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TransACT Communications Pty Ltd

Submission on

Australian Competition & Consumer Commission

Domestic Transmission Capacity Service

An ACCC Discussion Paper

reviewing pricing of the domestic transmission capacity service

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Mr Grahame O'Leary
Director
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"By Email"

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Dear Mr. O'Leary

TransACT Communications Pty Ltd (TransACT) is pleased to submit a response to the Australian Competition & Consumer Commission (ACCC) *'Discussion Paper'* reviewing pricing of the Domestic Transmission Capacity Service (DTCS), released by the Commission on 30 April 2010.[1]

As the Commission would appreciate, there has been a considerable amount of time and effort placed in the ongoing review of access pricing principles, where recently a review of the 1997 Guide to Telecommunications Access Pricing Principles for fixed-line services (the APP Review) was conducted by the ACCC. TransACT Capital Communications Pty Ltd (a 100% subsidiary of TransACT Communications Pty Ltd) provided a response on the *APP Review*[2] to the ACCC and also the *Draft Pricing Principles and Indicative Prices for LCS, WLR, PSTN OTA, ULLS and LSS,* released by the Commission on 21 August 2009.[3]

As the ACCC has noted in the *Discussion Paper* there are a number of other regulatory developments, other than the review of access pricing principles that may have relevance to a review of pricing for the DTCS including:

- Regulatory reform proposals in the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 (the CCS Bill 2009);
- the Regional Backbone Blackspots Program; and
- National Broadband Network (NBN) company (NBN Co) pronouncements on its wholesale services and backhaul.

It will be important that the ACCC not only provides regulatory certainty in a National Broadband Network (NBN) environment, but also ensures that regulated pricing for the DTCS during any transition period to an NBN continues to promote industry investment, competition and the long-term interests of end users (LTIE). In order to promote the LTIE, the regulatory framework should support ubiquity and equivalence of access to transmission and access networks for all access seekers (Retail Service Providers), pre and post deployment of an NBN.

[1] http://www.accc.gov.au/content/index.phtml/itemId/923575
[2] TransACT's response to the discussion paper - 26 February 2010.pdf
[3] TransAct submission on draft pricing principles & indicative prices 9 October 2009.pdf

Introduction

Since 2001 TransACT has been rolling out a fibre-optic network in the Australian Capital Territory (ACT) region to provide Canberra and Queanbeyan with the next generation of communication services. TransACT's philosophy has always been to operate an open access network. The Australian Government's announcements to invest up to $43 billion over eight years to build and operate a "wholesale only" NBN and to immediately invest up to $250 million to improve the supply of transmission services to black spot areas, supports TransACT's original premise.

TransACT has successfully built, and operates a fibre rich network, which supports a rich array of retail and wholesale telecommunication services. TransACT offers a comprehensive selection of telecommunications products and services including:

- fixed line and mobile telephony;
- high speed broadband;
- broadcast subscription television services featuring a wide choice of channels; and
- demand based video featuring a wide variety of content.

TransACT also works with a range of service and content providers in order to deliver these services. Currently eleven ISPs access TransACT's network to provide competitive broadband products and services to end users.

TransACT products and services are now available to over 100,000 premises across the ACT and Queanbeyan, directly connected via TransACT's fibre networks and supplemented by ADSL over the ULLS. Utilising other wholesale access services, such as LCS and WLR, a complete local and long distance phone service is also available in Sydney and south-east NSW including Bega, Berridale, Bombala, Crookwell, Cooma, Goulburn, Gunning, Nowra, Thredbo village and Yass. TransACT also provides its TransMOBILE (mobile telephony) service covering 94% of the Australian population, which is also complemented with its national broadband product through Grapevine Ventures.

Neighbourhood Cable Pty Ltd (NCPL), a wholly owned subsidiary of TransACT Communications Pty Limited, is also investing significantly in the provision of broadband infrastructure, products and services to other areas of Regional and Rural Australia. NCPL is an advanced telecommunications company servicing the Victorian regions of Ballarat, Mildura and Geelong. Committed to delivering high speed cable broadband and entertainment services to regional Australia, NCPL began rolling out a hybrid fibre and coaxial (HFC) network in 1997. Starting in Mildura and later expanding to Ballarat and Geelong, the Neighbourhood Cable network now reaches over 95,000 households across the three regions.

