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The Ladder of Investment and the Exemption Provisions - A Report for Telstra

Martin Cave

Overview

1 I have been asked by Mallesons Stephen Jaques, acting on behalf of Telstra, to address six questions concerning the application of the 'ladder of investment' (LoI) approach to issues raised in the ACCC's 'Inquiry onto varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services Issues Paper' (hereafter, the Issues Paper). The questions are confined to the implications of the LoI approach and do not therefore address all the matters raised in the Issues Paper. My letter of instructions is attached (Annexure A), together with a curriculum vitae (Annexure B).

2 The questions are addressed in Sections A) to F) below.

3 I have read, understood and complied with the *Federal Court of Australia Practice Note CM7-Expert Witnesses in Proceedings in the Federal Court of Aust*

Section A

To what extent does the approach to telecommunications access regulation forbearance taken by European regulators, including Ofcom, align with you "ladder of investment" ("LoI") theory? To the extent there is such an alignment, in your opinion, how effective has this approach been in promoting competition and encouraging efficient infrastructure investment and use in European jurisdictions where it has been applied?

4 Summary: the evidence suggests that the form of regulation of telecommunications promoted in Europe by the European Regulators Group (ERG) and others is aligned with the LoI, and that adoption of this approach has promoted infrastructure competition and investment by competitors.

5 The LoI approach to the development of competition in telecommunications has both a descriptive and a normative or policy-related element. In the former role, it offers a description of how access-based competition develops in telecommunications markets, with competitors switching to more infrastructure-rich forms of supply, as they acquire more customers.[1] It is then a natural step to ask how a regulator favouring infrastructure over service competition can encourage this process.[2]

6 There is no canonical version of the policy-related LoI. My preferred summary is as follows:

(a) end users' long term interests are best served by infrastructure competition where it is efficiently attainable; and

[1] See M Cave & I Voglesang, 'How access pricing and entry interact', Telecommunications Policy, 27, 2003, pp. 717-727.

[2] M Cave, 'Encouraging infrastructure competition via the ladder of investment', Telecommunications Policy, 30, 2006, pp. 223-237.

(b) in many circumstances, regulators can best realise infrastructure competition (which requires competitors to make significant investments in infrastructure) via the stage of service competition (in which competitors simply resell the incumbent's services without investing in infrastructure themselves).

7 But this general account can in practice include a number of variants.

8 In the European Union, the LoI approach, as broadly interpreted above, was widely adopted by regulators from about 2003/4. A recent article, discussed further below, by Bourreau, Doğan and Manant (hereafter BDM) describes how, beginning in 2005, the European Regulators Group, the ERG, a 'college' of EU telecommunications regulators, described and endorsed the LoI policy approach, most notably in its Common Position on Remedies. Individual EU regulators did the same, notably ARCEP, the French regulator, which developed a broadband ladder involving two variants (local and national) of bitstream. Its annual report for 2008 states that 'the development of competition in France since 1998 is a good illustration of the theory of the ladder of investment.'[3]

9 In the UK, Ofcom does not generally refer to the LoI in its policy statements.[4] However, some at least of its access policies are consistent with it. At the time of its acceptance of undertakings on functional separation from BT in 2005, in a separate agreement Ofcom agreed with BT that the price of ULL should be cut by a quarter and that BT would not reduce the price of its bitstream product for two years in order to 'provide greater certainty and clarity of pricing during the key build-up phase of LLU.[5] In relation to access to fibre networks, Ofcom's approach has similarly been to impose cost-based pricing for access to passive (physical) elements but a looser pricing regime for more comprehensive active access products including electronic elements, as an inducement to infrastructure investment.[6]

10 The outcome in telecommunications markets in the EU in the period from 2000 has obviously been affected by a range of factors in addition to LoI regulatory policies. Tables 1 and 2 present data on the composition of competitive current generation (ADSL) broadband from 2003 to 2007 in the 15 States which formed the EU in 2003 (the EU15). As well as a rapid expansion in provision and a growth in non-incumbent share, the data shows that in 2003 resale accounted for three quarters of competitive supply and ULL for a quarter, while in 2007 these proportions had been reversed.

