

**Inquiry into varying the exemption provisions in the final
access determinations for the WLR, LCS and PSTN OA
services**

Issues paper

Submission by Herbert Geer Lawyers on behalf of:

Adam Internet Pty Ltd,

iiNet Limited, and

Internode Pty Ltd

14 October 2011

1. INTRODUCTION

This submission is made on behalf of Adam Internet Pty Ltd, iiNet Limited and Internode Pty Ltd (collectively, **our Clients**) in response to the ACCC's issues paper of September 2011 entitled *Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services (the Issues Paper)*. Our Client's welcome the opportunity to make a submission in response to the Issues Paper.

In addition to the submissions set out below, our Clients wish to rely on section 5 of the submissions dated 3 June 2011 that were made on behalf of our Clients in response to the ACCC's discussion paper of April 2011 entitled *Public inquiry to make final access determinations for the declared fixed line services (Previous Submissions)*¹. As in the Previous Submissions, for ease of expression, these submissions will refer to WLR. However, a reference to WLR also includes, as the context requires, a reference to LCS and PSTN OA. Also for ease of expression:

- *'the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA'* will be referred to in these submissions as **the Exemptions**;
- those exchange service areas to which the Exemptions apply will be referred to collectively as the **Exemption Footprint**; and
- those services to which the Exemptions apply will be referred to as the **Exempt Services**.

In addition to the points made in the Previous Submissions, our Clients wish to make the following points:

- The underlying justifications for the Exemptions are problematic.
- The appropriate threshold for the withdrawal of regulated access to WLR has not been reached.
- The Exemptions lead to undesirable outcomes.
- A 'future with / future without' assessment shows that the Exemptions are not in the LTIE.
- The practical effect of the Exemptions will be negated by the interim equivalence requirements arising from Telstra's structural separation.

Our Clients submit that the above points amount to compelling reasons why the Exemptions should be removed. Further detail on each of these points is set out below.

2. THE UNDERLYING JUSTIFICATIONS FOR THE EXEMPTIONS ARE PROBLEMATIC

Working from the lowest level of abstraction to the highest level of abstraction, the underlying justifications for the exemptions appear to be as follows:

¹ In addition to our Clients, Aussie Broadband Pty Ltd was a party to the Previous Submissions.

- The exemptions will encourage competition based on the ULLS².
- ULLS based competition in retail markets is superior to resale based competition³.
- The Exemptions are consistent with the 'ladder of investment' theory⁴.

Each of these justifications will be considered in turn.

2.1 The exemptions will encourage competition based on the ULLS

The problem with this justification is that the available evidence shows that the availability of regulated access to WLR does not hinder the take up of ULLS⁵. In other words, the Exemptions are seeking to push on an open door. What has hindered the take up of ULLS, and slowed down the growth in ULLS market share, is Telstra's well documented anti-competitive practices regarding access to exchanges⁶ and the absence of an effective LSS to ULLS migration process. The Tribunal recognised these problems by including conditions in its Orders that were intended to address these issues⁷.

Furthermore, the continued desirability of investment in ULLS based infrastructure needs to be considered in the context of the NBN. While it may be correct to say that the NBN has not yet totally extinguished every conceivable business case for continued investments in ULLS based infrastructure⁸, there will come a point when all ULLS based infrastructure investment is no longer viable due to the simple fact that the NBN will make ULLS based infrastructure obsolete. Given that the ACCC is required to take a long term view, this simple fact cannot be ignored and needs to be given sufficient weight. It is submitted that it is impermissibly short sighted for the ACCC to pursue a regulatory policy which seeks to withdraw regulated access to WLR in order to push investments in ULLS infrastructure, without having sufficient regard to the moribund nature of ULLS investment. If such a regulatory policy is also put in the context of regulated access to WLR not being a hindrance to the take up of ULLS, it strays dangerously close to being perverse.

² ACCC - Telstra's local carriage service and wholesale line rental exemption applications Final Decision and Class Exemption August 2008, at p.6 and p.28.