It will be important for TransACT that pricing principles and indicative prices for the DTCS do not inhibit or stifle investment where these services are required for the expansion of retail products to the market, and that the long-term interests of end users are protected from non-regulated price increases and reduced competition as a result.

Current transmission market and products and Network structure

Questions to be addressed in submissions:

- *What grade of network do service providers and businesses require?*

The grade of a network can be determined by a number of factors including, but not limited to:

- Reliability;
- Availability;
- Quality of Service (QoS); and
- Coverage.

When assessing the requirements for a DTCS these are some of the factors that are taken into consideration, however, it is well accepted that alternative or redundant paths are required where there is a need for service providers to minimise the risk of potential network failure/s.

The grade of service required on any transmission path is usually determined by the volume of aggregated traffic between any two points and the relative availability of the network. The greater the volume or the higher the priority of the traffic, the more likely that redundancy is required. This is generally the case where a high level of availability is required by Enterprise and Government clients for priority services.

It is TransACT's view that in most cases, while it is desirable to have alternate or redundant transmission paths available, cost is generally a determining factor. As such, TransACT supports the ACCC in considering a pricing mechanism that encourages investments in networks with ring architectures.

- *Should the ACCC seek to cost and set regulatory prices for the DTCS based on ring structures, point-to-point links or some other network design?*

As stated above, TransACT supports the ACCC in considering a pricing mechanism that encourages investments in networks with ring architectures, given redundancy is a feature that is desired for most major transmission paths. However, consideration also needs to be given to how existing 'tails' or 'spurs' are priced, where it is unlikely that investment in ring structures or competitive infrastructure in these locations will occur due to geographic constraints, low demand, high cost or overall viability.

TransACT believes that in these tail-end transmission markets, where there is little or no prospect of entry, that it may be appropriate to implement a pricing structure based on the Regulatory Asset Base (RAB) approach and reconciling with domestic and international benchmarks.

Transmission costs - allocation

Questions to be addressed in submissions:

- *How should the ACCC allocate costs between competitive and non-competitive routes, declared and non-declared routes?*

It is interesting to compare both competitive and non-competitive routes with those that are declared and non-declared. In most circumstances competitive routes are those that are non-declared (or in fact exempt from the declaration), while non-competitive routes are those that are declared.

On competitive routes, which in most cases the ACCC has excluded from declaration, prices generally dictate themselves as result of market competition. To an extent, this why the ACCC has yet to release indicative prices and has not yet had to set a price in any access dispute for the DTCS. However, for non-competitive routes TransACT believes that the ACCC needs to formally set out pricing principles or indicative prices pursuant to section 152AQA under Part XIC of the *Trade Practices Act 1974* (Act) and that these principles may also apply to competitive routes that are not currently exempt from the declaration. The ACCC should also continue to monitor competitive routes (where exemption has been given) to ensure that pricing on these routes remain competitive, are benchmarked and evaluated against indicative pricing principles on non-competitive routes and continue to promote the LTIE.

As stated in the Frontier Economics Report[4], if adopting an aggregated costing approach where there is a likelihood to cover a mix of competitive and non-competitive services, there will need to be some means of allocating any shared costs between them. The view to allocating costs according to a relevant cost driver such as percentage share of total capacity and/or percentage share of total distance of the route/s is supported by TransACT. TransACT also agrees that the ACCC needs to ensure that there is minimal opportunity to disproportionally load costs on to non-competitive routes when setting the framework and assessing the allocation of costs.

- *How should the ACCC allocate costs that use the same infrastructure for mobile backhaul, fixed services and transmission services?*

Similar to an aggregated costing approach on competitive and non-competitive routes, the allocation of costs needs to be attributed appropriately where the infrastructure is being shared by different types of services.

In November 2009, the ACCC released a *Discussion Paper* reviewing the declaration for the DTCS[5], where the service description was being reviewed. The current service description referred to transmission over network interfaces at a 'designated rate', where the designated rate is defined as:

> *"a transmission rate of 2.048 Megabits per second, 4.096 Megabits per second, 6.144 Megabits per second, 8.192 Megabits per second, 34 to 35 Megabits per second, 140/155 Megabits per second (or higher orders)"*

[4] Frontier Report.pdf
[5] http://www.accc.gov.au/content/index.phtml/itemId/903359

Dependant on whether these specific service types form part of the DTCS by definition or are designated as either 'trunk' or 'terminating' may determine how their associated costs are allocated. TransACT believes that it may be appropriate to aggregate different services types into higher level categories, such as 'trunk' or 'terminating', to reduce complexity and ensure that providing any associated regulatory reporting data is not too burdensome for wholesale service providers. However, it may also be appropriate to disaggregate 'terminating' routes based on differing geographies, locations and underlying service types.

