Fixed Services Review

Further consultation on draft ULLS pricing principles

1. Introduction

This submission is provided by iiNet Pty Ltd, Agile Pty Ltd, Amcom Pty Ltd and Adam Internet Pty Ltd (***the Access Seekers***). Each of the Access Seekers acquires access to the ULLS from Telstra and actively intends increasing the number of services that they acquire. As such, their business plans are closely impacted by the ACCC's decisions in regards to the ULLS pricing principles as absent commercial agreement with Telstra regarding access prices, the ACCC's position will likely determine key cost inputs going forward.

The Access Seekers support the ACCC's view that:

- It remains appropriate to use a Total Service Long Run Incremental Cost (TSLIRIC) pricing principle for the ULLS; and
- ULLS charges should be geographically de-averaged.

2. Total Service Long Run Incremental Cost (TSLIRIC)

One of the most important distinctions between costing methods is between methods that use historical data and methods that use a forward-looking approach, such as TSLIRIC. Generally, forward-looking costs are preferable because they better reflect the workings of competitive markets and are therefore more likely to promote competition than historical cost models. In such markets, from the moment an investment is made, the asset's value to the operator depends more on what use can be made of it than what it cost. If a competitor is more efficient, the operator will need to respond by adjusting its prices, rather than to continue pricing on the basis of its historical costs. In other words, competitive operators are compelled to look forward to set prices, and hence be able to compete, rather than to look backward to prices based on their original investments or costs.[1]

Though the use of historical data in cost modelling may represent 'real world' analysis, its inherent weakness is that it is difficult to allocate costs between services and allows the incumbent to pass on inefficient costs to its wholesale and retail customers.

The ACCC has previously stated that the TSLRIC approach to access pricing is consistent with the requirements of Part XIC of the *Trade Practices Act* (***TPA***), which requires that pricing:

- reflects the direct costs of supply;
- takes account of the interests of the access provider and access seekers; and
- encourages the economically efficient use of, and the economically efficient investment in, the infrastructure of telecommunications services.[2]

The ACCC has also previously stated[3] that TSLRIC is particularly appropriate for services that are well developed, necessary for competition in dependent markets and where the

[1] Intven, I, Tetrault, M, *Telecommunications Regulation Handbook*, Appendices, paragraph 1.4.3
[2] ACCC, *Pricing of Uncondtioned Local Loop Service, Final Report,* March 2002, p 17
[3] ACCC, *Access pricing principles – a guide, telecommunications* (July 1997)

forces of competition work poorly in constraining prices. Telstra's CAN clearly meets each of these criteria as it is the most basic building block in Telstra's network, which has been developed and in use for generations. The ULLS is provided via the CAN and is a vital input for the provision of a variety of voice and high-bandwidth data services and is one in which Telstra is the predominant supplier throughout Australia.

The access seekers consider that in evaluating the costs components of TSLRIC, the ACCC should consider the costs of efficient forward looking technology rather than actual technology in use. Such an approach provides stronger incentives for efficient investment decisions, would discourage Telstra from shifting costs from competitive areas to less competitive areas, and remove incentives for access seekers to make inefficient build-buy decisions as a result of excessive access charges based on historical costs. The Access Seekers consider it imperative that the ACCC's ULLS pricing principles and any indicative prices are based upon the forward looking costs of an efficient operator. The Access Seekers request that the ACCC take all reasonable steps to ensure that any cost model it relies upon, and in particular Telstra's PIE II model or other costing model produced by Telstra, does not reflect Telstra's claimed historical costs or include allowances for inefficient practices or outdated technology. It is noted that the Australian Competition Tribunal (***ACT***) was not satisfied that Telstra's PIE II model could be relied upon to estimate accurately Telstra's costs of supplying the ULLS for the period of Telstra's ULLS undertaking.[4]

3. Geographic de-averaging of ULLS charges

The Access Seekers agree with the views expressed both by the ACCC and the ACT that geographic averaging would adversely affect competition and distort usage and investment decisions.

The Access Seekers submit that ULLS charges should remain geographically de-averaged. The ACCC has previously stated that cost-based pricing for declared services is preferable and that a geographically averaged pricing structure may distort the economically efficient use of and economically efficient investment in infrastructure by which services are supplied. As the vast bulk of the Access Seekers services are in Bands 1 and 2 (i.e. CBD and metro areas), geographically averaged ULLS charges would significantly increase the costs that Access Seekers incur and must pass on in higher charges to customers. Given that these higher charges would not be based on efficient forward looking costs, but rather to cover higher charges that Telstra incurs in Bands 3 and 4 (i.e. rural areas), the Access Seekers submit that such increased costs would represent inefficient use of their investment in DSLAM infrastructure and a disincentive to competing in the voice and broadband markets, and be likely to diminish the benefits brought to end-users through the competitive process.

