Optus Submission

in response to the ACCC's issues paper

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

October 2011

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Section 1. Executive Summary

1.1 Optus welcomes the opportunity to participate in the Australian Competition and Consumer Commission (ACCC)'s inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services (the exemptions).

1.2 This consultation will have important consequences for competition. The exemptions release Telstra from its obligation to provide access seekers with wholesale access to the affected voice services on regulated terms, and apply in a large and growing number of metropolitan exchange service areas (there are currently over 200 Exemption ESAs).

1.3 When the exemptions were established by the ACCC and the Australian Competition Tribunal (ACT) in 2008 and 2009, the theory was that access seekers would be encouraged to invest in DSLAM infrastructure, to stimulate infrastructure-based competition. This rationale no longer applies, given the over-riding impact of the National Broadband Network (NBN) deployment on investment decisions. As the NBN rollout gathers pace, it is highly unlikely that a decision to retain the exemptions beyond 2011 would produce any incremental DSLAM investment.

1.4 Further, when the exemptions were introduced it was thought that Telstra would be restrained from exercising market power in the affected exchanges because acceptable substitute services would be available from alternative wholesale suppliers.

1.5 The expected restraint on Telstra's market power has failed to materialise. Whilst alternative wholesale suppliers do exist, **CiC begins CiC ends** Telstra's scope for exercising market power in the affected ESAs will not be restrained by alternative sources of supply. Retaining the exemptions will permit Telstra to set wholesale prices for the affected voice services which exceed the competitive level.

1.6 Indeed, this has already occurred. Telstra has introduced a significant differential between the price it charges for WLR in exempt exchanges and the regulated price which applies elsewhere. **CiC begins CiC ends**

1.7 The exemptions will have different impacts on different classes of end user. For contestable end-users who can be served via the ULLS, competition from access seekers with DSLAM infrastructure was already vigorous before the exemptions were proposed. For these contestable customers the exemptions will have no ill effects – but no benefits either. On the other hand, end-users who cannot be served effectively via the ULLS (for example, customers connected to a pair gain system or who require "business grade" SLAs) will experience less intense competition and higher retail prices with the exemptions than without.

1.8 Moreover, by removing a critical stepping stone for potential service providers, the exemptions will discourage entry and reduce the intensity of retail level competition both before and after the NBN becomes Australia's main fixed line access platform. This means that the exemptions' negative impact on the interests of end users will be an enduring one.

1.9 In this paper Optus will submit that there is no longer any valid rationale for the exemptions. Optus urges the ACCC to eliminate these pernicious measures as soon as is practicable.

Section 2. Framework for Analysis

2.1 The ACCC has stated that in undertaking its inquiry into the exemptions, it intends to undertake a 'future with and without' assessment'. That is, it will assess whether price and service offerings to end-users are likely to be better in the 'future with exemptions' scenario or the 'future without exemptions' scenario.

2.2 Optus considers that the proposed assessment framework is broadly appropriate. If price and service offerings to end-users were likely to be better in the 'future with exemptions' scenario (compared to the alternative scenario) then the exemptions should remain in place. If the converse is the case, then the exemptions should be removed.

2.3 A key factor in determining which scenario will lead to better price and service offerings to end-users is the extent to which Telstra's market power would be restrained in the 'future with exemptions' scenario.

2.4 If Telstra's market power would be restrained, regulation of resale services would arguably no longer be necessary, as noted in the issues paper,[1] since a major source of negative impacts on end users in the 'future with exemptions' scenario would be removed. Moreover, there could in theory be positive impacts for end users if the exemptions led to self-supply (that is, encouraged access seekers to invest in DSLAM infrastructure or switch end users across to services provided via ULLS rather than WLR), given that DSLAM-based service provision arguably leads to superior choice, diversity of service offerings and quality of service.

2.5 On the other hand, if Telstra *is* able to exercise market power (consistent with a scenario in which the exemptions did not encourage self-supply), end users would experience reduced competition and pay relatively higher prices in the 'future with exemptions' scenario.

2.6 A firm exercises market power when it charges prices that are above efficient cost and earns monopoly profits. In the current context, this means that Telstra will be exercising market power if it charges a price for exempted services above the regulated FAD rate, given that rate is set at efficient cost – as is clear from the following ACCC description of its pricing approach:

> *The ACCC notes that the BBM approach is based on allowing the access provider to recover its efficient costs and does not include monopoly profits in prices....*[2]

2.7 This provides a clear test for whether or not the exemptions are in the LTIE: if Telstra is able to charge a price above the regulated FAD rate in the 'future with exemptions' scenario, this would be a strong indication that retaining the exemptions would not be in the LTIE.

2.8 In order to accurately assess Telstra's ability to exercise market power in the 'future with exemptions' scenario, the ACCC will examine the potential restraints on Telstra's market power, that is, self-supply via access seekers' own infrastructure and purchase of resale services from access seekers that have invested in their own DSLAM infrastructure. [3] The likelihood that Telstra's exercise of market power could be restrained by these potential alternative sources of supply is assessed in the following sections of this submission.

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[1] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.43

[2] ACCC, Inquiry to make final access determinations for fixed line services, Final Report, July 2011, p.100

[3] ACCC, Inquiry into varying the exemption provisions for the WLR, LCS and PSTN OA services, Issues Paper, p.43

Section 3. Exemptions Will Not Induce Additional Self-Supply

3.1 A key question for the ACCC's review is whether, in the 'future with exemptions' scenario, Telstra's market power will be restrained by access seeker "self-supply". That is, if the exemptions are retained, will Telstra be deterred from raising the wholesale price of the exempt services in exemption ESAs because of access seekers' ability to invest in their own DSLAM infrastructure?

3.2 Optus submits that there will be no more DSLAM investment by access seekers in the 'future with exemptions' scenario than in the 'future without exemptions' scenario, particularly in the context of the ongoing deployment of NBN Co's fibre network. Accordingly, Telstra's market power will not be restrained by access seeker "self-supply".

Investing in DSLAM infrastructure to self-supply

3.3 In its issues paper, the ACCC has expressed the preliminary view that the exemptions might encourage access seekers to invest in DSLAM infrastructure:

> *Even if wholesale competition has not developed, and is unlikely to develop, in the exempt ESAs, the exemptions may benefit end-users by encouraging access seekers to invest in infrastructure for self-supply. End-users may benefit from greater choice and/or improved service as a result of infrastructure investments by access seekers. If the costs of investing in infrastructure do not lead to any increase in the cost of supplying retail services for a given service quality (that is, the investments are efficient), end-users are likely to be better off.*[4]

3.4 Optus considers that this scenario is unlikely, and that there will be no difference in the extent of access seeker investment in DSLAMs in the 'future with exemptions' scenario, compared to the 'future without exemptions' scenario, for the following reasons:

(a) access seekers have faced an incentive to invest in DSLAMs for a number of years which is independent of the exemptions (since the ULLS access price is superior to the WLR price and DSLAM-based service gives access seekers greater control over quality of service and greater flexibility in product offerings including its pricing). This suggests that if it was feasible for an access seeker to invest in DSLAMs, it would already have done so;

(b) an access seeker's decision to invest in DSLAM infrastructure is not driven primarily by the availability of resale services; for example Optus began investing in DSLAMs in 2005 and ceased offering resale-based services to new customers in 2007 for reasons unrelated to the exemptions. It follows that the geographic exemptions which took effect in 2011 and removed the option of a regulated resale service are unlikely to have had any impact on the decisions taken by Optus, and in particular have neither encouraged DSLAM investment nor discouraged use of resale. **CiC begins CiC ends** In summary, for Optus the DSLAM investment decision is not highly sensitive to the availability of regulated resale services.

