



# DOMESTIC TRANSMISSION CAPACITY SERVICE

Final Access Determination  
Discussion Paper - Primary  
Prices

July 2014

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## List of abbreviations and acronyms

ACCC	Australian Competition and Consumer Commission
BBM	Building Block Model
CCA	Competition and Consumer Act 2010
CSP	Carriage Service Provider
DAA	Data Analysis Australia
DTCS	Domestic Transmission Capacity Service
ESA	Exchange Serving Area
FAC	Fully Allocated Costs
FAD	Final Access Determination
Gbps	Gigabit per second
IAD	Interim Access Determination
LTIE	Long-Term Interests of End-users
Mbps	Megabit per second
MLL	Managed Lease Line
MTAS	Mobile Terminating Access Service
NBN Co	National Broadband Network Corporation Ltd
PDH	Plesiochronous Digital Hierarchy
POI	Point of Interconnection
POP	Point of Presence
RKR	Record Keeping Rule
RSP	Retail Service Provider
SDH	Synchronous Digital Hierarchy
SLC	Special Linkage Charge

# 1. Introduction

On 23 May 2014 the Australian Competition and Consumer Commission (ACCC) commenced a public inquiry under Part 25 of the *Telecommunications Act 1997* into making a final access determination (2015 DTCS FAD) for the declared domestic transmission capacity service (DTCS) under section 152BC of the *Competition and Consumer Act 2010* (CCA). As part of that inquiry, this discussion paper sets out the ACCC's views on the methodology and approach to setting the primary price terms for the 2015 DTCS FAD and invites members of the public and representatives of industry to make submissions.

The current DTCS FAD was made on 21 June 2012 and will expire on 31 December 2014 (2012 DTCS FAD). The current FAD uses a domestic benchmarking approach to price transmission services covered under the declared service. The ACCC's preliminary view is that a domestic benchmarking approach to set primary price terms for the DTCS continues to be appropriate for the next FAD period. However, the ACCC is interested in views of stakeholders about this approach and whether an alternative approach might result in more efficient regulated prices.

If the domestic benchmarking approach is retained, the ACCC proposes to consult further with stakeholders about a regression model that would be used to benchmark prices for the next period. The ACCC also proposes to engage consultants for the analysis and development of the regression model and to actively engage with stakeholders in the development of the model to refine and improve the current model. Consistent with the previous FAD, the ACCC proposes to request information regarding customer pricing from DTCS providers.

The ACCC is separately examining in a [concurrent consultation the non-price terms and conditions and supplementary prices for the DTCS](#) and other declared services. Stakeholders are invited to refer to that consultation and make submissions to that consultation for all issues not relating to the primary price terms for the DTCS covered by this paper.

The ACCC will however, consider all submissions made in response to either consultation in the final DTCS FAD. The non-price terms and conditions and supplementary prices for the DTCS determined as part of the broader inquiry process noted above will be incorporated separately into the DTCS FAD once the outcome of that consultation is finalised.

## 1.1 Legislative Background

The telecommunications access regime in Part XIC of the CCA requires, among other things, the ACCC to make FADs for all declared services. A FAD provides a base set of terms and conditions that access seekers can rely on if they are unable to come to an agreement with an access provider on the terms and conditions of access to a declared service. If parties come to an agreement on terms and conditions of access, their access agreement will prevail over the FAD to the extent of any inconsistency.<sup>1</sup>

The DTCS is an essential wholesale communications service and was deemed a declared service in June 1997.<sup>2</sup> The declaration was varied and extended in November 1998, May 2001, April 2004, April 2009 and September 2010. The ACCC varied and extended the [DTCS declaration in March 2014 until 31 March 2019](#). The varied service description for the DTCS will apply from 1 January 2015.

The 2012 DTCS FAD will expire on 31 December 2014. Under the CCA, the ACCC must have commenced a public inquiry into making a FAD for the DTCS six months before the expiry of the access determination, that is, by 30 June 2014.<sup>3</sup>

The ACCC must consider a range of factors when making a FAD. These factors are set out in the criteria specified in subsection 152BCA(1) of the CCA and include:

- a) whether the determination will promote the long term interests of end-users (LTIE) of carriage services or services supplied by means of carriage services
- b) the legitimate business interests of a carrier or carriage service provider (CSP) who supplies, or is capable of supplying, the declared service, and the carrier's or provider's investment in facilities used to supply the declared service
- c) the interests of all persons who have rights to use the declared service
- d) the direct costs of providing access to the declared service
- e) the value to a person of extensions, or enhancement of capability, whose cost is borne by someone else
- f) the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility, and
- g) the economically efficient operation of a carriage service, a telecommunications network or a facility.

The ACCC may also take into account any other matters that it thinks are relevant when making a FAD.<sup>4</sup> Information about the above requirements and how the ACCC will apply these criteria at **Appendix 1**.

Compliance with a FAD is both a carrier licence condition and a service provider rule,<sup>5</sup> the breach of which may lead to a pecuniary penalty of up to \$10 million for each contravention.<sup>6</sup> Private enforcement of a FAD is available in the Federal Court.<sup>7</sup>

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<sup>1</sup> Section 152BCC of the CCA.

<sup>2</sup> ACCC, *Deeming of Telecommunications Services: a statement pursuant to section 39 of the Telecommunications (Transitional Provisions and Consequential Amendments) Act 1997*, June 1997.

<sup>3</sup> Subsection 152BCI(3) of the CCA.

<sup>4</sup> Subsection 152BCA(3) of the CCA.

<sup>5</sup> Sections 152BCO and 152BCP of the CCA.

<sup>6</sup> Section 570 of the *Telecommunications Act 1997*.

## 1.2 Consultation process for the DTCS final access determination

The ACCC is required to commence a public inquiry into making a FAD for a currently declared service. Once a public inquiry has started, the ACCC must make a FAD within six months. This period may be extended by a further six months if the ACCC explains the reasons for the extension.<sup>8</sup>

The ACCC is proposing to consult with stakeholders and other interested parties at various stages during the inquiry. This discussion paper invites submissions on specific issues relevant to the approach that the ACCC should adopt in pricing the DTCS. This discussion paper poses a series of specific questions but submitters are encouraged to raise other issues that they consider to be relevant to the inquiry in their submissions.

The ACCC's preliminary view is that domestic benchmarking approach continues to be an appropriate pricing model for the DTCS. This is because there are now a considerable number of domestic transmission routes in Australia that the ACCC has found to be competitive. The ACCC is able to determine prices in these markets as a benchmark for the prices that would apply in regulated areas or routes if they were competitive.

The ACCC will undertake a further consultation process on the modelling for the pricing methodology that is adopted after considering submissions from stakeholders to this discussion paper. Stakeholders will be invited to analyse the proposed modelling and, if appropriate, to engage independent experts to assist in their responses.

### *Submission of commercial-in-confidence material*

All submissions will be considered by the ACCC as public submissions and will be posted on the ACCC website. If interested parties wish to submit commercial-in-confidence material to the ACCC they should submit both a public version and commercial-in-confidence version of their submission.

The ACCC has issued a guideline setting out the process parties should follow when submitting confidential information to communications inquiries commenced by the ACCC. The guideline is available on the ACCC website at: <http://www.accc.gov.au/publications>.

The *ACCC-AER information policy: the collection, use and disclosure of information* sets out the general policy of the ACCC and the Australian Energy Regulator (AER) on the collection, use and disclosure of information. A copy of the guideline can be downloaded from the ACCC website: <http://www.accc.gov.au>.

The ACCC prefers to receive submissions in electronic form, either in PDF or Microsoft Word format which allows the submission text to be searched.

Submissions about this discussion paper will be accepted until **5:00 pm on 19 September 2014**. Any submissions received after this time may not be considered.

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<sup>7</sup> Section 152BCQ of the CCA.

<sup>8</sup> Section 152BCK of the CCA.

