CCC

COMPETITIVE CARRIERS' COALITION Inc

Submission to the Draft Indicative Fixed Line Prices

October 2009

Uncertainty and the Risk of Inappropriate Lock-In

Since the release of the draft indicative prices in August, the Government has revealed the most profound set of regulatory changes in telecommunications for 12 years.

These changes, if passed into law, include elements that go to the powers of the Commission and directly influence the future arrangements both for determining prices and the powers under which the Commission will be able to apply them.

Importantly, the Commission will be provided with the power to determine prices, and not be required to publish only indicative prices that may or may not be later enforced through bilateral arbitrations.

Further, these decisions will not be subject to merits review. The Commission will continue to be guided by the long term interests of end users test, but the legislation also facilitates the Commission's ability to move to a regulated asset base methodology rather than persisting with the TSLRIC, modeling-based approach. This comes in the context of the Commission itself arguing that TSLRIC is becoming increasingly irrelevant to the industry circumstances.

The draft indicative prices appear to rely heavily on the Analysys model outputs and give little weight to other considerations, such as the benchmarking work. This seems somewhat at odds with the comment from the Commission in April that:

> Cost models are a useful tool for the Commission in performing its statutory undertaking and arbitral functions. Typically they have not been the sole input in determining appropriate prices for declared services. [1]

The CCC concludes that the Commission has been influenced by the history of constant and repeated appeals of Commission decisions by Telstra over the past four years, and the threat of future appeals, to take a more conservative approach to determining the appropriate rate of indicative prices than it might have. If this is a consideration, the Government proposes to make such concerns irrelevant in future price determination processes.

The announcement of the NBN in April has also been followed by increasingly public activity from the NBNco itself since the indicative prices were released in August. Further, Telstra's most recent appeal to the Competition Tribunal on its ULLS undertaking is awaiting judgment.

All of these conditions have created a situation where uncertainty is at an historic high.

In these circumstances, the CCC believes it would be inappropriate for the Commission to publish indicative prices for three years. The CCC submits that in its final decision, the Commission should publish indicative prices for one year only. Circumstances are

[1] Michael Cosgrave letter to Tony Warren April 2009

changing so quickly that it is highly unlikely that appropriate rates for years beyond that can be established at this point.

The Urgent Need for a New Pricing Methodology

Among the issues creating uncertainty, the one that needs the most urgent actions from the Commission is the clear need to move away from TSLRIC.

The Commission has clearly signaled in its draft decision that the limitations and inappropriateness of TSLRIC pricing can no longer be ignored. The decisions by the government to build the National Broadband Network and to reconsider the very basis of regulation of the industry in the future indicate that the use of TSLRIC is not in keeping with the Government's policy precepts.

The use of TSLRIC and, more generally, the Commission's regulatory approach are grounded in two assumptions that have been repudiated by the Government's actions this year.

The first of these assumptions is that the owner of bottleneck facilities can be persuaded to provide access to that infrastructure on fair commercial terms. This is assumed even if the network owner is vertically integrated and therefore has an incentive to advance its own interests by discriminating against access seekers competing with its downstream interests.

The Government has clearly concluded that this is not realistic. It has proposed instead measures to functionally or structurally separate Telstra's wholesale and retail activities to change the incentives driving the management of infrastructure. The Government has further stated an intention to require the NBN Co to refrain from any retail activity once it is operational.

The second and related historical assumption is that the last mile infrastructure is capable of being replicated and that regulated price signals to access seekers should communicate to entrants the cost of choosing to bypass the Telstra CAN with their own investment – the so called build or buy signal.

If this was ever a reasonable assumption, it is clearly one that no longer holds. The Government has repeatedly stated that it believes that the future CAN will be a monopoly and has created the NBN to build and manage the next generation network.

Any prospect that the legacy copper CAN will be replicated by an alternative fixed line network can also be dismissed. The Government in fact tested the market with its NBN tender that preceded the NBN announcement and found that no private investor was willing to build a duplicate CAN on acceptable terms.

Therefore, continued pricing of access to the copper CAN based on TSLRIC clearly over-compensates Telstra for access to an obsolete network that will not be duplicated, and diminishes the ability of access seekers to compete fairly.

