

# ACCC INQUIRY TO MAKE A FINAL ACCESS DETERMINATION FOR THE WHOLESALE ADSL SERVICE

## CONGESTION ON TELSTRA'S ADSL NETWORK

### RESPONSE BY HERBERTGEER LAWYERS ON BEHALF OF ADAM INTERNET AND iiNET

#### PUBLIC VERSION

## 1. INTRODUCTION

On 5 September 2012 the Australian Competition and Consumer Commission (**ACCC**) issued an open letter seeking submissions from interested stakeholders on congestion on ADSL networks (**the ACCC's Letter**). This submission is provided on behalf of Adam Internet and iiNet (**our Clients**) in response to the ACCC's Letter.

The confidential version of this submission contains confidential information of Telstra and iiNet. All confidential information is marked as '[c-i-c]' and highlighted (in yellow for Telstra confidential information and in green for iiNet confidential information). This confidential information has been removed from the public version of this submission.

The ACCC's Letter was prompted by a submission that was made by Telstra relating to the effect of congestion on ADSL networks and the implications that this has for the terms and conditions of access to the declared wholesale ADSL service (**WDSL**)<sup>1</sup>.

It is submitted that the salient propositions in Telstra's Submission are as follows:

- ADSL networks are congestible<sup>2</sup>.
- Congestion leads to a degradation in end user experience<sup>3</sup>.
- Telstra and its competitors have been using price to manage congestion<sup>4</sup>.
- Telstra considers that the pricing principle that would best promote the long-term interests of end users is one that results in no substantial worsening of experience for retail and wholesale ADSL customers relative to current levels<sup>5</sup>.
- The retail minus pricing approach is less likely to cause material damage to customer experience in the form of congestion rather than pricing based on the Fixed Line Services Model (**FLSM**)<sup>6</sup>.
- An increase in regulated WDSL prices would best promote the statutory criteria because although end users would pay more for ADSL services, they would pay for a less congested network and a better customer experience<sup>7</sup>.

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<sup>1</sup>Telstra Corporation Limited Response to the Commission's Issues Paper (a second discussion paper) into the public inquiry to make a final access determination for the wholesale ADSL service: Pricing to Improve Customer Experience Public version 24 August 2012 (**Telstra's Submission**) at p.4.

<sup>2</sup>ibid, at p.4.

<sup>3</sup>ibid, at p.11.

<sup>4</sup>ibid, at p.12.

<sup>5</sup>ibid, at p.3.

<sup>6</sup>ibid at p.20.

<sup>7</sup>ibid at p.24.

Our Client's wish to put forward the following propositions on the issue of congestion as it relates to Telstra's WDSL network:

- Unbundling the Aggregated Virtual Circuit (**AGVC**)<sup>8</sup> is a measure that can ease congestion.
- If congestion on Telstra's ADSL network exists, it will present an opportunity for Telstra to discriminate against access seekers<sup>9</sup>. Accordingly, it should be made explicit in the WDSL Final Access Determination (**FAD**) that in taking measures to deal with congestion, Telstra must ensure that Telstra Retail traffic and access seeker traffic is treated in exactly the same way.
- Increasing prices for WDSL in the manner that Telstra suggests is inconsistent with the economic theory that Telstra itself relies on.
- The issue of congestion should not be considered in isolation from the existence of an uneven playing field between access seekers and Telstra Retail.
- If existing mechanisms to control congestion are failing to keep congestion at acceptable levels, the appropriate response is to make improvements to the network.
- The existence of congestion on an ADSL network does not mean that the ACCC should not set cost based prices for WDSL.

The remainder of this submission is in two parts:

- Part A provides further detail on our Clients' propositions above; and
- Part B sets out our Clients' response to the specific questions asked in the ACCC's Letter.

## **PART A - FURTHER DETAIL ON OUR CLIENTS' PROPOSITIONS**

### **1. Unbundling the AGVC**

Although our Clients acknowledge that unbundling the AGVC would not completely eradicate the possibility of congestion, unbundling the AGVC has the potential to ease or prevent congestion that occurs in transmission infrastructure from the exchange to the point of interconnection where competitive backhaul exists. In addition to easing any such congestion, unbundling of the AGVC would also have the advantage of encouraging investment in backhaul infrastructure and stimulating competition in backhaul markets. If a particular exchange service area (**ESA**) is suffering congestion, then the attractiveness of competitive backhaul is increased, as is the likelihood that a competitive carrier will have a business case to provide a service into the ESA.

### **2. The potential for discrimination against access seekers**

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Furthermore, Telstra has the ability to select the data path that traffic on its network takes. Our Clients submit that in order to ensure equivalence between Telstra Retail and access seekers, the WDSL FAD should include a term that expressly states that Telstra will provide

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<sup>8</sup> Note that for ease of expression a reference to an AGVC includes a reference to a VLAN as appropriate.

<sup>9</sup> Note that for ease of expression a reference in this submission to an 'access seeker' is a reference to an acquirer of WDSL.

WDSL to access seekers on the same data paths, the same geographic paths, and subject to the same network congestion controls as Telstra Retail.