Please forward submissions and enquiries by email to:

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## 2. Background

### 2.1 Transmission services

Transmission services are supplied by transmission network owners to access seekers (carriers and CSPs) to carry traffic between two locations. The term 'transmission' refers to high capacity data links that are used to carry large volumes of communications traffic. Types of traffic which may be carried via transmission networks include voice, data or video communications.

Wholesale transmission services essentially allow access seekers to connect customers in places where they do not own their own transmission infrastructure. Transmission services therefore enable carriers and CSPs to connect their core networks with points of service delivery (such as exchanges or end customer premises) around Australia. The DTCS is the regulated part of all wholesale transmission services and is defined by the DTCS service description. Prices set by the FAD only apply to the DTCS.

### 2.2 The declared service – the DTCS

The DTCS was deemed to be a declared service in June 1997.<sup>9</sup> The declaration was extended or varied in November 1998, May 2001, April 2004, April 2009, September 2010 and March 2014. The current DTCS declaration is due to expire on 31 March 2019. The DTCS service description is set out in the DTCS declaration.

The DTCS is a service which carries large volumes of voice and data communications from one point to another point via symmetric network interfaces on a permanent and uncontended basis, subject to a range of exceptions. For the purposes of the FAD, the DTCS does not include communications between:

- one customer transmission point directly to another customer transmission point
- one access seeker network location directly to another access seeker network location
- selected inter-capital routes
- selected regional routes, and
- selected metropolitan routes.

In the 2014 DTCS Declaration Inquiry the ACCC assessed the level of competition for DTCS services on all DTCS routes (including both deregulated and regulated routes) using a revised competition methodology. This assessment found that in addition to the existing 88 deregulated metropolitan Exchange Serving Areas (ESAs), an additional 112 ESAs could be deregulated because they met the competition methodology. It also found that of the existing 23 capital-regional routes three regional routes failed to meet the revised methodology and were re-regulated. Eight additional regional routes that were found to be sufficiently competitive were deregulated.

The full DTCS service description including the list of routes that are not subject to regulation is available on the [Regulated Infrastructure area of the ACCC website](#).

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<sup>9</sup> ACCC, *Deeming of Telecommunications Services*, June 1997.

## 2.3 The 2012 DTCS FAD

Prior to the 2012 DTCS FAD, there was no regulated price for the DTCS and no agreed methodology for setting prices. As part of its inquiry to set regulated prices, the ACCC undertook a wide ranging consultation which examined a number of approaches to pricing, including bottom-up long-run incremental cost, top-down long-run incremental cost, fully allocated cost (FAC), international and/or domestic benchmarking and a combined approach.<sup>10</sup>

Following consideration of submissions and independent analysis of the best approach for setting transmission prices, the ACCC adopted a domestic benchmarking approach. This approach considered that prices in competitive areas and on competitive routes were reflective of the costs of supplying efficient services. It therefore relied on pricing information obtained from transmission providers for services provided in the market to form the basis for prices and price structures on non-competitive routes.

The ACCC obtained information and data from seven transmission providers about transmission prices and services being provided in the market. This information was used as the basis for developing a regression model that informed the benchmarking approach for the 2012 DTCS FAD.<sup>11</sup> The regression model benchmarked transmission prices observed in competitive (deregulated) areas as the basis for regulated prices to apply in uncompetitive (regulated) areas.

The 2012 DTCS FAD set prices for a standalone DTCS service supplied for a one year period. It did not set prices for DTCS services sold in a bundle with other services or services supplied under multi-year contracts.

A DTCS Pricing Calculator was made available on the ACCC website to assist stakeholders to determine the regulated FAD prices. Telstra subsequently incorporated the FAD prices into its Rate Card as required under its structural separation undertaking, and is [published on the Telstra Wholesale website](#).

## 2.4 Pricing approaches prior to the 2012 DTCS FAD

In 2009 the ACCC commissioned a report from Frontier Economics (Frontier) on the economics of transmission capacity services, which is [available on the Regulated Infrastructure section of the ACCC website](#). Although the ACCC had previously considered a number of approaches for pricing, particularly in relation to exemption applications and arbitration hearings, it asked Frontier to conduct a 'first principles' review of the regulatory approach that would best promote efficiency and competition.

Frontier noted that transmission networks have a number of characteristics that create pricing difficulties. In particular, the unique characteristics of transmission networks (such as their mesh or ring structure and the sharing of equipment over a wide range of transmission services) create difficulties in cost-allocation setting which is compounded by the mix of regulated and non-regulated routes in a single network.

Frontier considered that a cost-based approach to pricing transmission was desirable, but this would likely be a costly solution to deal with very complex networks and carried a high risk of regulatory error.

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<sup>10</sup> ACCC, *Domestic Transmission Capacity Service, an ACCC Discussion Paper reviewing pricing of the domestic transmission capacity service*, April 2010.

<sup>11</sup> ACCC, *Final Access Determination No. 1 of 2012 (DTCS)*, June 2012.

Frontier's preference was to use different pricing approaches to account for differing degrees of competition. It noted that where there had been competitive entry, a non-cost-based approach, such as domestic price benchmarking, may be appropriate. This would reduce the reliance on cost modelling and encourage facilities-based competition. In relation to monopoly routes, Frontier concluded that there is no costing approach that is more appropriate than the others in all circumstances.

#### *2010-2012 DTCS pricing inquiry*

As noted above, the ACCC consulted on a range of approaches for pricing the DTCS as part of its [2012 DTCS FAD Inquiry](#). Following consideration of submissions, the ACCC concluded that the traditional approaches of either a top-down FAC or bottom-up TSLRIC were not the best options to price DTCS at that time for the following reasons:

- it would be costly, time consuming and impractical to model an entire transmission network and would require a large number of subjective judgements that would provoke lengthy and contentious discussion with stakeholders
- implementation would be time consuming, and
- the Regulatory Accounting Framework would need to be amended in order to provide sufficient information on asset allocation.

The ACCC's review also observed that most prices are generally linked to the costs associated with providing a given quantity of a service where there is competition. Where the cost-base is difficult to define and/or determine the risk of regulatory error is high.

The ACCC decided that a domestic benchmarking model was its preferred pricing model for the current market. This was because there are a number of routes or areas within Australia that are regarded as being provided in competitive markets and these prices can be used as a benchmark for the prices that would prevail in the non-competitive or regulated routes and areas, if they were competitive. In 2011 the ACCC developed an Interim Access Determination for the DTCS (2011 DTCS IAD) which used a basic averaging approach to pricing based on publicly available price lists data.

Between the 2011 DTCS IAD and 2012 DTCS FAD, the ACCC obtained actual (confidential) contract price data from the major transmission providers which it incorporated into a regression model that set prices for the non-competitive routes. The regression model adopted by the ACCC sought to identify the variables that would most impact on prices in order to determine the benchmark efficient price.

In the 2012 DTCS FAD, the ACCC used the mean value of prices that were predicted by the regression model as the regulated prices to mitigate the risk of setting prices too high or too low given that this was the first time the ACCC had priced the DTCS.

#### *Stakeholder concerns about the 2012 DTCS FAD pricing*

In applying the regression model to determine the final prices, regulated prices set in the 2012 DTCS FAD reflected the diverse range of transmission prices for services at different capacities, different distances and across different geographies.<sup>12</sup> On some regional transmission routes which had historically high prices the FAD prices were considerably lower. However, some access seekers found that some regulated prices were higher than they had expected the market rate to be.

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<sup>12</sup> The final FAD prices reflected the mid-range of 80 per cent of prices in the data set.

In adopting a benchmarking approach in the current FAD Inquiry, the ACCC proposes to carefully consider the regression model that will be used to set prices to ensure that it is effective to determine efficient prices for benchmarking.