[3] M Bourreau, P Doğan and M Manant, 'A critical review of the "ladder of investment" approach,' Telecommunications Policy, 34(11), 2010, p. 686.

[4] My search of the Ofcom website identifies dozens of references to LoI in responses to Ofcom consultation documents, but almost no use of the expression by Ofcom itself.

[5] Ofcom, Telecommunications Statement, 25 June 2005.

[6] M Cave & K Hatta, 'Transforming telecommunications technologies', Oxford Review of Economic Policy, 25 (3), 2009, pp. 488-503.

Table 1. Diffusion of Broadband in the EU15 (millions of subscribers)

	2003 (July)	2004 (July)	2005 (October)	2006 (July)	2007 (July)
DSL, of which	12.5	22.5	40.8	56.4	68.2
Incumbent	9.6	15.6	24.3	31.4	37.0
Non-incumbent, of which	2.8	6.9	16.5	25.0	31.3
Resale	1.5	2.3	4.9	9.1	8.2
Bitstream	0.7	2.4	4.6	3.9	5.4
ULL	0.7	2.2	6.9	12.0	17.6
Cable	4.1	5.6	8.2	10.1	11.8
Other technologies	0.9	0.7	1.1	1.3	1.4
Total	17.5	28.8	50.1	66.3	81.4

Source: M. Cave,'Broadband regulation in Europe', *Competition and Regulation in Network Industries*, vol. 8 No.4 p. 414, based on EC, *Implementation Reports* (2004-7) and *Broadband Access in the EU* (2007).

Table 2. Percentage breakdown of competitive DSL 2003-07 in the EU15

Year	Resale	Bitstream	ULL
2003	54	23	23
2004	33	35	32
2005	30	28	42
2006	36	16	48
2007	26	17	56

Source: As for Table 1.

11 I take these two pieces of evidence as showing that many European regulators accepted the LoI approach as calculated to achieve the objectives of the regulatory framework (including benefits to consumers and efficient investment)[7]); by its own explicit account, at least one adopted it; and the sequel showed that competitors in the Member States covered by tables 1 and 2 above did make the corresponding infrastructure investment – the number of homes served by unbundled loops increased 25-fold between 2003 and 2007 while broadband lines increased five-fold.

[7] EU Framework Directive, Article 8.2, 2002/21/EC.

Section B

What is your opinion on the concerns about the LoI theory and geographic exemptions set out in section 4.3 of the Issues Paper and in particular, the concerns expressed by Bourreau et al and Xavier and Ypsilanti? If your opinion is that those concerns are unfounded or irrelevant, please state why you consider them to be so.

12 *Summary: Bourreau et al. have exaggerated the secondary nature of the role played by competition in the supply of resale products in my analysis of the LoI, when infrastructure-based competition is established. Xavier and Ypsilanti magnify the difficulties of segmenting regulation on a geographic basis, and offer no substantial analysis of its benefits.*

13 The ACCC Issues Paper in Section 4.1 identifies relevant comments on the LoI by two sets of authors. One set, BDM, offers a critique of the LoI approach; the other set (Xavier and Ypsilanti - hereafter XY) addresses the geographical segmentation of regulation. I discuss each of their opinions in turn.

14 BDM, in their generally sympathetic account of the LoI, identify what they call two critical assumptions of the approach:[8]

(a) "Assumption 1: Service-based competition serves as a stepping stone to facility-based entry if the replacement effect is neutralised.

(b) Assumption 2: The regulator has the instruments to neutralise the replacement effect."

15 The 'replacement effect' arises because access providers will be aware that if a competitor obtains access to a narrower access product, such as ULL, the access provider loses the larger revenue from a wider access product, such as resale.

16 It is not entirely clear to me that Assumption 1 plays so decisive a role in the LoI policy approach as this account implies, since regulators can normally require incumbents, even against their objections, to make access products available at specified prices.

17 Under the LoI the goal is to enhance competition by a cumulative process in which the balance of rivalry among operators moves towards infrastructure competition. This process normally extends the intensity of rivalry and the extent of product differentiation among operators; it does not necessarily entail more competitors.