(c) given that there are already a large number of DSLAMs in the exempt ESAs (the ACCC has noted that in the current exempt ESAs, there are on average 5.4 ULLS-based competitors plus Telstra), a new entrant will anticipate fierce competition, which

[4] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.43

suggests that any further investment from 2012 onwards is unlikely to be commercially feasible.[5]

(d) DSLAM investment costs are significant, and the impending NBN deployment reduces the expected return from a DSLAM investment since it reduces the time available to earn revenue and recoup the investment costs. The lack of information on the timetable for deployment adds to the uncertainty around returns.

Impact of the NBN on investment decisions

3.5 A more important driver of DSLAM investment decisions is the imminent construction of the NBN. Optus' recent customer access decisions are illustrative. **CiC begins CiC ends**

3.6 The ACCC has noted that there has been ongoing DSLAM investment in recent years, "which suggests that, despite uncertainty surrounding the NBN, access seekers intend to continue to invest in DSLAM/MSAN equipment." In support of this view, it reproduces a statement by an Internode representative stating an intention to keep deploying more ADSL2+ DSLAMs despite the NBN.[6] There are two points to note in response to this statement.

3.7 First, the Internode statement was made in March 2010. However, the time period relevant to the ACCC's current consultation is the period beginning 1 January 2012. By that time, the Internode statement will be almost two years old. In that time, much will have changed; in particular, the NBN deployment will have will have become much more advanced. Further, the time period in which operators can receive positive cashflows from any investment in DSLAMs will have reduced materially (by 21 months). Moreover, the continuing uncertainty around the deployment timetable leads to uncertainty around the recovery of investment costs. The economics of DSLAM investment will therefore be significantly less appealing in 2012 compared to 2010.

3.8 Second, it is apparent from the statement that Internode's DSLAM investment plan was driven by the need to provide customers with the best service levels. So the investment was always going to happen regardless; there is no evidence that Internode's investment plan (or that of any other operator) has been materially influenced by the exemptions. It follows that there will be no more DSLAM investment in the 'future with exemptions' scenario than in the 'future without exemptions' scenario.

DSLAM investment costs

3.9 The ACCC has stated in the issues paper that "*it estimated that the fixed costs of the DSLAM/MSAN infrastructure were in the order of $12,000 - $14,000 per DSLAM. This includes the DSLAM/MSAN sub-rack and racks, the DSLAM itself, alarm and power distribution units, power cabling to the racks, and signal and cabling to the racks.*"

3.10 Optus submits the ACCC's estimate underestimates the cost of DSLAM investment. As Optus submitted previously, excluding fibre costs, the costs of installing a single DSLAM is in the order of **CiC begins CiC ends**

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[5] Further, given that there are already a large number of DSLAMs in the exempt ESAs (the ACCC has noted that in the current exempt ESAs, there are on average 5.4 ULLS-based competitors plus Telstra), any further investment from 2012 onwards is unlikely to be efficient, given it would involve further duplication of DSLAM infrastructure in these exchanges.

[6] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.35

3.11 Moreover, if a carrier was to make the decision to invest in new DSLAM infrastructure, it would not begin earning revenue immediately. Telecommunications networks are capital intensive and the lead time for DSLAM investment is necessarily very long. **CiC begins**

CiC ends

3.12 It follows that the ACCC may have underestimated the time required to recover the costs of DSLAM investment. This is highly relevant to the investment decision, particularly given that the window for cost recovery is closing (due to the NBN deployment).

3.13 Given these matters, significant further DSLAM investment appears unlikely at current ULLS price levels. The factors which impact the DSLAM investment decision are ULLS access prices, the significant costs of new infrastructure, the long lead times for new investment and the impending construction of the NBN. Compared to these matters, Optus submits that any stimulatory impact of the exemptions would be absolutely minimal.

Threat of entry

3.14 In its issues paper, the ACCC has expressed the preliminary view that the mere fact that access seekers have the option of DSLAM investment may restrain Telstra from exercising its market power:

> *Alternatively, the option for access seekers to invest in their own infrastructure, and avoid purchasing resale services, may be sufficient to limit the scope for resale service providers to charge prices in the exempt areas that significantly exceed the costs of supply. This constraint on wholesale prices may, in turn, benefit end-users through lower retail prices, greater product choice and/or improved service.*[7]

3.15 Optus considers that this threat of entry is unlikely to constrain Telstra from exercising its market power in the 'future with exemptions' scenario, for the following reasons.

3.16 First, Telstra has the same information as do access seekers, and is fully aware of the reasons noted above as to why access seekers are unlikely to invest further in DSLAMs in exempt exchanges. Telstra knows its resale price increases are unlikely to stimulate further investment. Any access seekers with the capability to deploy DSLAMs have already done so and a new DSLAM investment program beginning in 2012 is unlikely given the NBN.

[7] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.43

3.17 The fact that Telstra has already introduced a price differential between exempt and regulated ESAs is clear evidence of the fact that Telstra has not been deterred by the threat of entry so far. In all likelihood it will become even bolder once the current regulatory review is finished and the immediate risk of regulatory action to remove the exemptions has receded;[8] that is, there will be even less restraint on Telstra's market power in the 'future with exemptions' scenario than there has been in the past 12 months.

3.18 If further evidence of the lack of restraint on Telstra is required, consider that, according to Telstra, it is planning to submit four expert reports and a detailed expert witness statement to the ACCC in support of retaining the exemptions. The ACCC should pause to consider Telstra's *motivation* for expending so much money in order to argue in favour of the exemptions. We respectfully suggest that the motivation is not a desire to stimulate greater infrastructure-based competition. There is no disagreement from any party that DSLAM-based operators have the ability to compete more effectively against Telstra than resale-based service providers (they can provide services of higher quality at a lower access price). It follows that if Telstra truly believed that more access seekers would invest in DSLAMs in the 'future with exemptions' scenario compared to the alternative 'without' scenario, it would be arguing *against* the exemptions. Clearly Telstra is very confident indeed that in the 'future with exemptions' scenario:

(a) there will *not* be greater DSLAM investment;

(b) it will be able to raise resale prices and earn monopoly profits; and

(c) the funds it has expended on securing the services of external experts will assist in securing these monopoly profits and are therefore a good investment.

3.19 Optus submits that the ACCC should treat this rent-seeking behaviour by Telstra as strong evidence that Telstra will be unrestrained in the 'future with exemptions' scenario.

Self-supply using existing DSLAMs

3.20 In addition to the encouragement of new investment, the ACCC has also noted as a possibility that in the 'future with exemptions' scenario access seekers may migrate customers across from resale services to existing DSLAMs.

3.21 Optus considers that this scenario is unlikely, since, as noted above, it is advantageous for the access seeker to supply its customers via ULLS regardless of the exemptions since:

(a) the ULLS access price is superior to the WLR price;

(b) ULLS allows data as well as voice;

(c) DSLAM-based service gives access seekers greater control over quality of service.

3.22 Consequently, if any access seeker had the option to migrate customers to existing DSLAMs, it would have been in its interests to do so already.

3.23 There is an important caveat to this line of argument: in many cases an access seeker may retain customers on resale services even in ESAs where it has existing DSLAMs, if DSLAM-based services are, from the end user's perspective, not an acceptable substitute for a Telstra resale service. Indeed Optus finds itself in just this position. Optus takes a number of resale services from Telstra in exempt exchanges where we have DSLAMs deployed. Optus would prefer to

[8] Assuming the exemptions are not removed in the current review.

supply these customers using DSLAM-based service provision (for the reasons outlined above) *if it was feasible*; however in many cases it is not feasible, for reasons explained in the next section. Access seekers in this situation are unable to migrate customers to DSLAM-based services, regardless of the exemptions.