### *2013-2014 DTCS Declaration Inquiry*

In the [2013-2014 DTCS Declaration Inquiry](#) several submitters raised concerns that transmission pricing, particularly in regional areas, was limiting competition in the provision of broadband and mobile services.

A number of submissions were received from Regional Development Australia Committees pointing to the high costs of regional transmission.<sup>13</sup> In general they argued that the cost of transmission in regional areas remained prohibitive and that lower transmission prices were essential for regional economic development, particularly in relation to extension of mobile and broadband coverage in regional areas. They indicated that expanding regional mobile coverage and broadband competition would be improved through lower transmission prices.

The ACCC has observed significant developments in competition and pricing in the transmission market since the last inquiry that are likely to be reflected in lower regulated prices if a domestic benchmark approach is used to set regulated prices.

### *Telstra's Managed Leased Line service*

Following the 2012 DTCS FAD, Telstra implemented a new product suite for wholesale data services including the declared DTCS service. The components of this product that are most relevant to the DTCS are the Managed Lease Line service (MLL) and the Data Carriage Service (DCS).

The DCS is Telstra's basic transmission product that is priced as per the 2012 DTCS FAD. The MLL service is a managed service that is comprised of the base declared product (that is, the product equivalent to the DCS) and additional 'managed service' features that are only supplied to Telstra wholesale customers (they are not supplied to Telstra Retail).

The MLL prices are set by commercial negotiation with Telstra. The major difference between the basic DCS and the MLL is the pricing construct and the additional managed service features that are provided with the MLL product. Unlike the DCS, the MLL is priced on the basis of zone, route type and capacity and incorporates the additional managed service features (including proactive monitoring and head-end aggregation). It is open to wholesale customers to seek the DCS at the regulated price should they be unable to agree terms and conditions with Telstra. It appears that the FAD prices may impose some constraint on MLL prices depending on the type of transmission services acquired and the value that is placed on the managed component of the MLL product.

The ACCC would welcome stakeholder's views on the impact of Telstra's MLL product on DTCS prices.

## **2.5 Other related inquiries**

The ACCC is also conducting FAD inquiries for the fixed line services and the mobile terminating access service (MTAS). There may be issues that are relevant to DTCS and

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<sup>13</sup> [Regional Development Australia Southern Inland, Regional Development Australia Sunshine Coast Inc, Regional Development Australia Townsville and North West Queensland and Regional Development Australia Wheatbelt WA,](#)

fixed services pricing and the ACCC will be ensuring consistency in pricing approach where appropriate.

### **2.5.1 Non-price terms and conditions and supplementary prices consultation**

The ACCC has initiated a separate concurrent [consultation into non-price terms and conditions and supplementary prices](#) for all of the FADs. That consultation will consider:

- non-price terms and conditions – including the appropriate principles for determining non-price terms and conditions, whether certain non-price terms and conditions should be consistent across some or all of the declared services, and any specific non-price terms and conditions that should be included in FADs, and
- supplementary prices – including how to set connection and special linkage charges (SLCs) and other facilities access service charges.

Submissions to the non-price terms and conditions and supplementary prices consultation will form the basis for the 2015 DTCS FAD non-price terms and conditions and supplementary prices.

Depending on the nature and magnitude of the price and non-price issues, submissions and other information provided during the ACCC's consultation processes, the ACCC will consider how best to make final FAD terms and conditions in a timely and effective manner.

Given the large number of issues for the current FAD inquiries, and the ACCC's expectation that completion of the consultations on the primary price issues is likely to take until at least the beginning of 2015, the ACCC may consider a staged approach to finalising its consideration of different aspects of the FADs. For example, this could mean that the ACCC would finalise its decisions on the non-price terms and conditions, supplementary prices and primary prices at different times.

If this transpires, the ACCC could consider varying the current FADs to include terms dealing with the matters on which it has finalised its consideration rather than waiting for the conclusion of the current FAD Inquiry to make terms dealing with those matters.

The ACCC considers that conducting separate consultations on non-price and supplementary price issues and on primary price issues may assist industry and other stakeholders in preparing submissions on these various aspects of the FADs.

To further facilitate effective engagement with stakeholders on non-price terms and conditions and supplementary pricing issues, the ACCC is considering how to conduct an industry forum as part of its consultation process on these issues. In this regard, the ACCC notes that it has previously held a number of open industry forums for discussion of targeted issues and that these forums were positively received by industry. The ACCC welcomes views on the benefits of conducting an industry forum on non-price and supplementary price issues and any suggestions for the topics that could be discussed in any such forum.

After considering submissions received in response to the non-price terms and conditions and supplementary prices position paper, the ACCC will release a draft report outlining its preliminary views on non-price terms and conditions and supplementary prices. Depending on the nature and extent of the issues raised in submissions, and any other relevant information, the ACCC expects to release its non-price terms and conditions and supplementary prices draft report in late 2014.

The ACCC will keep stakeholders informed about its processes during the course of the FAD inquiries.

### 3. Methodology for pricing the DTCS

The ACCC considers that the key factors relating to the 2010 - 2012 pricing inquiry and methodology are still relevant and appropriate. Accordingly, the ACCC's preliminary view is that a domestic benchmarking approach continues to be an appropriate model for determining regulated prices for the 2015 DTCS FAD. Importantly, the ACCC considers that this approach satisfies the criteria specified in subsection 152BCA(1) of the CCA and provides an appropriate balance between resourcing and simplicity. The ACCC considers that whilst there are alternative approaches these would likely be more complex, require more resources and potentially impose higher regulatory costs without a materially better outcome in seeking to set efficient pricing. Having said that, the ACCC invites detailed submissions and supporting evidence of alternative approaches that it might consider.

In previous consultations on the regulation of the DTCS some stakeholders argued that an alternative cost-based approach such as a fully allocated cost (FAC) model or a Building Block Model (BBM) may be more appropriate to set efficient prices. The ACCC carefully considered these arguments and it acknowledges that cost-based pricing methodologies are appropriate in areas with limited competition and high prices. However, the development of an appropriate model is costly and time consuming and the overall benefits of doing so, must be weighed against these difficulties.

The ACCC notes that unlike other regulated services the DTCS comprises thousands of diverse transmission service agreements. These individual transmission services vary according to factors such as capacity, distance and quality of service. In addition the variation of commercial prices and levels of demand across various route categories add to the complexities of pricing the DTCS. Therefore, an effective BBM that accurately reflects the characteristics of the DTCS would need to generate a diverse range of prices for the currently regulated transmission routes and capacities in Australia.

The ACCC also notes that a BBM approach for the DTCS would require allocating costs to particular transmission service categories (including both regulated and unregulated transmission services). Some of these costs can be assigned directly to regulated transmission services while some are shared with other services and as such would require either the determination of sharing factors (including across regulated and unregulated services) or direct cost allocation. The FLSM can provide an estimate of the revenue requirement relating to the transmission assets in the FLSM but it does not include all the relevant costs and cannot be used to identify or take account of other factors relevant to particular routes (for example, demand, route type and the level of protection available).

The ACCC concluded that although the domestic benchmarking model has limitations, prices on the competitive routes would provide a good baseline of what would be expected on non-competitive (regulated) routes given the number of competitive routes and areas in the DTCS market. The ACCC considered that domestic benchmarking would provide an appropriate cost structure to promote efficiency and competition in the transmission market.

The ACCC has also recently conducted a comprehensive review of the level of competition in the DTCS market during the declaration inquiry for the DTCS. The ACCC used a more robust assessment of competition to define the competitive market. It considers that the areas removed from regulation in that review clearly delineate the competitive routes. The ACCC considers that the prices that are negotiated on competitive routes provide a reasonable indication of the prices that should apply on regulated routes.

Therefore the ACCC considers that pursuing alternative cost-based pricing approaches for the DTCS at this time would not lead to a significantly better regulatory outcome compared

to maintaining and improving the domestic benchmarking approach for another regulatory period.