18 The regulator's instrument is flexing the availability or attractiveness of alternative access products. Two principal means are employed – withdrawal of an obligation to supply a lower rung product or an increase in its regulated price. BDM use the misleading metaphor of 'burning up' (which means destroying by fire) to describe this process. It is misleading because, necessarily in the latter case and plausibly in the former case, the access product remains available, if on less favourable terms than before.

19 An imaginable version of the LoI might have separate ladders available for entrants of different vintages, with access to fewer lower regulated rungs (or more highly priced rungs) for earlier entrants. My 2006 paper assumes that this was impracticable. There might therefore be higher access regime-related barriers to entry for later than for earlier

[8] Op. cit. in fn. 3 above, p. 686

entrants: possibly mitigated by lower barriers of other kinds, associated with declining customer inertia, for example. In my view, this does not negate the policy, as a sufficient number of infrastructure competitors would ensure that the long term interests of end users (hereafter, LTIE) were protected even if service-based entry were restricted.

20 I wrote in 2006 that the lower rung could be maintained in place through a commercial agreement with the incumbent or through offers by operators which had moved to a higher rung. This would mitigate the effect noted in the previous paragraph.

21 BDM misrepresent my view on the prospects for an unregulated wholesale market for lower rung services. Because I believed that the outcome in this respect would depend on particular circumstances, I wrote that later entrants could '*seek access* either from the initially dominant firm or from earlier entrants'- emphasis added. This reflects my view that the key issue for LTIE is the strength of the competitive constraint on the incumbent – which is more effectively imposed by an infrastructure competitor. Thus it may be worthwhile to sacrifice some later service-based entrants to achieve the goal of infrastructure competition. The argument in favour of the LoI thus does not depend on what BDM erroneously describe as my 'presumption about the emergence of a wholesale market'. This error may itself encourage a partial competition assessment which focuses excessively on competition at lower, possibly obsolete rungs in the ladder, in place of the broader assessment of competition, with a focus on the end user. This is recognised by the ACCC when it writes that 'even if wholesale competition at the resale level has not developed, and is unlikely to develop, it does not necessarily follow the exemptions are not in the LTIE'.[9]

22 Parenthetically, it is note-worthy that exactly this retail-originating approach is adopted by European regulators in deciding where in a value chain to mandate access. The European Commission summarised the approach in 2007 as follows:[10]

> *"Likewise N[ational] R[egulatory] A[uthorities] should take into account regulation imposed on the market for wholesale (physical) infrastructure access when analysing the wholesale market for fixed origination. Remedies imposed on the markets for local loop unbundling should then be taken into account when assessing S[ignificant] M[arket] P[ower] on a forward-looking basis on the retail fixed access market."*

23 According to this procedure, if unbundling local loops alone could generate effective competition in the relevant retail market, other more comprehensive access products would not be subject to mandatory regulation.

24 There is also the important aspect of the operation of indirect constraints upon one market from a vertically-related one.[11] The wholesale market for resale services can also be affected by the downstream retail market to end users. Thus competing providers of voice services place a limit upon the price which even a monopoly supplier of resale services can charge, as a result of the capacity of end users to switch to an alternative supplier, in the event that the retail price of services based on a resale products goes up in price. Clearly they might switch to the supplier of the resale service, augmenting that operator's

[9] ACCC, Issues Paper, p, 53.

[10] Explanatory note to Commission Recommendation on relevant product and service markets, 2nd edition, 2007, SEC(2007) 1483/2, p. 13.

[11] See R Inderst & T Valletti, 'Indirect versus direct constraints in markets with vertical integration' Scandinavian Journal of Economics, 111, 2009, pp.527-546.

revenues. But they might equally go to another supplier relying either on ULLS or on another network entirely; in which case the revenues of the supplier of resale products would decline.

25 It is useful to record Ofcom's recently expressed views on this issue, set out in their statement on Wholesale Broadband Access:[12]

> *"Our view has always been that both direct and indirect constraints will form the basis of competition in the WBA market. Thus even when purchasers of wholesale inputs have few alternatives to BT, demand substitution at the retail level can constrain BT's ability to raise prices or reduce service quality.'*

26 To summarise the general theoretical points at issue (and abstracting from the current situation in the exempt exchanges in Australia), in my opinion, BDM misinterpret and exaggerate the role of wholesale markets for resale products in ensuring that the goals of the LoI policy are realised. If retail markets are differentiated and competitive, end users enjoy the full benefits of the policy. This outcome can in principle be achieved without an active and competitive resale market. Secondly, as Ofcom observe in relation to another market, competitive constraints can be applied both directly in the marketplace and indirectly from related markets.

