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INTERPRETATION

ACCC means the Australian Consumer and Competition Commission.

CLCs means Carrier Licence Conditions (Networks supplying Superfast Carriage Services to Residential Customers) Declaration 2014.

LTIE means long-term interests of end users.

Market means the market for superfast broadband services to residential end-users.

NBN means the national broadband network and NBNCo as is appropriate to context.

SFBS mean superfast broadband services to residential and users.

TA means the Telecommunications Act 1997 (Cth.)

TRP means the Telecommunications Reform Package 2017.

INTRODUCTION

This document is Spirit Telecom's (*Spirit*) response to the Telecommunications Reform Package announced by the Minister for Communications on 12 December 2016. The Exposure Drafts of proposed regulation and accompanying Regulatory Impact Statements discuss the competitive importance of small-scale, innovative providers (*SSPs*) but do not adequately appreciate the relative impact that the proposed options in regulatory reform will impose upon those important participants.

Small-scale providers of superfast broadband services to residential customers shall be overly impacted and impeded by the proposed amendments to the level playing field rules and by the Regional Broadband Scheme impost, combined with the regulatory burden of contemporaneous ACCC declaration of SBAS. In particular, the proposed 11% tax¹ by levy on revenue will be unsustainable, particularly when combined with the indirect impost of creating structural, or quasi-structural, separation. Both direct and indirect imposts are unnecessary to achieve the government's objectives and should not be applied to small-scale providers because they are important in driving competition benefits such as quality of service improvements.

The impact of each element creates barriers to new entrants and shall suppress the viability of existing small-scale innovative broadband providers, due to the combination of all pillars of regulation, including combination effects with SBAS declaration.

Enabling small-scale providers through exemption is recognised as important for competition reasons and so was embodied in the level playing field design from the 2010 package of legislation, even though its dominant purpose was to protect NBN's viability from the effect of substantial "cherry picking" conduct. Innovative smaller providers were recognised to not threaten the viability of the NBN, whereas such conduct by larger providers would. Hence, small-scale providers that are important for competition reasons were intended to be exempted, to prevent disproportionate regulatory effects. Small-scale suppliers provide drivers of competition in a highly-concentrated market without jeopardising the NBN business case. They are better able to introduce alternative and innovative technologies, implement supply more quickly and address smaller segments of the market. They are important to provide a contrast to any potentially inert monopolist conduct delivered almost completely through a handful of dominant resellers.

¹ Based on a \$7 levy against an ARPU of \$65

What is a small-scale provider in an addressable market of approximately 12 million premises?

Such a supplier is not likely to have less than 100,000 services, or less than 1% of premises. Notwithstanding this, the proposed levy threshold of 2000 services, in a market of approximately 11.9 million premises², appears grossly incongruent to the relative size of the small-scale providers and, therefore, questions the Contestability³ of such a minute threshold.

Even at a threshold of 100,000 services a small provider would not present any challenge to NBN's viability, but would motivate quality of service competition, particularly through innovation.

Cogent examples of the benefits of quality of service competition are starkly visible in the impaired data transmission experience of many end users, who have migrated to NBN. There are public expressions of frustration and dissatisfaction from numerous consumers, discovering that NBN based contention impairs their data transmission speeds, to lower than previously experienced on the decommissioned copper network. Their expectation was that they would enjoy reliable superfast broadband. By contrast, that is what an innovative small-scale provider, such as Spirit, delivers to its consumers' enjoyment. It demonstrates a standard for NBN to achieve.

BACKGROUND INCLUDING SPIRIT HISTORY

Spirit Telecom is a small licensed carrier and retail service provider, servicing customers in high and medium-density inner metropolitan areas of Melbourne, Brisbane and Sydney and, to a lesser extent, Australia-wide. Its business model was established before 2011, initially utilising pre-2011 networks, exempt from Part 8 of The Act, at locations where unmet demand impelled provision of superfast broadband services.

Spirit has been recognised as the fastest overall Internet Service Provider⁴ in Australia and set the standard in Superfast Internet, by servicing buildings with unlimited data on synchronous plans, with common speeds in excess of 100/100Mbps.