The ACCC expects that if a benchmarking approach continues to apply, it will be able to refine and further improve the [2012 DTCS FAD regression modelling](#) in the 2015 DTCS FAD domestic benchmarking. Further, the collection of access providers' most recent prices for DTCS services will improve the quality of data available for the regression analysis. The ACCC expects that refinements to the methodology will include ongoing analysis of the key variables in determining prices and further consideration of how to set regulated prices derived from the model.

### Questions

- 1 Does the domestic benchmarking approach continue to be an efficient and appropriate methodology for setting regulated DTCS prices? Please provide detailed reasons.
- 2 Are there other methodologies that the ACCC should consider in determining a pricing model for setting regulated prices?
- 3 Regarding a methodology identified in question 2, how does it address the criteria specified in subsection 152BCA(1) of the CCA?
- 4 Regarding a methodology identified in question 2, how would it be applied (for example, with a fully allocated cost model) how would costs be allocated (including cost sharing factors) given transmission network characteristics?
- 5 Regarding a methodology identified in question 2, what are the likely resourcing requirements needed to give effect to it?
- 6 Regarding a methodology identified in question 2, what are the information requirements needed to undertake a robust analysis?
- 7 Regarding a methodology identified in question 2, what are the likely methodology costs?
- 8 Regarding a methodology identified in question 2, explain how that approach is likely to provide a materially better outcome to the benchmarking approach.

### 3.1 Stakeholder engagement in developing the regression model

The ACCC is mindful of issues raised by stakeholders in development of the regression model during the 2012 DTCS FAD consultation process and subsequent concerns (particularly about price) raised during a number of regulatory processes after the 2012 DTCS FAD was implemented (see Section 2.4).

The ACCC considers that any refinement of the regression model used for the benchmarking approach will be assisted through the engagement of stakeholders during the development of the 2015 DTCS FAD regression model. This will include:

- consideration of stakeholder submissions to this discussion paper
- engagement of stakeholders in preliminary analysis of the 2014 dataset to be used in the regression model (subject to the adoption of suitable confidentiality arrangements)

- consideration of the most appropriate way to determine final prices from the outputs of the regression model, and
- industry discussion via an industry forum.

The ACCC considers that there would be merit in stakeholders directly engaging in refining and improving the approach taken in the 2012 DTCS FAD. The ACCC is aware that some stakeholders have considered engaging independent statistical analysis experts to examine data obtained from industry participants. The ACCC would welcome such measures. The ACCC considers that a collaborative approach between relevant independent experts, with appropriate confidentiality safeguards in place in relation to the confidential industry data, will assist the ACCC to determine appropriate regression modelling analysis to inform prices for the 2015 DTCS FAD.

### Questions

- 9 What level of engagement by industry or independent experts would be necessary/appropriate for analysis of the pricing data in establishing the regression model for benchmarking DTCS prices?
- 10 What specific confidentiality safeguards are required to ensure that relevant experts have appropriate access to raw pricing data to assist the ACCC?

## 3.2 Issues for consideration of price terms of the 2015 DTCS FAD

The ACCC consulted extensively on a pricing approach to the DTCS prior to making the 2012 DTCS FAD. The ACCC's recent DTCS declaration inquiry assessed the state of competition for DTCS services to determine which services are sufficiently competitive to remove regulation. The ACCC considers that prices on those routes that the ACCC has assessed as competitive provide a reasonable indication of competitive pricing that should apply to non-competitive services.

### 3.2.1 Components of the regression model

Once the ACCC has obtained the pricing information required for the new dataset, it will consider whether the current variables used in the model remain appropriate and whether any other variables that impact on the price of the DTCS should be considered. The ACCC notes that in the course of the 2012 DTCS FAD Inquiry it considered a number of variables that it thought would impact on the price of the DTCS. Exploratory data analysis conducted by the ACCC's consultant Data Analysis Australia (DAA) found that many of these variables did not have a statistically significant input on price and were excluded from the final model. The ACCC proposes to re-evaluate these variables.

The ACCC recognises that there are many factors that may affect prices in the market, including the duration of contracts, the level of protection provided for a service,<sup>14</sup> quality of service levels in providing the service, demand for the service in particular regions/areas and discounts that may be made available as part of commercial negotiations such as the bundling of routes and whole of business contracts. The ACCC acknowledges that these factors and their influence on the regression analysis may have changed since the last process.

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<sup>14</sup> Protection of a service is also referred to as redundancy, where a route between two places has a backup route either alongside the main route (called "path" protection or diversity), or has a backup route via another geographically separate path (called "geographic" protection or diversity).



A regression model is favoured over a simple average of available prices, as used in the 2011 DTCS IAD, because it is more effective at accounting for the complex inter-relationships between the factors affecting DTCS pricing.

With regard to selecting price points, the ACCC notes that the mean value of the range of predicted prices is approximately midway between high and low predicted prices and is intended to balance the risk of setting prices too high or too low.

The ACCC considers that it may be appropriate to reconsider this mean value approach in the next FAD.

#### **Questions**

- 11 What changes to the 2012 DTCS FAD regression model should the ACCC consider in building the 2014 regression model to calculate benchmark prices for the 2015 DTCS FAD?
- 12 Which variables should the regression analysis focus on? Which variables should the regression analysis place less emphasis on and which should it disregard? Are there any additional variables that the ACCC should take into account in the model? Please provide reasoning.
- 13 Should the ACCC focus on prices negotiated since the 2012 DTCS FAD in establishing pricing benchmarks or should the ACCC only focus on prices negotiated in 2014?
- 14 Should the ACCC reconsider the approach to selecting the benchmarked price point to use to set regulated prices? If so, which approach would be more appropriate and why?
- 15 Are there any other issues that the ACCC should consider when developing the model?

### **3.2.2 Length of price term/s**

The ACCC expects to have a time series of pricing data to analyse including data gathered in 2011 for the 2012 DTCS FAD and data gathered in 2014 for the 2015 DTCS FAD. This longitudinal data may be useful in considering any trends in DTCS pricing over the period of the determination. The ACCC notes that technological advances may lead the cost of transmission equipment and infrastructure to fall over time. The ACCC wishes to consider whether it is appropriate to implement a pricing approach that would incorporate price reductions during the period of the access determination.

Alternatively the ACCC may consider a review of regulated prices during the term of the FAD (using new pricing data) to account for any price movements (due to market changes or demand changes) over time. The ACCC could conduct a variation inquiry if needed.

#### **Questions**

- 16 Is an approach that accounted for expected changes in price over time (that is, based on analysis of pricing data from 2011 to 2014 and projected forward into the next FAD period) appropriate for the next FAD?

17 Alternatively, should the ACCC consider periodic re-pricing during the next FAD? If so, why? How frequently should the ACCC consider re-pricing and should it be automatic or a full review?

### 3.2.3 Technology interface

The DTCS is provided using SDH, PDH and Ethernet network interfaces. The costs, data rates and prices vary for each, as do the capital costs associated with deploying either technology.

In the 2012 DTCS FAD the ACCC decided not to set separate prices for different network interfaces. Based on the dataset used by the ACCC for the 2012 DTCS FAD, the network interface variable was found to be statistically insignificant in determining DTCS prices and therefore did not warrant inclusion as a separate item in the Final Regression Model. The analysis by the ACCC consultant DAA during the 2012 DTCS FAD found that there was no statistically significant relationship between network interfaces to enable the model to predict separate prices based on this feature.

The ACCC will review whether the same level of pricing for both SDH and Ethernet services should remain in the 2015 DTCS FAD based on the information provided by industry in the updated dataset.

#### Questions

18 Should the pricing of services over the SDH interface be considered separately from Ethernet services?

### 3.2.4 Protection

The DTCS service description does not distinguish between protected and unprotected services. The ACCC remains of the view that a geographically protected service would be the minimum a DTCS access seeker would require to provide high quality downstream services and that FAD pricing of the DTCS should account for protected transmission services. The 2012 DTCS FAD regression model included protection as an explanatory variable.