In 'Pricing of unconditioned local loop services (ULLS), final report, March 2002', the ACCC detailed why it considered de-averaged access pricing is more efficient, as follows:

- **Consistent with the ACCC's principles**

  A de-averaged approach is consistent with the ACCC's standard approach to access pricing that relates to the direct costs of service supply and promotes economic efficiency of infrastructure use and investment.

[4] ACT, Telstra Corporation Ltd (n.3 {2007] ACompT3, Summary, p. 4

- **Investment efficiency**

  A geographically de-averaged approach is less likely to distort either the build-buy decision of competitors or Telstra's own investment plans. An averaged pricing approach, by contrast, is likely to result in inefficient investment decisions.

- **Other technologies more suitable in rural and remote areas**

  The ULLS is most suitable for providing high-speed services in CBD and metropolitan areas. In many regional and remote areas, high speed services are more likely to be appropriately delivered by alternative technologies, such as satellite or wireless networks. The correct cost based pricing of the ULLS (copper network) in these area will help to ensure that the correct incentives are faced for the deployment of such alternative technologies for the benefit of end-users. This means that, in addition to the above effects on efficient supply, an averaged approach to ULLS pricing, far from ensuring affordable high-speed services for regional and remote consumers, would likely lead to an inadequate provision of such services to these customers.

As such, the Access Seekers consider it inappropriate for ULLS charges to be averaged across geographical areas and submit that a pricing schedule based upon actual efficient costs for each band should be implemented.

Basing ULLS charges on a geographically averaged estimate of the efficient costs of providing the ULLS would be consistent with the ACCC's final decision on Telstra's LSS undertaking relating to connection and disconnection charges, published in April 2006. In that decision, the ACCC indicated that "the geographic differences in the LSS connection price are relatively small and so any distortion would be similarly small (particularly given that connection and, where appropriate, disconnection charges are once-off in nature)." It then indicated it considered "while averaged pricing may have some distorting effect on the economically efficient use of and investment in infrastructure (and consequent effect on competition), the effect is likely to be small in this case."

In response to these reasons advanced by the ACCC, the Access Seekers makes the following points in reference to the ULLS

- The differences between charges in the four geographic bands are material, as such the distortionary affect on competitive decisions would also be material.

- The charges are ongoing, rather than once-off in nature, thus perpetuating the distortionary affect.

- As the percentage distribution of ULL services per band will vary with time and between individual carriers using Telstra's ULL service, the application of per band rather than averaged charges will result in a more accurate allocation of costs.

- Averaged charges are inconsistent with principles previously expressed by the ACCC and send contradictory signals to the marketplace.

- Higher ULLS charges in Bands 1 and 2 will give Telstra a lower costs basis relative to its competitors and enable Telstra to undercut access seekers. This will diminish competition as access seekers will likely be forced out of the market and eventually allow prices to gravitate up as the level of competition drops.

- Apart from ULLS access charges there are other significant factors that make it unattractive for access seekers to acquire ULL services in Bands 3 and 4. These include very high backhaul costs making the service commercially unviable and technical limitations regarding the ability to service end-users more than several kilometres from the exchange. iiNet considers that the massive government subsidies for rural customers, such as the HiBIS and Opel subsidies, have further distorted competition in those areas so that the costs of the ULLS in Bands 3 and 4 is no longer a determining factor when considering whether to enter those markets. iiNet consider that these subsidies have reduced its ability to compete in Bands 3 and 4.

The Access Seekers current and future plans for ULLS acquisition in Bands 3 and 4 are minimal. As such, the Access Seekers will only ever derive a minimal benefit from lower averaged charges in those bands. The Access Seekers consider that the number of ULL services they acquire in Bands 1 and 2 are likely to steadily increase, by migrating current LSS and DSL customers to the ULLS (when appropriate migration processes are in place, please see below) and acquiring new customers. If a geographically averaged price policy is followed, the Access Seekers will continually pay above efficient cost rates for access to the ULLS. In the Access Seekers' opinions, the higher charges that they would incur as a result of price averaging across the bands are significant and detrimental to both their business plans and the promotion of competition in the bands in which they operate.

In assessing Telstra's ULLS undertaking, the ACT gave considerable thought to Telstra's contention that averaged ULLS charges are required to reflect Telstra's retail price parity obligation. Telstra's claim relied on its argument that the Universal Service Fund (***USF***) fails to subsidise it for the costs that it incurs as a result of its obligation to provide line rental services in unprofitable rural areas. Telstra's claims in this regard fail to mention the clear benefits that Telstra obtains by being the ubiquitous service provider, such as strong brand recognition and acceptance by having Telstra vehicles, payphones and premises throughout Australia in carrying out its Universal Service Obligations. Nonetheless, the Access Seekers consider that any USF losses incurred by Telstra need to be assessed and dealt with as part of a review of the Universal Service Regime rather than an assessment of ULLS pricing principles. The ACT concluded that it was not satisfied that averaging would promote competition in either urban or rural areas.