Spirit's business model is somewhat atypical, in that it services those customers:

- not via a fibre network it owns or controls;
- or by reselling a specific wholesale offering from another Carrier or Carriage Service Provider;
- but rather by engaging wholesale operators of pre-existing fibre networks in to carry its traffic, from buildings that it services to Spirit equipment that is located in third party data centres, and using those specific buildings' pre-2011 existing Ethernet cabling to service premises in those buildings. Spirit then arranges from its data centre equipment distribution and termination of that traffic to other destinations.

Spirit does not own a physical wide area network (i.e. the network footprint outside of any particular building it services) of the kind that the level playing field restrictions are directed toward. Its broader footprint is virtually its wholesalers' compliant fibre networks. Since a recent acquisition of an even smaller competitor, Spirit also operates a number of rooftop radios that transport some traffic between buildings.

² NBN Corporate plan 2017

³ Dept of Communications: 'Regulation Impact Statement: Establishing an ongoing funding arrangement for nbn's fixed wireless and satellite networks' December 2016. Page 5

⁴ PC mag 25 August 2015

Spirit's activities in buildings:

- do not constitute vertical integration
- do not show characteristics of a natural monopoly, or
- do not use a bottleneck technology.
- Represent the Long Term Interest of the End user

Spirit's speeds, reliability and service have been recognised as superior to that of the NBN. Spirit's standard offering is synchronous speeds, unlimited plans, and much less contention, due to the lack of NBN CVC charges. From a price perspective Spirit is recognised as being a lower priced provider, to the end user, against 'High Allowance NBN packages' and 'High allowance non-NBN superfast broadband offers'⁵.

In September 2015, the Prime Minister, when Minister for Communications, recognised that Spirit's activities were not captured by Parts 7 and 8 of the Telecommunications Act 1997 (Cth.) **(TA)**. Nonetheless, regulatory uncertainty about the application of Part 8 of the TA has impeded its service development even though as a small-scale provider, Spirit brings and does not preclude competition.

In June 2016, Spirit attracted investment to develop its services as it became a public company whose securities are listed on ASX. Since that time, Spirit has continued investing in developing its business providing superior superfast broadband quality of service to consumers at competitive values.

NBN resellers, TPG and other competitors enjoy unimpeded competition at sites where Spirit operates. None of those competitors, or any potential competitors, have made any enquiry to Spirit about access or wholesale over Spirit networks, as they have preferred utilising their usual alternative technologies.

Defects in delivery of NBN services (mentioned above) at the present time are matters causing serious public concern.

IMPORTANCE OF SMALL-SCALE PROVIDERS IN THE NBN LEVEL PLAYING FIELD SCHEME

Mr Rod Sims, Chair of the ACCC, has stated the importance of such providers participating in the market and, that it is important that such providers ensure at least same service outcomes as would be available through the national broadband network **(NBN)**.

The small-scale provider exemptions adopted by the ACCC affirm the importance of such small-scale innovative providers, to the long-term interests of end-users. Accordingly, Spirit's contribution to quality of service improvement through competition is important, although its presence does not have any material effect on the NBN business case.

As proposed, this package shall set minuscule innovative providers thresholds that relieve competitive pressure upon the ubiquitous NBN and its massive dominant resellers.

Competition is necessary to drive service improvement in the long-term interests of end-users. Small-scale providers have led quality of service in superfast broadband.

MARKET SEGMENTS

In the Superfast Broadband Access Service (SBAS) declaration inquiry, published by the ACCC 1 July 2016, four product segments were tabled:

⁵ ACCC. 'Superfast Broadband Access Service declaration inquiry Final Decision'. July 2016. Tables 3.4 & 3.6

1. Entry level NBN packages⁶
2. High allowance NBN packages⁷
3. Entry level non-NBN superfast broadband offers⁸
4. High allowance non-NBN superfast broadband offers⁹

It therefore stands to reason that segments of market participants follow a similar logic;

1. Small (<20,000 subscribers) NBN participants
2. Large (>20,000 subscribers) NBN participants
3. Small (<20,000 subscribers) non-NBN superfast broadband participants
4. Large (>20,000 subscribers) non-NBN superfast broadband participants

Segment 1 above, occupies 2% of the NBN services;

Segment 2 above, operates 98% of NBN services;

Segment 3 is occupied by 13 providers – a combination of wholesale only, and retail only¹⁰, including Spirit;

Segment 4 is operated by mainly wholesale only providers (LBNCo, Open networks), save for TPG.