The majority of the 2011 pricing data received from transmission service providers related to services that included some kind of protection, although the nature and extent of the protection was not always specifically disclosed. The 2014 data request will seek additional information from access providers regarding the type of protection for each service.

#### Questions

19 Should the ACCC maintain the approach to incorporate a variable for 'protection' in the regression model?

20 What is the minimum form of protection required for a DTCS service?

### 3.2.5 Quality of Service

Transmission service providers differ in their quality of service. For example, this may be due to their network coverage, their ability to service maintenance and repairs, or their ability to offer a wide suite of services. The 2012 DTCS FAD regression model accounts for the differences in quality of service between different providers by incorporating an assessment

of 'quality of service' as a separate explanatory variable. Prices have been based on those of a provider with the highest quality of service.

#### **Questions**

- 21 Is quality of service sufficiently reflected in the 2012 DTCS FAD regression model?
- 22 If so, should the ACCC maintain the same approach in the next FAD? What are the benefits and costs of maintaining the same approach?
- 23 If not, how should quality of service be incorporated into the regression model?

### **3.2.6 Route category**

The 2012 DTCS FAD adopted three route categories for the FAD regression model inter-capital, metropolitan and regional. The ACCC notes that Telstra is using a route type matrix to price its Managed Leased Line (MLL) service. The matrix prices a route based on its A-end and B-end locations categorised under sixteen different route types. Other providers use radial distance or zone based approaches.

The ACCC will consider whether a route type matrix is an appropriate form of DTCS pricing for the 2015 DTCS FAD or whether it should maintain the route categorisation approach used in the 2012 DTCS FAD model.

#### **Questions**

- 24 Are the route categories of inter-capital, metropolitan and regional relevant for the next FAD?
- 25 Should the ACCC consider adopting a route type matrix approach for pricing in the next FAD?
- 26 Are there any alternative approaches to the existing route categories or Telstra route type matrix that balance transparency and simplicity with a higher level of cost reflectivity?

### **3.2.7 Distance**

The ACCC recognises that various commercial pricing constructs are used by access providers to account for the distance variable for DTCS services. For example, as noted above, Telstra uses a route type matrix to price its MLL service. The 2012 DTCS FAD used radial distance between the A-end and B-end locations.

The ACCC notes that distance is one of the key statistically significant variables that impacts pricing in the regression analysis.

#### **Questions**

- 27 Should the ACCC continue with its approach to the distance variable in the regression analysis?
- 28 Should the ACCC consider using a route type matrix in deriving DTCS pricing from the regression model?

### 3.2.8 Capacity

The DTCS declaration specifies a minimum capacity of 2Mbps. During the data gathering exercise for the 2012 DTCS FAD the ACCC found that the majority of services (over 90 per cent) were provided at the 2Mbps capacity. There was general agreement among stakeholders during the 2012 consultation process that the ACCC should set prices for the capacities that are commonly available for transmission services.

However, the ACCC notes from recent information provided to the ACCC and data obtained from DTCS access agreements lodged with the ACCC that 2Mbps services are reducing as a proportion of total contracts entered into for DTCS services. The current service description specifies that the network interface for DTCS services is used to provide a transmission rate of 2.048Mbps or above.

During the 2012 DTCS FAD process the ACCC obtained limited data on prices for higher order capacities such as 1, 2.5 and 10Gbps services due to the relatively small number of higher capacity DTCS services in the market. The ACCC expects that there will be an increased level of data for higher capacity services obtained for the 2015 DTCS FAD.

The ACCC invites submissions on the appropriate range of capacities for DTCS services to be priced.

#### Questions

- 29 What range of capacities should the ACCC price?
- 30 Should the range of capacities for which the FAD prices apply be reviewed during the term of the next FAD?

### 3.2.9 Contract length and terms

The ACCC notes that contracts of varying length are normal for the supply of the DTCS, with contract length generally ranging from 12 to 36 months. The ACCC understands that discounts for connection charges are applied for longer term contracts and notes that it is likely that this reflects the incremental costs of continuing to provide a service. The 2012 DTCS price calculator was based on a contract period of 12 months.

#### Questions

- 31 To what extent should the regression analysis focus on contract length?
- 32 Should the ACCC continue to price the DTCS for a contract period of 12 months in the next FAD? If not, what term period should be considered and what are the costs and benefits of an alternative approach?

### 3.2.10 Discounts

The 2012 DTCS FAD pricing was based on a dataset that contained a variety of discounts included in the data. However not all discounts were included or identified by access providers. For the 2015 DTCS FAD the ACCC intends to include all possible discounts into the pricing data set to ensure that the output reflects the efficient costs of providing the DTCS.

### Questions

- 33 How should the ACCC take into consideration the effect of term and/or whole-of-business discounts in setting DTCS prices in the next FAD?
- 34 Which of the discounts, which are made available as part of commercial negotiations, should be taken into account in the regression analysis?

#### 3.2.11 Demand

The ACCC is considering if the effect of demand on non-competitive routes would impact on the benchmarking approach. Demand variables such as population density, business and residential components and expected growth influence the level of transmission services required.

The ACCC considers that there may be difficulties in incorporating actual demand into the regression analysis. The ACCC will consider how to incorporate proxies for demand or utilisation in the modelling.

### Questions

- 35 Should the regression analysis consider the level of demand (reflected by some measure such as a combination of population density and services in operation) as a variable in the analysis?
- 36 Should some other account of demand be included in the regression analysis?

#### 3.2.12 Tail-end services

The ACCC notes that all tail-end services, including tail-end services that are bundled with an inter-exchange component, are considered regulated and remain within the scope of the declaration. The ACCC also notes that where a bundled product contains a deregulated route and a regulated tail-end, such services remain regulated.

The ACCC recognises the market practice of bundling a tail-end service with other routes and notes that the prices provided by the 2012 DTCS FAD contained end-to-end prices for declared inter-capital, regional and metropolitan services that included a bundled tail-end element.

In the 2012 DTCS FAD the ACCC considered that setting prices for stand-alone tail-end prices using the regression model with an average distance of two kilometres was an appropriate approach. This applied only to tail-end services that are provided as stand-alone services and not to tail-end services that are bundled with other transmission services.

### Questions

- 37 Should the pricing of tail-end services as a stand-alone product be revised to reflect the market practice of bundling?

#### 3.2.13 NBN POIs

Transmission services will also be necessary to support the delivery of NBN services. RSPs providing end-users with NBN voice and data services will require transmission services to carry traffic between the 121 NBN POIs and their points of presence (POP), usually located

in a capital city location. The ACCC considers that NBN POIs are likely to form an important location from which transmission investment and competition is likely to emerge.

The ACCC is considering whether transmission pricing on NBN POI routes should be a particular focus for the benchmarking approach. The ACCC notes that under the current declaration, 75 of the 121 NBN Co POIs are located in deregulated ESAs. The remaining POIs will be subject to regulated pricing in the 2015 DTCS FAD.

#### Questions

- 38 Should pricing on deregulated NBN POI routes be considered separately in undertaking the regression analysis for the next FAD?

### 3.2.14 Prices for services between the mainland and Tasmania

For the 2012 DTCS FAD modelling, services between the mainland and Tasmania incorporated a submarine cable route of approximately 300km in length. ACCC analysis found that the average price of submarine routes was 40 per cent higher than mainland inter-capital routes. The 2012 DTCS FAD provided an uplift factor of 40 per cent (on the undersea cable component only) for transmission services to Tasmania to account for the higher costs of deploying and maintaining the submarine link.

#### Questions

- 39 Should the 2015 DTCS FAD maintain an uplift on pricing to Tasmania to reflect the higher costs associated with the route? If so, does 40% remain appropriate?