None of this is news to the Commission. There has been a year of discussion from the Commission itself about a move away from TSLRIC.

The CCC submits that the Commission's proposed discussion paper on a move to a regulated asset base pricing methodology should be released as soon as possible. Further, the Commission should signal that it intends to move from TSLRIC by publishing indicative prices based on the existing methodology for one year only.

In anticipation of this change, the CCC has chosen to devote its scarce resources to researching the implications of RAB methodologies as discussed in the draft decision, rather than spending yet more effort on modeling work that it understands will be soon of limited application.

It requests that the Commission recognizes the imbalance of resources available to the competitive industry compared to Telstra, the uncertainty in the market caused by the many disruptive factors presently at play and the grave risk that indicative prices based on TSLRIC into 2012 will cause further dislocation beyond that point, and publishing final indicative prices for one year only.

ULLS Indicative Prices

Nowhere is the inappropriateness of the TSLRIC methodology more starkly illustrated than in the Commission's draft indicative price for ULLS.

The failure of the methodology can be simply described – how can it be possible that the price of access to the copper network can increase at all, let alone so markedly, at the very same time as the process of replacing that copper has commenced? The assumption inherent in TSLRIC that an access seeker might choose to replicate and bypass the copper is clearly nonsensical in these circumstances.

Further, as it is in the process of being replaced, it is a more reasonable assumption that the copper is at the end of its life and is fully or near fully depreciated. Yet the price modeling is built on the assumption that the network has just been built and access seekers are asked to pay according.

The application of TSLRIC in these circumstances causes the Commission to risk failing to meet its most basic objective – advancing the long term interest of end users.

This is because the impact of this flawed pricing on competitors is potentially so profound. Competitors advised the Commission of their deep concerns and shock at the indicative prices soon after they were published. Those who have invested to be able to acquire the ULLS service are especially exposed to harm from the proposed price increases in that service.

The expectation that the Commission will move away from TSLRIC to a regulated asset base methodology with a depreciation component only creates further uncertainty. Access seekers have no way of knowing at this time what the RAB-derived pricing will be, yet clearly expect that they should logically result in reduced prices immediately and reducing prices over time, given the circumstances.

If the Commission's draft prices translate into the market over the next three years, this is likely to result in saw-tooth pricing for this service over the course of a decade – prices first falling sharply, then rising dramatically before falling again, possibly very quickly.

These wild and unpredictable fluctuations will no doubt have a severe chilling effect on the immediate investment plans of competitors, which will be heightened by the separate uncertainty that presently exists with regard to the rollout of the NBN.

The CCC submits that the primary concern of the Commission in setting final indicative prices should be to mitigate the harm to competition and consumer interests caused by its price variations to date while it moves to a more suitable long term basis for pricing the service in future. The CCC submits that the Commission should set a price of below $19 for the first year, and make every effort to move to an RAB methodology reflecting depreciation in a 12 month time frame. If this is not possible, it is imperative that the Commission not increase prices above $19 before a move to an RAB pricing methodology.

The CCC also questions the Commission's decision to move from four pricing bands as used in the past to only two bands. The CCC suggests that the Commission should retain the four band pricing structure rather than make such an important change in a period when there are so may other areas of uncertainty affecting the industry (as discussed above).

Local Carriage Service

The Commission's reasoning for the use of a glide path to reduce prices gradually – to avoid regulatory shock caused by a regulatory decision causing a large or unexpected change in the prices presently in the market – is inappropriately applied in relation to the indicative LCS prices.

The CCC understands that LCS prices in the market today are presently typically in single figures. That is, actual prices in the market are such that the Commission's proposed year one indicative price of 13.5 cents year is effectively irrelevant. If anything, an indicative price at that level could cause disruption in the market by encouraging Telstra to attempt to raise rates above the level being paid presently.

Further, the prices in the market today reflect the widely held expectation that the Commission would reduce indicative rates to below 10 cents to at least bring indicative rates into line with reality. Therefore, there is no basis on which a glide path can be justified on grounds of regulatory shock.