³ *ibid.*

⁴ *ibid* at p.29. Note a reference in these submissions to the 'ladder of investment theory' is a reference to the theory of Professor Martin Cave as set out in the article *Encouraging infrastructure competition via the ladder of investment* (2006).

⁵ For example, ULLS take up from September 2007 to June 2008 (i.e. before the Exemptions) increased by 93% - see *Telstra's local carriage service and wholesale line rental exemption applications, Final Decision and Class Exemption*, August 2008, at p.70. See also *Application by Chime Communications Pty Ltd (No 2) [2009] ACompT 2*, at [137].

⁶ These practices have resulted in the ACCC taking Federal Court action against Telstra - see *Australian Competition and Consumer Commission v Telstra Corporation Limited [2010] FCA 790*. The Minister has also determined that there is a need for Telstra exchange building access to be a regulated service for the purposes of achieving equivalence under Telstra's structural separation undertaking - see *Telecommunications (Regulated Services) Determination (No.1) 2011*.

⁷ See *Application by Chime Communications Pty Ltd (No 3) [2009] ACompT 4* - see clauses 6.3, 6.4 and 6.9.

⁸ See for example Annexure 2 to the Previous Submissions.

2.2 ULLS based competition in retail markets is superior to resale based competition

The problem with this justification for the Exemptions is that it assumes a zero sum game (i.e. it assumes that competition in retail markets based on WLR is at the expense of competition based on ULLS). It is submitted that such a binary view of the world does not accord with reality nor does it accord with the Tribunal's findings. As the Tribunal pointed out:⁹

Unless there is in existence a state of affairs in which it is likely that entrants (and potential entrants) will constrain Telstra, the grant of the exemptions sought will be positively contrary to the long-term interests of end-users. The Tribunal appreciates that Telstra believes ULLS-based technology is superior to that based on WLR/LCS. That, however, is of little concern to the Tribunal. It is not the function of the Tribunal to make a choice between technologies and between competing goods and services based on their quality (or on any other factor). Those choices are made by consumers. But, while the consumer makes that choice, they benefit from the availability of both old and new technologies or old and new products and services. Competition between old and new lowers the production costs of both. Product quality and performance are also improved and choices are broadened.

Therefore, the Tribunal's view was that regulated access to WLR actually enhances competition as compared to competition based on just ULLS. It is submitted that the inescapable conclusion from the available evidence is that the benefits to end users that come from use of the ULLS are already present¹⁰.

2.3 The Exemptions are consistent with the ladder of investment theory

A slavish adherence to the ladder of investment theory would lead ultimately to the conclusion that Optus should not have access to ULLS within the footprint of its HFC network (**the Ultimate Outcome**)¹¹. This was precisely the argument that Telstra advanced to justify an exemption from it having to provide ULLS to Optus within the footprint of Optus' HFC network¹². However, the ACCC and the Tribunal both decided that the Ultimate Outcome would not be in the LTIE¹³. Therefore, it is implicit in these decisions that a slavish adherence to the ladder of investment theory is not in the LTIE, and a more sophisticated approach is required. Significantly, when considering the ladder of investment theory in the context of the Optus HFC exemption application by Telstra, the ACCC stated:¹⁴

While the ACCC considers that the 'ladder of investment' concept may be a useful analogy for the process by which competition emerges, the ACCC does not consider that the idea of the 'ladder of investment' is a vital or integral concept within its approach to regulating declared services.

⁹ *Application by Chime Communications Pty Ltd (No 2)* [2009] A CompT 2 at [161].

¹⁰ See further, section 5.3 of the Previous Submissions and Annexure 2 to the Previous Submissions.

¹¹ i.e. as Optus has 'climbed to the top of the ladder', it no longer needs access to the lower rungs.

¹² See *Telstra's exemption application in respect of the Optus HFC network Final decision*, November 2008, at p.19.

¹³ *ibid*, and *Application by Telstra Corporation Limited* [2009] ACompT 1.

¹⁴ *Telstra's exemption application in respect of the Optus HFC network Final decision*, November 2008, at p.28.