27 While BDM focus on broader conceptual issues relating to the LoI, XY focus on the problems of different regulation of separate geographical areas within a jurisdiction. In essence they argue that while it is logical to apply different regulation in areas subject to different market conditions, doing so in practice 'is contentious and problematic in principle, and complex and subjective in practice.'[13] They then list a series of problems:

(a) the lack of clear principles to guide implementation;

(b) complexity and discretion in processes leading to less predictable regulation;

(c) uncertain effects on competition and investment;

(d) uncertain effects on end users, especially in an NGN environment;

(e) risk of premature deregulation;

(f) more complex, less transparent regulation;

(g) -additional burdens for the regulator; and

(h) additional burdens for operators.

28 Many of these problems beset regulation at whatever geographic level. Thus there is always a risk that deregulation may be premature, and the effects of a change of regulatory policy on competition and investment in any circumstances likely to be open to some doubt. It seems to me that XY have made no serious attempt at either a

[12] Ofcom, Review of the wholesale broadband access markets, Statement, December 2010, para. 3.153.
[13] P Xavier & D Ypsilanti, 'Geographically segmented regulation for telecommunications', INFO, 13, 2011, pp. 3-18.

conceptual or a practical level to set out the incremental costs of geographical differentiation against the benefits, which are not enumerated or examined.

29 The key issue on the benefit side is that, if a single regulatory remedy is applied over two areas in which conditions of competition are not homogeneous,[14] it is likely to be suited to neither. Deregulation will come too soon in one area and too late in the other. Before deregulation, some end users in *competitive* areas are denied the 'better price-product-service package' which the Australian Competition Tribunal (hereafter, ACT) noted that deregulation can bring; after deregulation, other end users in *non-competitive* areas may be subject to abuses of market power. This segmented approach can produce the necessary level of regulatory certainty if the regulator explains the principles upon which the application of different remedies is based, and consistently applies these principles. When market conditions differ to a considerable extent in different areas, I believe that regulators should give very serious consideration to the segmented approach, and maintain the uniform approach only if the alternative, segmented approach incurs costs which outweigh its benefits.

30 Both of these outcomes can be avoided by separate remedies, and clearly the larger the disparity in competitive conditions, resulting, for example, from rural/urban conditions, the greater the harm done by imposing a single remedy. Separate remedies also permit adherence to one of the OECD's principles of better regulation (repeated by other organisations as well), which is: to 'design economic regulations in all sectors to stimulate competition and efficiency, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests.'[15] XY appear to adopt the opposite presumption, that regulation should stay in place until it can be shown to be harmful.

31 In a sense, commentators confronted with the same set of facts on the practical experience of geographically segmented markets can describe the bottle as being half empty or half full. XY prefer the former description. My interpretation, by contrast, emphasises the potential deregulatory benefits, and favours building on the results of implementations of geographically differentiated markets or regulatory remedies; where conditions of competition are clearly not homogeneous, considering copying processes adopted by other regulators, especially those like Ofcom, which have repeated the experience; and undertaking systematic *ex post* evaluations of the results when they have had time to take effect.

[14] This is the formulation employed in European competition. In its 2007 Recommendation on markets, the Commission wrote: '..Investment in alternative infrastructure is often uneven across the territory of a Member State, and in many countries there are now competing infrastructures in parts of the country, typically in urban areas. Where this is the case, an NRA could in principle find sub-national geographic markets.' Op. cit. in fn. [10], p. 12.

[15] OECD, Guiding Principles for Regulatory Quality and Performance, 2005. p. 6.

Section C

Is the current state of competition in the relevant markets as set out in a report entitled "On-going Exemption from Access Regulation for WLR, LCS and PSTN OA Services where Workable Infrastructure Competition Exists" prepared by Mr Aleksandr Sundakov dated July 2011("Sundakov Report"), consistent with your LoI theory? To what extent is the widespread "self-supply" of resale services such as WLR, LCS and PSTN OA by ULLS-based vertically integrated operators a reflection that effective competition is occurring at the "resale" layer of the value chain?