These segments are the basis of the SSP and are referred to throughout this submission.

Equity of Competition and Access at Spirit Sites

Competitors do not require access to any of Spirit's infrastructure in order to provide competing services in buildings. Hence, given networks are frequently owned by third parties and available to Spirit's competitors but have preferred to deliver via competitive platforms such as NBN and VDSL. Either functional or structural separation over reaches and reduces small-scale provider capability. Therefore, concern apparent in this reform package and contemporaneous SBAS declaration to ensure competition by means of structural or functional separation is misconceived given the ease with which Spirit's competitors have established delivery of their services without regard to or impedance from Spirit's in-building network activities.

2017 TELECOMMUNICATIONS REFORM PACKAGE

GOVERNMENT OBJECTIVES

In high-level summary, the government seeks through this package that -

- Regulation should allow competition at both the retail and wholesale infrastructure levels.
- To the greatest extent possible, industry players should be treated consistently under the regulatory framework.
- New high speed broadband access networks (which control 'last mile' connections to consumers) should be vertically separated.

Competition is not assisted by unrealistic thresholds for exemption from level playing field restrictions

Without ensuring the viability of small-scale providers there shall be less incentive to invest in improving quality of service by NBN as a quasi-monopoly. TRP 2017 conceptualises small-scale providers as having less than 2000 services. That is unrealistic and an unsustainable level of activity which will substantially inhibit SSP competitors and the LTIE benefits they supply. The thresholds

⁶ SBAS Page 23 - Table 3.3 Entry level NBN packages

⁷ SBAS Page 23 – Table 3.4 High allowance NBN packages

⁸ SBAS Page 24 - Table 3.5 Entry level non-NBN superfast broadband offers

⁹ SBAS Page 25 – Table 3.6 High allowance non-NBN superfast broadband offers

¹⁰ SBAS Page 5 – Table 1.2 Fixed-line superfast broadband network operators.

must provide a realistic incentive to be in business and even the initial cap of less than 20,000 superfast services for SBAS exemption, set by ACCC, was insufficient. Its recent reduction to 12,000 services, at the urging of NBNCo, which seeks removal of all small-scale provider exemption along with competitions benefits, was misconceived. The threshold adopted in this reforms package is just 1/10th of that initially adopted by the ACCC and no rationale is apparent for such an unrealistic limit, which is up more likely to jeopardise, than encourage investment in small-scale providers.

What is a small provider in this enormous addressable market for supply superfast broadband services to residential end-users? Scale is relative and, a provider with 100,000 customers would be so small that it could not present threat to the NBN business model. Providers with 20,000 end users would not reach the concept of a small service provider, which was importantly contemplated in the design of the level playing field legislation leading up to 2010. The low number of micro sized participants (less than 15, mostly wholesale only) over the ensuing 8 years demonstrates that that there are only micro sized, innovative providers in this difficult market despite its enormity.

Note the broad ranging saving power of Ministerial exemptions yet this reform package eliminates that merit-based preservation of competition. That saving mechanism enabled relief for the establishment of innovative providers in the long-term interests of end-users and so prevented unintended anti-competitive effects that can occur.

Whatever the definition of a smaller scale provider, the reality is that significant elements of this telecommunications reform package defeat those objects patently expressed in the explanatory memorandum of the 2010 legislative package, which established level playing field rules. They are complex and have provided regulatory uncertainty as to viability of entrants even though very few small-scale superfast broadband providers to residential end-users exist before the proposed imposition of such minute thresholds.

IMPACT OF \$7 LEVY

The government seeks to identify how best to sustainably fund non-commercial broadband services in regional Australia and proposes a regional broadband service funding levy of \$7 per potentially superfast service.

The government cannot achieve its objectives of -

- contestability
- economic efficiency of infrastructure investment
- competitive neutrality
- sustainability
- equity

by taxing the very small service providers with the same blunt impost as applied to Telstra, Optus and TPG. SSPs cannot achieve comparable scale economies. The contestability of such a levy on the SSP segment is unsustainable and uncompetitive.

The imposition of the \$7 levy on small service providers results in an immaterial contribution to \$9.8b regional broadband funding costs but shall materially suppress contestability through innovative competition.