3.24 In summary, there will be no more self-supply using existing DSLAMs in the 'future with exemptions' scenario compared to the alternative 'without' scenario.

Section 4. Alternative Suppliers Cannot Restrain Telstra's Market Power

4.1 A key question for the ACCC's review is whether, in the 'future with exemptions' scenario, Telstra's market power will be restrained by the presence of alternative wholesale suppliers. That is, if the exemptions are retained, will Telstra be deterred from raising the wholesale price of the exempt services in exemption ESAs because of access seekers' ability to switch from Telstra Wholesale to a ULLS-based wholesale provider?

4.2 Optus submits that whilst alternative wholesale suppliers do exist, **CiC begins CiC ends** Telstra's scope for exercising market power in the affected ESAs will not be restrained by alternative sources of supply in the 'future with exemptions' scenario; so Telstra will be able to set wholesale prices for the affected voice services which exceed the competitive level.

ACCC preliminary views

4.3 In its issues paper, the ACCC observed that the case for retaining the exemptions was dependent on the theory that investment in DSLAM infrastructure by access seekers would create the conditions for wholesale competition. To believe that retention of the exemptions would be in the interests of end users, it would be necessary to accept the view that:

> *The incumbent access provider's scope for exercising market power in that ESA will be restrained by the availability of alternative sources of the services required to provide retail fixed line services to end-users... [including] actual and/or potential purchase of resale services from access seekers that have invested in their own infrastructure and have spare capacity.*
>
> *The development of (actual or potential) competition in supplying resale services relies on access seekers with their own infrastructure being willing and able to offer resale services to other access seekers.*[9]

4.4 This analysis raises a number of questions:

(a) Are there access seekers with their own infrastructure which are willing and able to offer resale services to other access seekers?

(b) Are those alternative resale services acceptable substitutes for Telstra's services?

(c) What are the implications for Telstra's ability to exercise its market power?

Alternative wholesale service providers do exist

4.5 Access seekers with DSLAM infrastructure adopt different strategies with respect to wholesale service provision. Some access seekers **CiC begins CiC ends** do not offer wholesale services, so far as Optus is aware. Optus is unable to comment on the reasons for these companies adopting a retail-only strategy.

[9] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.43

4.6 Optus is unaware of any access seeker with DSLAM infrastructure choosing to pursue a wholesale-only business strategy over the copper network.

4.7 Other companies, including Optus, provide both retail and wholesale services over the copper network. Optus is the second largest wholesale service provider after Telstra, so far as Optus is aware. In March 2011, Optus Wholesale provided ULLS resale services to **CiC begins CiC ends**

4.8 The ACCC has raised the possibility that access seekers such as Optus which are also wholesale service providers may not be competing "vigorously" in the supply of resale services, due to the fact that they compete with their customers in retail markets:

> *Vertically integrated access seekers may not, however, have incentives to offer resale services to access seekers that compete with them in retail markets. Vertically integrated access seekers may not be willing to compete vigorously to supply resale services.*[10]

4.9 Optus considers that, in general, this is more likely to be the perspective of an incumbent, rather than a challenger wholesaler. An incumbent will generally be reluctant to voluntarily take on wholesale customers because to do so it will cannibalise its own market share and high margins. Challengers, on the other hand, which have a lower market share and lower margins, are more likely to want to voluntarily take on wholesale customers.

4.10 Whatever the merits of the argument advanced by the ACCC for other access seekers, it does not apply to Optus. Optus is a committed provider of services to its wholesale customers. Optus currently offers both retail and resale ULL services via using its DSLAMs. Equal opportunity is opened to both residential customers and wholesale customers on a "first come first served basis"**. CiC begins CiC ends**

4.11 It is clear that there do exist access seekers with their own infrastructure which are willing and able to offer resale services to other access seekers. It is another question, however, as to whether the services on offer are acceptable substitutes for the exempt services. Entry, of itself, does not establish competitive circumstances, as OECD has recognised:

> *... the critical values used in rule of thumb are a matter of judgement. The problem is that entry into the market by one firm, or even more than one firm, in itself does not establish competitive circumstances. It does not say much about the extent to which the incumbent is either presently restrained or is likely to be restrained by the competitive process in the future, by either the entrant(s) or by further new entrants. Even where there are relatively low costs of entry and few sunk costs, the competitive impact of entry depends on what the entrant does after it has entered, and how the incumbent responds to it.* [11]

[10] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.43

[11] OECD, Geographically segmented regulation for telecommunications, DSTI/ICCP/CISP(2009)6/FINAL, 22 June 2010, p.45

Alternatives may not be acceptable substitutes for exempt services

4.12 As discussed in section 2 of this paper, Telstra will be able to exercise its market power in the 'future with exemptions' scenario if it finds it profitable to charge prices for the exempt services which are above the regulated FAD price. The ability of a firm to profitably raise prices above cost depends on the extent to which consumers will substitute to other suppliers.[12]

4.13 Telstra will be restrained in its ability to charge prices for the exempt services which are above the regulated FAD price only if the services available from alternative suppliers are acceptable substitutes for the exempt services, from its customers' perspective.

4.14 In considering this issue it is important to recognise the difference between supply and demand side substitution:

> *It is possible to distinguish between supply and demand substitution. Supply side substitution is relevant when products are homogeneous, whereas demand side substitution is applicable when products are differentiated.*
>
> *The potential for demand substitution depends on the extent to which other products are acceptable substitutes. If products are sufficiently differentiated so that they are not close substitutes, then some consumers will not substitute to other products when price rises above marginal cost.*[13]

4.15 The ACCC and the Tribunal have hitherto focussed on supply side substitution. This is clear from the focus on the amount of spare capacity in DSLAMS in the Exemption ESAs. For example, the ACCC found that in 87% of the exempt ESAs, there was already enough ULLS spare capacity to absorb all access seekers' total WLR SIOs in 43% of exempt ESAs in March 2011.[14] This is a supply side issue, which implicitly assumes that the relevant services are homogeneous.

4.16 But this is not so. The relevant services are *not* homogeneous; rather, there are differences between the exempt services supplied by Telstra and the services supplied by alternative wholesale suppliers – and critically, these differences are considered significant by access seekers – significant enough that the access seekers will not substitute away from Telstra, even in the event that Telstra charges prices for the exempt services above the regulated FAD price (how else to explain why access seekers including Optus continue to purchase resale services from Telstra in the exempt areas despite being forced to pay a substantially higher price?).

4.17 Optus submits that in considering this issue the ACCC must recognise the crucial point that the relevant services are differentiated and that for some purchasers of the exempted services, alternative sources of supply (access seekers' products) will not be acceptable substitutes – and that for these purchasers the amount of spare capacity available in DSLAMs is *irrelevant*. To the extent the alternative resale services are not acceptable substitutes, Telstra will have market power in respect of the exempt services in the 'future with exemptions' scenario.

4.18 Optus submits that the resale services available from alternative providers are not acceptable substitutes for the exempt services for the following categories of Telstra wholesale customers; that is, wholesale customers which require:

[12] Church, J. and Ware, R., Industrial Organization: A strategic approach, McGraw-Hill, 2000, p.29

[13] Church, J. and Ware, R., Industrial Organization: A strategic approach, McGraw-Hill, 2000, p.30

[14] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.46

(a) Voice-only services;

(b) A multicast service or complex services or “business grade” SLAs;

(c) National coverage;

(d) Ubiquitous coverage within the exempt ESAs;

(e) A “Switchless Long Distance” service to supply the long distance market; and

(f) Not to pay switching costs.