32 *Summary: the Sundakov Report shows that the number of ULLS competitors, their combined market share, and the number of DSLAMs they deploy are all growing in the exempt ESAs. The growth of this form of competition also enhances competitive pressure in resale products, which ULLS-based competitors supply to themselves.*

33 I understand that exemptions are only available in ESAs where the following conditions apply:

(a) there are three or more ULLS-based competitors (excluding Telstra) in an ESA;

(b) the ULLS-based competitors have an aggregate market share in the ESA equal to or greater than 30 per cent; and

(c) the aggregate ULLS spare capacity for that ESA is equal to or greater than 40 per cent of the aggregate number of WLR SIOs in that ESA

34 In my opinion, the first and arguably most important point to make about the outcomes of the exemptions is that they have been in operation in 129 ESAs since 30 December 2010, and in a further 52 ESAs from 30 June 2011, and will come into effect in a further 34 ESAs on 30 December 2011.[16] While it is true that the decision to exempt was made in 2009, offering some notice to potential access seekers, it is still very early days to expect the consequences of the changes in the marketplace to be clearly visible or to make a reliable assessment of them. This makes it very difficult for the ACCC to draw any conclusions about the long term effect of the measures on competition and investment. In my opinion, were it to do so, there is a risk that a perception might take hold that regulation was an unpredictable and volatile process, subject to change without reasonable evidence. I also note that the Australian Competition Tribunal in its Order issued in 2009 provided for the exemptions, absent revocation, to operate until 2014.[17]

35 I note that Mr Sundakov in his Report, prepared at the request of Mallesons Stephens Jaques, acting for Telstra, has noted the following as having occurred in the recent past:

(a) Telstra continues to supply the resale products WLR and LCS to its customers;

[16] Throughout this paper, reference is made to:
129 ESAs exempt from December 30 2010;
181 (129+52) ESAs exempt from June 30 2011;
215 (181+34) ESAs to be exempt from December 30 2011;
380 so-called Attachment A ESAs analysed by the ACCC, 215 of which are actually exempt or destined for exemption by the end of 2011.

[17] Application by Chime Communications Pty Ltd (No 3) [2009] ACompT 4 (24 August 2009), para. 3.2.

(b) the nominal transaction prices of these two products have remained stable, and are subject to some discounting;

(c) two thirds of the WLRs acquired in the 181 exemption areas were acquired by 3 firms, the remainder by a further 108 firms;

(d) Optus offers WLR in exemption areas bundled with other voice services; other wholesale suppliers have not emerged, but Telstra has informed me that a sub-wholesale market exists in which some operators resell Telstra's WLR product;

(e) the number of ULLS services has grown by 20% in the 12 months to March 2011 in the 181 ESAs exempt by June 2011;

(f) the regulated price of ULLS has remained fairly constant since January 2010; its price relative to WLR has also remained constant in exempt areas;

(g) the average number of ULLs acquirers in the 215 ESAs to be exempted from 30 December 2011 is between 5 and 6;

(h) DSLAM investment grew in the 129 exempted ESAs in the 12 months to March 2011, but fell as a proportion of total DSLAM investment compared with the 12 months to March 2009; this continuing investment in DSLAMs in exempt areas does not support the view that the forthcoming NBN has not brought investment by ULLS competitors in exempt ESAs to a halt18.

36 The goal of LoI policy is to increase the degree of infrastructure competition, which can be measured by the proportion of lines served by access-based competitors using ULLS. Unless the lower rung product ceases to be available, its instrument, at the stage where investment in DSLAMs etc is required, is a change in relative price of access products; alternatively or additionally, the change in relative prices of the latter may encourage operators and customers to switch their provision to a mode which uses infrastructure investment which has already been installed. I have noted above the possible emergence of an unregulated wholesale market in resale products available to new entrants. This is an additional benefit if it emerges from the competitive interactions of a sufficient group of infrastructure competitors already active in the marketplace, but it defeats the purpose of the LoI if resale prices are kept low by regulation.

