IT'S HOW WE CONNECT

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Public version

Dear Grahame,

Further Submission to the Draft Decision regarding the Final Access Determination (FAD) for the Domestic Transmission Capacity Service (DTCS)

I am writing to clarify certain claims and statements contained in various submissions to the Australian Competition and Consumer Commission's Draft Decision regarding the DTCS FAD published on 4 September 2015.

2 Mbps services

Some submissions[1] have sought to argue that as the Draft Decision has generated higher pricing for some 2 Mbps services, the entire regression model is critically flawed. Telstra strongly disagrees with this view as these criticisms suggest a cherry-picking approach intent on accepting only regulated pricing outcomes which are deemed agreeable and excluding as 'exceptional' those which are deemed not to be agreeable. Telstra considers that the regression analysis is robust and should apply across the entire data set and that, as a matter of good practice, regulatory decisions should apply equally to all stakeholders.

Moreover, our analysis shows that **[COMMISSION ONLY]…[COMMISSION ONLY].**

Dynamic pricing and mid-term reviews are not relevant to the DTCS

Some submissions[2] have argued for the introduction of dynamic pricing and/or a mid-term review on the grounds that DTCS prices are very competitive. Telstra considers that this is, in

[1] See Optus (2015) "Submission in Response to Domestic Transmission Capacity Service Final Access Determination: Draft Decision (Public version), October; Nextgen (2015) "Response to the ACCC public inquiry to make a final access determination for the domestic transmission capacity service draft decision", 8 October; and Competitive Carriers Coalition (2015) "Submission to draft decision on domestic transmission carriage service FAD, October.

[2] See nbn (2015) "Public inquiry to make a final access determination for the domestic transmission capacity service – draft decision", 8 October; and VHA (2015) "Final access

fact, the very reason dynamic pricing and mid-term reviews are not relevant to DTCS. Specifically, unlike some other markets, competition in DTCS is pricing services lower than regulated prices, so that competition is ahead of regulation. Indeed, this is demonstrated by the fact that **[COMMISSION ONLY] … [COMMISSION ONLY]**.

Consequently, Telstra supports the Commission's proposal to effect the FAD until 31 December 2019 without the need for a mid-term review or other variation to the FAD. This proposed period offers certainty and stability to the industry during a period of great change with the transition to the National Broadband Network. Telstra also considers that it is therefore appropriate that prices should be set generally aligned with the expiry date for the service declarations for the unconditioned local loop Service, line sharing service, wholesale line rental, line carriage Service, and fixed originating access and terminating services (31 July 2019).

The existing data capacity range is appropriate at between 2 and 1,000 Mbps

There was general agreement among stakeholders during the 2012 DTCS FAD Inquiry that the Commission should only set prices for the capacities that are commonly available for transmission services. Given the lack of observations of benchmark data at bandwidths exceeding 1 Gbps, Telstra supports the proposal to set prices to an upper limit of 1 Gbps as it avoids the risk of pricing higher bandwidth services below the cost of supply and the lack of data points makes any price points that could potentially be determined unreliable.

Substitute services should not be included in the regression analysis

Some submissions[3] have sought to argue that the Commission's regression analysis should be expanded to include services which are substitutes for the DTCS, such as internet transit/exchange (Layer 3 services). The features and functionality of these services are not directly comparable and renders them partial substitutes at best. For example, dark fibre cannot of itself replicate the end user experience of a full transmission service such as Managed Lease Line. As the Commission noted in its *Position Statement on Pricing Methodology* (November 2014) the purpose of the benchmarking approach is to capture the competitive dynamic for the set of competitive transmission services:

> *The underlying rationale of the domestic benchmarking approach is that those routes (or exchange service areas (ESAs)) for which there is effective competition will have commercially-determined prices for transmission services that reflect their supply costs (including a reasonable commercial rate of return). Further, competition on these routes will promote efficiency in supplying transmission services and provide incentives for dynamic efficiency improvements over time.*[4]

In any event, the claim that substitutes should be included in regulation is contrary to accepted economic theory concerning the proper regulation of 'bottleneck' infrastructure. Economic theory advocates that 'bottleneck' infrastructure should be regulated only where it

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determination: the domestic transmission capacity service: Submission in response to the ACCC's draft decision: Public version, 9 October.

[3] See for example Competitive Carriers Coalition (2015) and Nextgen (2015).

