FROM: Network Technology (Aust.) Pty. Ltd.

TO: the Australian Competition and Consumer Commission.

Telstra's line sharing service undertakings 2003

Introduction

The unbundling of the monopoly copper based local loop is vital to broadband deployment in Australia utilising DSL technology. Setting the pricing of ULL and LSS appropriately is crucial for the widespread rollout of infrastructure based competition via DSLAMs versus the resale of Telstra's Wholesale DSL service.

Infrastructure based competition will provide maximum innovation and competition which will benefit the long term interests of end users. In the current economic climate for Telecommunications companies, it's likely that DSL technologies will dominate broadband for the next decade by volume, particularly in metropolitan areas.

As a CSP, we welcome the opportunity to make this submission, having operated for 9 years in the ISP industry covering both metropolitan and regional areas, and now focusing on a DSL infrastructure rollout on the Gold Coast. We will try and address the specific questions raised by the commission.

In summary:

- Telstra forecasts for this service are **very** low. By modeling low volumes, which keeps the price high, low volumes can become a self-fulfilling prophesy. The hurdle for competitive DSLAM infrastructure deployment will be higher.

- Non undertaking terms and conditions, specifically disconnection fees, make the price of a line shared service held for a period of less than 12 months more expensive than a band 1 and band 2 ULL line held for the same period.

Views

Pricing of LSS

The Commission seeks interested parties' views on how Telstra's proposed price meets each of the reasonableness criteria under Section 152AH of the Act. Does the proposed LSS access charge promote competitive neutrality with regard to an efficient access seekers' ability to compete with Telstra in dependent downstream markets?

No. The current price negatively affects the ability to compete as there are also significant other charges payable, predominantly to Telstra, by competitive infrastructure providers including exchange rack and cable tray rental, power and backhaul transmission charges. In most cases except at the margins, it is not meaningful for Telstra to account for the other costs for their own DSL services as they can simply utilise existing excess capacity. The LSS charge needs to be as close to $0 as possible to help overcome these other barriers.

The Commission seeks comment on the appropriate pricing principles relevant to assessing Telstra's pricing proposal.

It's important to remember that Telstra offered LSS commercially before the Commission decided to declare it. To apply TLSRIC principles is the correct approach in theory for an access provider forced to offer a service.

Telstra has also shown that if TLSRIC was strictly applied in this case it would provide a "rate shock" to the price.

It is unclear why the Commission believes that "connection costs" are relevant as connection fees are charged separately from the ongoing monthly fees and are not part of the undertaking.

The Commission seeks comment on Telstra's contention that the proposed LSS price is at the upper end of currently negotiated rates.

The proposed LSS price is the only price ever offered to us.

The Commission seeks the views of interested parties on the appropriateness of using TSLRIC to calculate the efficient costs of supplying the LSS access service.

TSLRIC may theoretically be an appropriate costing methodology but as can be seen from the undertaking, it is very sensitive to SIO volume. By modelling low volumes which keeps the price high, low volumes can become a self-fulfilling prophesy. The hurdle for competitive DSLAM infrastructure deployment will therefore be higher.

The Commission seeks the views of interested parties on the appropriateness of Telstra proposed LSS access charge only comprising the incremental or LSS-specific costs of providing the LSS to access seekers.

Working backwards using the proposed forecasts and the $57/line calculated "efficient" cost, it's possible to deduce the total costs being in the order of $7M over the 3 year period.

While not having read Telstra confidential information, based on our own experience in developing IT systems for ISP ordering, provisioning & billing, this seems to be a very high figure. LSS is a relatively simple wholesale product to deliver and the resultant IT systems would require very few staff to administer on an ongoing basis.

The Commission seeks the views of interested parties on the appropriateness of Telstra cost model used for the purpose of calculating its claimed LSS-specific costs.

No comment.

The Commission seeks the views of interested parties on the appropriateness of the WACC (including WACC parameters) used by Telstra for the calculation of LSS-specific costs

No comment.

