Telstra's Access Undertaking for the Line Sharing Service, dated 1 September 2003

Submission by PowerTel Limited

PowerTel Limited and Request Broadband Pty Limited (**Request**) have recently merged into one entity under the PowerTel brand (**PowerTel**). As a result, this submission encompasses the combined view of both organisations.

PowerTel welcomes the opportunity to comment on the Australian Competition and Consumer Commission's (**the Commission's**) discussion paper titled *Telstra's Undertaking for the Line Sharing Service*, dated December 2003 (**discussion paper**) on Telstra's undertaking for the Line Sharing Service (**LSS**), dated 1 September 2003 (**LSS undertaking**).

This is a critical issue for PowerTel and a number of other competing service providers because the LSS is a fundamental building block to the competitive supply of retail broadband services in Australia. Consequently, the price that Telstra charges for the LSS has a direct and significant impact on the ability of these competing service providers to compete in the provision of retail broadband services with significant flow on effects to the long term interests of end users (**LTIE**).

Some of the information in this submission is commercial-in-confidence and as a result PowerTel will provide a non-confidential (public) version of this submission for posting on the Commission's website.

Executive summary

PowerTel has a number of concerns about the LSS undertaking, specifically:

- that Telstra is using the LSS undertaking to keep the price of the LSS artificially high;
- the absence of substantive non-price terms and conditions in the LSS undertaking make it impossible to assess whether the undertaking as a whole is consistent with the standard access obligations (**SAOs**) or whether it is reasonable;
- the network costs purportedly incurred by Telstra in providing the LSS:
    - are extremely high; and
    - have been developed using a flawed cost model; and
- the price proposed in the LSS undertaking is not reasonable because it:
    - is much higher than prices previously commercially agreed;

- is at odds with Telstra's unbundled local loop (**ULL**) pricing; and
- potentially represents a vertical price squeeze.

Consequently, PowerTel urges the Commission to reject the LSS undertaking.

1. Telstra is using the LSS undertaking to keep the price of the LSS artificially high

Telstra, in its document titled *Telstra's Submission in Support of its Undertaking dated 1 September 2003*, stated that the LSS undertaking was lodged with the Commission for the purposes of providing increased regulatory certainty[1]:

> *" Telstra has given the Undertaking with the primary objective of providing the industry and itself with increased regulatory certainty over future prices. Obtaining a reasonable degree of certainty is important to the future planning of Telstra's telecommunications network and for the planning purposes of businesses that seek access to Telstra's network."*

PowerTel rejects this explanation and considers that Telstra is using the LSS undertaking as a tool to keep the price of the LSS artificially high.

Regulatory certainty is important but so is fairness and timeliness. Regulatory certainty should not be at the expense of a level playing field with a direct impact on the ability of competing service providers to effectively compete and with negative flow on effects for the LTIE.

When negotiating access to the LSS with access seekers, Telstra will be able to insist on the prices specified in the LSS undertaking (should they be accepted) knowing that if the matter went to arbitration that the Commission could not make a binding decision that was inconsistent with the LSS undertaking. Telstra will have no incentive (unless it is in its own commercial interests) to negotiate terms and conditions which differ from those contained in the LSS undertaking and as a result, the price specified in the LSS undertaking effectively becomes the default price for the LSS.

This is a real concern for PowerTel because c-i-c.

[1] Para 2, Telstra's Submission in Support of its Undertaking dated 1 September 2003

2. There is not enough detail to assess consistency with the SAOs or reasonableness

The LSS undertaking is silent on a number of critical non-price terms and conditions. As a result, PowerTel considers that it is not possible to properly assess whether the LSS undertaking is consistent with SAOs or whether it is reasonable.

In relation to the SAOs, the LSS undertaking does not contain:

- provisions specifying how Telstra will satisfy its obligations in respect of the quality and timing of fault detection, handling and rectification in respect of the LSS. Nor does it contain provisions relating to the commencement, refusal, suspension or termination of supply;

- provisions relating to the technical and operational quality and timing of interconnection, or provisions in relation to interconnection, fault detection, handling and rectification; and

- terms and conditions in relation to the provision, timing and content of billing information.

Other key non-price terms and conditions that should be specified in the LSS undertaking include:

- technical standards (eg use of filters and interconnection to DSLAMs);

- service provisioning terms (including any related charges); and

- payment terms.