- *Is it appropriate for the ACCC to adopt different regulatory pricing methodologies for "tail" segments and "trunk" segments of the transmission network?*

Regardless of which methodology the ACCC may choose to adopt, TransACT believes that it is appropriate to reconcile and incorporate domestic and/or international benchmarking.

However, as stated above, TransACT believes that it may be appropriate to adopt different pricing methodologies for 'tail' (terminating) and 'trunk segments of the transmission network, as these segments may carry different types of services.

- *What level of spare capacity is available within current transmission network configurations? How should future capacity be accounted for in network cost calculations?*

As TransACT understands, most major transmission networks have a degree of spare capacity available, certainly new transmission networks that are being built today. Where spare capacity is being underutilised and this information is not available to the ACCC, it may be appropriate that under section151BU of the Act that the ACCC make record keeping rules (RKR) to obtain that information for the purpose of making cost calculations.

TransACT does not believe it is appropriate that where a DTCS has been constructed allowing for a large percentage of spare capacity on any specific route, and is vastly underutilised, should have it's full costs attributed as allocated costs when determining pricing. It may be prudent for the ACCC to set some guidelines based on industry agreed standards as to what percentage of spare capacity should be accounted for in network cost calculations and DTCS pricing principles.

Setting prices for transmission services

Questions to be addressed in submissions:

- *Are capacity and distance the critical cost drivers for transmission services?*

It is TransACT's view that capacity and distance tend to be the critical cost drivers for transmission services, although distance tends to prevail as the wholesale costs of purchase typically increase with distance while they decrease per Megabit of data as you purchase more capacity. However, the 'interlocking ring' structure of

transmission networks, where there is a sharing of common costs, can mitigate the effect of distance when analysing the costs associated with particular routes.

- *Are fixed connection charges an appropriate method to recover costs?*

In most cases, fixed connection costs are applied to recover costs. However, in TransACT's experience these costs can vary widely with different service providers, where in some cases an access seeker has no choice but to pay exorbitant connection fees. While TransACT believes that connection costs are appropriate to recover up-front costs incurred to establish connectivity of services, the ACCC should consider how these costs may also be regulated when setting out pricing principles or indicative prices.

- *Are distance based charges appropriate? If so, on what basis should distance charges be calculated e.g., actual distance, radial distance or by geographic region?*

TransACT believes that it is the actual distance that is applicable to the build costs that are incurred to actually provide the service, which in many cases can be influenced by the associated geography. However, other costs associated with the aggregation of services (common costs) at each terminating end or intermediate locations on a route, such as equipment costs, are geographically based.

Charging based on radial distance is less complex to implement and where radial distance does not vary by any large percentage to actual distance, it would be appropriate to apply this method and it is much easier to administer. In most cases, TransACT believes that distance based charges are appropriate and should be calculated by radial distance unless specific routes as specified by the ACCC would qualify for an actual distance based calculation, for example, where a specific route may vary significantly in actual distance to the radial distance.

- *Should regulated prices vary between transmission service types e.g., tail end and inter-exchange transmission?*

As stated previously, TransACT believes that it may be appropriate to establish different regulated pricing methodologies where services may be disaggregated on 'tail-end or terminating' routes and are then aggregated and differentiated from 'trunk' routes.

- *Should regulated prices for transmission vary between different regions e.g., metropolitan and regional?*

Not dissimilar to issues addressed in the recent *APP Review* it can prove difficult not to differentiate between metropolitan and regional services. It was evident in the *APP Review* that attempts to implement average pricing methodologies, rather than de-averaged, and reduce the number of ULLS bands from four (Band 1-4) down to two (Zone A and Zone B) was not well supported.

Similarly, unless the ACCC were to implement methods of subsidisation, whereby metropolitan routes in some way subsidised rural transmission routes through some form of imposed levy, then it would be appropriate to regulated prices distinctly

between regions or geographically based. However, the ACCC would need to set clear guidelines to identify and differentiated those transmission routes which would be classified as metropolitan as opposed to regional or clearly identify any geographic banding of routes.