And further:¹⁵

The ACCC agrees with Cave's view that the 'ladder of investment' is simply a hypothesis. The ACCC has had regard to the approach but does not consider that it forms a major part of the ACCC's approach to regulation.

3. THE APPROPRIATE THRESHOLD FOR THE WITHDRAWAL OF REGULATED ACCESS TO WLR HAS NOT BEEN REACHED

Given the positive effects on competition that the availability of WLR has, and the fact that availability of regulated access to WLR does not hinder the take up of ULLS (see section 2.2 above), it is submitted that the appropriate point at which to withdraw regulated access to WLR would be when there is a competitive, or likely competitive, wholesale market for WLR. This would ensure that access to competitively priced WLR would continue.

As the ACCC rightly points out¹⁶, there are problems with assuming that:

spare DSLAM capacity = a likely competitive wholesale market for WLR

The fundamental problem with the Exemptions is that it is this unsafe assumption that is at their heart.

4. THE EXEMPTIONS LEAD TO UNDESIRABLE OUTCOMES

Our Clients have identified three obviously undesirable outcomes that result from the Exemptions¹⁷.

Firstly, In the absence of a competitive wholesale market, it is likely that withdrawing regulated access to WLR will allow Telstra to prevent new entrants entering the relevant retail markets. Telstra could do this by raising the price of WLR to an uncompetitive level. In this situation a potential new entrant would be faced with either:

- the impossible task of trying to compete with Telstra and ULLS access seekers by using the uncompetitive WLR provided by Telstra; or
- making the necessary investments in ULLS based infrastructure without first having achieved the scale that would justify this investment (note it is implicit in the ladder of investment theory that such investments are not viable).

Secondly, the Exemptions have the undeniable effect of increasing the regulatory burden. This fact is clearly established by means of a comparison between:

- the regulatory burden with the Exemptions; and
- the regulatory burden without the Exemptions.

¹⁵ *ibid.*

¹⁶ Issues Paper at pp. 49,50. The information at Annexure 1 to the Previous Submissions supports this conclusion.

¹⁷ Note this is not intended to be an exhaustive exposition of all possible undesirable outcomes. An additional undesirable outcome that was identified in the Previous Submissions is the likely exit of resellers from the relevant retail markets.

This comparison is as follows:

- With the Exemptions - the ACCC is required to set terms and conditions of regulated access for WLR (i.e. because regulated access still applies outside the Exemption Footprint); in addition, the ACCC is required to monitor the scope of the Exemption Footprint and, although they are not compelled to do so, it is in the interests of Telstra and access seekers to collect and provide data to the ACCC regarding service numbers and DSLAM capacity respectively.
- Without the Exemptions - the ACCC is only required to set terms and conditions of regulated access for WLR.

This means that a reduction of the regulatory burden cannot be a justification for the Exemptions because the Exemptions actually lead to an increase in the regulatory burden.

Thirdly, the Exemptions have the undeniable effect of increasing regulatory uncertainty because the Exemption Footprint is capable of increasing every six months.

5. A 'FUTURE WITH / FUTURE WITHOUT' ASSESSMENT SHOWS THAT THE EXEMPTIONS ARE NOT IN THE LTIE

On the basis of the current state of competition in the relevant wholesale markets and the likely future state of competition in those markets, the salient characteristics of the likely 'future with / future without' analysis are as follows:

	Future with the Exemptions	Future without the Exemptions
Effect on competition	<p>Telstra will likely be unconstrained in the wholesale markets for voice and bundled voice/broadband services.</p> <p>Competition in retail markets for voice and bundled voice/broadband services will be dependent on ULLS based access seekers providing retail services in competition with Telstra.</p>	<p>The availability of regulated access to WLR will continue to act as a constraint on Telstra in the wholesale markets for voice and bundled voice/broadband services.</p> <p>Competition with Telstra in retail markets will continue on the basis of ULLS based competition and also resale based competition.</p>
Effect on investment in infrastructure	<p>There is a risk that access seekers may be forced into inefficient investment in ULLS based infrastructure, especially in light of the NBN (the NBN will have a major impact on determining when it ceases to be efficient to invest in new ULLS based infrastructure in any given case).</p>	<p>Access seekers will continue to invest in ULLS based infrastructure where it is efficient to do so (the NBN will have a major impact on determining when it ceases to be efficient to invest in new ULLS based infrastructure in any given case).</p>
Effect on consumers	<p>Consumers are only able to enjoy the product differentiation and choices that result from ULLS based competition.</p>	<p>Consumers are able to enjoy the product differentiation and choices that result from ULLS based competition as well as from resale based competition.</p>
Regulatory burden	<p>Increased (as compared to future without).</p>	<p>Decreased (as compared to future with).</p>
Regulatory uncertainty	<p>Increased (as compared to future without).</p>	<p>Decreased (as compared to future with).</p>