### **3. Increasing prices for WDSL in the manner that Telstra suggests is inconsistent with the economic theory that Telstra itself relies on**

Our Clients note the following statement in the economic expert report relied on by Telstra (emphasis added and footnotes omitted)<sup>10</sup>:

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When considering what the appropriate pricing structure for WDSL should be, it is important to keep in mind that the WDSL service is a layer 2 service. It is respectfully submitted that unless the service description for WDSL is changed so that it becomes a layer 3 service, the Gowrisankaran Mackie-Mason Proposition provides absolutely no assistance in the debate on how to deal with congestion on Telstra's ADSL network. This is because according to Telstra's Submission<sup>11</sup>, Telstra can only measure customer usage at layer 3. Therefore, what Telstra's economic experts consider to be optimal congestion charging for WDSL is not possible. It is respectfully submitted that Gowrisankaran and Mackie-Mason's evidence may have been more helpful if they had been made aware of this basic fact.

### **4. The issue of congestion should not be considered in isolation from the existence of an uneven playing field between access seekers and Telstra Retail**

The following two facts are stated in Telstra's submission:

- the AGVC charge is having an impact on access seeker customer usage at peak times<sup>12</sup>; and
- Telstra Retail charges its customers additional fixed monthly fees for high traffic content such as Foxtel supplied over T-Box<sup>13</sup>.

Two things should be noted as regards these two facts. Firstly, due to the AGVC charge, it is not economically viable for access seekers to offer their customers the high traffic content packages that Telstra Retail is able to offer to its customers<sup>14</sup>. Secondly, it is unclear whether the price that Telstra Retail charges for these high traffic content packages is sufficient to account for the disutility that results from the use of such packages as regards other users of the network<sup>15</sup>. Given that it is not economically viable for access seekers to offer comparable packages at comparable prices, it is submitted that either, or both, of the following must be correct:

- the AGVC price is too high; or
- the price that Telstra Retail charges for high traffic content is too low.

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<sup>10</sup> Efficient Pricing of ADSL Wholesale Services - Gautam Gowrisankaran and Jeffrey MacKie-Mason, 23 August 2012, at p.20.

<sup>11</sup> Telstra's Submission at p.19.

<sup>12</sup> Telstra Submission at p.18.

<sup>13</sup> Telstra Submission at p.19.

<sup>14</sup> See Submission by Herbert Geer Lawyers on behalf of Adam Internet Pty Ltd, iiNet Limited, Internode Pty Ltd, Primus Telecommunications Pty Ltd, and TransACT Communications Pty Ltd in response to the ACCC discussion paper of December 2011 into whether wholesale ADSL services should be declared under Part XIC of the Competition and Consumer Act 2010, at pp 5-8.

<sup>15</sup> Note that on the basis of Telstra's own economic theory, this is unlikely to be the case given that it appears that Telstra charges a fixed monthly fee rather than having a 'the more you use, the more you pay' pricing structure.

Further evidence of this uneven playing field is that due to the constraint applied by the AGVC charge, many access seekers, including our Clients, include peak/off peak quotas in their retail plans. As such, access seekers already deal with congestion issues by implementing plans designed to reduce AGVC charges, which reduces traffic on Telstra's ADSL backhaul network. Access seekers buy sufficient AGVC to satisfy peak usage and design retail plans to manage and limit the need to purchase a higher level of AGVC at the wholesale level. This can be contrasted with Telstra Retail, which does not face an AGVC charge and which does not include any peak/off peak quotas in its retail plans but provides unmetered IPTV products to its customers<sup>16</sup>.

In light of the above, our Clients submit that due to the uneven playing field between Telstra Retail and access seekers, Telstra Retail is disproportionately contributing to congestion. Therefore, any attempt to deal with congestion by increasing wholesale pricing is likely to make the playing field even more uneven, with resultant negative effects on competition.

**5. If existing mechanisms to control congestion are failing to keep congestion at acceptable levels, the appropriate response is to make improvements to the network**

Given that there is clear evidence that access seekers are already engaging in congestion charging at retail level, as well as using peak/off peak quotas<sup>17</sup>, it is submitted that WDSL pricing already accounts for congestion to the maximum extent possible given that it is not possible for Telstra to charge wholesale customers for usage. In light of this, it would seem clear that the ACCC should not artificially inflate WDSL prices as a way of dealing with congestion. This is for two reasons.

Firstly, such an approach is highly debatable from a social utility perspective. This is because there is no guarantee that an arbitrary increase in wholesale prices would lead to prices being set at an optimal level, and it could simply mean that either:

- end users end up paying more for the same service; or
- some end users are priced out of using what is now being increasingly seen as an essential service in circumstances where they would not have been priced out of using the service if optimal prices were available.

Secondly, due to the uneven playing field discussed in the previous section of this submission, any increase in WDSL charges would be damaging to competition.

Therefore, the policy that would best promote the LTIE is one that seeks to achieve a level playing field between Telstra Retail and access seekers and deals with congestion by means of existing mechanisms, and where these are not sufficiently effective, encourages efficient investment in infrastructure.

