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15 February 2008

Mr Graeme Samuel
Chairman
Australian Competition and Consumer Commission
GPO Box 520J
MELBOURNE VIC 3001

By facsimile: (03) 9663 3699
By email: Graeme.Samuel@accc.gov.au

Dear Mr Samuel

ADSL2+ Services

We act on behalf of Internode, iiNet, Primus, EFTel, Westnet, TSN Communications, Wideband Networks, Network Technology, Adam Internet and Netspace ('Our Clients').

We write to express Our Clients' grave concerns regarding the recent announcement by Telstra of its intention to activate high-speed ADSL2+ broadband at more than 900 telephone exchanges for the purposes of retail sale, on the basis of an apparent understanding that Telstra will not be obliged to offer equivalent services wholesale.

Our Clients consider that Telstra's proposed conduct in respect of ADSL2+ services, combined with its ongoing behaviour in obstructing effective competition via other broadband platforms ('Telstra's Combined Conduct'), together amounts to anti-competitive conduct in breach of section 151AK of the *Trade Practices Act 1974* ('the Act').

We consider that the following action is appropriate:

- In the immediate term, we submit that Telstra's Combined Conduct merits the issuing of an urgent Competition Notice by the Commission under Part XIB of the Act in order to prevent rapid damage to the competition that has already developed in the market for broadband services generally and in order to remove obstacles to new entry to the market for high-speed broadband services.

- In parallel, we request that the Commission re-examine declaration of wholesale xDSL services under Part XIC of the Act, at least in respect of certain locations where it has been demonstrated that competition via alternative platforms is simply not viable.

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- In the longer term, we consider that the Commission needs to assess and consider other options that are available to address telecommunications competition problems that are demonstrated by the considerable obstacles to access to declared services stemming from Telstra's position both as the incumbent network owner and retail competitor.

Given the very substantial implications of these matters for Our Clients, senior representatives from each of Our Clients request an opportunity to meet with you in person at your earliest opportunity to discuss these matters in more detail. In order to facilitate that discussion, a summary of our concerns is set out below.

Urgent need for a Competition Notice under Part XIB of the Act

Section 151AJ(2) of the Act provides that a carrier engages in anti-competitive conduct if the carrier:

(a) has a substantial degree of power in a telecommunications market; and

(b)(ii) takes advantage of that power in that or any other market, and engages in other conduct on one or more occasions, with the combined effect, or likely combined effect, of substantially lessening competition in that or any other telecommunications market.

We address these criteria in turn.

1. Substantial degree of market power

Telstra's substantial degree of power in the market for wholesale broadband services is clear. As the Commission itself recognised in its 2006 Fixed Services Review:

> "Broadband-capable networks are expensive to build and involve significant economies of scale. Telstra's market power in this market is reflected in its high and relatively stable market share. … The ubiquity of Telstra's wholesale DSL service, together with Telstra's very high market share in the supply of wholesale residential broadband services, suggests that Telstra is currently unlikely to be meaningfully constrained in its wholesale pricing and product offering decisions."[1]

The Commission has acknowledged that Telstra's wholesale DSL market power could be undermined over the coming years by emerging competitive constraints, including supply of broadband via separate networks (such as wireless networks and Optus' HFC network) and via competitors accessing Telstra's ULL services. However, wireless coverage is limited by many factors such as limited availability of spectrum, geography and local interference and Optus' HFC network lacks the national coverage and substantial economies of scale enjoyed by Telstra, such that neither of these platforms can yet be classed as a true alternative to Telstra's ADSL offering. Further, as set out below, Telstra continues to block other infrastructure based competition via monopoly backhaul cost barriers and a comprehensive list of physical blocks to the deployment of DSLAM technologies in Telstra exchanges. As

[1] ACCC, *A strategic review of the regulation of fixed network services - ACCC position paper, June 2006*. pp. 89-90.

a result, Telstra's degree of power in the market for wholesale broadband continues to be substantial.

2. Engages in conduct on one or more occasions in that or any other market

We submit that Telstra's decision not to offer wholesale access to ADSL2+ services and instead deliberately constrain the wholesale offering to every other speed except ADSL2+ is a strong *prima facie* example of conduct which will lead to a substantial lessening of competition. Whilst this might not necessarily be the case if there was scope for substitution with comparable alternative services provided by competitors, unfortunately in many locations this is not possible.