PowerTel accepts that it may not be necessary to include all possible non-price terms and conditions in an undertaking, however, it is necessary to include those non-price terms and conditions that impact on the assessment of whether the terms and conditions specified in the undertaking are consistent with the SAOs and whether they are reasonable.

3. The purported network costs are extremely high and have been developed using a flawed cost model

3.1 Telstra's purported costs are extremely high

Telstra argues that the efficient network costs of each LSS is in excess of $57 per month.

PowerTel considers that these network costs are significantly overstated. Any comparison of these costs with the actual rates charged for these services in other markets around the world would show that they are absurdly high. PowerTel considers that Telstra has grossly over stated its costs in order to achieve such an outcome.

3.2 The Telstra model is flawed

Telstra is the dominant provider of broadband services in Australia given the extent and scope of its national DSL infrastructure and cable HFC network. In terms of ADSL, PowerTel estimates Telstra infrastructure is delivering at least 80% of reported DSL services in Australia as of June 2003.

It is PowerTel's understanding that all of Telstra's ADSL services delivered using Telstra's infrastructure (ie 80% of all DSL services) are currently provided in conjunction with a standard analogue PSTN voice telephony service on the same copper line. In fact Telstra will only provide its ADSL services (both wholesale and retail) in conjunction with an analogue PSTN voice telephony service.

In other words, approximately 80% or over 200,000 ADSL services as of June 2003 were provided over a service which conforms with the definition of the LSS, albeit these services were provided completely within Telstra's control and involved no third parties at the infrastructure level[2].

Accordingly, Telstra has been able to exploit a significant 'first mover advantage' in being the only carrier able to utilise the benefits of line sharing from its introduction of ADSL services in August 2000. No other carrier has been able to obtain certainty in regard to the terms of supply of the LSS whilst the service has been unregulated (until August 2002) and the pricing subject to Telstra's undertakings and assessment thereof. As a result Telstra has probably achieved a three year advantage over the remainder of the industry in exploiting the benefits of line sharing.

Telstra's submission in support of the LSS undertaking takes the position that the LSS is totally separate and divorced from the service it provides all of its own wholesale and retail ADSL services (ie DSL Layer 2, DSL Layer 3 and BigPond ADSL services) although in most respects Telstra's own services are built on the same infrastructure from both a network, systems and process perspective.

By segregating the LSS from its own internal use of line sharing services Telstra is able to construct a cost model where all of the start up costs and uncertainties with respect to demand for these types of services are borne totally by the prospective new entrants.

In particular, the risk in respect of demand for new entrants wishing to use line sharing in a market in which Telstra provides 80% of DSL services and virtually 100% of line shared ADSL services is extremely onerous. Telstra's own forecasts reflect this with the majority (if not all) of the forecast services being attributed to Request which operates solely in the SME business market (ie no residential focus)

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[2] A key part of Request's submissions to the ACCC supporting the declaration of the LSS in November 2001 and again in May 2002 was that Telstra alone, through its ownership of practically 100% of the copper access infrastructure, controls the ability (absent any regulation) of third parties to provide ADSL services on the same basis on which Telstra currently provides approximately 80% of all ADSL services in Australia.

and virtually nothing attributed to other possible new entrants such as Optus / XYZed, AAPT, Primus, iiNet, TPG and numerous other retail ADSL service providers who are all potentially users of a LSS.

This may be appropriate in some markets where Telstra also faces the same risks because it is also a new entrant, however, Telstra's position in the ADSL market is already well established on the basis of it having access to line sharing since August 2000.

As a result, by imposing all the risks in respect of start up costs and uncertainties of demand on prospective new entrants into a market in which Telstra is already well established, a significant barrier has been created that will in most cases preclude any new entrants attempting to enter the same market.

It would appear that Telstra expects to recover the initial start up costs over a number of years. This would mean that new entrants would be exposed to a higher entry cost in the long run regardless of Telstra's decision to adopt what Telstra refers to as a reduced monthly Line Sharing price in the near term.

In summary, Telstra's model seeks to impose significant start up costs and risks on new entrants into a market which it currently dominates and has achieved a 'first mover' advantage by virtue of its effective monopoly on deploying line sharing for the delivery of broadband ADSL services until late 2003. As a result, the model and resulting cost structures create a significant barrier to entry to prospective infrastructure based new entrants wishing to compete in the broadband ADSL market.

