Unwired Australia Pty Ltd

Submission in response to

Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking- Draft Decision November 2008

and

Draft MTAS Pricing Principles Determination November 2008

1 Introduction

This submission is made by Unwired Australia Pty Ltd in response to two recent ACCC draft decisions. These are the *Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking- Draft Decision*[1] (the **ULL decision**) and the *Draft MTAS Pricing Principles Determination*[2] (the **MTAS decision**).

The submission is being made in response to both these decisions to highlight some worrying trends in the decision making of the Australian Competition and Consumer Commission (the **Commission**) in relation to the operation of the telecommunications access regime including some inconsistencies in approach. Specifically these trends are;

- A bias in regulatory decision making to promote one kind of facilities based competition (based on ULL) versus services based competition or competition from alternative infrastructure.
- An incorrect depiction of the mobile services market and of the role of wireless data.
- An inconsistent approach to the apparent market power of Telstra in the fixed line market.

The purpose of this submission is to highlight these inconsistencies. Unwired is not arguing in favour of the Telstra undertaking, just in relation to some of the discussion in the ULL decision. Unwired is arguing against the MTAS decision and, in particular, the indicative prices to apply in 2010 and 2011.

The remainder of the submission is structured as follows;

> **Section 2** summarises the key points of the ULL decision and the MTAS decision, and of other recent decisions, that Unwired wishes to discuss.
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> **Section 3** discusses how these decisions reflect the positions described in the introduction.
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> **Section 4** is a brief conclusion

2 Summary of Commission decisions

2.1 The ULLS decision

In its ULL decision the Commission has discussed the approach to assessing appropriate forward-looking costs at some length. To facilitate the subsequent discussion the ULL decision is quoted at some length below.

> *The application of TSLRIC+ ('+' refers to the addition of common and indirect costs) pricing is based on the idea that, in certain circumstances, it can be desirable to set an access price that mimics the price that would prevail if the access provider faced effective competition and therefore faced the threat of being displaced as a supplier through the possibility of bypass. Such an access price could potentially promote efficient 'build or*

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[1] *Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking- Draft Decision – November 2008.* Available from the ACCC website.

[2] *Draft MTAS Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011 – November 2008.* Available from the ACCC website.

buy' decisions, such that an access seekers' decision to build by-pass infrastructure would be based on the relative resource cost of doing so. Setting prices based on TSLRIC+ was intended to create the right incentives for carriers operating in downstream markets to make the appropriate choice as to whether they should invest in their own upstream infrastructure (i.e. build) in order to provide services to end-users, or to seek access from an existing upstream provider of the listed service (i.e. buy).

… One key reason this pricing principle has been adopted in the past has been the ACCC's concern to promote efficient build/buy decisions - in particular, building by-pass infrastructure, where efficient. In some respects, TSLRIC+ has been a generous approach to pricing, and has probably overestimated the potential for infrastructure-based competition. However, the ACCC acknowledges that the past rationale of promoting efficient build/buy decisions through the application of TSLRIC+ may be less relevant in a regulatory environment where the competitive state of telecommunications markets is changing and there may be fewer prospects for efficient by-pass. …

The ACCC is also aware of the limitations in the application of TSLRIC+ outside its original focus for PSTN assets in that the TSLRIC+ concept revalues the network assets in each regulatory period such that it does not take account of depreciation in the value of the assets. This limitation is particularly apparent in the case of enduring assets such as trenches which are likely to be less susceptible to bypass.[3]

In this discussion the Commission is signalling a possible move away from TSLRIC pricing for Telstra's copper assets, and that the basis for moving away from it is a concern that the methodology may be over-pricing the service. The specific justification appears in the phrase "there may be fewer prospects for efficient by-pass". That is the Commission is effectively deciding that the only practical access technology is Telstra's copper network.

This is patently absurd. In any new estate it is technically cheaper to deploy a fibre-to-the-home (**FttH)** network. The question of when the efficient build decision for FttH in a "brownfields" environment becomes economically viable is an empirical exercise. However, the efficient build/buy decision for an access seeker in these circumstances will not be made if the access to the existing copper network is priced below its current build cost.

The historic reason for choosing a hypothetical new network build in the case of access to copper networks in Australia (and most other jurisdictions) was the poor state of the historic cost data available in Telstra. The assets had been deployed over many years, often before it was feasible to keep accurate records of individual costs. The Commission is correct in its analysis that re-estimating the forward looking cost of the network each year will ultimately over-price the network, but the solution to this is to choose a base year and then use either (new) actual costs or a reasonable index to set forward prices.