In particular, current impediments to effective competition via ULLS/LSS include:

(a) Untenably high wholesale transmission pricing

ADSL2+ DSLAMs require considerable backhaul bandwidth to allow customers to reach maximum download speed. Access seeker penetration into regional areas (Bands 3 & 4) is low because the cost of wholesale transmission ('backhaul') between a regional exchange and a capital city is so high that access seekers are simply unable to compete with Telstra. We are instructed that currently Telstra's wholesale transmission charges are many multiples higher than the costs itself incurs. If access seekers were able to achieve a similar backhaul price, ULLS and LSS could be used to compete with Telstra BigPond in all Bands.

By way of example, Internode instructs us that it has approximately 560 customers connected to the Mt Gambier exchange via Testra Wholesale ADSL ports. However, given the excessive cost of obtaining transmission for backhaul from Adelaide to Mt Gambier, taking overheads into account the total cost per subscriber to service these customers on Agile DSLAMs would be approximately $90 excluding GST while current average revenue per subscriber is only $68 including GST. Mt Gambier is an example of a band 3 exchange with a relatively large number of subscribers (it is the second largest town in South Australia) but it has no competitive supplier of backhaul services.

In Whyalla (the third largest town in South Australia) on the other hand where Silk in co-operation with NextGen provides competitive transmission services, Internode has a similar number of subscribers on Agile DSLAM ports with a similar average revenue per subscriber but with a backhaul operating cost approximately one tenth of that charged by Telstra for a similar service. As a result Internode can operate DSLAMs in Whyalla and other towns in the Eyre Peninsula region.

Mt Gambier is one of the cheaper band 3 locations to obtain transmission from Telstra. Costs to obtain access in Alice Springs, Darwin and Broken Hill are considerably higher. South Australia is not a special case, exactly the same issue is seen in each state. However, this example clearly demonstrates that where prohibitively expensive Telstra backhaul is the only backhaul available, there is simply no prospect of ULLS/LSS based competition because the cost of servicing a customer on an access seeker's DSLAM exceeds the revenue that could be derived from the customer.

(b) Capped exchanges

For some time Telstra has been announcing a steadily increasing list of full, or 'capped', exchanges where there is no space for access seekers to install DSLAMs or the core MDF is full.

As of 4 February 2008, Telstra stated that 76 of its exchanges were capped. If an access seekers wishes to provide competitive services in an area with a capped exchange, they must build or lease a remote structure to house their equipment and run cables to the exchange. Apart from the cost implications, this imposes a range of further problems including technological constraints, planning and land access difficulties, and vandalism potentially impairing service levels. Frequently, this means that it is untenable to provide any form of access and the access seeker is simply not able to service that area.

If the exchange's MDF is declared full, then even if a competitor is willing to put an equipment box in the street, they will not be able to access the local loop at the exchange and provide services.

Our Clients consider that there are solutions to this issue, however, Telstra will not consider the options. As a result, a growing number of metro exchanges serving hundreds of thousands of customers are now places where new ADSL2+ services can only be provided by Telstra and other existing service providers as further service providers can not obtain access to install DSLAMs.

Our Clients have also stated that they have examples where they have been able to prove that exchanges were not full, despite Telstra's claims that they were. Telstra's growing list of capped exchanges is available on Telstra Wholesale's website.

(c) Delays for approval to access exchanges to install DSLAMs

Telstra has imposed a serial queuing system whereby access seekers may only access exchanges one at a time to construct or expand DSLAM infrastructure. This is combined with an excruciatingly slow process for approving access seekers' plans for the installation of equipment in Telstra exchanges. In Our Clients' direct experience this is causing delays that are routinely in the order of 6 - 12 months and often up to 24 months before they are able to access key metro exchanges in order to install equipment and provide competitive services. Telstra also refuses to permit access seekers sitting in the queue to collaborate on works to their mutual benefit.

Our Clients consider that there is no substantive reason for this process and delay except to create barriers to competition. Telstra's recent announcement outlining its rapid ADSL2+ rollout in 900 exchanges shows that BigPond does not have to wait in the same queue. As Telstra's recent announcements show, it can commence providing ADSL2+ in 48 hours, whereas its competitors must wait up to 24 months to access an exchange in order to install the necessary equipment to provide the same broadband service to consumers.