4.19 In practice, wholesale customers of Telstra which fall into any of these categories cannot simply switch to an alternative provider such as Optus, even if Telstra charges prices for the exempt services above the regulated FAD price. Wholesale customers of Telstra which fall into at least one of these categories will constitute the majority of the market. This means that when Telstra charges prices for the exempt services above the regulated FAD price in the exempt exchanges, it may lose some wholesale customers, but the lost revenue will be outweighed by the revenue gained through the price differential. Therefore it will be profitable for Telstra to exercise its market power, and the presence of alternative wholesale suppliers will be no restraint.

Wholesale customers which require voice-only services

4.20 Some wholesale customers of Telstra have a business model which means that they do not require data services, or they do not wish to purchase data services from an alternative provider. For example, they may wish to serve voice-only end users (who may include senior citizens and who still make up a large proportion of total SIOs), or they may have invested in LSS-capable DSLAMs, which means they can self-supply data services using the LSS, and also need to purchase a resale voice service in order to be able to offer combined voice and data services to their retail customers.

4.21 These wholesale customers will be unable to switch to an alternative provider (such as Optus), since supply of voice only services over ULL is:

(a) not commercially viable;

(b) not proactively offered; and

(c) available only subject to restrictive conditions.

4.22 Optus submits that it is not commercially viable for ULLS-based access seekers to supply voice-only services at wholesale in competition with Telstra. **CiC begins CiC ends**

4.23 For this reason, Optus generally sells bundled voice and internet services, not voice-only services, to its wholesale customers. Optus does not proactively offer ULLS-based voice-only services to its wholesale customers. It does not encourage its wholesale customers to take up ULLS-based voice-only services. As a result, only **CiC begins CiC ends** of its total wholesale services are standalone voice-only customers.

4.24 Alternatively, Optus will make voice-only services available to its wholesale customers, but only subject to certain conditions. The nearest equivalent service to a voice-only WLR service offered by Optus Wholesale is a residential grade service called RBT. **CiC begins CiC ends**

4.25 It follows that Telstra will be able to charge a wholesale price for WLR in the exempt exchanges above the FAD rate, and wholesale customers of Telstra whose business plan requires voice-only services cannot simply switch to an alternative provider such as Optus.

Wholesale customers requiring a multicast service or complex services or "business grade" SLAs

4.26 Some wholesale customers have special technical requirements of their wholesale service provider, such as:

(a) a multicast service (in order to provide video services to retail customers);

(b) complex services (required by many business customers); or

(c) "business grade" SLAs (since service assurance and rapid fault restoration are important to business customers, particularly where the business is time-critical).

4.27 These customers may be unable to switch away from Telstra to an alternative ULLS-based wholesale supplier, since:

(a) Some DSLAMs currently in use by alternative wholesale providers are unable to cater for multicast (video) services**;**

(b) Some alternative wholesale providers do not have the capability to offer complex services over DSLAMs to customers who are on legacy circuit switched services (for these customers to upgrade to IP-based services would require customers to incur significant additional costs, as explained below and in Appendix D); or

(c) ULLS-based wholesale providers are reliant on Telstra for the SLAs they can provide their business customers (since they are reliant on Telstra to provide service assurance in respect of the ULLS). However, Telstra offers inferior SLAs for its ULLS service compared to the SLAs offered for its WLR. In particular, the restoration time is much longer for ULLS, and ULLS customers will receive no rebates if Telstra fails to restore the service within the specified timeframe. Further, business products may be offered only subject to certain additional set up costs, minimum spend requirements and a minimum lines requirements.

Multicast capability

4.28 Some DSLAMs currently in use are unable to support multicast technology. Multicast is the ability to provide a single stream of data (for example a TV channel) simultaneously to multiple customer premises in a single transmission from the DSLAM at the exchange. For example, a video channel is fed directly to the DSLAM in a single stream and then the channel is distributed from this point onwards to multiple end users. Multicast is the most efficient technology for the delivery of video services to end users since it reduces the bandwidth required to deliver a stream of data over the network. An example would be an exchange which has 500 customers. Without multicast-enabled DSLAMs, every customer who requests the TV channel feed would have the channel delivered from deeper in the network – essentially 500 streams of the same data could be traversing the network (rather than one stream), which imposes significant costs in terms of capacity.

4.29 **CiC begins CiC ends**

4.30 In practice, if Telstra charge prices that are above the regulated FAD rate, wholesale customers of Telstra which wish to provide a multicast (video) service to their end users cannot switch to an alternative provider which does not have multicast-enabled DSLAMs. **CiC begins CiC ends**

Complex services

4.31 Large business and government end-users typically require different grades of functionality than residential customers. One of the business grade functionalities is "complex services" including:

(a) analogue NT 1 (PSTN services provided using ISDN infrastructure with Analogue NT1;

(b) ISDN;

(c) call diversion number only;

(d) virtual private networks;

(e) line hunt;

(f) fax duet (two service numbers on a single line, the second for a fax, so there is no need for two line rentals);

(g) payphones;

(h) securitel (security alarm monitoring service); and

(i) huntgroups.[15]

4.32 Complex services including fax duet, huntgroups, voicemail on huntgroup and line hunt are some of the typical features often required by Optus' corporate and government customers. Optus is able to offer the majority of these features using its 'Optus Evolve' IP-based VPN platform and the associated suite of products, which are delivered via Ethernet access infrastructure or the ULLS. **CiC begins CiC ends** Optus has previously made submissions to the ACCC about complex services. Optus refers and relies on its submission to the ACCC on Telstra's PSTN OA Service Exemption Application, December 2007, submission in response to the ACCC's Draft Decision on PSTN OA exemptions, September 2009, submission in response to the ACCC's Draft Decision on Telstra's LCS and WLR Exemption Applications, June 2008 and its letter to the ACCC on 10 January 2008 regarding the impact of WLR/LCS Exemptions in the Corporate and Government Market Segment.

[15] Telstra Wholesale ULL Complex Products

4.33 Another important feature required by large business and government end-users is the ability to procure service on a ‘whole of business’ basis, since these customers often have customer sites located at different geographic locations. **CiC begins CiC ends**

4.34 Further, large business and government end-users prefer to deal with a single supplier for reasons of simplicity and convenience. It is less costly to manage than to have multiple contracts, it allows simple cost reconciliations that enables costs to be allocated to the customers cost centres, lower tariff benefits (intra-fleet vs. inter-fleet calls), and the ease and convenience of a single help desk. Optus has previously submitted to the ACCC the importance of having a ‘whole of business’ deal for large business and government customers. Optus refers and relies on its submission to the ACCC on Telstra’s PSTN OA Service Exemption Application, December 2007, submission in response to the ACCC’s Draft Decision on PSTN OA exemptions, September 2009, submission in response to the ACCC’s Draft Decision on Telstra’s LCS and WLR Exemption Applications, June 2008 and its letter to the ACCC on 10 January 2008 regarding the impact of WLR/LCS Exemptions in the Corporate and Government Market Segments.

4.35 **CiC begins**

4.36 **CiC ends**

4.37 This discussion should assist in explaining why Telstra’s freedom to act without constraint is greater in respect of business customers compared to residential customers. It also explains why resale services available from alternative wholesale suppliers are not likely to be considered an acceptable substitute to the exempted services from the perspective of Telstra’s wholesale customers, many of which will wish to serve corporate end users who require complex services on a WOB basis. **CiC begins**

CiC ends

4.38 In practice, if Telstra charge prices that are above the regulated FAD rate, wholesale customers of Telstra which take complex services cannot switch to an alternative DSLAM-based wholesale provider.