Based on the NBN objective to address 11.9 million premises and analysis indicating that 98% of the current superfast services market is concentrated in the hands of Telstra, Optus and TPG, then 13 small service providers project to deliver approximately 1.1% of the RBS

five year funding¹¹. Not only can such a minor percentage be achieved through reasonable NBN spending cuts, the levy's predatory nature illustrates a desire to remove small players altogether.

At the proposed 2000 service threshold, the immateriality of the contribution to the RBS, by the SSP's, is almost incalculable. Future sustainability of small-scale providers will be at serious risk if there are further increases in the levy which are available to the Minister. Applying the impost as soon as the provider reaches such a minute threshold of 2000 services appear likely to deter entrants, rather than enable them for competition reasons. Note that if a provider reaches 2000 capable services, which could be low value, non-superfast services, without any economies of scale, that provider is then taxed at the same level as dominant providers Optus and TPG. Bearing in mind that this blunt impost will be imposed on non-superfast, lower value services because they sit on potentially superfast lines, \$7 could represent up to 20% of an individual service's revenue and effectively eliminate its positive net margin.

Recommendations concerning impost of Regional Broadband Funding Scheme.

The \$7 tax upon providers greatly reduces the ability of small-scale providers to develop. While they do not threaten the NBN business case, this immaterial contribution to the cost of regional broadband rollout may impact the short to medium term future of the 13 small-scale providers in the market. Although not intentional, that appears to be a reckless course as such an impact on small scale providers is not in the interests of end-users.

WHILE THE BENEFITS FROM SSPs ARE RECOGNISED, THRESHOLDS ARE UNREALISTIC

Although this telecommunications reform package recognises and seeks to preserve the existence of such small-scale innovative competitors in the long-term interests of end-users, considered separately, the elements of this package will impair their viability once they reach 2000 services (whether or not those services provided are superfast broadband). In combination with other contemporaneous regulatory developments, such suppression of important innovative activity will operate against the LTIE.

If the threshold is not raised, new entrants will be deterred and the viability of existing small scale providers are stressed

Regulators shall always be urged to apply unviable lower thresholds for small scale providers in order to eliminate their competitive presence

The combined effect of unfavourable regulatory reforms upon these innovators will be further exacerbated if the ACCC maintains its express intention to reduce the SBAS threshold for small service providers to 12,000 because that is unviable. In any event the Commission's levels demonstrate that there is no case for restricting thresholds to 2000 services. Such a business case could not appeal to an entrant and fails sustainability test for current smaller scale market participants. The TRP maximum threshold of 20,000 services was set for consistency with the ACCC's Interim Final Access Determination. It is wholly inconsistent to immediately reduce that threshold by 90% to 2000 end-users and express the intention to not review it upwards in the foreseeable future despite having the power.

¹¹ Based on 13 SSP's with, say, 20,000 services at \$7 levy over 60 months (5 years); divided by the 9.8Billion requirement.

COMPETITION RISKS IN CHANGES TO LEVEL PLAYING FIELD PROVISIONS OF PART 8 OF TA AND TO CLCs

Intent of Part 8 in 2010 legislative package

Level playing field regulation has allowed a retail oligopoly outcome while limiting enterprise opportunity for SSPs providing quality of service competition.

It is well known that as end users are aggregated to NBN and 98% of the market for superfast broadband services is now in the hands of three major providers. Goldman Sachs report that Telstra's market share of super fast broadband services has increased to a greater proportion than its overall market share in telecommunication services. Telstra's transition to this quasi-monopoly platform has is advancing its dominance even within the 98% oligopoly. Competition is diminishing in favour of this oligopoly layered upon an underlying infrastructure monopoly.

This is a typical outcome of a market dominated by an oligopoly with starkly different economies of scale between participants.

Inconsistent with their importance, the package increases the difficulties of the small service providers in addressing the remainder 2% of the market. There is no need a more realistic exemption, for example, 100,000 services from approximately 12 million premises to allow some scale across which to absorb the regulatory impacts.

Despite the presence of competitors in Spirit's locations, there has been and remains no demand for access and wholesale services to satisfy. Spirit does not deter such competition in any case. This is a regulatory response to presumed circumstances that are absent at the cost of suppressing competition benefits.