It is submitted that the analysis above clearly shows that the 'future without' scenario would better promote the LTIE.

6. THE PRACTICAL EFFECT OF THE EXEMPTIONS WILL BE NEGATED BY THE INTERIM EQUIVALENCE REQUIREMENTS ARISING FROM TELSTRA'S STRUCTURAL SEPARATION

Our Client's acknowledge that arguments about Telstra's Structural Separation Undertaking (**SSU**) are more appropriately dealt with as part of the ACCC's specific consideration of the SSU. However, as the Issues Paper refers to the possible effects of the SSU on the Exemptions, our Clients felt it was appropriate to address these issues in these submissions.

Acceptance of Telstra's SSU is governed by s. 577A of the *Telecommunications Act 1997* (**TA**). Section 577A(3) of the TA provides as follows:

(3) The ACCC must not accept an undertaking under this section unless the ACCC is satisfied that:

(a) the undertaking provides for transparency and equivalence in relation to the supply by Telstra of regulated services to:

- (i) Telstra's wholesale customers; and*
- (ii) Telstra's retail business units;*

during the period:

- (iii) beginning when the undertaking comes into force; and*
- (iv) ending at the start of the designated day; and*

(b) the undertaking does so in an appropriate and effective manner.

Section 577A(3) of the TA identifies the period that begins when the undertaking comes into force and that ends at the start of the 'designated day'¹⁸ (**the Interim Period**). Section 577A(3) of the TA is part of a statutory mechanism for achieving transparency and equivalence during the Interim Period which works as follows:

- the ACCC must not accept the SSU unless satisfied that:
 - the SSU provides for transparency and equivalence (i.e. as per s. 577A(3)(a)); and
 - that the manner in which the SSU provides for transparency and equivalence is appropriate and effective (i.e. as per s. 577A(3)(b))

(the ACCC SSU Obligation); and
- Telstra must comply with the SSU and, assuming the ACCC has complied with the ACCC SSU Obligation, the SSU will oblige Telstra to provide transparency and equivalence in relation to the supply by Telstra of regulated services during the Interim Period.

¹⁸ i.e. when the requirement for Telstra to have structurally separated commences.

Note that for ease of expression the equivalence component of the requirement arising from s. 577A(3)(a) will be referred to as **the Equivalence Obligation**.

Our Clients note that:

- Telstra originally attempted to carve out the entire Equivalence Obligation from applying to the Exempt Services. However, Telstra has subsequently limited this carve out to price terms only, following concerns raised by the ACCC¹⁹.
- In order to comply with the Equivalence Obligation in respect of price terms for non exempt WLR services, Telstra intends to apply the regulated price for WLR (i.e. the price set by the ACCC in an access determination) (**the Telstra Equivalence Term**)²⁰.

For the reasons set out below, our Clients submit that, due to the ACCC SSU Obligation, the ACCC will be unable to accept the SSU if the SSU does not fully apply the Equivalence Obligation to the Exempt Services. Therefore, if Telstra wishes to proceed with its SSU, it will need to remove the carve out relating to the Exempt Services, and ensure that the Telstra Equivalence Term applies to all WLR services, including the Exempt Services. Due to the nature of the Telstra Equivalence Term, this will result in the practical effect of the Exemption as it relates to price terms being negated²¹.