If the ACCC does consider it appropriate to set average ULLS charges, the Monthly Rental Charge should be lower than the combined indicative prices set for Wholesale Line Rental (***WLR***), currently $23.12 and the Line Sharing Service (***LSS***), currently $2.50. As the Commission is aware, the WLR cost includes the costs of conditioning the line in order to provide voice services, whereas the ULLS is solely the unconditioned line and significantly cheaper for Telstra to provide to its wholesale customers. If the ULLS Monthly Rental Charge coupled with the voice service conditioning costs did exceed the combined WLR/LSS price, it would be more advantageous for access seekers to avoid the ULLS and provide broadband services only to end-users via the LSS. Even under the preferred de-averaged ULLS pricing model, the logical maximum pricing in all bands for the ULLS should also be less that the combined WLR /LSS price, and therefore less that the current sum of $25.62 per month.

The quantum by which current Band 3 and 4 prices for the ULLS exceeds the sum of WLR and LSS is so large that the only economically efficient access path for Access Seekers in Bands 3 and 4 today is to (in effect) synthesise an approximation of a ULLS by acquiring WLR plus LSS from Telstra in those bands instead. No Access Seeker could ever rationally compete in Bands 3 and 4 using the ULLS today - and the service is effectively nonexistent in those bands as a result.

Agile Pty Ltd, on the basis of its existing regional broadband deployment experience, submits that the long term interests of end users would be better served in regional areas by using a price lower than the WLR/LSS price as a ceiling to the access price for ULLS. Agile considers that this will result in no material change in per-service income for Telstra (as regional services in Bands 3 and 4 are already being serviced using the LSS and WLR and Telstra would avoid the conditioning costs of supplying the WLR). Such a change will, however, advance the long term interests of end-users in regional areas by providing them with access to new service types which may only be delivered via the ULLS (including, specifically, the emerging 'Naked DSL' service).

Applying this logical ceiling to the banded pricing model will allow regional customers to access the fruits of this (and other) forms of technical innovation, instead of being limited to existing (line sharing) based services for the foreseeable future. Conversely, if this limit is not applied, regional customers can never advance along the 'ladder of investment' beyond the LSS stage as they will never have access to current or future ULLS based services and they will permanently be limited to LSS based services and barred from access to more advanced forms of service provision based on the ULLS.

4. Other matters

The Access Seekers understand that the ACCC is seeking submissions on the principles that should be applied in determining reasonable *prices* for access to the ULLS. However, pricing principles are only of assistance to the Access Seekers to the extent that the Access Seekers are able to take advantage of them. The Access Seekers are currently extremely frustrated by their inability to migrate customers to the ULLS.

The Access Seekers together have in excess of 200,000 customers on LSS that they could migrate to a ULLS based product at some time, but the lack of a migration process means these customers are stuck on LSS.

In respect of migration to ULLS, the biggest single blocker in this migration path is Telstra. Mass migration to ULLS from LSS remains almost impossible. Telstra has no process for such migrations and discussions with Telstra do not provide any idea of when this may be rectified. The only option for an existing customer to be migrated to a ULLS based service is for the customer to cancel their service, have the LSS torn down and then re-apply as a new customer. This situation is clearly untenable. Access Seekers simply cannot expect customers to accept disconnection of their service for a period of up to three weeks. The risk of customers transferring to a different service provider in the meantime is too high to contemplate.

This means that ULL based services can only be offered to new customers while LSS based services must remain on the LSS. However, the market is clearly approaching saturation. The Access Seekers estimate that 70% of their customers churn from existing ADSL providers and there are very few 'new' customers out there. As a result, Access Seekers need migration processes that are efficient and automated, in order to move customers on to the ULLS.

The ACCC has previously expressed support for the 'stepping stone' or 'ladder of investment' model of telecommunications regulation, where industry participants are encouraged to move up the 'ladder of investment' towards full facilities-based competition'.[5] In order to progress up the ladder of investment, it is important to have the steps in place. By including the LSS 'step', smaller investors are able to build scale, develop skills and build profitability. However, Telstra's refusal to develop techniques and processes for the cost-

[5] ACCC, *Fixed Services Review - A second position paper*, April 2007, p20.

effective migration of services from the LSS to ULLS acts as a serious impediment to investors taking the next step.

In addition to formulating pricing principles in relation to ULLS pricing, the Access Seekers also request that the ACCC take urgent steps to encourage the development of migration processes to ensure that Access Seekers are able to fully utilise the ULLS going forward.

5. Conclusion

The Access Seekers submit that TSLIRIC costing and de-averaged charges remain appropriate for the ULLS pricing principles as they are most likely to reach the objective of promoting the long-term interests of end-users. TSLIRIC and de-averaged ULLS charges promote the process of competition and ensure benefits such as lower consumer prices, and efficient use and investment in network infrastructure.

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