SSPs should be exempted as a providers having less than 20,000 services before being put to this additional level of margin contraction from this reform package. Amendments to Carrier Licence Conditions also present an opportunity to remove such counter-productive requirements.

Part 8 preservation of the important role of small innovative providers is effectively removed by the minuscule threshold levels

Part 8 was provided with an important facilitator by way of Ministerial exemption. Setting the threshold for exemption at 2000 services in the long-term, shall prevent small-scale providers gaining any economies of scale. It shall deter entry of innovative competitors and, may lead to exit of any of the small number of non-NBN superfast broadband providers. In absence of SSPs, there is effectively subliminal competition between service offerings, quality and value. This is a matter that should be determined in the circumstances by the Minister from time to time. Otherwise regulatory response is likely to lag the evolution of market competition.

It is clearly intended to not raise the threshold of exemption to small-scale providers in the short or medium term future. Yet, 20,000 services represents a minuscule proportion of the addressable market. If the threshold was 100,000 that would remain unable to have any effect upon the business case of the NBN but nonetheless able to set a standard for quality of services in the long-term interests of end-users.

Then, given the likely unmanageable regulatory burdens that apply once only 2000 services is reached, it is almost impossible to foresee any new entrants. Such ventures must compete

predominantly against providers that have accumulated several million customers in mature, varied and complex businesses that have attracted enormous capital.

The capability of SSPs resourcing for heavily regulated measures, when introduced, shall be severely diminished by the blunt impact of revenue diversion and margin contraction by the this flat, inelastic tax which can vary from 10 to 25%, regardless of the elastic value of the customer's service selection. Without mature capital and business models with wholesale or numerous other products and service lines through which to amortise margin contraction, junior retail service providers are likely to further vacate the market more swiftly than regulatory monitoring and modification can address, preserving an oligopoly of, apparently, three competitors.

The reform package amendments to CLCs and Part 8 are designed to bring about an equitable result, that all persons desirous will be able to receive access to superfast broadband services by imposing extensive regulatory burdens that operate in combination with other pillars of regulation upon the most important small-scale innovators. Legislating structural and even functional separation of small-scale providers is unnecessary to achieve and does not serve those interests, but rather works against their important role in maximising quality of data transmission services for consumers' rising needs.

Small-scale providers cannot harm the NBN investment model but overregulation can severely impact smaller scale provider competition.

A combination of contemporaneous regulatory reforms may have addressed government objectives but in actuality pose unintended anti-competitive effects upon small-scale innovative providing competition benefits to the long-term interests of end users.

The government's objectives have also been significantly addressed by the ACCC's declaration of superfast broadband access service (**SBAS**). It is clear from its interim Final Access Determination exemption, initially of suppliers of less than 20,000 services and later 12,000, that the ACCC sees that in the case of small-scale providers this objective has been achieved and that SSPs remain important to advance interests of end users through driving necessary competitive conditions and outcomes.

SSPs promote additional investment in infrastructure with revenue from retail operations segments. Otherwise such investment would be constrained to that available from wholesalers.

The government objectives include contestability anticipating that access and competition inhibitors such as bottlenecks and vertical integration that favour retail operations of network operators but those presumed impediments to competition are absent.

These reforms seek to remove presumed bottlenecks and competition restrictions available to small-scale providers in "islands" of network locations. They do not exist in Spirit's activity. They are presumed to exist in the few small-scale SFBS retail providers but, in Spirit's example, it does not present any competition challenges to other superfast providers, as it is not vertically integrated, does not have a natural monopoly and does not present bottleneck issues. Therefore, other competing providers freely enter the sites where Spirit is present without any interest in wholesale or access to Spirit's in-building networks. Hence the government's objective of promoting infrastructure investment competition to ensure outcomes at least equivalent to those of NBN end users has been already met. In effect, those objectives were redundant prior to these reforms due to absence of such presumed impediments to competition in Spirit's activities. By contrast, Spirit is of importance as a small-scale provider of innovative quality services. Without such smaller providers, there would be less incentive to differentiate service offerings in the LTIE in improving quality of superfast broadband residential services.

In contrast to the typical deployments that the level playing field restrictions were intended to prevent, Spirit's technical and contractual arrangements do not impede wholesale competition from the NBN or any other wholesale or retail provider reselling NBN reseller or utilising alternative technologies, such as PSTN, ADSL, ADSL 2+ or VDSL.