3.3 An independently developed and broader cost model should be used

PowerTel considers that the price of the LSS should be determined using a cost model that nurtures competition not one that rewards inefficiency, is in the LTIE and which can not be criticised for its lack of independence and transparency. This can only be achieved through use of an independently developed cost model.

In addition, PowerTel considers that a broader view should be taken when establishing a framework for modelling the costs of providing the LSS, and in particular one that encompasses Telstra's extensive deployment for line sharing for its current broadband ADSL offerings.

PowerTel considers that the cost modelling should involve an analysis of the costs involved in the relevant line sharing components of the following services provided by Telstra:

- Wholesale DSL Layer 2 (introduced under the name of L2BG);
- Wholesale DSL Layer 3 (previously known as Flexstream); and
- the LSS.

It is PowerTel's understanding that there is significant commonality in the systems and processes deployed by Telstra in the delivery of these services. In fact during initial discussions between Request and Telstra regarding the development of the LSS Telstra advised that it had a strong preference for using as much of the existing Wholesale DSL Layer 2 and Layer 3 systems and processes as possible in order to reduce the cost of introducing the Spectrum Sharing service.

In particular, it is PowerTel's understanding that all three services in question are handled using the same systems (in particular the Linx On-Line Ordering system) and the same wholesale 'front of house' personnel.

In addition, PowerTel considers that Telstra's corresponding retail products (i.e. BigPond ADSL) could also be included in the modelling, however this is likely to introduce significant complexities into the model given the separate front of house systems and personnel Telstra may have deployed for its retail products.

By taking a broader view of the LSS and including in all the line sharing specific costs the costs of developing the relevant components for the 3 products identified above and using combined forecasts for the 3 services we believe a more accurate and fairer view of the true costs in deploying the LSS will become evident.

In particular, by using the combined forecasts of Telstra wholesale DSL and access seekers demands for line sharing a more accurate view of the potential demand for these services can be ascertained and the line sharing specific costs on a per service basis can be more accurately determined over the relevant timeframes.

Given the wholesale nature of these services the demand is still primarily being generated by the marketing efforts of Telstra's retail competitors (eg. Optus, AAPT, Primus, iiNet and many more). By excluding this demand from the cost model these competitors (the larger ones of which are potential ADSL infrastructure carriers) that Telstra is being rewarded through economies of scale by the marketing efforts of potential new entrants who are not then able to leverage this scale in deciding whether to enter the infrastructure based ADSL market. In effect, the success of the Telstra's retail competitors makes the barrier higher rather than lower to enter the infrastructure based ADSL market.

By combining both Telstra's existing use of line sharing for its own wholesale products with the industry requirements for line sharing a more equitable picture is likely to emerge in terms of the start-up costs and risks involved in developing this new technology and establishing this new market. Prospective new infrastructure based entrants are not likely to be so disadvantaged in bearing the entire risks of entering a new market and competing with a well-established incumbent in the wider broadband ADSL market. Furthermore, potential new entrants, as well as Telstra, are rewarded for their market development activities and the increasing demand for line sharing type services prior to becoming an infrastructure based ADSL provider.

4. The price proposed in the LSS undertaking is not reasonable

The price proposed in the LSS undertaking is c-i-c.

In addition, the price of the LSS appears at odds with the ULL pricing proposed in Telstra's core services undertaking, dated 14 November 2003 (**November 2003 access undertaking**). In the November 2003 access undertaking, Telstra proposed a price of $13 per month for the ULL in CBD areas. Why would it cost more to acquire part of the copper (ie $15 for the LSS) than it would cost to acquire all of the copper (ie $13 for the ULL) in CBD areas but the reverse in all other areas?

Finally, the price of the LSS relative to the price of Telstra's retail ADSL prices (particularly given the recent drop in Telstra's retail 256Kbps/64 Kbps ADSL price) is indicative of a retail price squeeze.

5. PowerTel responses to the Commission's questions

PowerTel has provided a number of responses to the specific questions raised by the Commission in the discussion paper in the table below.