Business grade SLAs

4.39 Service assurance and rapid fault restoration are important to business customers, particularly where the business is time-critical and cannot sustain a lengthy period without telecommunications services without losing its own customers (for example, a business which makes sales over the telephone) or causing other serious negative impacts (for example, a hospital).

4.40 ULLS-based wholesale providers are reliant on Telstra for the SLAs they can provider their business customers (since they are reliant on Telstra to provide service assurance in respect of the ULLS). However, Telstra offers inferior SLAs for its ULLS service compared to the SLAs offered for its WLR. In particular, as set out in Appendix E, the restoration times available are significantly shorter for WLR, and WLR customers will receive rebates if Telstra fails to restore the service within the specified timeframe. End users on ULLS services taking Telstra's new "Fastfix" option, for example, must still wait up to four times as long as a WLR customer for fault restoration. Telstra has consistently failed to provide SLAs in respect of ULLS which are on a par with those it offers for WLR.

4.41 The nearest equivalent service to the WLR service offered by Optus Wholesale is the residential grade service, RBT. **CiC begins**

4.42 **CiC**

4.43 **CiC ends**

4.44 In practice, if Telstra charge prices that are above the regulated FAD rate, wholesale customers of Telstra which require business grade SLAs will not switch to an alternative DSLAM-based wholesale provider. A clear example of this lack of substitutability is provided by the **CiC begins CiC ends**

Wholesale customers which require national coverage

4.45 Some wholesale customers require national coverage either for reasons of advertising simplicity (they want to be able to offer services anywhere) or because they want to be able to serve business customers who require a single supplier to be able to serve all customer sites located at different geographic locations on a 'whole of business' (WOB) basis.

4.46 The ability to supply integrated product offerings, that is, the supply of a range of telecommunications services by a single supplier, is a critical requirement for many business end-users, including small and medium business as well as large corporate and Government (C&G) customers. **CiC begins CiC ends** Landline telephones are still very important for SMBs, with nearly all (97%) reporting use of a landline for incoming communications. 85% of total SMBs use or promote a local phone number for their customers to contact them.[16]

4.47 The exemptions make it difficult to serve customers with WOB requirements, because in many cases a business will have premises located in more than one exchange area, including exempted ESAs. Optus does not have the capability to offer national service coverage without reliance on Telstra's exempted services to some extent because its DSLAM footprint is limited to **CiC begins CiC ends** The availability of voice-only resale service therefore allows Optus' SMB to provide its customers (outside Optus' ULL footprint) a bundled fixed telephony and mobile solution and compete with Telstra.

4.48 It might be thought that Optus could acquire wholesale broadband services from Telstra outside the exempted exchange areas, in order to supplement its DSLAM investment and obtain the capability to offer national coverage to its wholesale customers.

4.49 However, this is not likely to be commercially feasible in practice, because of the way in which Telstra prices its wholesale broadband services. In particular, **CiC begins**

4.50 **CiC**

4.51 **CiC ends**

[16] ACMA, Community research into consumer behaviours and attitudes towards telecommunications numbering and associated issues, May 2011, p.4

4.52 Alternatively, it might be thought that a wholesale customer of Telstra which requires national coverage could acquire a mixture of services, including:

(a) Bundled voice and data services from Optus inside the exempt exchange areas; and

(b) Bundled WLR and ADSL2+ services from Telstra outside the exempted ESAs.

4.53 However, this is not likely to be commercially feasible in practice, because of the way in which Telstra prices its wholesale broadband services. In particular, **CiC begins**

CiC ends

4.54 It is important to note that the introduction of these Telstra pricing constructs predate the exemptions, and is thus not a consequence of the exemptions. It is the result of a pre-existing strategy by Telstra to leverage its market power in non-competitive geographic areas to deter potential wholesale customers from taking services from alternative providers such as Optus in competitive areas.

4.55 In practice, if Telstra introduces a differential between the price of WLR in the exempt exchanges and the price of WLR in regulated exchanges, wholesale customers of Telstra which require national coverage will not find it commercially feasible to switch to an alternative provider such as Optus.

4.56 The inability of DSLAM-based wholesale suppliers to provide national coverage is exacerbated by cases where the copper network is removed and ULLS is no longer available, as in the case of South Brisbane. In such cases, Optus submits, the ESA should be removed from the Exemption list and regulated access to WLR (albeit over fibre) restored.

4.57 A special case of customers which require nation coverage is provided by wholesale customers who supply the market for long distance (LD) services.

Wholesale customers who supply the market for long distance (LD) services

4.58 Some wholesale customers require a “Switchless Long Distance” service in order to supply the market for long distance (LD) services. Optus Wholesale still offers its customers a product called “Switchless Long Distance”. In the ‘future with exemptions’ scenario, there would be a negative impact on competition in long distance (LD) services. This is because Telstra would have the ability and incentive to reduce competitors’ ability to compete in that market and thus competition in the LD services generally would be diminished.

4.59 The declaration of PSTN OA has enabled the provision of LD, IDD and FTM services to be unbundled from network access and local call services. As a result, an end-user may elect to obtain LD, IDD and FTM services from a particular service provider while obtaining network access and local call services from a different provider (such as Telstra). This may be achieved through the end-user preselecting a pre-selection provider for the purpose of all LD, IDD and FTM calls, or through the end-user dialling an override code for the purposes of making particular LD, IDD or FTM calls via the override provider.

4.60 For example, Optus participates in the standalone market as a wholesaler of switching and carriage services, in addition to PSTN OA (but not WLR or LCS), to a number of service providers who provide pure pre-selection and/or override services to end-users. Some such service providers operate entirely on a resale basis without using switching or transmission infrastructure of their own. Optus also acquires the PSTN OA for re-supply as an input, together with limited transmission and call termination services over the Optus network, to service providers who own limited network infrastructure and switches.

4.61 Note that in the context of the standalone market for LD services, the relevant bottleneck infrastructure is the individual customer’s line. Likewise the real geographic limit of the relevant market is the individual customer’s line –not the ESA. That is (putting aside for the moment competition in bundled services) provided an end user continues to purchase line rental services from Telstra, only Telstra can offer LD services with respect to that customer. Substitution to another provider with respect to LD services alone is only made possible through the PSTN OA declaration. And only Telstra can offer wholesale PSTN OA services with respect to that customer. Optus has previously made submissions regarding the impact of geographic exemptions in the LD market. Optus refers and relies on its submission to the ACCC on Telstra’s

PSTN OA Service Exemption Application, December 2007 and submission in response to the ACCC's Draft Decision on PSTN OA exemptions, September 2009.

4.62 The exemptions have already caused damage to competition in the long distance preselect market. **CIC begins**

CiC ends

4.63 In practice, in the 'future with exemptions' scenario, wholesale customers of Optus which require a "Switchless Long Distance" service in order to supply the market for long distance (LD) services may fear that Optus will be unable to guarantee supply on a nationwide basis (given that Optus relies on Telstra continuing to provide PSTN OA services in order to supply this service). Further, if Telstra is able to charge a price above the regulated FAD rate in the 'future with exemptions' scenario, wholesale customers which require a "Switchless Long Distance" service in order to supply the market for long distance (LD) services may be forced to switch away from providers such as Optus.

Wholesale customers which require ubiquitous coverage within exempted exchanges

4.64 Some wholesale customers require ubiquitous coverage within exempted exchanges, perhaps because they want to be able to serve corporate customers who require a single supplier to be able to serve all customer sites located at different geographic locations on a 'whole of business' basis, or because they want to be able to serve all residential customers within an exchange, to maximise market share or perhaps for reasons of advertising expediency (they want to be able to make above the line offers to the public generally relating to service provision that is not geographically limited).

