time.

### 3.3 WLR pricing in CBD ESAs

It has been suggested by a number of access seekers that pricing of WLR/LCS services in CBD areas provides a possible basis to reconsider the declaration of WLR and LCS services due to the differences in Telstra's pricing for services in these areas compared to other areas in which the Commission's FAD pricing for these services applies.

As set out in section 2.1, the threshold question for whether or not regulation is likely to be in the LTIE is whether or not WLR/LCS services constitute an enduring bottleneck within CBD areas. As set out above, it is clear that the WLR and LCS services cannot reasonably be considered to pass the threshold test for an enduring bottleneck.

In any event, Telstra's behaviour with respect to WLR/LCS supply in CBD areas is indicative of the strength of competition in the fixed line market rather than providing evidence of a lack of effective competition. Specifically, Telstra has maintained supply of the WLR and LCS services in CBD areas and has not refused access to those services, despite the fact that they are not regulated. Furthermore, rather than raising prices in those areas, Telstra has not increased its commercial rates for these services in the past eight years.

### 3.4 The Enterprise and Government segment of the market is highly competitive

Telstra strongly disagrees with Optus' submission that removing the CBD exemptions would facilitate competition in the enterprise and government segment of the market. The existing exemptions do not impact upon the ability of access seekers to compete for customers in the enterprise and government sector. Such customers typically require a broad range of telecommunications and data services and the contracts are typically of a high value. Telstra believes that the enterprise and government segment is already highly competitive; for example, Optus itself has recently announced substantial deals in the corporate and government market segment, including a \$530m managed services deal with the ANZ bank. This suggests that the current CBD exemptions are not adversely impacting competition in the enterprise and government market segment.

Optus states that the enterprise and government segment of the market has the following unique characteristics:

- *“Enterprise and government customers require consistent national connectivity, requiring access seekers to utilise Telstra’s resale services outside their network footprints;*
- *Enterprise and government customers have large premises within the CBD areas that require Access Seekers to utilise Telstra resale services; and*
- *Capacity constraints at CBD exchanges make it difficult for access seekers to provide additional services using ULLS.”*

Given the levels of competitive activity within the CBD ESAs and the low percentage of WLR SIOs that are business WLR lines, Telstra believes that there is a relatively low level of reliance upon its resale services within the CBD ESAs. As already noted, access seekers have installed more interconnect pairs in CBD ESAs than there are active CAN SIOs<sup>23</sup> suggesting there is no impediment to competitive supply.

With respect to capacity constraints, many access seekers are already present in CBD exchanges. The Commission can easily review the level of queuing and capping activity within CBD ESAs through the Telstra Exchange Facilities RKR reports. These show that there has not been any queuing within CBD exchanges within the past six months and that no CBD exchanges are flagged as potentially capped.

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<sup>23</sup> Telstra, September 2013, p.32

Optus has also suggested that in order to compete in the enterprise and government segment, access seekers require certainty of access to Telstra's infrastructure and products, and that an entire corporate account may be lost if even one location is inaccessible via ULLS. However, Telstra does not believe that this is a valid argument for removing the WLR/LCS exemptions in the CBD ESAs, for a number of reasons, including:

- Telstra continues to commercially supply WLR and LCS in the CBD ESAs;
- CBD ESAs have less than 1% of PSTN services which are delivered through 'line blockers' like large pair gain systems; and
- Access seekers have significant spare capacity on their already installed interconnect pairs in the CBD ESAs.

Finally, with respect to the enterprise and government segment – which does make up a significant proportion of services within the CBD ESAs – it is likely that customers in those sectors will expect higher levels of fault rectification guarantees, for example, a corporation that is headquartered in a CBD would likely expect any faults to be given the highest priority. Telstra reiterates that in CBD ESAs, the ULLS has available a better level of fault guarantee (four hours targeted) than the WLR (six hours targeted) and notes that of the [c-i-c] with a presence in the CBD ESAs, [c-i-c] themselves of the opportunity to provide that higher level of service for at least some of their ULLS services.

### 3.5 Conclusion

The unique demographic and demand qualities exhibited in CBD areas has not only driven intensive competition in markets for the supply of voice and broadband services via the use of ULLS and LSS, but has also supported competition via a number of alternative fibre-based access networks. As outlined above, there is no evidence of any enduring bottlenecks that would justify regulation, nor is there any suggestion of a market failure. Given this evidence it would be an extraordinary decision for the Commission to now decide to remove LCS exemptions that have stood for 10 years, and implement WLR regulation in CBD areas where this has never existed.

Telstra urges the Commission not to impose unnecessary regulation. The significant development in competition in CBD ESAs has taken place against the background of no regulation of WLR and LCS, although alternatives – including ULLS and DTCS – have been, and continue to be, declared. The absence of regulation of these services has not in any way impeded the development of competition, which has benefited all end users in the CBD ESAs.

There is a real cost to introducing regulation in markets where no enduring bottleneck exists. In his August 2013 report for Telstra, Professor Martin Cave noted the risks and potential costs that unnecessary and poorly targeted access regulation can have on the development of competitive service offerings and effective competition:

*“Requiring any provider to supply a regulated product risks distorting the market place and stifling innovation, as the regulator typically defines the attributes of the regulated product in a fashion which may pre-empt rivals’ offerings and curtails or eliminates the market discovery process from which customers benefit.”<sup>24</sup>*

Although Professor Cave's report was directed towards the declaration of resale services provided over the NBN, his conclusion is equally applicable in the context of the CBD exemptions. Customers in CBD areas – whether in the enterprise and government, small business or consumer market segments – have undoubtedly benefited from the competitive environment that has developed, through alternative infrastructure providers and product and service innovation. Telstra urges the Commission not to jeopardise the benefits that have accrued and that can be expected to continue to develop in the absence of regulation.

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<sup>24</sup> Report by Professor Martin Cave entitled “The declaration of resale services provided over the NBN: a response to aspects of the Commission's Fixed Services Review – Discussion Paper on the Declaration Inquiry”, dated 30 August 2013 (Appendix 4 to Telstra's September submission).





## **Appendix 1: Response to ACCC market information request**

The entirety of this Appendix is confidential.