### 3.3 Non-price terms for the DTCS

Submissions regarding non-price terms for the DTCS are being initially considered in the [Telecommunications Final Access Determination inquiries—non-price terms and conditions and supplementary prices consultation](#). Please refer to the concurrent consultation for information.

### 3.4 Access to facilities

Submissions regarding non-price terms for the DTCS are being initially considered in the [Telecommunications Final Access Determination inquiries—non-price terms and conditions and supplementary prices consultation](#). Please refer to the concurrent consultation for information.

### 3.5 Commencement and expiry

The 2012 DTCS FAD will expire on 31 December 2014. A FAD must have an expiry date which should align with the expiry of the declaration for that service unless there are circumstances that warrant a different expiry date.<sup>15</sup>

The ACCC notes that the DTCS, and transmission services more generally, are provided in the market under contracts of different duration. Based on the most recent available information, the most common duration for transmission contracts appear to be 12 to 36 months. Contracts of shorter and longer terms are evident in the market but appear to be

<sup>15</sup> Subsection 152BCF(6) of the CCA.

offered less frequently. The ACCC is also aware that DTCS customers may be on month-by-month arrangements in the interim period between contract negotiations.

The 2012 DTCS FAD expiry date was set at 31 December 2014 to allow for the DTCS declaration inquiry to be completed as FAD prices under a benchmarking approach are set based on the areas declared under the service description.

The declaration for the DTCS expires on 31 March 2019. The ACCC is considering whether the FAD for the DTCS should expire when the DTCS declaration expires or at some time after the expiry of the declaration (to allow for any renewal or variation of the DTCS declaration).

If the expiry date is set in alignment with the expiry date for the declaration, this would result in a regulatory period for the 2015 DTCS FAD of just over four years. The ACCC considers this period would be long enough to provide sufficient stability and certainty to support industry investment planning. However, the ACCC notes that should prices change significantly, the price terms of the DTCS could be reviewed subject to a variation inquiry if deemed necessary.

#### **Questions**

- 40 What is an appropriate time period for the next FAD?
- 41 Are there any circumstances that warrant a difference in the expiry dates of the access determination and the DTCS declaration?
- 42 If price terms of the DTCS are reviewed during the course of the FAD term, what would be an appropriate period in which such a review should take place?

## Appendix 1 – Legislative framework for final access determinations

This section sets out the relevant legislative framework in relation to FADs and the approach the ACCC will take in applying the legislative provisions.

### ***Content of a FAD***

Section 152BC of the CCA specifies what a FAD may contain. It includes, among other things, terms and conditions on which a carrier or carriage service provider (CSP) is to comply with the standard access obligations provided for in the CCA and terms and conditions of access to a declared service.

A FAD may make different provisions with respect to different access providers or access seekers.<sup>16</sup>

### ***Fixed principles provisions***

A FAD may contain a fixed principles provision, which allows a provision in a FAD to have an expiry date after the expiry date of the FAD.<sup>17</sup> Such a provision would allow the ACCC to 'lock-in' a term so that it would be consistent across multiple FADs.

### ***Varying a FAD***

Section 152BCN allows the ACCC to vary or revoke a FAD, provided that certain procedures are followed.

A fixed principles provision cannot be varied or removed unless the FAD sets out the circumstances in which the provision can be varied or removed, and those circumstances are present.<sup>18</sup>

### ***Commencement and expiry provisions***

Section 152BCF of the CCA sets out the commencement and expiry rules for FADs.

A FAD may be backdated up to 1 January 2011.<sup>19</sup>

A FAD must have an expiry date, which should align with the expiry of the declaration for that service unless there are circumstances that warrant a different expiry date.<sup>20</sup>

### ***Criteria to consider when making a FAD***

The ACCC must have regard to the criteria specified in subsection 152BCA(1) of the CCA when making a FAD. These criteria are:

- a) whether the determination will promote the LTIE of carriage services or services supplied by means of carriage services

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<sup>16</sup> Subsection 152BC(5) of the CCA.

<sup>17</sup> Section 152BCD of the CCA.

<sup>18</sup> Subsection 152BCN(4) of the CCA.

<sup>19</sup> Subsections 152BCF(2) and (2A) of the CCA.

<sup>20</sup> Subsection 152BCF(6) of the CCA.



- b) the legitimate business interests of a carrier or CSP who supplies, or is capable of supplying, the declared service, and the carrier's or provider's investment in facilities used to supply the declared service
- c) the interests of all persons who have rights to use the declared service
- d) the direct costs of providing access to the declared service
- e) the value to a person of extensions, or enhancement of capability, whose cost is borne by someone else
- f) the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility
- g) the economically efficient operation of a carriage service, a telecommunications network or a facility.

The subsection 152BCA(1) criteria mirrors the repealed subsection 152CR(1) criteria that the ACCC was required to take into account in making a final determination (FD) in an access dispute. The ACCC intends to interpret the subsection 152BCA(1) criteria in a similar manner to that used in access disputes.

Subsection 152BCA(2) sets out other matters that the ACCC may take into account in making FADs.

Subsection 152BCA(3) allows the ACCC to take into account any other matters that it thinks are relevant.

The ACCC's initial views on how the legislative criteria in section 152BCA should be interpreted for the FAD process are set out below.

### ***Paragraph 152BCA(1)(a) – long-term interests of end-users***

The first criterion for the ACCC to consider when making a FAD is 'whether the determination will promote the long-term interests of end-users of carriage services or of services supplied by means of carriage services'.

The ACCC has published a guideline explaining what it understands by the phrase 'long-term interests of end-users' in the context of its declaration responsibilities.<sup>21</sup> This approach to the LTIE was also used by the ACCC in making determinations in access disputes. The ACCC considers that the same interpretation is appropriate for making FADs for the declared DTCS.

In the ACCC's view, particular terms and conditions promote the interests of end-users if they are likely to contribute towards the provision of:

- goods and services at lower prices
- goods and services of a high quality, and/or
- a greater diversity of goods and services.<sup>22</sup>

The ACCC also notes that the Australian Competition Tribunal (Tribunal) has offered guidance in its interpretation of the phrase 'long-term interests of end-users' (in the context of access to subscription television services):

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<sup>21</sup> ACCC, *Telecommunications services – declaration provisions: a guide to the declaration provisions of Part XIC of the Trade Practices Act*, July 1999, in particular pp. 31-38.

<sup>22</sup> *ibid.*, p. 33.

Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary to take the following matters into account when applying the touchstone – the long-term interests of end-users:

- End-users: “end-users” include actual and potential [users of the service]...
- Interests: the interests of the end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings. ...[T]his would include access to innovations ... in a quicker timeframe than would otherwise be the case ...
- Long-term: the long-term will be the period over which the full effects of the ... decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the ... industry) to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit – strategies.<sup>23</sup>

To consider the likely impact of particular terms and conditions on the LTIE, the CCA requires the ACCC to have regard to whether the terms and conditions are likely to result in:

- promoting competition in markets for carriage services and services supplied by means of carriage services
- achieving any-to-any connectivity, and
- encouraging the economically efficient use of, and economically efficient investment in:
  - the infrastructure by which listed carriage services are supplied, and
  - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.<sup>24</sup>

### **Promoting competition**

In assessing whether particular terms and conditions will promote competition, the ACCC will analyse the relevant markets in which the declared services are supplied (retail and wholesale) and consider whether the terms set in those markets remove obstacles to end-users gaining access to telephony and broadband services.<sup>25</sup>

Obstacles to accessing these services include the price, quality and availability of the services and the ability of competing providers to provide telephony and broadband services.

The ACCC is not required to precisely define the scope of the relevant markets in which the declared services are supplied. The ACCC considers that it is sufficient to broadly identify the scope of the relevant markets likely to be affected by the ACCC’s regulatory decision.