[4] Australian Competition and Consumer Commission (2014) *Domestic Transmission Capacity Service: Public inquiry into making a final access determination: Position statement on pricing methodology* (November): page 14.

is a natural monopoly that cannot be substituted by another service.[5] Where it can be substituted, it is by definition not a 'bottleneck' facility as access seekers can avail themselves of a substitute service. Consequently, far from an argument for expansion of the data set to include these other services, this claim is in fact further evidence of the fact that – as Telstra has previously argued[6] – DTCS is not a 'bottleneck' infrastructure in all cases.

Ethernet and SDH interface types should be treated equally

As some submissions[7] have argued, the Draft Decision's treatment of interface types is highly problematic and 'does not make commercial sense'[8]. The Draft Decision has seen fit to draw technology policy conclusions about the preferred use of Ethernet to SDH interface on a basis that is not properly justified.

Specifically, the coefficient from the regression equation has no clear interpretation as a structural parameter of a technical or behavioural relationship. The regression equation is a reduced-form relationship and so contains a mixture of supply and demand effects, and lacks clarity that *all* factors relevant to pricing in the DTCS have been included in the model. Other concerns include the possibility that SDH services are mostly offered on routes where there are few economies of scale, which would account for SDH services priced at a higher point.

As there is no clear understanding among stakeholders of how the interface coefficient should be interpreted, Telstra considers it is an unsound foundation on which to draw a policy conclusion regarding the preferred form of technology.

Additional pricing information should not be included retrospectively

Telstra strongly disagrees with any proposal for additional pricing information to be included in the Commission's regression analysis as:

- The inclusion of the additional pricing information would not be consistent with the fundamental purpose of the competitive benchmarking exercise as there may be questions concerning the extent to which it reflects competitive market prices,[9] and it is unlikely to align with the structure of the pricing formula within the Draft FAD.
- It is not transparent that the data is relevant to the benchmarking exercise. In particular, it is not clear whether the additional data relates to just one part of a broader deal between Optus and Vodafone and so distorts the regression results.

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[5] See for example King, S. and Maddock, R. (1996) *Unlocking the Infrastructure: The Reform of Public Utilities in Australia* (Allen and Unwin, Sydney).

[6] Telstra Corporation Limited (2014) *Submission to the Commission's Draft Report on the review of the declaration for the Domestic Transmission Capacity Service (Confidential version)*, 14 February: page 4.

[7] See for example Optus (2015) and Competition Economists Group (2015) "Review of the draft decision on DTCS FAD", October: page 23.

[8] Optus (2015): paragraph 5.34, page 32.

[9] See for example Optus, (2012) "Optus accelerates 3G and 4G expansion via extended site sharing arrangement" https://media.optus.com.au/media-releases/2012/optus-accelerates-3g-and-4g-expansion-via-extended-site-sharing-arrangement/ (3 May) (accessed 6 October 2015) and Vodafone (2013) "Vodafone's momentum building with regional expansion" https://www.vodafone.com.au/doc/VodafoneExtendsRegionalCoverage.pdf (30 May) (accessed 6 October 2015).

- It is also not possible to compare the additional pricing information with the Commission's dataset.

As per the earlier advice of our expert Professor Trevor Breusch, inclusion of the additional data would require a substantial revisitation of the empirical work, necessitating in turn further stakeholder engagement and an extension of the inquiry period.

Telstra's Managed Leased Line service offers the declared service but with additional features

Telstra's Data Carriage Service (DCS) is a service that reflects Telstra's implementation of the existing DTCS FAD price formula to set rate card prices directly based on the radial distance, capacity (rate), and protection status of the transmission service purchased.

Telstra introduced the Managed Leased Line Service (MLLS) in response to wholesale customer demand for a service incorporating a product equivalent to the DCS accompanied by a simplified pricing structure and additional value-added features, such as proactive monitoring. Customers' understanding and preference for the MLLS construct is evidenced by the extent of its selection over DCS.[10]

The development and provision of the MLLS by Telstra is indicative of the way the market has responded in offering customers new and innovative products, and highlights how competitive pressures and appropriate regulatory settings have incentivised service providers to develop and offer additional features or functionality that go beyond the scope of the regulated DTCS.

Please contact Flavio Romano on (02) 9866 0268 or at Flavio.Romano@team.telstra.com should you have any queries in relation to this matter.

Yours sincerely,

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[10] Telstra Corporation Limited (2014) *Submission to the Commission's Draft Report on the review of the declaration for the Domestic Transmission Capacity Service (Confidential version)*, 14 February: page 16 points out that [**COMMISSION ONLY**] times more customers prefer MLL to DCS.