The Commission seeks the views of interested parties on the appropriateness of Telstra's methodology for the calculation of capital, operational and maintenance, and indirect costs.

It is unclear what "processing orders" refers to in the Telstra response to information requested by the ACCC "2. Estimation of direct and operational and maintenance costs". The vast majority of orders would be service qualifications, connections and disconnections, each of which are charged separately from the monthly rental fee, and should therefore not be used in the calculation of the monthly rental fee costs. It is therefore unclear as to why "connections per staff per day" is even a relevant metric for estimating costs per staff member.

The Commission seeks the views of interested parties on the issue of whether there is any commonality in the efficient provision of the LSS and Unconditioned local loop service (ULLS) to access seekers, and any implications this commonality may have for the calculation of efficient LSS-specific costs.

There is not only commonality between LSS and ULL but also with other existing wholesale and retail ADSL services (e.g. LOLO ordering system, service qualification databases and line testing, exchange line jumpering, updating line codes in databases etc.).

Telstra latest financial results state that there was a 68,000 net increase in broadband services in the December 2003 quarter[1], a vast majority of which would have been ADSL. This suggests that each working day, particularly in metropolitan exchanges, technicians are performing several connections and disconnections at each exchange which would not require a specific visit to the exchange for just one service. Although not covered in the undertaking, connection and disconnection fees are likely to be very profitable for Telstra.

Further, transferring customers from a wholesale DSL service to LSS, which would be a typical pathway for a customer's line, a full connection fee is charged, even when performing them in bulk by the hundreds. This would lead to a line jumpering technician's time being worth $10,000+/day.

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[1] p52 http://www.telstra.com.au/communications/shareholder/docs/financialhighlightshy04.pdf

The Commission seeks the views of interested parties on the appropriateness of Telstra proposed LSS access charge relative to the ULLS access prices that the Telstra has proposed in context of its core services undertakings.

The relative prices of ULL and LSS seem to be converging. LSS should be much cheaper than ULL, particularly in high line density metropolitan band 1 and band 2 areas.

There is also a price squeeze happening between LSS at $15 and Wholesale DSL at the recent price of $29.75/month at the lowest speed. Wholesale DSL prices also include the equipment cost, exchange rental, power, and most importantly backhaul transmission charges. If the Commission forces Telstra to drop the Wholesale DSL price further, LSS should drop by at least the same amount.

The Commission seeks the views of interested parties on the appropriateness of the adjustment mechanism proposed by Telstra for reallocating any unrecovered LSS-specific costs through prices in future periods beyond the scope of the undertaking.

No comment.

The Commission seeks the views of interested parties on Telstra International benchmarking study and any other relevant information regarding the LSS experience in overseas jurisdictions.

The international benchmarking study of just the LSS component is only marginally helpful as there are many other component costs required to build a complete competitive DSL service including facilities access (rack rental, cable tray rental, power costs etc.) and very importantly backhaul transmission.

As for the benchmarking presented, Telstra should also factor in their disconnection fees into their comparison. If they did it would raise the average monthly price by several additional dollars, pushing them further up the international comparison.

The commission should learn from overseas markets like Japan which have both:

- high DSL penetration which shows that consumers are responding well to the competitive environment by buying the service.
- high non-incumbant DSL market shares which shows that a more level competitive playing field is possible and that market share is a function of innovation and efficiency rather than incumbency.

In that particular market the line sharing cost was around 168 yen per month[2] (approx AUD$2/month) and the cost of backhaul transmission is very low due to the declaration of dark fibre.

[2] p13 Footnote 17 http://www.rieti.go.jp/jp/publications/dp/03e023.pdf

The Commission seeks the views of interested parties on whether there are any other important terms and conditions of access which should be considered by the Commission that are not contained in Telstra's proposed undertaking.

Non undertaking terms and conditions, specifically disconnection fees are of great concern.

