26 April 2019

Manager – Fixed Line Service FAD Inquiry
Australian Competition and Consumer Commission

By email: fixedservices@accc.gov.au

To whom it may concern

Re: Inquiry into final access determinations for fixed line services, consultation and position paper

Vodafone Hutchison Australia (**VHA**) welcomes the opportunity to make this submission to the ACCC's consultation and position paper (**Paper**). While VHA's comments are primarily aimed at addressing the Fixed Terminating Access Service (**FTAS**), VHA's arguments can be applied generally to all fixed line services.

VHA does not support the ACCC's initial views expressed in the Paper. By proposing to maintain the existing Final Access Determinations (**FADs**), particularly the Fixed Terminating Access Service (**FTAS**), the ACCC has not adequately recognised the importance of revisiting the FTAS rate given substantial changes to the environment for fixed line services since it was last examined by the ACCC, and the effects of the substantial imbalance between FTAS rates and Mobile Terminating Access Service (**MTAS**) rates. Both issues are likely to have led to a one-way subsidising effect from mobile operators largely to Telstra[1], which distorts competition and does not support the long-term interests of end-users (**LTIE**). VHA believes that the FTAS rate is too high relative to the MTAS rate. In New Zealand for example, we note that the ratio of MTAS to FTAS rates is approximately 3:1.

The NBN migration is nearing completion, and Telstra is therefore highly unlikely to be incurring significant ongoing costs in maintaining its fixed line network. Telstra is also being compensated for fixed line costs via other mechanisms including the Universal Service Obligation (**USO**) and the NBN migration payments (as the ACCC alluded to in its Paper). These subsidies need to be publicly and rigorously tested to ensure Telstra is not double (or triple) dipping. Otherwise Telstra is likely to be extracting economic rents from other industry participants and the Australian public which impose serious competitive distortions. Since Telstra is horizontally and vertically integrated, these distortions are not confined to the fixed line industry and are likely to be having distortionary flow-on impacts in a range of telecommunications markets including mobile and content.

The ACCC ought not to exercise forbearance simply based on the presence of uncertainty and complexity. VHA believes that the FTAS rates should decrease (or in the alternative the

[1] While fixed voice termination services are provided by a range of carriers, the majority of traffic is ultimately handed off to Telstra.

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MTAS rates should increase) to address the likely reduction in Telstra investment in fixed line networks, the substantial subsidies which Telstra has received and continues to receive for its fixed line network, and the significant one-way subsidy from mobile operators primarily to Telstra. As a necessary step, the ACCC should rethink its approach to setting rates for fixed line services and ensure that its approach to FTAS and MTAS are consistent and that the ACCC has taken account of substantial developments in relation to Telstra's likely cessation of investment in its fixed line network and the effect of subsidies which are likely to be over-compensating Telstra for any residual fixed line costs.

A ACCC's initial view

The ACCC's initial view is to maintain the existing FADs. The ACCC's reasoning is summarised in section 6.1.3:

> *The ACCC considers that maintaining existing price relativities for declared services will provide a degree of stability to the industry in the lead up to and during the transition to the NBN. The ACCC's view is that stability in prices (and price relativities) for declared services will maintain efficient use of declared services investment in fixed line assets by Telstra and provide a more stable environment for access seekers as customers migrate to the NBN.*

In addition, the ACCC also does not favour updating the Fixed Line Service Model (**FLSM**) at this time due to its expectation of the regulatory burden imposed on industry, which it believes is likely to offset any potential gains.

B FTAS is too high

VHA does not agree with the ACCC's initial views and believes that it is deficient in two key respects.

First, the ACCC's rationale is not based on economic principles. The fixed line services are well established and understood, and more importantly are supplied by a monopolist. To suggest that a monopolist requires stability to maintain efficient use of the fixed line assets during a period of change (ie the completion of the NBN) is to suggest that the dominant incumbent telecommunications operator should be protected from competition[2] without first undertaking the necessary due diligence to confirm or disprove it is behaving in an economically efficient manner. This approach does not promote the LTIE in the circumstances.

Second, the existing FTAS and MTAS rates have a material one-way subsidising effect between mobile operators and Telstra which the Paper has not recognised. While MTAS payments between the carriers are generally net neutral (ie equal volume at reciprocal rates both ways), FTAS payments are not because of the different approach the ACCC has taken to set the FTAS and MTAS. This means that if the rates of FTAS and MTAS are not set

[2] The NBN is a direct competitor to Telstra in respect to its wholesale legacy fixed line services. The NBN-Telstra payments are effectively anti-competitive compensation that NBN pays Telstra. These payments already have a stabilising effect.

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appropriately *relatively to each other*, then it risks a distorted outcome[3] where Telstra over recovers for mobile-to-fixed voice traffic and underpays for fixed-to-mobile voice traffic. This one-way subsidy does not promote the LTIE.

Furthermore, these issues are compounded by other economic transfer mechanisms which Telstra is the sole beneficiary of. Specifically:

- each year, Telstra is subsidised by the Government and industry to provide voice services under the USO, which are now likely to represent the bulk of fixed voice lines, which has been publicly and consistently criticised by Government agencies[4] as inefficient, outdated and opaque; and

- each year, Telstra receives hundreds of millions of dollars from NBN as direct payments for use of what is effectively fully depreciated fixed line assets.

It is unclear how these subsidies have been accounted for in setting the FTAS to ensure Telstra is not double (or triple) dipping.

Given the above, VHA believes there are good grounds for examining whether the FTAS rate should be lowered.

C A consistent approach is necessary

The ACCC should ensure that there is a consistent approach to setting FTAS and MTAS. This is a necessary step to stop the one-way subsidising effect from mobile carriers to Telstra. This would promote the LTIE.

It is not justifiable for the ACCC to maintain a fully allocated cost recovery approach[5] to FTAS but impose an incremental cost recovery approach to MTAS. In VHA's view, the ACCC's approach to both FTAS and MTAS should be based on incremental cost recovery as this better reflects efficient costs and hence best promotes competition and the LTIE.

A fully allocated cost recovery approach is inappropriate as it risks artificially keeping afloat ingrained inefficiencies[6]. This leads to inferior competition and inefficient use of infrastructure and investments. Where there are other social objectives such as guaranteed access to voice/broadband services to be achieved, other public/Government policy mechanisms are better suited to address those goals (eg a better implemented USO).

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[3] The distortion occurs where fixed to mobile termination charges are set too low relative to mobile to fixed termination charges. While Telstra does not incur the same mobile to fixed termination charges because it is "on net", other mobile carriers will need to pay FTAS for mobile to fixed termination.

[4] Including the Productivity Commission and the Australian National Audit Office.

[5] The ACCC's Building Block Model approach considers all costs that is determined to be "efficiently" incurred. Telstra fully recovers all costs.

[6] As a starting point, it is safe to assume that vertically integrated monopolies will generally result in inefficiencies. So long as Telstra can recoup its incurred costs, it may not have the necessary incentives to discipline its spending to maximise economic efficiency. An incremental cost recovery approach to setting the FTAS rate is a superior approach.

Therefore, VHA disagrees with the ACCC's initial view that the fixed principles should remain unchanged. VHA submits that there are good grounds to consider whether the approach to pricing fixed line services should be updated to be consistent with the ACCC's approach to MTAS.

We would be happy to meet with the ACCC to discuss the matters raised above. If you have any questions, please do not hesitate to contact me or Louie Liu at Louie.Liu@vodafone.com.au.

Yours sincerely

Dan Lloyd
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