IMPORTANCE OF SMALL-SCALE PROVIDERS IN THE NBN LEVEL PLAYING FIELD SCHEME

Promotion of infrastructure investment and competition-driven accretes to the LTIE

Without such quality of SSP competitors NBN's monopolistic character can mitigate against the government's objectives. NBN advocates extracting the few small-scale competitors from the market arguing that as being necessary to sustain its viability against immaterial impacts from their minuscule providers. On the other hand, NBN and its resellers exploit scale to defeat the small providers. If it is unnecessarily protected, there shall be a lack of competitive drive impacting NBN and its dominant resellers to improve its offering in the interests of consumers.

Protection of NBN business case from innovative small scale providers through level playing field restrictions is now unnecessary

It is well known that end users are aggregated to NBN through those major providers, and competition is diminishing in favour of a developing oligopoly layered upon an underlying wholesale monopoly.

The dominant purposes of the level playing field provisions of Part 8 in preventing cherry picking competitors of the NBN are well-known. But it was a clearly articulated concern that there should be small-scale, innovative providers in the long-term interests of end-users. Such SSPs should be supported by exemption in order to ensure that disproportionate effects and inefficiencies do not operate to suppress their competition with the long-term interests of end-users upon the establishment of the NBN.

Whatever the definition of a smaller scale provider, the reality is that significant elements of this telecommunications reform package defeat competition objects patently expressed in the explanatory memorandum of the 2010 legislative package which established level playing field rules. They are complex and have provided regulatory uncertainty as to viability of entrants even though very few small-scale superfast broadband providers to residential end-users exist before the imposition of these minute thresholds.

CUMULATIVE EFFECT OF COMBINED REGULATORY REFORMS SHALL HAVE GREATER IMPACT THAN RECOGNISED WHEN CONSIDERING ANY SINGLE ELEMENT

The impacts of each pillar of regulatory reform under consideration appear to have been assessed according to isolated rather than cumulative effects. While the impact on each pillar may appear manageable by SSPs, without scale the effect of the combined reforms is not justified.

Combined with the effects of SBAS declaration, the impacts of each pillar of the TRP are magnified when acting in combination upon micro providers as determined by the minuscule thresholds for exemption. Yet these regulatory burdens are applied to providers who may never attain economies of scale to absorb effects such as a flat tax per potentially superfast services regardless of their revenue or margin value to the provider.

Just when needed to drive quality of service beyond current adverse outcomes that are frequently described as unreliable and inadequate, the benefits of small-scale providers may be suppressed.

{Most concerning, the 50 metre limit in these reforms will retard and possibly freeze expansion of Spirit's offerings to any new location, that is, it could strand Spirit's business development and investment in its existing networks from reaching new locations within its existing footprint or even within some high-rise buildings. This is unnecessary because it is now proven that Spirit and similar providers are, and shall remain minuscule in an estimated addressable market of approximately 12 million premises while having no effect on the NBN business case.}

CONCLUSION

The elements of each reform may be considered separately but their effects are not siloed. They combine to exacerbate margin subtraction and suppression of small-scale providers competing in the market for sufficient weight is not given you my impact was requirements when combined with SBAS declaration requirements. It appears sufficient weight has not been to the accumulated impact of these requirements being layered upon providers that service approximately 2% of the market. Yet the presence of innovative small service providers make significant contribution to improvement of services in the long-term.

The proposed reform measures will not support the government's objective of promoting efficient infrastructure investment by small service providers if it deters their entrance and sustainability in the market.

The telecommunications reform elements discussed serve to restrain small service providers from innovative competition in favour of protecting NBNco and its dominant resellers from superfast broadband quality of service competition which is in the long-term interests of end-users.

Yet it is having been demonstrated that as a small service provider, Spirit Telecom poses no restriction to competitor entry into its discrete, market segments.

The proposed levy shall be a damaging tax if applied to small scale competitors in order to reap 1% contribution to the estimated \$9.8 billion cost for regional broadband networks. Government's funding challenge would be far better advanced by ensuring cost discipline within NBN expenditure then by adopting these proposals that damage consumer's long term interests.

RECOMMENDED COURSE: Spirit prefers Option3 but will support Option 2 with realistic thresholds.