2.2 The MTAS decision

In its MTAS decision the Commission again raises issues relating to the appropriateness of TSLRIC pricing principles. This time the Commission states;

A key implication from the recognition of a pragmatic application of TSLRIC is that while estimates of costs in such models provide important information, they cannot be

[3] ULL decision pp 34-35.

considered conclusive in determining an appropriate indicative price. Thus, the ACCC in this pricing principles determination is relying on various sources of information, including cost model estimates and international benchmarks. The ACCC also considers that in certain circumstances it is appropriate use regulatory accounting framework data to assist in verifying the efficient cost of supplying the MTAS.[4]

This set of limitations to the application of TSLRIC seems to be at variance to the Commission's approach to TSLRIC in the PSTN. Whereas the concerns with the TSLRIC process for the ULL is that it might produce prices that are too high, the concern in this case is that they are too low.

This approach is reinforced by the Commission's consideration of 2G and 3G networks. The Commission notes that 3G is expected to be more efficient, but determines that as operators will operate both it is appropriate to continue to use a 2G model for estimating MTAS.

It is the current view of the ACCC that the WIK model effectively provides a floor price on the cost of supplying the MTAS on a 2G network. The ACCC considers that a cost model based on a 2G network remains an appropriate tool to inform decisions, but its application as the primary tool to estimate the efficient costs of supplying the MTAS in the Australian context may become increasingly limited.[5]

The Commission has also commented on the approach to allocation of common costs and has endorsed its current process of using EPMU over any other approach. However, in the consideration of common costs the Commission ignores the increasing role being played in the mobile services business model of data services and of "premium" SMS services. The choice of a 2G model means that these services will be underestimated in their contribution to common costs.

The Commission has also found sympathy with the view of the non-Telstra operators that the benefits of the lower MTAS prices have been captured by Telstra (and presumably other fixed to mobile offers) rather than being passed to consumers.

The table below shows the change in the average Telstra unit prices of the major PSTN services over from 2007 to 2008.

Changes in Telstra average unit prices

Service	%change
Fixed to Mobile	0.5%
National LD	-4.9%
International DD	-5.2%
Local Calls	0.1%
Access Lines	-1.7%

The table has been constructed using the volume and revenue data from the Telstra annual financial results. As consumers purchase a bundle of PSTN products there is no reason why the reduction in the input cost of one product should necessarily be reflected in the unit price of that product. The Commission could equally wonder why national and international call prices have declined without there being any obvious regulatory intervention.

[4] MTAS decision P.13
[5] MTAS decision P.15

More specifically, however, the Commission's conclusion that there has been insufficient pass is an admission by the Commission that Telstra retains significant market power in the pricing of fixed line services.

2.3 Other recent decisions

The Commission has made a number of recent decisions on applications for exemptions by Telstra. The Commission has granted exemptions to Telstra for the Wholesale Line Rental, the Local Carriage Service and the PSTN Originating and Terminating Access service.[6]

The first of these decisions has since been over-turned by the Australian Competition Tribunal (the **Tribunal**), though there does not appear to be a copy of the decision yet made public.[7] The Commission release quoted the Tribunal reasoning that, "The problem is that… the fact of entry by one firm, or even by more than one firm, of itself does not establish that the incumbent is either presently restrained or is likely to be subject to the constraints of the competitive process in the future...".

The Unwired concern with the decision is different to the concern that appears to have been addressed by the Tribunal. The Commission granted the exemptions only in areas where the Commission was satisfied that Telstra faced effective competition from ULL based services. The Commission did not base the assessment on the nature of the specific offerings of these services or whether they actually provided a voice service. The decision appears to be based entirely on the presence of a certain number of DSLAMs.

The decision seems to once again be technologically deterministic, that is, that competition in the voice and data markets is dependent on the use of ULL. In the areas applied for there are cheaper "voice only" solution provided by mobile network offerings, yet these don't seem to have been considered as significant competitive offerings. However a data offering that might not provide voice was considered a competitive offering.

This again reflects the bias currently inherent in the Commission's decision making process towards a specific technology.

3 Consequences

The consequences of these decisions are a bias towards ULL based providers, a bias towards the provision of data services provided by 3G offerings and an inconsistent approach to Telstra's market power.

3.1 Bias towards ULL

The Commission has revealed in its ULL decision an approach to pricing principles that it will vary the application of the principles if the existing principles would result in increased ULL prices. This is an unfortunate development, both as it provides incorrect incentives to inform build/buy decisions in actual infrastructure (e.g. the copper loops, wireless or HFC) and in adjunct infrastructure (e.g. DSLAMs and backhaul transmission).