It is important to note that section 577A(3) of the TA has two limbs²² and each limb has distinct work to do. The work that the first limb of s. 577A(3) of the TA does is to identify the obligations that the SSU must impose on Telstra. In other words, the first limb establishes the 'what'. This 'what' consists of transparency and equivalence in relation to the supply of regulated services during the Interim Period. What is 'equivalence' and what is a 'regulated service' is defined by the legislation²³.

'Equivalence' is defined as:

equivalence in relation to terms and conditions relating to price or a method of ascertaining price; and equivalence in relation to other terms and conditions.

A 'regulated service' is defined as a declared service within the meaning of Part XIC of the *Competition and Consumer Act 2010 (CCA)* or a service that is determined to be a regulated service by the Minister. It is important to note that these definitions are set by the legislation. They are not negotiable.

The work that the second limb of s. 577(3) of the TA does is to dictate the manner in which the obligations that are identified in the first limb are complied with. In other words, the second limb establishes the 'how' (i.e. transparency and equivalence in

¹⁹ See ACCC discussion paper of August 2011 entitled: *Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan*, at p. 76.

²⁰ See clause 1.2 of Schedule 8 of the SSU submitted to the ACCC on 29 July 2011.

²¹ It is important to recognise that the terms included in an access determination may not necessarily meet the requirements of the Equivalence Obligation (i.e. the Equivalence Obligation may require improved terms of access). However, the important point as far as the practical effect of the Exemptions is concerned is that the Equivalence Obligation would prevent Telstra from charging the CRA price for WLR.

²² i.e. s. 577A(3)(a) is the first limb and section 577A(3)(b) is the second limb

²³ See clause 69 of Division 1 of Part 9 of Schedule 1 to the TA.

respect of regulated services must be delivered by the SSU in a manner that is appropriate and effective). It is important to note that the first limb is not subject to the second limb. Therefore, it would be incorrect, and impermissible, for the ACCC to conflate the two limbs of section 577A(3) of the TA and read section 577A(3) of the TA as if it stated:

the undertaking must provide for effective transparency and equivalence in relation to the supply of regulated services to the extent that this is appropriate.

It is important to note that the statutory definition of 'equivalence' means that the Equivalence Obligation is not satisfied if equivalence in relation to price terms is not provided for in the SSU. In other words, merely providing equivalence in respect of non price terms will not satisfy the Equivalence Obligation.

It is also important to note that notwithstanding that the Exemptions make the standard access obligations (**SAOs**) inapplicable to the Exempt Services, it is clear that each of WLR, LCS and PSTN OA come within the statutory definition of 'regulated service' even within the Exemption Footprint. Therefore, the Exempt Services come within the definition of 'regulated service' for the purposes of the Equivalence Obligation. Given that the legislature has deliberately chosen to define 'equivalence' and 'regulated service' in the way that it has, there is no scope for the ACCC to 'read down' the scope of the Equivalence Obligation by accepting an SSU that clearly and expressly attempts to carve out price equivalence from applying to regulated services simply because the SAOs do not apply to those services.

Furthermore, even if such 'reading down' of the Equivalence Obligation were permissible, it is not appropriate to do so. The only possible justification for not including the Exemptions within the scope of the Equivalence Obligation is the fact that the SAOs are inapplicable to the Exempt Services. It is submitted that this fact is of no relevance to the Equivalence Obligation. The fact that the statutory definition of 'regulated service' includes two services to which the SAOs do not apply²⁴, clearly shows that it was not intended that the reach of the Equivalence Obligation should be determined by the extent to which the SAOs apply. In light of this, there is no justification for not applying the Equivalence Obligation to a regulated service, or a subset of that regulated service, simply on the basis that the SAOs are inapplicable. The Equivalence Obligation is a specific legislative measure that is part of a wider reform of the industry. Therefore, the Equivalence Obligation is an entirely separate obligation from the obligation to comply with the SAOs, and it should be treated as such.

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²⁴ i.e. Wholesale ADSL Layer 2 and Telstra Exchange Building Access - see *Telecommunications (Regulated Services) Determination (No.1) 2011*.