Response to Domestic Transmission Capacity Service FAD on Primary Prices

October 2014

The CCC welcomes the opportunity to comment on the DTCS Primary Prices discussion paper.

The DTCS domestic benchmarking process used to establish the FAD 2012 has clearly failed to result in regulated prices that approximate efficient costs. The flaws in the domestic benchmarking methodology were clearly apparent at the time of the FAD, the had the Commission subjected the outputs of its regression model to some basic reality checking. The industry reported pricing anomalies to the Commission that should have caused it to revise its approach.

For example, the CCC and its members reported to the Commission that there were numerous instances of regulated prices on non-competitive transmission routes, that were above the price being offered commercially. This is clearly counter-intuitive and should have caused the Commission to review its methodology.

In addition, international comparisons of leased line charges published by the OECD (*OECD Communications Outlook 2012*) should be of grave concern to the Commission. The OECD found Australia had the third most expensive monthly charges for its 2mbps leased line basket.

The CCC submits that the Commission should, as a matter of course, utilise these additional data as points of comparisons if it is to be confident that its pricing decisions are sensible. If the Commission is to avoid a repeat of the obviously wildly inadequate results produced by its benchmarking exercise in 2012, it must actively seek out further sources of information to provide validation - or otherwise - of its proposed pricing.

The CCC believes the Commission should move toward a cost-basedbuilding block approach to setting DTCS pricing. However, the regulated prices in the market today are so flawed that immediate action is required. If the Commission wishes to proceed with a domestic benchmarking methodology to provide that timely action, it must do so based on a roundly revised and improved approach.

That is, only a willingness on the part of the Commission to rigorously reappraise its benchmarking methodology and the assumptions underlying it can bring the benchmarking approach closer to providing a meaningful proxy of efficient costs. These outputs should then be assessed alongside other data as a form of reality check, and adjusted in response.

The flawed FAD prices have caused disruption and dislocation in transmission markets, and it is incumbent on the Commission to employ much more rigorous and detailed analysis to avoid a repetition of this situation.

The damaging impacts of the Commission's flawed 2012 DTCS FAD cannot be overstated. The DTCS is a crucial input into all downstream retail services, both in fixed line and mobile, and a failure to regulate these prices effectively entrenches Telstra's incumbency across all markets. Telstra remains uniquely able to leverage market power nationally, both vertically and horizontally, for as long as it is able to enjoy the massive above-cost pricing advantage it has over competitors in transmission markets.

This is not only true in those regional locations where Telstra enjoys monopoly transmission access. The ability of Telstra to self-supply in these locations at internal costs that are clearly of an order of magnitude below regulated prices, means it can offer nationally bundled services at prices competitors cannot replicate.

Chief among the methodological flaws and additional sources of information the CCC believes the Commission must address, in order to develop more reliable benchmarks are:

- The practice of averaging prices to establish benchmark competitive prices should be abandoned. The rationale for benchmarking competitive routes is that this provides a proxy to efficient prices. Averaging prices corrupts the output because it does not take account of the reality that customers without bargaining power continue to pay above-cost prices.
- Much more critical analysis must be applied to the routes determined to be competitive. The decision to remove some routes from the list of those previously considered competitive demonstrates the risks associated with poor analysis.
- Outdated technologies (such as TDM) should be removed from the modelling sample. These inefficient and more costly technologies skew the results, and are inconsistent with establishing an efficient, forward-looking cost benchmark.
- Discounts must be accounted for, even those hidden in "bundled" contracts or not linked to a specific service. These discounts create artificially high headline prices.
- Internal Telstra cost data, such as that used to establish contract prices, should be interrogated to provide insights into Telstra's own cost analyses.
- The Commission should analyse the impact of competitive entry in the form of new fibre builds on the level of prices on specific routes, to establish the types of margins by which prices can be expected to fall once monopoly rents are stripped back.
- Retail price levels and trends for high capacity data services (such as tail services for corporate customers) should be used to compare with wholesale transmission services.
- Deeper engagement with the industry and independent experts to further reality-check the outputs of the Commission's model as it is refined.

Contact

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