### **Any-to-any connectivity**

The CCA gives guidance on how the objective of any-to-any connectivity is achieved. It is achieved only if each end-user who is supplied with a carriage service that involves communication between end-users is able to communicate, by means of that service, with each other end-user who is supplied with the same service or a similar service. This must be

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<sup>23</sup> *Seven Network Limited (No 4)* [2004] ACompT 11 at [120].

<sup>24</sup> Subsection 152AB(2) of the CCA.

<sup>25</sup> Subsection 152AB(4) of the CCA. This approach is consistent with the approach adopted by the Tribunal in *Telstra Corporations Limited (No 3)* [2007] A CompT 3 at [92]; *Telstra Corporation Limited* [2006] A CompT at [97], [149].

the case whether or not the end-users are connected to the same telecommunications network.<sup>26</sup>

The ACCC considers that this criterion is relevant to ensuring that the terms and conditions contained in FADs do not create obstacles for the achievement of any-to-any connectivity.

### **Efficient use of and investment in infrastructure**

In determining the extent to which terms and conditions are likely to encourage the economically efficient use of and investment in infrastructure, the ACCC must have regard to:

- whether it is, or is likely to become, technically feasible for the services to be supplied and charged for, having regard to:
- the technology that is in use, available or likely to become available
- whether the costs involved in supplying and charging for, the services are reasonable or likely to become reasonable
- the effects or likely effects that supplying and charging for the services would have on the operation or performance of telecommunications networks
- the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope
- incentives for investment in the infrastructure by which services are supplied; and any other infrastructure (for example, the NBN) by which services are, or are likely to become, capable of being supplied, and
- the risks involved in making the investment.<sup>27</sup>

The objective of encouraging the 'economically efficient use of, and economically efficient investment in ... infrastructure' requires an understanding of the concept of economic efficiency. Economic efficiency consists of three components:

- productive efficiency – this is achieved where individual firms produce the goods and services that they offer at efficient cost
- allocative efficiency – this is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e. those that provide the greatest benefit relative to costs), and
- dynamic efficiency – this reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and productive opportunities.

On the issue of efficient investment, the Tribunal has stated that:

...An access charge should be one that just allows an access provider to recover the costs of efficient investment in the infrastructure necessary to provide the declared service.<sup>28</sup>

...efficient investment by both access providers and access seekers would be expected to be encouraged in circumstances where access charges were set to ensure recovery of the efficient costs of investment (inclusive of a normal return on

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<sup>26</sup> Subsection 152AB(8) of the CCA.

<sup>27</sup> Subsections 152AB(6) and (7A) of the CCA.

<sup>28</sup> *Telstra Corporation Ltd (No. 3)* [2007] ACompT 3 at [159].

investment) by the access provider in the infrastructure necessary to provide the declared service.<sup>29</sup>

...access charges can create an incentive for access providers to seek productive and dynamic efficiencies if access charges are set having regard to the efficient costs of providing access to a declared service.<sup>30</sup>

### ***Paragraph 152BCA(1)(b) – legitimate business interests***

The second criterion requires the ACCC to consider 'the legitimate business interests' of the carrier or CSP when making a FAD.

In the context of access disputes, the ACCC considered that it was in the access provider's legitimate business interests to earn a normal commercial return on its investment.<sup>31</sup> The ACCC is of the view that the concept of 'legitimate business interests' in relation to FADs should be interpreted in a similar manner, consistent with the phrase 'legitimate commercial interests' used elsewhere in Part XIC of the CCA.

For completeness, the ACCC notes that it would be in the access provider's legitimate business interests to seek to recover its costs as well as a normal commercial return on investment having regard to the relevant risk involved. However, an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.<sup>32</sup>

The Tribunal has taken a similar view of the expression 'legitimate business interests'.<sup>33</sup>

### ***Paragraph 152BCA(1)(c) – persons who have a right to use***

The third criterion requires the ACCC to consider 'the interests of all persons who have the right to use the service' when making a FAD.

The ACCC considers that this criterion requires it to have regard to the interests of access seekers. The Tribunal has also taken this approach.<sup>34</sup> The access seekers' interests would not be served by higher access prices to declared services, as it would inhibit their ability to compete with the access provider in the provision of retail services.<sup>35</sup>

People who have rights to currently use a declared service will generally use that service as an input to supply carriage services, or a service supplied by means of carriage service, to end-users.

The ACCC considers that this class of persons has an interest in being able to compete for the custom of end-users on the basis of their relative merits. This could be prevented from occurring if terms and conditions of access favour one or more service providers over others, thereby distorting the competitive process.<sup>36</sup>

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<sup>29</sup> *ibid.* at [164].

<sup>30</sup> *ibid.*

<sup>31</sup> ACCC, *Resolution of telecommunications access disputes – a guide*, March 2004 (revised) (Access Dispute Guidelines), p. 56.

<sup>32</sup> ACCC, *Access pricing principles—telecommunications*, July 1997 (1997 Access Pricing Principles), p. 9.

<sup>33</sup> *Telstra Corporation Limited* [2006] ACompT 4 at [89].

<sup>34</sup> *Telstra Corporation Limited* [2006] ACompT 4 at [91].

<sup>35</sup> *ibid.*

<sup>36</sup> *ibid.*

However, the ACCC does not consider that this criterion calls for consideration to be given to the interests of the users of these 'downstream' services. The interests of end-users will already be considered under other criteria.

#### ***Paragraph 152BCA(1)(d) – direct costs of providing access***

The fourth criterion requires that the ACCC consider 'the direct costs of providing access to the declared service' when making a FAD.

The ACCC considers that the direct costs of providing access to a declared service are those incurred (or caused) by the provision of access, and includes the incremental costs of providing access.

The ACCC interprets this criterion, and the use of the term 'direct costs', as allowing consideration to be given to a contribution to indirect costs. This is consistent with the Tribunal's approach in an undertaking decision.<sup>37</sup> A contribution to indirect costs can also be supported by other criteria.

However, the criterion does not extend to compensation for loss of any 'monopoly profit' that occurs as a result of increased competition.<sup>38</sup>

The ACCC also notes that the Tribunal (in another undertaking decision) considered the direct costs criterion 'is concerned with ensuring that the costs of providing the service are recovered.'<sup>39</sup> The Tribunal has also noted that the direct costs could conceivably be allocated (and hence recovered) in a number of ways and that adopting any of those approaches would be consistent with this criterion.<sup>40</sup>

#### ***Paragraph 152BCA(1)(e) – extensions or enhancements of capability***

The fifth criterion requires that the ACCC consider 'the value to a party of extensions, or enhancements of capability, whose cost is borne by someone else' when making a FAD.

In the 1997 Access Pricing Principles, the ACCC stated:

This criterion requires that if an access seeker enhances the facility to provide the required services, the access provider should not attempt to recover for themselves any costs related to this enhancement. Equally, if the access provider must enhance the facility to provide the service, it is legitimate for the access provider to incorporate some proportion of the cost of doing so in the access price.<sup>41</sup>

The ACCC considers that this application of paragraph 152BCA(1)(e) is relevant to making FADs.

#### ***Paragraph 152BCA(1)(f) – safe and reliable operation***

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<sup>37</sup> *Application by Optus Mobile Pty Limited and Optus Networks Pty Limited* [2006] ACompT 8 at [137].

<sup>38</sup> See Explanatory Memorandum for the *Trade Practices Amendment (Telecommunications) Bill 1996*, p. 44: [T]he 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.

<sup>39</sup> *Telstra Corporation Limited* [2006] ACompT 4 at [92].

<sup>40</sup> *ibid.* at [139].

<sup>41</sup> 1997 Access Pricing Principles, p. 11.

The sixth criterion requires the ACCC to consider ‘the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility’ when making a FAD.

The ACCC considers that this criterion requires that terms of access should not compromise the safety or reliability of carriage services and associated networks or facilities, and that this has direct relevance when specifying technical requirements or standards to be followed.