37 It is also necessary to recognise the role of self-supply by ULLS operators of resale products. I have already noted the importance of indirect constraints on resale markets: these arise because end users can switch to a rival retail service if the charges levied on resale products price their users out of the market. It is also possible that a competitor using resale products can become a ULLS operator, which then competes in the retail market by self-supplying its own resale products. The availability to a purchaser of WLR of this option (switching to ULLS access) represents a viable form of substitution for WLR.

38 For reasons given above, I am not able on the basis of 6-8 months of data to reach a firm conclusion concerning the consistency of Mr Sundakov's data over that period with the LoI policy prescription. However, the trend for competitors to rely more on ULLS and less on resale has continued, although I am not able to say whether it has accelerated. Relative prices of access products have remained constant. And there is some limited wholesale and sub-wholesale activity in resale products. My provisional view is that the data is consistent with

[18] See Sundakov Report, pp. 16-19.

the view that the exemptions are achieving the LoI objectives which the ACCC looked forward to when it introduced the policy in 2008 and 2009.

Section D

Assuming that the current state of competition set out in section 5.1 of the Issues Paper is accurate, is that state of competition in relevant markets consistent with your LoI theory?

39 *Summary: the review undertaken by the ACCC is premature and relies on data from a mixture of exempt and non-exempt ESAs. Nonetheless the ACCC describes a situation consistent with the LoI in which infrastructure competition advances and accounts for an increasing proportion of access-based competition in the ESAs analysed.*

40 Section 5.1 of the ACCC Issues Paper describes the current state of competition in retail voice, and in the wholesale markets for ULLS and WLR.[19] In summary:

(a) Telstra has a high but declining share in the national retail market for voice calls; its share in the 380 Attachment A ESAs is 72%; its share in CBD ESAs is unknown;

(b) in June 2011, ULLS-based lines in the ACCC's 380 Attachment A ESAs accounted for 17% of total lines in those ESAs.20 Their total grew at an annual rate of about 150,000 lines in the two years to December 2010, when the exemption began in 129 ESAs;

(c) in the 380 Attachment A ESAs, the ratio of competitive ULLS-based lines to WLR-based lines in March 2011 was approximately 3 to 1;

(d) between December 2010 and June 2011, the average number of ULLS-based competitors grew from 4.3 to 4.7 in the 380 Attachment A ESAs;

(e) access seekers' spare DSLAM capacity in the 380 Attachment A ESAs is large relative to WLR-based lines in those ESAs; more precisely, in March 2011, excess DSLAM capacity was capable of absorbing all WLR lines in 43 % of the Attachment A ESAs;

(f) DSLAMs were continuing to be installed in the Attachment A ESAs in the first half of 2011, (gross) investment amounting to 9.4% of the stock at the end of 2010; amd

(g) in section 6.1 of the Issues Paper, the ACCC tentatively concludes that currently available evidence supports the view that competition in wholesale voice-only resale markets has not developed to a significant extent since the exemptions were granted by the Tribunal in 2009.

41 In addition to the caveat noted above concerning the very short period of operation of exemptions, the ACCC's data is subject to the problem that the universe of ESAs to which they relate is the 380 Attachment A ESAs. Of these only 129 (one third) were

[19] Issues Paper, pp. 31-35.

[20] Note that a precondition for exemption is that the combined share of ULLS-based competitors in an ESA is 30%.

exempt from December 2010 and 181 (about one half) from June 2011. In other words, the sample was predominantly non-exempt in the period in which data was collected.

42 Stepping over this issue, the data shows an increasing proportion of ULLS-based and a declining proportion of WLR-based competition. It shows an increasing number of ULLS-based competitors, some of which are switching their customers from resale-based to ULLS-based modes. It shows continuing investment in DSLAMs by competitors and excess capacity capable of absorbing their own resale-based customers and customers won from Telstra (or Optus).

43 In my view, if these effects were observed over a longer period in exempt ESAs, they would be consistent with the outcome implied by the operation of the LoI.

Section E

Based on your knowledge of the Australian telecommunications market, in your opinion is the application of your LoI approach in Australia likely to be in the LTIE?