4.65 These customers will be unable to switch away from Telstra, because alternative wholesale suppliers including Optus do not have the capability to offer service coverage that is ubiquitous within the exempted exchanges. A proportion of addresses are not serviceable via ULLS since they are on RIMs or large pair gains systems: approximately 7% of SIOs within the ACCC's exemption footprint cannot be supplied by ULLS based competitors due to deployment of pair pain systems.[19]

4.66 Further, distance limitations preclude alternative wholesale suppliers from offering bundled voice and data services to a proportion of customers. Optus refers the ACCC to the map of the Castle Hill ESA provided at Attachment 5 to this submission. This map highlights a number of key issues that demonstrate that ULLS-based services are not an adequate substitute for the exempt resale services (and in particular, bundled voice and internet services provided via ULLS are not an adequate substitute for bundled voice and broadband services provided using Telstra resale services including the exempt services). These issues are as follows:

(a) The existence of RIMS and pair-gain systems;

(b) Distance limitations that reduce speed of service that can be provided to an end-user; and

(c) The location of business addresses.

[19] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.39

4.67 The presence of pair gain systems or RIMs on a copper line mean that a line cannot be DSL enabled.[20] Optus notes that RIMs are particularly prevalent in business parks and near office buildings, which means that these issues are proportionately greater for business services. **CiC begins CiC ends**

4.68 In terms of broadband services (which are often provided in a bundle with the exempt services) ULLS cannot necessarily provide bandwidth equivalent to Telstra's resale services. This is because ULLS quality/speed of service for data deteriorates as the copper line travels further from the exchange. In general, only 60% of Band 2 services are close enough to the exchange to receive a 2Mbps service (and this is assuming away issues with copper pairs, copper quality, exchange capacity and pair gain). The remaining 40% of Band 2 services are restricted by distance limitation from receiving a 2Mbps service.

4.69 **CiC begins**

4.70 **CiC ends**

4.71 **CiC begins CiC ends** It was reported in June 2011 that Telstra is undergoing a trial upgrade to its copper network which will allow it to service broadband services to customers in the RIM affected areas.[21] The upgrade involves a custom-made extension that sits on top of existing street cabinets that allow Telstra to fit in more equipment.[22] It is reported that under the upgrade, Telstra will be able to treble the number of available ADSL ports in the cabinets and increase speeds to ADSL2+ level of up to 20Mbps. The trial commenced in June in Cranbourne on Melbourne's south eastern suburban fringe and is already serving new customers.[23] Telstra has stated that the capital expenses for the upgrades will cost it a quarter of the capital needed to install a new street cabinet.[24]

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[20] Optus submitted evidence on pair gain affected ESAs in its March 2008 submission on Telstra's exemption application in respect of Optus' HFC area including a map illustrating the extent of pair gain affected premises in the Miller ESA. Optus refers the ACCC to this material.

[21] Mitchell Bingemann, the Australian "Telstra hedges its bets on NBN deal and upgrades copper network", June 2011, http://www.theaustralian.com.au/business/telstra-hedges-its-bets-on-nbn-deal-and-upgrades-copper-network/story-e6frg8zx-1226079509177

[22] Geoff Long, "Exclusive: Telstra breathes new life into copper network," Communications Day, 21 June 2011

[23] Geoff Long, "Exclusive: Telstra breathes new life into copper network," Communications Day, 21 June 2011

[24] Mitchell Bingemann, the Australian "Telstra hedges its bets on NBN deal and upgrades copper network," June 2011, http://www.theaustralian.com.au/business/telstra-hedges-its-bets-on-nbn-deal-and-upgrades-copper-network/story-e6frg8zx-1226079509177

4.72 Consequently, if Telstra charges prices above the regulated FAD rate for the affected services in the exempt exchanges, wholesale customers of Telstra which require ubiquitous coverage within exempted exchange areas cannot switch to an alternative provider such as Optus.

4.73 Given that the purpose of the exemptions is to promote ULLS-based competition, it is difficult to see how application of the exemptions in areas affected by pair gain systems can have any impact other than to weaken competition by Telstra's competitors.

4.74 The ACCC has stated that it has "dealt with the issue of lines affected by pair gain technology by excluding those lines from the calculation of the total number of 'addressable SIOs' within an ESA." The ACCC appears to consider that the pair gain issue will not have a significant competitive impact at the geographic level of ESAs.

4.75 Optus submits that the "presence" of ULLS-based competitors *in an exchange area* is manifestly incapable of ensuring "sufficient competition" in respect of services delivered to the 7% of SIOs which are unable to be supplied by ULLS-based competitors. The ACCC's statements serve only to highlight the inadequacy of any attempt to analyse the competitive impact of the pair gain issue at the geographic level of ESAs. To a home or business owner, the fact that a competitor to Telstra may be offering relevant services in the next street over is simply irrelevant. The additional cost of an uncompetitive telephone service is unlikely to provide sufficient reason to move house. The ACCC's decision to continue the exemptions would leave these customers unable to be served by anyone except for an unconstrained monopoly supplier. If the exemptions were to be retained, the sensible response to this issue would be to establish a new a limitation in the exemption orders to limit the exemption from applying to those lines affected by the presence of a pair gain system.

4.76 However, as the ACCC notes, Telstra has opposed such a limitation on the grounds that it would be "complex, costly and impracticable". Optus submits that the ACCC should not accept Telstra's submission is respect of this point, which is self-serving and which makes no attempt to balance the claimed costs against the very real competitive detriment which would otherwise be caused. Without such a condition, the exemption orders sought would have the effect of creating a sizeable class of end-users in the Metro ESAs who could not be serviced by means of any regulated services and in respect of whom Telstra would be restored as the monopoly provider.

Wholesale customers for whom any benefit is outweighed by switching costs

4.77 Wholesale customers of Telstra which switch to an alternative wholesale supplier will incur additional costs to integrate various IT systems with those of the alternative wholesale supplier. Switching costs are a barrier to switching, which, for some customers, which may outweigh the costs of remaining with Telstra and paying additional wholesale fees.

4.78 Wholesale customers have to incur IT integration costs in order to purchase ULLS resale service from each ULLS resale provider. The cost is approximately **CiC begins CiC ends**

4.79 Secondly, customers have to incur ongoing operational costs for purchasing ULLS resale services. This includes training for call centre operators and support for the provisioning and fault management systems.

4.80 In practice, if Telstra introduces a differential between the price of WLR in the exempt exchanges and the price of WLR in regulated exchanges, wholesale customers of Telstra for whom any benefit is outweighed by switching costs will not switch to an alternative provider such as Optus. **CiC begins CiC ends**

<u>Summary on acceptable substitutes</u>

4.81 In summary, the resale services available from alternative providers are not acceptable substitutes for the exempt services for the following categories of Telstra wholesale customers; that is, wholesale customers which require:

(a) Voice-only services;

(b) A multicast service or complex services or “business grade” SLAs;

(c) National coverage;

(d) Ubiquitous coverage within the exempt ESAs;

(e) A “Switchless Long Distance” service to supply the long distance market; and

(f) Not to pay switching costs.

4.82 This is *not* to say that alternative wholesale suppliers are incapable of supplying *any* wholesale customers; clearly there are some wholesale customers who do not mind paying switching costs and do not have any of the above requirements. But they will be in the minority. And they will be unable to address non-contestable end users in the exchange areas (those end users connected to large pair gain systems, and those with special technical requirements as discussed above).