The ACCC has previously stated in the context of model non-price terms and conditions that:

...this consideration supports the view that model terms and conditions should reflect the safe and reliable operation of a carriage service, telecommunications network or facility. For instance, the model non-price terms and conditions should not require work practices that would be likely to compromise safety or reliability.<sup>42</sup>

The ACCC considers that these views will apply in relation to the paragraph 152BCA(1)(f) criterion for the making of FADs.

### ***Paragraph 152BCA(1)(g) – economically efficient operation***

The final criterion of subsection 152BCA(1) requires the ACCC to consider ‘the economically efficient operation of a carriage service, a telecommunications network facility or a facility’ when making a FAD.

The ACCC noted in the Access Dispute Guidelines (in the context of arbitrations) that the phrase ‘economically efficient operation’ embodies the concept of economic efficiency as discussed earlier under the LTIE. That is, it calls for a consideration of productive, allocative and dynamic efficiency. The Access Dispute Guidelines also note that in the context of a determination, the ACCC may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated efficiently.<sup>43</sup>

Consistent with the approach taken by the Tribunal, the ACCC considers that it is relevant to consider the economically efficient operation of:

- retail services provided by access seekers using the access provider’s services or by the access provider in competition with those access seekers, and
- the telecommunications networks and infrastructure used to supply these services.<sup>44</sup>

### ***Subsection 152BCA(2) – other eligible services***

Subsection 152BCA(2) provides that, in making an FAD that applies to a carrier or CSP who supplies, or is capable of supplying, the declared services, the ACCC may, if the carrier or provider supplies one or more eligible services,<sup>45</sup> take into account:

- the characteristics of those other eligible services
- the costs associated with those other eligible services
- the revenues associated with those other eligible services, and
- the demand for those other eligible services.

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<sup>42</sup> ACCC, *Final determination – Model Non-price Terms and Conditions*, November 2008, p. 8.

<sup>43</sup> Access Dispute Guidelines, p. 57.

<sup>44</sup> *Telstra Corporation Limited* [2006] ACompT at [94]-[95].

<sup>45</sup> ‘Eligible service’ has the same meaning as in section 152AL of the CCA.

The Explanatory Memorandum states that this provision is intended to ensure that the ACCC, in making an FAD, does not consider the declared service in isolation, but also considers other relevant services.<sup>46</sup> As an example, the Explanatory Memorandum states:

...when specifying the access price for a declared service which is supplied by an access provider over a particular network or facility, the ACCC can take into account not only the access provider's costs and revenues associated with the declared service, but also the costs and revenues associated with other services supplied over that network or facility.<sup>47</sup>

The ACCC proposes to consider the costs and revenues associated with other services, whether declared or not declared, that are provided over a transmission network when making a FAD for the DTCS.

### ***Subsection 152BCA(3) – any other relevant matters***

This subsection states the ACCC may take into account any other matters that it thinks are relevant when making a FAD.

The ACCC is of the view that considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs.

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<sup>46</sup> Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 178.

<sup>47</sup> *ibid.*

## Appendix 2 – Consolidated list of questions for comment

- 1 Does the domestic benchmarking approach continue to be an efficient and appropriate methodology for setting regulated DTCS prices? Please provide detailed reasons.
- 2 Are there other methodologies that the ACCC should consider in determining a pricing model for setting regulated prices?
- 3 Regarding a methodology identified in question 2, how does it address the criteria specified in subsection 152BCA(1) of the CCA?
- 4 Regarding a methodology identified in question 2, how would it be applied (for example, with a fully allocated cost model) how would costs be allocated (including cost sharing factors) given transmission network characteristics?
- 5 Regarding a methodology identified in question 2, what are the likely resourcing requirements needed to give effect to it?
- 6 Regarding a methodology identified in question 2, what are the information requirements needed to undertake a robust analysis?
- 7 Regarding a methodology identified in question 2, what are the likely methodology costs?
- 8 Regarding a methodology identified in question 2, explain how that approach is likely to provide a materially better outcome to the benchmarking approach.
- 9 What level of engagement by industry or independent experts would be necessary/appropriate for analysis of the pricing data in establishing the regression model for benchmarking DTCS prices?
- 10 What specific confidentiality safeguards are required to ensure that relevant experts have appropriate access to raw pricing data to assist the ACCC?
- 11 What changes to the 2012 DTCS FAD regression model should the ACCC consider in building the 2014 regression model to calculate benchmark prices for the 2015 DTCS FAD?
- 12 Which variables should the regression analysis focus on? Which variables should the regression analysis place less emphasis on and which should it disregard? Are there any additional variables that the ACCC should take into account in the model? Please provide reasoning.
- 13 Should the ACCC focus on prices negotiated since the 2012 DTCS FAD in establishing pricing benchmarks or should the ACCC only focus on prices negotiated in 2014?
- 14 Should the ACCC reconsider the approach to selecting the benchmarked price point to use to set regulated prices? If so, which approach would be more appropriate and why?



- 15 Are there any other issues that the ACCC should consider when developing the model?
- 16 Is an approach that accounted for expected changes in price over time (that is, based on analysis of pricing data from 2011 to 2014 and projected forward into the next FAD period) appropriate for the next FAD?
- 17 Alternatively, should the ACCC consider periodic re-pricing during the next FAD? If so, why? How frequently should the ACCC consider re-pricing and should it be automatic or a full review?
- 18 Should the pricing of services over the SDH interface be considered separately from Ethernet services?
- 19 Should the ACCC maintain the approach to incorporate a variable for 'protection' in the regression model?
- 20 What is the minimum form of protection required for a DTCS service?
- 21 Is quality of service sufficiently reflected in the 2012 DTCS FAD regression model?
- 22 If so, should the ACCC maintain the same approach in the next FAD? What are the benefits and costs of maintaining the same approach?
- 23 If not, how should quality of service be incorporated into the regression model?
- 24 Are the route categories of inter-capital, metropolitan and regional relevant for the next FAD?
- 25 Should the ACCC consider adopting a route type matrix approach for pricing in the next FAD?
- 26 Are there any alternative approaches to the existing route categories or Telstra route type matrix that balance transparency and simplicity with a higher level of cost reflectivity?
- 27 Should the ACCC continue with its approach to the distance variable in the regression analysis?
- 28 Should the ACCC consider using a route type matrix in deriving DTCS pricing from the regression model?
- 29 What range of capacities should the ACCC price?
- 30 Should the range of capacities for which the FAD prices apply be reviewed during the term of the next FAD?
- 31 To what extent should the regression analysis focus on contract length?
- 32 Should the ACCC continue to price the DTCS for a contract period of 12 months in the next FAD? If not, what term period should be considered and what are the costs and benefits of an alternative approach?
- 33 How should the ACCC take into consideration the effect of term and/or whole-of-business discounts in setting DTCS prices in the next FAD?

- 34 Which of the discounts, which are made available as part of commercial negotiations, should be taken into account in the regression analysis?
- 35 Should the regression analysis consider the level of demand (reflected by some measure such as a combination of population density and services in operation) as a variable in the analysis?
- 36 Should some other account of demand be included in the regression analysis?
- 37 Should the pricing of tail-end services as a stand-alone product be revised to reflect the market practice of bundling?
- 38 Should pricing on deregulated NBN POI routes be considered separately in undertaking the regression analysis for the next FAD?
- 39 Should the 2015 DTCS FAD maintain an uplift on pricing to Tasmania to reflect the higher costs associated with the route? If so, does 40% remain appropriate?
- 40 What is an appropriate time period for the next FAD?
- 41 Are there any circumstances that warrant a difference in the expiry dates of the access determination and the DTCS declaration?
- 42 If price terms of the DTCS are reviewed during the course of the FAD term, what would be an appropriate period in which such a review should take place?