44 *Summary: the analyses presented in the Sundakov Report and by the ACCC portray the effects of the LoI approach which I have advocated, which I believe are in the LTIE.*

45 The Issues Paper notes that:[21]

> *'[A]n important factor in the ACCC's decision [to grant Exemption Orders in August and October 2008] was its view that the facilities-based competition was preferable to resale-based competition. Specifically, the ACCC considered that ULLS-based competition was likely to be in the long term interests of end-users (LTIE) as access seekers could compete on greater dimensions of service of supply to end-users and would be encouraged to 'dynamically innovate' their services.'*

46 The ACCC had also previously noted that:

> *'[P]roviding regulated access to resale services, in the initial stages of competition, would facilitate access seekers' investments in their own infrastructure.'*

47 In my view, these conclusions are wholly consistent with my understanding of the LoI set out above. Based upon the data to which I have referred above, and with which I became acquainted in connection with my earlier submissions to the ACCC in exemption proceedings and related matters in 2007-8,[22] I judge that the ACCC's application of the LoI has been in the LTIE.

48 In the current situation, it is likely that the initial stages of competition have been completed in the ESAs satisfying the three conditions for an exemption set out above. The evidence for this is both satisfaction of the conditions for exemption and the data provided in the Sundakov Report to the effect that the average number of ULL acquirers in the 215 exemption exchanges will, by December 2011, be between 5 and 6; that ULL acquirers have excess capacity and hence are generally free from investment-related barriers to expansion; and that lines supplied by access-based competitors via ULLS exceed those provided by WLR by a factor of 3 to 1.

[21] Issues Paper, p. 25.
[22] Cited at fns. 46 and 47 of the Issues Paper.

49 I thus consider that the regulatory regime has achieved the initial objectives of the LoI. On that assumption a major forward-looking goal of the LoI is to promote further infrastructure competition between Telstra and access-based competitors throughout the value chain and hence in the retail voice market (and market for bundles including voice); this is likely to involve further migration of access-based customers from WLR to ULLS.

50 As for the existence of and competitive constraints on the wholesale market for resale services, as the Issues Paper makes clear, the situation is as follows. Supply of the previously regulated services by Telstra has been maintained at a constant price in ESAs subject to exemption.[23] In the very short time which has elapsed since the exemptions came into force, new suppliers have not emerged. But there are good grounds for believing that the market for resale products is constrained indirectly by the possibility of retail customers switching their custom from operators relying on resale access products to alternative suppliers, and by resale-based operators switching to provision of service via ULLS (and in effect "self-supplying" the exempt resale services). The ACCC does not appear to have investigated these aspects in detail. In any event, the situation in the resale markets in the exempt ESAs seems to have remained pretty much as it was under regulation.

51 As indicated above, in my understanding of the LoI, the issue of re-instating the regulatory *status quo ante* on lower rungs is appropriate only if the expected progression to the higher rung is stalled *and* if a market review of the lower rung reveals restricted supply, high prices and inadequate competition. I see no clear evidence that either of these events is occurring. Accordingly, I consider that application in Australia of the LoI as set out above is in the LTIE.

Section F

If your LoI approach is applied by the Commission, in your opinion, how long should regulated access to the lowest "rung" of the ladder (i.e. resale services) be provided, and what might be appropriate triggers for this withdrawal to occur? Is the geographic exemption approach reflected in the Australian Competition Tribunal's Exemption Orders, and implemented by the Commission, in alignment with you LoI theory, and your views on how long the lowest rung should be provided and what might constitute appropriate triggers for exemption to commence?

52 *Summary: The adoption of the LoI should lead to the emergence of a number of significant infrastructure competitors. When this outcome, as expressed for example in the ACT's exemption criteria, has been achieved, the lowest rung of the ladder (resale services) can be removed.*

53 The LoI approach is predicated on the hypothesis that resale competition is less effective than infrastructure-based competition in ensuring the LTIE. Infrastructure competition is likely to be more vibrant the larger the number of competitors' customers served by ULLS. Benefits thus accrue from the transfer of customers from resale products to ULLS. However, ULLS-based competition is not likely to be attainable in all ESAs, particularly those containing fewer and more scattered households.

[23] Telstra's response to access seekers' submissions regarding the public inquiry to make final access determinations for the declared fixed line services, dated 15 July 2011 section 4.3.