4.83 For most access seekers, the services supplied by alternative wholesale suppliers will not be acceptable substitutes for the exempted services – for one of the above reasons. These access seekers will not switch away from Telstra in the event that it charges prices that are above the regulated FAD rate. Consequently, ULLS-based wholesale suppliers will be unable to restrain Telstra’s ability to exercise market power in exempt exchanges in the ‘future with exemptions’ scenario.

4.84 Optus itself is an example of an access seeker which cannot readily switch its demand for the exempt services away from Telstra. **CiC begins CiC ends**

4.85 Clearly Optus is an established RSP with its own DSLAM infrastructure. Nevertheless, Telstra resale services remain highly important to Optus, since for some purposes (and for serving some end users) self-supply is not an acceptable substitute. Telstra resale services allow Optus to provide:

(a) a WOB offering.

The importance of WOB offering is discussed in Optus' response to q 6.2 and 6.4;

(b) complex services to its customers.

Optus refers the ACCC to its submission in response to the ACCC's discussion paper on FAD for the declared fixed line services[26];

(c) retail services in areas where ULLS is not available including pair gain areas.

Optus refers the ACCC to its submission in response to the ACCC's discussion paper on FAD for the declared fixed line services[27]; and

(d) an interim solution to corporate and government customers before migrating across to ULLS

(e) **CiC begins**

(f) **CiC ends**

4.86 For these reasons, Optus is unable to switch its demand for the exempted services away from Telstra. Even if there was an alternative ULLS-based wholesale supplier willing and able to supply DSLAM-based services, these services would not be acceptable substitutes from the point of view of Optus as purchaser. This example also provides a further reason why it is unlikely that access seekers experiencing an increase in the price of the exempted services will switch to *self-supply using existing DSLAMs* (a scenario which the ACCC has proposed as a possibility).

[26] Optus, Submission in response to the ACCC's discussion paper on FAD for the declared fixed line services, pp.33-45

[27] Optus, Submission in response to the ACCC's discussion paper on FAD for the declared fixed line services, pp.33-45

Implications for Telstra's ability to exercise its market power in exempted ESAs

4.87 When Telstra is considering whether to raise its wholesale prices for the exempted services, it will take its decision with the knowledge that:

(a) Some proportion of its wholesale customers will be unable or unwilling to switch away to an alternative supplier and will be forced to pay the higher price;

(b) Some proportion of its wholesale customers will switch away, but will be forced to give up non-contestable end users (those connected to large pair gain systems, and those with special technical requirements) – these end users will be forced to switch back to Telstra and thereby increase Telstra's retail market share.

4.88 So when Telstra is considering whether to charge prices that are above the regulated FAD rate for the exempted services, it must consider whether:

(I) the higher profit it receives from charging higher wholesale prices for the exempted services and from increasing its retail market share; exceeds

(II) the lost profit from those wholesale customers who are able to switch away to an alternative supplier (or self-supply).

4.89 If (I) exceeds (II) then Telstra has market power, that is, it is able to profitably charge prices that are above the regulated FAD rate for the exempted services. If (II) exceeds (I) then it will not pay for Telstra to charge prices that are above the regulated FAD rate.

4.90 This is ultimately an empirical question. A good way to determine whether Telstra currently has market power is to observe Telstra's actual behaviour since the exemptions were imposed, giving it the freedom to charge prices that are above the regulated FAD rate.

4.91 We find that Telstra has in fact charged prices that are above the regulated FAD rate. That is, Telstra has introduced a significant differential between the price it charges for WLR in exempt exchanges and the regulated price which applies elsewhere. **CiC begins**

4.92 **CiC ends**

4.93 Since Telstra has chosen to charge prices that are above the regulated FAD rate, it must be the case that (I) exceeds (II); since otherwise it would have no incentive to charge higher prices. It follows that Telstra does have market power in respect of the exempted services. Given that Telstra is currently charging a price above the regulated FAD rate in exemption ESAs, it follows that Telstra is currently exercising market power and is not being restrained in doing so by any of the potential restraints identified by the ACCC (the potential for self-supply and the services offered by alternative wholesale suppliers).

4.94 However, the question for the ACCC is not whether Telstra is currently exercising market power, but rather, whether Telstra would be able to exercise market power (that is, charge a price above the regulated FAD rate) in the 'future with exemptions' scenario. It might be the case that the 'potential restraints' on Telstra (which are currently failing to restrain Telstra's market power) could somehow strengthen between now and January 2012, such that Telstra would be restrained from exercising market power in the 'future with exemptions' scenario (even though it is currently able to exercise market power).

4.95 In Optus' view, the converse is more likely. That is, in the 'future with exemptions' scenario the 'potential restraints' on Telstra (which are currently failing to restrain Telstra's market power) will only *weaken* between now and January 2012, since:

(a) Access seekers will have less time to recover the costs of DSLAM investment in 2012 than they have had previously (due to the NBN deployment the window for cost recovery before the copper is disconnected will be shorter), so the incentive to self-supply is weakened; and

(b) Telstra may currently be 'restrained' in its conduct to some extent by the possibility that the ACCC could take regulatory action to remove the exemptions in the course of the current review; however, once the current review is complete,[29] and that immediate risk has receded, Telstra will have a freer hand.

4.96 It follows that Telstra will be even *less restrained* in the exercise of its market power in the 'future with exemptions' scenario than it is currently. This would suggest that Telstra' s conduct to date in the exempt exchanges (charging a price above the wholesale rate for exempt services) is merely "Phase 1" of its plan, carried out when there is a risk of revocation of the exemption. It is highly likely that it will take more extreme action once the exemptions are confirmed.

[29] Assuming the exemptions are not removed in the current review.

Section 5. Exemptions Will Harm End Users

5.1 Telstra's scope for exercising market power in the affected ESAs in the 'future with exemptions' scenario will not be restrained by alternative sources of supply (including self-supply and DSLAM based access seekers), as should be clear from the discussion in the preceding chapters. This means that Telstra will be able to set wholesale prices for the affected voice services in Exemption ESAs which exceed the competitive level.

5.2 The next logical question is the impact that higher wholesale prices will have on end users. Optus considers that the impact will differ with respect to different classes of end user. Contestable end-users who can be served via the ULLS will continue to experience vigorous competition in both the 'future with exemptions' scenario and the 'future without exemptions' scenario.

5.3 On the other hand, end-users who cannot be served effectively via the ULLS (for example, customers connected to a pair gain system or who have special requirements, such as "business grade" SLAs) will experience considerably less intense competition and higher retail prices in the 'future with exemptions' scenario compared to the 'future without exemptions' scenario. For a substantial number of end users, the opportunities and environment for competition will be better without exemptions than they would be with the exemptions.

Competition will be less intense in the "future with exemptions" scenario

Existing service providers

5.4 For a full service provider such as Optus, which needs to be capable of serving all end user premises in a given exchange area, the exempt resale services and the ULLS are not substitutes. It is not possible to supply non-contestable customers (those customers connected to a pair gain system or who have special requirements, such as "business grade" SLAs) using the ULLS, so the exempted resale services are the only option. For contestable customers, on the other hand, the ULLS will be the preferred mode of service provision, because it allows greater control over quality of service. It follows that, access seekers such as Optus require access to both the ULLS and the exempt resale services. To the extent that such an access seeker is serving non-contestable customers, it will be forced to absorb increases in the price of the exempt services imposed by Telstra.

5.5 Telstra's exercise of market power in the "future with exemptions" scenario will have a variety of effects on access seekers, for example:

(a) Some access seekers will absorb the price increases.

(b) Some access seekers will go out of business.

(c) Some access seekers will switch to alternative ULLS-based wholesale service providers.

5.6 As a result of its exercise of market power, Telstra's market share and revenue will increase in the "future with exemptions" scenario.