In light of the above, the ACCC should adopt cost based pricing for WDSL and allow the problem of congestion to be dealt with by the existing mechanisms that are being deployed at retail level as well as by the upgrading of infrastructure (where existing mechanisms are not effective).

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<sup>16</sup> <http://www.telstra.com.au/tv/tbox/terms/>  
<http://www.telstra.com.au/tv/foxtel-from-telstra/products-services/#tab-on-demand>

<sup>17</sup> Telstra's Submission at pp 16-18.

## **6. The existence of congestion on an ADSL network does not mean that the ACCC should not set cost base prices for WDSL**

Telstra puts forward four reasons as to why applying the ACCC's FLSM to WDSL would 'substantially harm the statutory criteria'<sup>18</sup>. In summary these reasons are<sup>19</sup>:

1. In Telstra's view the ACCC has adopted an incorrect approach to unitising annual costs.
2. The building block framework is not suited to dynamic markets such as ADSL.
3. The FLSM would need to account for truncated asset lives due to the NBN.
4. Current prices for ADSL are comparative to the prices for comparable NBN services. If the application of the FLSM were to result in a change in wholesale ADSL prices, then this would impact the incentives for customers to migrate to the NBN. The implications of any change to the timing of customer migration from Telstra's network to NBN Co's impact the timing and therefore present value of NBN Co's costs and revenues.

As regards 1 above, even if Telstra is correct (which our Clients do not accept) on this point, this should not lead to a rejection of the FLSM model as a whole. Rather, it would require any errors in the model to be corrected through existing regulatory review mechanisms.

As regards 2 above, as relevant to congestion, what is important is that Telstra is able to recover its efficient costs (including a reasonable return on capital). There is no reason why the ACCC could not adopt an adjustment mechanism to deal with unpredicted additional expenditure on network infrastructure to deal with congestion.

As regards 3 and 4, these issues are not matters that relate specifically to the issue of congestion. These issues have no doubt been raised and considered in previous consultations on the FLSM.

As regards the economic expert report from Frontier Economics on which Telstra relies<sup>20</sup>, it is respectfully submitted that this simply amounts to no more than saying that retail minus retail cost pricing methodology (**RMRC**) is the easier option for setting regulated pricing. However, against this must be weighed the fact that adopting RMRC in the WDSL FAD would fly in the face of the clear regulatory policy that the ACCC has adopted for all other fixed line services after considerable analysis and industry consultation. It is respectfully submitted that expediency is not a sufficient justification to depart from this clearly established regulatory policy.

## **PART B - ANSWERS TO SPECIFIC QUESTIONS IN THE ACCC'S LETTER**

### **1. Telstra's submissions that ADSL networks are subject to congestion**

Please see Part A above.

### **2. How congestion in ADSL networks should be measured or quantified**

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<sup>18</sup> Telstra's submission at p.22.

<sup>19</sup> *ibid* pp 22-23.

<sup>20</sup> Frontier Economics - ADSL network congestion pricing and use of RMRC - A report prepared for King & Wood Mallesons - August 2012.

Congestion is difficult to quantify, and ultimately it may be necessary to rely on customer feedback.

### **3. How congestion on ADSL networks impacts end-users**

Our Clients agree with the effects of congestion on end users as described in Telstra's Submission.

### **4. How congestion on ADSL networks affects you as an access provider and/or access seeker of wholesale ADSL**

There are a number of ways in which the congestion affects the access seeker, including (but not limited to):

- Increased call centre costs from increased customer contact.
- No visibility on congestion occurring at a deeper network level.
- Impacted quality of provided services such as VoIP.
- Reputational impact as a result of degraded quality of service.

If an access seeker is not treated identically to Telstra Retail, then a level playing field is not provided for and the access seeker is disadvantaged as a result. See also section 2 of Part A above.

### **5. How the ACCC should account for congestion in making the FAD and determining prices for wholesale ADSL**

Please see sections 3, 4 and 5 of Part A above.

### **6. The extent to which wholesale ADSL prices affect congestion**

Please see sections 3 and 4 of Part A above.

### **7. The extent to which current wholesale ADSL prices reflect the cost of network congestion**

Please see section 3 of Part A above.

### **8. The extent to which current retail prices reflect the social cost (i.e. the impact on other network users) of network congestion**

Please see section 3 of Part A above.

### **9. The effectiveness of retail ADSL plan prices and caps to manage ADSL network congestion at peak usage times**

Our Clients believe that any measure that restricts usage or incentivises off peak usage, will have a positive effect on congestion. However, these measures are unlikely to work effectively unless Telstra Retail has the same incentives as access seekers to implement such measures. Despite what Telstra says in its submission about the effectiveness of peak/off peak quotas, the effectiveness of peak/off peak quotas should not be dismissed out of hand. **[c-i-c]**

## **10. Other possible measures to manage ADSL network congestion**

Please see section 4 of Part A above.

**Herbertgeer on behalf of:**

**Adam Internet  
iiNet**

**19 October 2012**