54 It is thus desirable that where ULLS-based competition is feasible, competitive providers of voice and data telecommunication services have an incentive both to serve newly acquired customers with ULLS and to transfer those served by resale products to ULLS. These incentives can be provided by an alteration in the terms on which resale products and ULLS are supplied: this can be accomplished either by changing the relationship between two regulated prices or by withdrawing regulation from resale products, while allowing transactions on commercial terms to go ahead.

55 According to the 'European approach' described in section A above, the regulator should use the 'relative price' instrument until the degree of competition expected from investments already made in the higher rung is sufficient to deal with competition problems across the value chain as a whole. At that stage it is considered 'safe' to withdraw regulation of the lower rung. This may inconvenience some operators still using it,[24] but the resulting migration of customers to the higher rung will further the interests of infrastructure competition.

56 This implies that the trigger for withdrawal of regulation on the lower rung is the expectation of an appropriate level of competition in the retail market, from both end-to-end network competitors and from competitors relying on access to a product the supply of which will still be regulated.

57 As for where this should be done, it seems to be generally accepted that it is not practicable to conduct a separate market analysis to evaluate the extent of competition in each ESA. Accordingly a rule of thumb must be found, of the kind established by the ACT and implemented by the ACCC, set out in section C above.

58 I note that the UK regulator Ofcom has used a similar approach in its analyses of wholesale broadband access markets in 2008 and in 2010. In 2010, the trigger adopted for deregulation was that there should be at least 4 principal operators offering service based upon ULL, or that there should be at least 3 and BT's market share should be less than 50%. A principal operator is defined as an operator with an ability to impose a material constraint on BT. In 2008 this required a 10% national coverage. In 2010 a more subjective approach was adopted, with the same objective – that of excluding niche operators.[25]

59 Ofcom's decision relates to different wholesale end user markets than do the decisions before the ACCC. The ladders involved are thus separate, but related because end user voice services can be provided using both narrow and broadband (VoIP) technologies, and because voice and data services are increasingly sold as bundles. However, at a general level the nature of the trigger is similar: in each case it relates to the number of competitors and their market shares in the ULLS market. The ACCC adds a condition relating to excess capacity; Ofcom adds a condition relating to the nature of the competitors (that they be active nationally), which may not be appropriate in a country like Australia with a different geographical distribution of population and economic activity. I lack the direct knowledge from first hand analysis of market conditions to comment on the precise criteria employed by the ACCC.

[24] An adequate notice period can mitigate this effect.

[25] Ofcom, Review of wholesale broadband access markets. Statement on market definition, market power determinations and remedies, 3 December 2010, paras 3.165-3.194.

60 Finally, the question arises of whether and how market conditions in the wholesale resale market should enter into the exemption decision. I noted above that an entrant coming into the market subsequent to the elimination of the lower rung might find it harder to enter if no resale product were available or were only available at a high price or under restrictive conditions.

61 The first question in any particular case is: do we observe problems of non-availability or excessive prices? In the 215 exempt ESAs, Telstra provides resale products at the formerly regulated price. Optus also supplies a product, but only in a bundle. A wider set of wholesale suppliers has not emerged in the nine months since the first exemptions came into effect. The degree of indirect constraint on the price of Telstra's wholesale resale products has not been fully examined.

62 Secondly it can be argued that the regulation of resale products should remain in place indefinitely, in order to provide a convenient rung for entrants. However, if a larger number of later entrants is a benefit of continued regulation, the costs of such a continuation is the likely abatement of the incentive for existing competitors to invest in ULLS-based infrastructure and to switch customers to this mode of supply. Moreover, if the triggers for introducing exemptions are appropriately chosen, the incremental benefits of later entry may be small or even zero.

63 For this reason, I do not consider it necessary to include among the triggers for exemption any conditions relating to the state of the wholesale market for resale products. Regulation should focus upon the competitive process and not the identity or nature of particular competitors or groups of competitors. I thus conclude that the form of the criteria currently in effect, focussing on the ULLS market, should be continued in the Final Access Determinations.

Note

64 I declare that I have made all the inquiries that I believe are desirable and appropriate, and that no matters of significance that I regard as relevant have, to my knowledge, been withheld from the Court.

28 September 2011