Responses to the Commission's Specific Questions

	Question	PowerTel Response
	Pricing of LSS	
1.	*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?*	PowerTel considers that the price of $15 per LSS per month: • is an arbitrary price rather than a price related to the underlying costs of providing the LSS, which as discussed above should be determined by a broad cost model encompassing Telstra's own use of the LSS for its wholesale DSL Layer 2 and Layer 3 products; and • will not promote competitive neutrality in the broadband ADSL market and in particular the residential market given Telstra's dominant position in this market and the significant start-up costs and risks in terms of the future LSS price beyond 31 December 2004 resulting from a narrow approach to modeling the true costs of Line Sharing proposed by Telstra.
2.	*The Commission seeks comment on the appropriate pricing principles relevant to assessing Telstra's pricing proposal.*	PowerTel considers that the TSLRIC model is the appropriate pricing principle for calculating the efficient costs of supplying the LSS provided a broader view is taken as outlined in section 3.2 and 3.3 above.
3.	*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 pricing c-i-c.

4.	*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.*	PowerTel considers that the TSLRIC model is the appropriate pricing principle for calculating the efficient costs of supplying the LSS provided a broader view is taken as outlined in section 3.2 and 3.3 above.
5.	*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.*	PowerTel agrees that only the incremental or LSS-specific costs of providing the LSS to access seekers is relevant provided a broader view of line sharing is taken.
6.	*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.*	See response to question 1 above.
7.	*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*	PowerTel considers that an independent economic analysis should be conducted to determine an appropriate WACC.
8.	*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.*	PowerTel considers that an independent economic analysis should be conducted to determine an appropriate WACC.
9.	*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.*	PowerTel considers that there is little commonality between the ULLS and LSS in terms of calculating the LSS-specific costs. As discussed above commonality exists with the Wholesale DSL Layer 2 and Layer 3 services currently provided by Telstra and this should be taken into account in calculating the LSS-specific costs.
10.	*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.*	PowerTel considers that the proposed price of the LSS appears at odds with the ULL pricing proposed in Telstra's core services undertaking, dated 14 November 2003 (**November 2003 access undertaking**). In the November 2003 access undertaking, Telstra proposed a price of $13 per month for the ULL in CBD areas. Why would it cost more to acquire part of the copper (ie $15 for the LSS)

		than it would cost to acquire all of the copper (ie $13 for the ULL) in CBD areas but the reverse in all other areas?
11.	*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.*	PowerTel believes that a broader cost model as outlined in section 3.3 above will allow a more realistic price to be determined that will not involve any need to recover LSS specific costs in future periods.
12.	*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.*	No comment.
13.	*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.*	PowerTel refers the Commission to section 2 above.
	Demand Estimates	
14.	*The Commission seeks the views of interested parties on the appropriateness of Telstra's demand estimates.*	The demand estimates appear to assume the majority of demand for LSS will come from PowerTel. c-i-c This implies that the feasibility of using the LSS is only applicable to the business ADSL market and not the residential market. However, Telstra, via wholesale and retail, is serving the majority of the residential market by utilizing the cost benefits of line sharing. These facts highlight the inappropriateness of the current model and the inherent barriers it will place on new entrants endeavoring to compete with Telstra at the infrastructure level in the residential market.

		The appropriate demand estimates are those encompassing Wholesale DSL Layer 2 and Layer 3 as well as demand for the Spectrum Sharing service.
15.	*What are the main factors for the poor take-up of the LSS so far? What method should be utilised for forecasting ULLS demand?*	The main factors for the poor take-up of LSS so far have been discussed in sections 3.2 and 3.3 above ie the dominant market position of Telstra in the broadband ADSL market place where line sharing is used and the inherent barriers imposed by the risks, startup costs and high price of LSS relative to the Wholesale DSL Layer 2 and Layer 3 products which are available from Telstra.
16.	*The Commission is interested in the views of industry on their demand estimates with respect to the LSS.*	c-i-c.
17.	*What approach should the Commission use for addressing the problem of circularity in estimated and realised demand discussed above?*	No comment.
	Service Descriptions	
18.	*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?*	Telstra's proposed service description in clause 2 of Attachment A to the LSS undertaking is an appropriate form of the declared service and describes PowerTel's currently deployed LSSs.
19.	*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.*	PowerTel is concerned that the technical splitter specifications are entirely at Telstra's discretion, and that overly onerous technical requirements for these splitters may unfairly disadvantage access seekers, particularly if Telstra does not comply with these requirements for their own ADSL services.