- *What type of pricing relationship should exist between distance and capacity?*

In TransACT's view, there is not necessarily a distinct relationship between distance and capacity. Monthly or annual distance related charges are generally related to the recovery of costs associated with the physical construction of the route (i.e. civil works, optical fibre cables and associated materials, construction labour and accommodation), while capacity charges related to the recovery of the optical equipment located at intermediate and end points of the route where re-transmission and aggregation occurs. This is highlighted by Frontier Economics in their report to the ACCC.

However, while the exercise of converting the costs associated with distance and capacity into prices charged to acquirers may require different methods of calculation, it becomes difficult to distinguish between them. For example, in TransACT's experience, when requesting a price from a supplier for a transmission service, the price is given as 'one price' based on a link between two points and the capacity required and does not separate the charge into distance and capacity.

- *Would prices set according to a trunk/terminating segment approach be more appropriate?*

As stated above, TransACT believes that it may be appropriate to adopt different pricing methodologies for 'tail' (terminating) and 'trunk segments of the transmission network, as these segments may carry different types of services and may also be segregated into areas that are considered competitive routes and those that are non-competitive or monopoly routes.

Pricing structure

Questions to be addressed in submissions:

- *What are the main types of transmission charges (e.g., are there connection/disconnection charges, special charges, monthly charges or annual charges)?*

As TransACT understands there are a number of different charges applied for the supply of transmission services including, connection/disconnection charges, special charges, monthly charges and annual charges. In fact, in some cases that TransACT is aware, charges have even been applied to upgrade the capacity of an existing service, albeit that the supplier will recover more ongoing revenue as a result of the upgrade.

Given that there is some disparity of charging methods, TransACT believes that the ACCC should consider all charges associated with acquiring a transmission service

and assess if/how regulated pricing should apply for each component when setting out pricing principles or indicative prices.

- *Are transmission products typically purchased as specific point-to-point links or as part of a bundle? If the latter, then what products are typically included in the bundle(s)?*

In TransACT's experience, transmission products are typically purchased on a point-to-point basis, although in cases where more than one link is required a bundled discount for two or more links may be offered. In this scenario, although the purchase is for specific point-to-point links, a volume discount is applied for purchasing more than one link.

- *Do transmission prices vary according to capacity, distance, some other factors (please specify), or a combination (please specify) of different factors? If so, how?*

In TransACT's experience, the two main factors affecting transmission prices are capacity and distance, however prices can also vary based on specific characteritistics of some links (e.g. terrain such as undersea cables in the case of bass-link or microwave technology where fibre transmission links are not commercially viable). Additionally prices also vary significantly where there is uncompetitive backhaul, which may also be the case where there are two providers (duopoly) present.

- *Does transmission pricing differ among geographic categories (i.e., inter-capital, 'other', inter-exchange local and tail-end transmission)?*

In TransACT's experience, transmission prices do differ among geographic categories and geographic locations. For example, the cost to TransACT to purchase a transmission link <100 Mbps from Melbourne to areas of regional Victoria is more than ten (10) times the cost of purchasing an inter-capital transmission link >500 Mbps.

- *Are the pricing structures for declared and non-declared routes different? If so, then what are the differences?*

The example given directly above outlines the vast difference in pricing structures for declared/non-declared and competitive/non-competitive routes.

- *Are there volume discounts based on the number of links purchased, capacity, distance, or other factors (please specify)? Are there term discounts based on contract length?*

In TransACT experience, discounts are applied based on, the number of links purchased, capacity, distance and contract length.

- *Where a supplier other than Telstra is present, are commercially negotiated transmission charges substantially different for an equivalent or comparable service?*

In TransACT's experience, where there are more than two providers of an equivalent service, charges become much more competitive. However, where Telstra and one other supplier are present this is not always the case (i.e. charges can be similar and charges can be substantially different, depending on the type of route, Bass-link is a good example).

- *If you are an access seeker, how important is the availability of redundancy in choosing a supplier for transmission services where two or more suppliers are present?*

In TransACT's view, the availability of redundancy is extremely important. However, the requirement for redundancy depends on the type and priority of services transmitted across the link and specific characteristics such as, the volume of traffic, the overall grade of service required and service availability to meet customer service level agreements (SLAs).