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[6] *Telstra's local carriage service and wholesale line rental exemption applications - Final Decision and Class Exemption* August 2008 and *Telstra's PSTN Originating Access exemption applications – CBD and Metropolitan areas - Final Decision and Class Exemption* October 2008. Both available from the ACCC website.
[7] ACCC Media Release "Wholesale access to Telstra network still required – Tribunal" Melbourne 23 December 2008.

The Commission's bias is reflected in the approach it has take to assessing the exemption applications lodged by Telstra. The consequence of these decisions is to further promote the investment in DSLAMs as it becomes the preferred choice for competition for voice services.

This continued bias is unwarranted. Whether competition develops from services based resale or pseudo-facilities based through ULL should be an empirical question determined by access seekers. It should arise as a consequence of build/buy decisions informed by a set of access prices that are consistent between services and mimic costs. The Commission should not be making decisions to encourage service providers to invest in certain kinds of facilities because it supports a pre-determined Commission model.

3.2 Bias towards 3G data

The Commission decision to leave the MTAS rates unchanged for the next three years has been based on the consideration of what happens to fixed to mobile prices and not what happens in other service areas. As discussed above mobile operators are faced with a significant pool of common costs. They have also been investing in 3G networks.

While these 3G networks can be considered to be additional investments, in practical reality they are extensions of their existing networks, especially since customers will "roam" onto the 2G network when out of range of the 3G network. In addition, as at least one operator has shown their 3G networks are not lying idle, in fact they are heavily capacity constrained.

The Commission has also identified that due to the greater efficiency of a 3G network it would expect the cost of MTAS to be lower in a 3G network. To continue to price MTAS based on 2G network is to bias pricing in favour of the operators.

Were the mobile operators only offering voice services this bias would presumably only be affecting voice services, or the ongoing capacity of mobile operators to subsidise handset costs. However, all the 3G operators are now offering data services. These data services include some limited functionality services designed to be accessed through a handset, but they also include services that operate through alternative CPE to work with computers.

The Commission approach to not requiring the mobile operators to price MTAS at cost results in fixed line voice callers potentially subsidising the mobile operators' offerings of services that compete with Internets service connections operating through other technologies.

3.3 Inconsistent approach to market power

The Commission in its MTAS decision, in noting that there has been ineffective pass through of the reductions in MTAS to reductions in Telstra's fixed to mobile call prices, is effectively claiming that Telstra is still able to exert significant market power in the fixed line market.

However, at the same time the Commission has made decisions that the fixed line resale and PSTN originating access services declarations be subject to significant exemptions. The consequence of these decisions is to potentially reduce the amount of competition Telstra will face in the fixed to mobile calling market.

The Commission has in the past received complaints about potential anti-competitive conduct in the pricing of fixed-to-mobile calls, including the cases where integrated providers price the whole fixed-to-mobile call at a price below the MTAS rate. The Commission's response has been two-fold. The first has been to inquire about the total price of the bundle of services, that is, to undertake in the specific the kind of analysis provided in the table above. The second response has bee to argue that the solution to any pricing distortion is to simply get the MTAS price down to its cost reflective price.

The Commission needs to recognise that these inconsistencies in its decision making can result in significant distortion of market outcomes.

4 Conclusion

The Commission's approaches in the ULL decision and MTAS decision have significant potential consequences for firms in other market segments. The specific example of concern to Unwired is I the market for Internet access services, and in particular wireless access services.

Unwired is concerned that the Commission has been significantly under-pricing the ULL service. We do not necessarily believe that the price proposed in Telstra's undertaking is appropriate, but that the Commission is making time inconsistent decisions that appear to be motivated by policy intent. That policy intent is the wholly unsupported view that the regulatory regime is designed to promote facilities based competition, and that such competition can best come from ULL based services.

In addition, the Commission in its MTAS decision is taking an approach that Unwired believes enables the mobile network operators to cross subsidise their wireless data services from above cost voice terminations. The Commission's reasons for not acting in this market are based on a view of Telstra's market power that is not consistently applied in other access decisions.

The consequence of these decisions is to distort the business case for genuine high-speed wireless Internet access services. A business such as Unwired that is preparing to invest in WiMAX capability needs o make the investment when competing against fixed line services where the retail price has been driven down by a over-zealous approach to ULL pricing. At the same time the services will need to compete with wireless data services being subsidised by continuing high mobile terminating access rates.