(d) The lack of an LSS to ULLS migration process

Access seekers have been consistently requesting development of an LSS to ULLS migration process. Again, Telstra has been less than forthcoming. As a result, there is no means whereby an access seeker can transfer a large number of LSS customers to the ULLS in order to provide them with voice services as well as broadband. Currently, a single LSS can only be transferred to the ULLS via an expensive and cumbersome process taking up to 3 weeks during which the end-user will be without any service. This considerable inconvenience is a significant disincentive to potential customers. In reality, an LSS to ULLS transfer is a simple process and only requires that Telstra install appropriate IT linkages to manage the process. However, Telstra has no incentive to assist its wholesale customers by providing a transition path. The lack of an effective migration process between LSS and ULLS reduces incentives for service providers to invest in their own DSLAM infrastructure, resulting in a greater need for access to wholesale DSL services.

(e) Telstra BigPond's refusal to join the Telstra LSS Churn process

Telstra BigPond has continually refused to participate in its own industry-wide ADSL2+ churn mechanism called Single Service Transfer. As such, transferring customers to and from BigPond ADSL2+ is an unnecessarily expensive exercise with imposed downtime, again acting as a strong disincentive for consumers wishing to change providers.

(f) RIM and pair gain constraints

Telstra's widespread use of this technology has frequently resulted in access seekers being unable to provide ADSL services to end-users. The high cost that Telstra charges access seekers to transpose a line on this technology to a copper line is a significant disincentive to competition as it makes provision of the service uneconomical. A consumer facing this barrier would of course be able to obtain an ADSL service from Telstra, which would not be faced with the excessive transposition charge.

(g) Telstra not meeting connection appointments

One of our client's has stated that at present, over 20% of Telstra's 'confirmed' ULLS connection dates are not being met by Telstra. In this situation, Telstra will advise the access seeker that the connection did not occur, often 48 hours after the specified connection time, and without negotiation that a new date has been scheduled. In the event that the end-user cannot meet the new date for a connection fee, a 're-target' fee of $85 (ex GST Band 2) is levied by Telstra.

Apart from the cost, Telstra's failure to meet an appointment for a connection makes the relevant access seeker look bad, as from the consumer's point of view, their service provider and not Telstra is at fault.

(h) Truck rolls for IULL vs VULL connections rather than reusing existing pairs still jumpered from previous services.

Rather than use existing lines that remain connected, Telstra sends out technicians to perform connections for in-use ULLS services. This is unnecessary, but by adding to cost and delay, again provides a disincentive for consumers to churn away from Telstra to service providers that utilise their own DSLAM infrastructure.

(i) Telstra's use of the court system, the access dispute process and the ACCC's undertaking process to create fear, uncertainty and delay

Our Clients consider that Telstra has continually engaged in unreasonable gaming tactics designed to hinder and delay the ACCC's arbitration of access disputes. This significantly adds to the costs of running a dispute for all parties, including the ACCC.

Apart from its actions during a dispute, Our Clients consider that actions such as Telstra's repeated lodging of ULLS undertakings at the same $30/month price despite a failed appeal to the Australian Competition Tribunal, are again designed to tie up the ACCC's resources and create delays in access disputes. Telstra is willing to use its considerable resources to run often weak legal arguments in the Courts. Even if Telstra does not win, the potential for extremely high legal costs resulting from litigation is frightening for Telstra's less wealthy competitors. Telstra's Federal Court appeal of the ACCC's LSS final determinations is a pertinent example of such action. In correspondence to Our Clients over the past several months concerning for example, access terms, Telstra has frequently referred to its High Court and Federal Court proceedings even when those clients were not parties to those proceedings. Seemingly, Telstra's implication is that Our Clients should not attempt to obtain competitive rates via an ACCC dispute as they will be running the risk of expensive litigation.

3. Combined effect of substantially lessening competition

As a result of the Combined Conduct described above, Telstra currently has the ability to offer ADSL2+ to approximately 600 exchanges that its competitors simply cannot viably access.

Until now, the clear precedent has been that if Telstra is a monopoly retail provider of a given broadband service over the monopoly CAN, eg. ADSL1, there is an onus upon Telstra to supply wholesale access at a price such that it is possible for Telstra's competitors to field an economically comparable retail service. This principle has driven the pursuit of two previous Competition Notices by the ACCC.

If Telstra does not offer wholesale access to ADSL2+ services and instead intentionally constrains the wholesale offering to offer every other speed except ADSL2+, Telstra will become the monopoly ADSL2+ provider to an overwhelming number of exchanges across Australia. There is no difference between the technology being used to deliver ADSL 1 or 2+. The difference is that wholesale customers have their wholesale ADSL services artificially constrained by their major competitor, so as not to be competitive with the Telstra retail products that are not speed constrained. It is not a question of "access" to DSLAMs or technology. It is a myth to think that these are technically different in any way.