Exemptions Will Deter Entry

5.7 By removing a critical stepping stone for potential service providers, the exemptions will discourage entry and reduce the intensity of retail level competition both before and after the NBN becomes Australia's main fixed line access platform.

5.8 The ACCC has recognised this possibility:

> *However, if the exemptions were to result in an increase in the prices of resale services in exempt areas, barriers to entry to those areas would likely increase. In the longer term, new entry may be discouraged, with potential negative implications for competition in the supply of retail services. In addition, limited wholesale competition in the exempt areas may have implications for the amount of competition likely to develop on the NBN. By removing the 'stepping stone' option provided by the availability of competitively priced resale services, smaller retail service providers (including new entrants) may face significant obstacles to establishing a market presence in the transition to the NBN.*[30]

5.9 Optus agrees. Fixed line telecommunications services are inherently 'sticky' in that customers do not often switch suppliers. This means that for access seekers, establishing a market presence, and customer base, *before* the NBN deployment is complete is a key imperative for prospective RSPs. Therefore, in order to promote competition *on* the NBN, competition needs to be promoted *before* the NBN is completed. Indeed, this is one of the main reasons Telstra is seeking to retain and extend the exemptions: it is seeking to make a pre-NBN land grab for market share by squeezing out the smaller retailers.

5.10 The NBN represents a fundamental change in the fixed-line services market. As a result, the business model for infrastructure investment has been fundamentally changed (as discussed in section 3). This means that it is no longer relevant to look backwards at the 'rung' of the ladder of investment that has been reached and strip away the regulation that is deemed no longer necessary. Rather, since the market circumstances have substantially shifted it requires a forward looking approach to ensure competition flourishes in the next era.

5.11 Consequently, in order to avoid a potentially 'unintended' outcome of the NBN (that is, Telstra remaining the dominant fixed-line supplier) the ACCC needs to look at whether higher 'rungs' on the ladder will be prudent under the NBN. And given that it most likely will not, in order to encourage competition on the new platform, a similar 'rung' should be regulated *now*.

5.12 It follows that the exemptions' negative impact on the interests of end users will be an enduring one. In the 'future with exemptions' scenario, there will be fewer established retailer service providers on the NBN, so end users will experience lower diversity of service offerings and less intense competition compared to the 'future without exemptions' scenario. Consequently, end users will be negatively impacted by a decision to retain the exemptions for many years to come.

Higher retail prices

5.13 Telstra's exercise of market power in the "future with exemptions" scenario will impact directly on (increase) retail prices for services supplied in reliance on WLR and PSTN OA.

5.14 Further, the price differential will also act as a barrier to entry for potential retailers of telecommunications services both in the exempt exchanges and more broadly (since the

[30] ACCC, Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services, Issues Paper, September 2011, p.43

viability of service provision in the exempt exchanges has an impact on the viability of service provision more broadly). The barrier to entry will reduce the degree of competition at the retail level and so will have a number of indirect impacts including an increase in retail prices, a decrease in quality of service and a decrease in the diversity of services supplied in reliance on WLR and PSTN OA.

5.15 The exemptions will have different impacts on different classes of end user.

5.16 Within every exchange area there is a class of end-users which cannot be effectively served via the ULLS (for example, customers which require complex services or “business grade” SLAs or whose premises is connected to a large pair gain system.) These customers cannot be contested by access seekers utilising an alternative network. It follows that the exemptions are incapable of stimulating competition for these non-contestable customers. Since they will always be non-contestable, they must continue to be served via Telstra’s network, either by Telstra or by an access seeker taking resale services from Telstra (the WLR, LCS and PSTN OA services); they cannot be served by an access seeker utilising its own DSLAMs, and they cannot be served by an access seeker utilising an alternative wholesale service provider’s DSLAMs. It follows that Telstra’s ability to exercise market power with respect to these customers will not be restrained by the existence of retail service providers or wholesale service providers which have made DSLAM investments.

5.17 End-users who cannot be served effectively via the ULLS (for example, customers connected to a pair gain system or who require “business grade” SLAs) will experience less intense competition and higher retail prices with the exemptions than without. **CiC begins**

5.18 **CiC ends**

5.19 By contrast, within every exchange area there is also a pool of contestable end-users which can be effectively served via the ULLS (since they do not require complex services or “business grade” SLAs and their premises are not connected to a large pair gain system). The investment by access seekers in DSLAMs which has occurred in competitive exchange areas has been aimed at winning these contestable customers. This investment and competition for contestable customers was already occurring before the exemptions, and would have continued regardless of the exemptions. The drivers of DSLAM investment are related to the ULLS access price (which has been and remains superior to the WLR price) and the fact that DSLAM-based service gives access seekers greater control over quality of service; it is in no way the result of the exemptions. Optus considers it likely that if the ACCC looks at the *trend* of DSLAM investment in the exemption exchanges and in non-exemption exchanges, it will find that the exemptions have not led to any increase in the rate of investment *compared to the pre-existing trend* in exemption exchanges.

5.20 In the “future with exemptions” scenario, whilst there will be no *more* DSLAM investment compared to the “future without exemptions” scenario, nevertheless Telstra will continue to face competition with respect to contestable customers from DSLAM –based retail service providers. For contestable end-users who can be served via the ULLS, competition from access seekers with DSLAM infrastructure was already vigorous before the exemptions were proposed. The exemptions have had and will continue to have no effect whatsoever on competition for contestable customers.

5.21 In summary, in the “future with exemptions” scenario:

(a) Contestable end users will be no better or worse off compared to the “future without exemptions” scenario.

(b) Non-contestable end users will experience lower levels of competition and quality of service, have fewer choices and pay higher prices (compared to the “future without exemptions” scenario).

5.22 Consequently, Optus submits that the LTIE are best promoted without the exemptions.

Appendices

Appendix A: Tender by a potential wholesale customer

5.23 **CiC begins**

5.24 **CiC ends**

5.25 The above example goes some way towards illustrating the reasons why ULLS-based competitors have been unable to exert a competitive constraint upon Telstra in exempt exchanges. It also assists in explaining why Telstra's freedom to act without constraint is greater in respect of business customers compared to residential customers.

Appendix B: Example of why wholesale competition has not developed

5.26 Optus refers the ACCC to Attachment 1 of this submission which provides a real world example of why wholesale competition has not developed. **CiC begins**

5.27 **CiC ends**

Appendix C: DSLAM investment costs

5.28 The ACCC has stated in the issues paper that "*it estimated that the fixed costs of the DSLAM/MSAN infrastructure were in the order of $12,000 - $14,000 per DSLAM. This includes the DSLAM/MSAN sub-rack and racks, the DSLAM itself, alarm and power distribution units, power cabling to the racks, and signal and cabling to the racks.*"

Costs of installing a DSLAM

5.29 Optus submits the ACCC's estimate is not correct**. CiC**

Appendix D: Impact of geographical exemptions in the corporate and government market

CiC begins

5.1 **CiC ends**

Appendix E: Fault restoration time for Telstra WLR vs ULLS

5.2 The fault restoration time provided by Telstra for its WLR service is better than that provided by Telstra for its ULLS.

SLAs offered by Telstra for the ULLS

5.3 The level of SLAs offered by Telstra for ULLS is not acceptable to business customers, as Optus has previously submitted to the ACCC. **CiC begins**

CiC ends

Attachments

Attachment 1: Minutes of Optus meeting with wholesale customer, November 2010

Attachment 2: Vendor pricing of DSLAM and transmission equipment

Attachment 3: DSLAM investment costs

Attachment 4: Answers to ACCC questions on Wholesale DSL

Attachment 5: Map of Castle Hill Exchange

Attachment 6: Optus VoDSL service