The CCC submits that the final indicative rate move to 9 cents. There is no justification for the price to be graduated down.

PSTN OA

The Commission has chosen a price for the PSTN OA that is higher than the Analysys model output and the benchmarking. Again, it has proposed a glide path.

The recent history of the Commission's pricing work relating to PSTN OA has caused serious disquiet and given rise to a lack of confidence in the Commission's willingness to follow through on indications that future decisions will result in more favorable prices for competitors.

The industry was led to expect in 2003 that the gradual removal of the Access Deficit Charge would lead to prices of 0.7cpm in 2007. The competitive industry has therefore been planning on prices that were heading toward that point for several years. These expectations have been at the core of decision making by competitors about their investment in expanding their network footprints. There was considerable surprise and disappointment when the Commission held prices at 1cpm in 2006/07.

The output of the Analysys model and the benchmarking both indicate that the Commission was closer to the correct price in its 2003 estimates than in the subsequent decisions in which it departed from this direction.

Yet the Commission now proposes to require access seekers to continue to pay above cost prices for a further two years under yet another proposed glide path, presumably to protect Telstra's profits from immediate impact.

The Commission's timid approach to bringing PSTN prices into line with costs has created an on going burden for access seekers, which has kept consumers prices inflated for too long. The glide path proposed simply allows Telstra two more years to enjoy above cost returns at the direct expense of consumers who have been subsidizing its over-recovery on these services for at least five years.

Competitors, in the meantime, have seen margins that they should have enjoyed over the same period transferred to Telstra. The Commission proposes to subject investors in struggling competitors to another two years of subsidizing Telstra shareholders. If any participants have suffered regulatory shock, it is access seekers who have been denied the prices they were led to expect in 2003, and which the evidence of the Commission's latest work suggests they should have enjoyed.

The Commission must put the interests of consumers and competitors above unsubstantiated notions of regulatory shock to Telstra in relation to these services and reduce PSTN OA prices to 0.8cpm immediately.

Given that all the evidence before the Commission indicates that this price is generous, there can be no legitimate reason to force consumers to over-compensate Telstra for another two years. To do so would not be in the long term interest of end users.

Wholesale Line Rental

The Commission has proposed indicative prices above the Analysys output for Zone A in all three periods. Further, the Commission concedes that its benchmarking work results in a geographically averaged price that is below even the Zone A Analysys model output.

The CCC understands that the international trend continues to be for WLR prices to fall. Creating further confusion, the Commission has published no price for Zone B but points to Analysys model outputs suggesting up to $69 a month.

This suggestion on the part of the Commission invites Telstra to offer the WLR service on Zone B at these clearly uncompetitive high prices. The CCC understands it has already inhibited on going negotiations for this service.

The Commission also notes that the retail market remains subject to retail price controls that oblige Telstra to offer the service at a single national rate.

In these circumstances, the Commission clearly needs to consider the potential for the WLR indicative prices to cause significant disruption to the market and in particular enormous disadvantage to consumers in Zone B. These consumers may already have no competitive alternative to Telstra available. Indeed, evidence from Telstra's annual report suggests that the total number of competitive services has contracted dramatically in recent years as competitors – responding to signals and pricing and regulatory decisions from the Commission – have concentrated on ULLS based services and moved away from seeking to serve customers who can only be reached via WLR.

All customers in Zone B locations will be at risk of seeing their competitive options reduced to zero if the Commission does not preserve WLR as an option in those locations. On the other hand, if the Commission were to set average WLR prices at a rate above the Zone A price, the wholesale price disparity against the retail price would be so severe that the trend toward large losses in total competitive lines would no doubt accelerate.

The CCC submits that the Commission has a primary duty to advance the long term interest of end users and not to a misplaced and implacable commitment to the output of a theoretical model and methodology whose future is questioned by the Commission itself.

The CCC submits that the Commission should look to the output from its benchmarking work, and the reality of the retail market, and set final indicative prices for the WLR in Zone B at below $23.30, and that the Zone A price should be set more in line with the modeling output and benchmarking to about $21.

Contact

For further information please contact:

David Forman
Executive Director
CCC Inc
02 62625821