- *If you are an access seeker who purchases/purchased transmission products from a supplier other than Telstra, is/was redundancy automatically included? If not, and you purchase/purchased redundancy separately, who performs/performed the switching in the event of a failure?*

In TransACT's experience redundancy is not automatically included when purchasing a transmission product from a supplier other than Telstra; if redundancy is required the access seeker will generally request it from the supplier. However, regardless of whether redundancy is included as part of an initial product purchase, or purchased separately, switching may need to be performed by both the access seeker and the supplier, dependant on the configuration of the link/s. Where TransACT requires automatic switching capabilities it will generally work with the supplier to ensure the required switching functionality sufficiently meets the requirements of the service.

Pricing methodologies

The issues associated with setting pricing methodologies are well documented; the recent APP review has highlighted some of those issues. While there are a number of different methods being contemplated by the ACCC, it is TransACT's view that there needs to be a clear set of criteria applied before commencing that assessment.

Pricing methodologies adopted and implement need to ensure that:

- the possibility of anti-competitive conduct is discouraged and almost negligible;

- there is as high a degree of simplicity as possible to minimise administrative and compliance costs;
- there is as much transparency in the process as possible to provide regulatory certainty for both suppliers and access seekers;
- they create incentives for investment in, and use of, transmission services (i.e. where build/buy investment decisions are relevant that the framework positively supports those decisions); and
- they support existing and new entrants into the market, promote competition and protect the LTIE.

As the ACCC has stated in the *Discussion Paper*, "any pricing methodology of the DTCS needs to allow for three general principles:

1. the service provider is adequately compensated (neither over or under);
2. the service is provide efficiently; and
3. any regulated price is set efficiently."

While the ACCC has historically considered the Total Service Long-Run Incremental Cost (TSLRIC) approach to cost-based pricing, TransACT believes that, moving forward, there needs to be a more "combined approach" when applied to the DTCS.

The Frontier Economics report suggests three high level methodologies:

1. a forward-looking cost model, that applies a bottom-up and/or top-down approach;
2. an actual cost-based model, that applies a fully allocated cost (FAC) and/or utility regulated asset-based (RAB) top-down approach; and
3. a lighter-handed method, that applies a retail minus, international/domestic benchmarking, non-discriminatory price rules and safeguard price capping approach.

It is TransACT's view that each of these methodologies has it discrete place in determining appropriate pricing principles and indicative prices for the DTCS. However, TransACT believes that adopting a combined approach is the most appropriate methodology.

As noted by the ACCC, different competitive forces affect different services that comprise the DTCS. As discussed in the Frontier Report, there a generally three types of markets that would be applicable to a DTCS, which are categorised as:

1. Markets which are effectively competitive;
2. Markets where there has been at least one additional entrant (duopoly) or there is prospective competition; and
3. Markets which are a monopoly and are likely to remain so.

In summary, TransACT is supportive of a more light-handed approach where it is recognised that there is effective competition. However, TransACT believes that the ACCC should still monitor these markets and be cognisant of pricing fluctuations and any anti-competitive conduct and act accordingly.

In duopoly markets (which may become more prevalent with the advent of NBN Co backhaul links) and in those markets which are likely to remain a monopoly, TransACT agrees that cost-based pricing would be appropriate. However, in many of these markets, particularly monopoly markets where build/buy decisions are not relevant, TransACT believes a TSLRIC model reconciled with a top-down FAC/RAB and benchmarking approach should be considered.

Conclusion

It is important that any draft pricing principles and indicative prices for the DTCS, as implemented by the ACCC, provides a level of regulatory certainty that will continue to promote industry investment, competition and the long-term interests of end users.

While TransACT understands that there will be an amount of complexity associated with the implementation of adopting potentially more than one methodology, TransACT supports the concept as discussed in the Frontier Report that it would be preferable to use different pricing approaches to account for differing degrees of competition.

Additionally, TransACT supports the concept of adopting a 'trunk' and 'tail or terminating' approach to service aggregation. However, it may be necessary to cost particular 'trunk routes' separately if certain routes have much higher costs of supply and also separate 'terminating segments' or 'tails' into appropriate geographic bands.

A review of the Regulatory Accounting Framework (RAF) and RKR (in which TransACT notes the ACCC has also released a separate *Discussion Paper*[6]), may also need review to allow the ACCC to obtain access to data that has relevance to making an efficient, constructive and well considered assessment of inputs in determining the most appropriate pricing principles or indicative prices for the DTCS.

For enquiries on this submission please contact:

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[6] Infrastructure RKR 2010 Public consultation