By way of comparison Telstra wholesale DSL has a small disconnection fee, relative to the monthly charge, and only if the service is cancelled within the first 6 months. ULL has a minimum term of 3 months and no disconnection fee. LSS on the other hand, although it has no minimum term it has a very large disconnection fee, relative to the monthly charge.

This disconnection fee makes the price of a LSS held for a period of less than 12 months more expensive than a band 1 and band 2 ULL line held for the same period. This defies economic logic. Fees more in line with either wholesale DSL or ULL would be much more appropriate.

Demand estimates

The Commission seeks the views of interested parties on the appropriateness of Telstra's demand estimates.

Based on our own experience, existing customer base and 2004 rollout plans, the demand estimates in the undertaking seem **very** conservative. LSS, unlike ULL, will become the dominant copper based competitive infrastructure by line volume because the price can reach down to the consumer sub $50/month price points.

ULL has to date been suitable only for business customers and has been closer to the $100/month price point. With the current ULL undertaking we believe ULL volumes will also increase, but LSS will overtake ULL volumes and dominate into 2005.

This is due to the fact that there are many provisioning process related advantages in simply re-using the existing line to end user premises rather than utilising ULL. There should also be economic advantages in using surplus capacity on a line which has been fully funded by the voice service.

What are the main factors for the poor take-up of the LSS so far? What method should be utilised for forecasting ULLS demand?

That the take-up has been low to date is as much a part of Telstra's pricing and terms and conditions as it is the stage of the industry development. The current commercially offered pricing is obviously too high to encourage widespread take-up.

The main economic factor for competitive DSLAM deployment in a particular exchange is customer spend, i.e. the amount of revenue obtained on a particular exchange needs to reach various thresholds to justify deployment. As it's a relatively early stage of the industry, service providers are just now beginning to reach those thresholds and several have publicly stated they will begin to deploy significant infrastructure in 2004. With competitive backhaul, providers need 150-200 consumer customers to justify deployment.

In addition the LSS pricing level, as well as non undertaking terms and conditions, particularly disconnection fees, have raised the threshold higher than it should be.

The Commission is interested in the views of industry on their demand estimates with respect to the LSS.

Based on our existing customer base distribution and 2004 infrastructure plans, it's likely that as a relatively small regional ISP we will have a significant double digit percentage of the 2003/04 Telstra estimates.

Other much larger ISPs like Request, iiNet and Internode have stated they will be rolling out infrastructure in 2004. We believe that approximately 100 exchange utilising LSS will be rolled out in 2004. Assuming just 150 lines per exchange, this translates to 15000 lines which are far above Telstra estimates.

What approach should the Commission use for addressing the problem of circularity in estimated and realised demand discussed above?

Keeping the price high by using a low demand forecast, will lead to a self fulfilling prophecy. The economic hurdle to deploy a DSLAM is significantly higher at $15/month than at say $2/month. Pricing has to be set to encourage volume growth. $15 is obviously way too high when ULL can be acquired for $13 and $22 in the metropolitan areas (band 1 and 2). An "aspirational" approach as adopted for ULL would be preferable.

With the recent $29.95 price point by Telstra and others, Telstra has acknowledged that demand has "more than doubled" from previous levels[3]. This justifies an optimistic forecast for future LSS deployment with providers migrating their existing customers from Wholesale DSL services.

Service Description

The Commission seeks the views of interested parties on the appropriateness of Telstra's proposed service description in clause 2 of Attachment A to the Undertaking. Is the Telstra Wholesale Spectrum Sharing Service a form of the declared service?

No comment.

[3] http://www.telstra.com.au/communications/media/mediareleases_article.cfm?ObjectID=31205

The Commission seeks the views of interested parties on the reasonableness of the proposed service description in the case where the undertaking is intended to preclude an arbitration determination from requiring Telstra to supply the declared service in a form different to that set out in the undertaking.

No comment.

Conclusion

We would be pleased to provide the commission with clarification and any further information that might be of value.

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