Telstra has aggressively marketed ADSL2+ as being a superior product to ADSL1. Accordingly, there is little doubt that over the coming weeks and months many of Our Clients' existing customers, plus customers from every other Australian ISP, will be lured across to Telstra. Our Clients can provide evidence that this has already begun to occur.

This risk is particularly acute in respect of business customers given the greater requirement for upload speeds with business applications. Whereas Telstra's ADSL1 wholesale offering has an upload speed limit of only 384 kilobits per second, Telstra's retail ADSL2+ service supports up to 1024 kilobits per second in the upload direction (a 300% speed differential). This is likely to be a 'deal breaker' for many business customers.

Based on Telstra's current ADSL2+ retail offerings, it is apparent that once customers are lured across to Telstra, they will be locked in to lengthy fixed term contracts (usually 24 to 36 months), inhibiting customers from moving to an alternative supplier and thereby further discouraging any future entry or expansion by a competitor into the market.

Our Clients submit that this will almost certainly affect existing expansion plans, as, prior to deployment, they must be able to project adequate growth. If Telstra is able to offer a superior product and lock customers in to long term supply arrangements, a greater number of areas will be deprived of the choice of a competitive carrier.

This substantial lessening of competition will clearly have an adverse impact on consumers in terms of the price and the product offerings available to them in the long term. Telstra's BigPond ADSL2+ offering is already the most expensive ADSL2+ retail proposition in Australia. As a monopoly service provider, there will be nothing constraining Telstra from continuing to charge premium rates. Further, without competition, there is no incentive for Telstra to invest in future technologies or to continue to improve performance.

For these reasons, Our Clients request that the Commission urgently commence an investigation into the issuing of a Competition Notice under section 151AKA of the Act. Our Clients consider that the interim remedy until Telstra's Combined Conduct is addressed, is for Telstra to provide wholesale ADSL2+ access to all access seekers at a price no higher than the existing ADSL1 wholesale price.

Need for declaration of wholesale xDSL services under Part XIC of the Act

In its 2006 Fixed Services Review, the Commission concludes its consideration regarding wholesale xDSL declaration with the following statement:

"At this point, the Commission believes that certain issues surrounding the supply of wholesale DSL services remain, and that the wholesale markets within which both ADSL and BDSL services are supplied are not effectively competitive. This suggests there could be some potential benefits from service declaration. That said, the case for declaration is not currently overwhelming … There are certain risks involved in declaring wholesale services, particularly in terms of the effect on facilities-based competition and in light of possible future network developments. … The

> Commission believes that there is some further scope to consider these issues in future."[2]

One of the Commission's main concerns appears to be that declaration of wholesale xDSL may inhibit longer term competition by encouraging regulatory dependency on use of wholesale xDSL services and undermining incentives for facilities-based investment. However, as the Commission has itself recognised, this risk can be minimised by a non-ubiquitous declaration targeting only those areas where, for all of the reasons set out above, there is unlikely to be significant ULL-based or other network entry.

In light of Telstra's Combined Conduct and, in particular, the clear detriment that Telstra's withholding of wholesale ADSL2+ services will cause to the long term interests of end users, Our Clients consider that there is now a compelling case for declaration of wholesale DSL services. Our Clients request that the Commission urgently reconsider this matter by conducting a public inquiry under Part 25 of the *Telecommunications Act 1997* about a proposal to declare a wholesale DSL service under section 152AL of the Act.

Other options

Our Clients would also like to discuss other options to overcome Telstra's conduct and enhance competition that are available to the Commission or the Government, such as commencement of an enquiry into Telstra's structural separation.

Provision of evidence

We appreciate that in order to pursue an investigation into issuing a Competition Notice or a public inquiry regarding declaration of wholesale DSL services, the Commission will require evidence of a compelling case for such action. We are instructed that Our Clients can provide statements and evidence to support all of the claims raised in this letter and we are happy to commence collating that information for you if you so require.

Proposed actions going forward

We request that you contact Graham Phillips as soon as possible on 03 9641 8639 with a view to arranging a time when Our Clients, and we, can meet with you to discuss these very important issues for the industry.

Yours faithfully

HERBERT GEER & RUNDLE

cc (by email) Michael Cosgrave, Group General Manager, Communications, ACCC
Scott Hicks, Managing Director, Adam Internet
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[2] Ibid. p93.

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