



**Submission by AAPT Limited to the Australian Competition
& Consumer Commission in response to *Draft pricing
principles and indicative prices for LCS, WLR, PSTN OTA,
ULLS and LSS, dated August 2009***



Introduction

1. AAPT Limited (**AAPT**) welcomes the opportunity to comment on the Australian Competition & Consumer Commission's (the **Commission's**) *Draft pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS and LSS*, dated August 2009 (**draft decision**).
2. AAPT welcomes the Commission setting indicative prices for access to wholesale line rental (**WLR**), local carriage service (**LCS**), public switched telephone network originating (**PSTN OA**) and public switched telephone network terminating access (**PSTN TA**) (together **PSTN OTA**), unbundled local loop service (**ULLS**) and the line sharing service (**LSS**) (the **fixed services**).
3. Each one of the fixed services is an enduring bottleneck and is a critical input to the supply by AAPT of wholesale and retail voice and broadband service across Australia. Consequently, the price paid by AAPT for each of the fixed services has a critical impact on AAPT's ability to effectively compete in these markets and is ultimately important for Australian consumers.
4. AAPT appreciates the considerable effort the Commission has gone to in order to deliver cost based pricing for all six fixed services, in particular the development of the complex and presumably expensive Analysys cost model. AAPT considers that a shift away from the retail minus retail cost (**RMRC**) approach previously used for WLR and LCS to a cost based approach has been long overdue.
5. While AAPT supports some aspects of the draft decision, it also has significant concerns about a number of other aspects, each of which are detailed below.

Outline of AAPT's submissions

6. AAPT considers that the Commission:
 - a) having formed the view that TSLRIC+ may no longer be appropriate, has inappropriately decided to set pricing principles and indicative prices for the fixed services on the basis of TSLRIC+ for the next three years; and
 - b) has made a fundamental error by placing too much emphasis on the outputs of the Analysys model despite that fact that in some cases the outputs of the model are not sufficiently validated by international benchmarking.

7. In order to best promote the long term interests of end users (**LTIE**), AAPT urges the Commission to make the following changes before finalising the draft decision:
 - a) the Commission should set pricing principles and indicative prices for each of the fixed services for the period 1 Aug 09 to 30 Jun 2010 only because there is a high degree of probability that they may need to be changed for the period commencing 1 July 2010, although AAPT recognises that this may not be the case for LSS where possibly a longer period could be contemplated;
 - b) the Commission should abandon the proposed two zone pricing structure for WLR in favour of a national price for 2009-10 set at the current draft indicative price for Zone A, ie \$23.30 pm. AAPT considers that this represents a moderate reduction in current indicative prices for WLR towards international benchmarks. If, however, the Commission considers that the setting of a national price for WLR in 2009-10 means that the indicative price must increase above \$23.30 pm then AAPT considers that the Commission should retain the two zone structure proposed in the draft decision. In other words, AAPT considers that \$23.30 pm is the absolute upper limit which must



not be traded off in order to set a national price. As an alternative, AAPT would be open to the Commission establishing a four band pricing structure for WLR based on the four band ULLS pricing structure advocated below;

- c) the Commission should retain the old four band pricing structure for ULLS in 2009-10 because the cost estimates across the bands vary to a significant degree and because the current prices of \$6 for B1, \$16.60 for B2 and \$31.30 for B3 produce a weighted average price which is broadly consistent with LRIC based charges in other countries; and
- d) if the Commission decides to set indicative prices for each of the fixed services beyond 30 Jun 2010, then:
 - i) the length of the glide path for LCS and PSTN OTA should be reduced so that effective from 1 July 2010 the prices for these services reflect the Analysys cost estimates which are validated by international benchmarks. AAPT considers that the rate shock argument used to support a longer glide path is not valid;
 - ii) the WLR indicative price for the period commencing 1 July 2010 should be set at around \$20.50 so as to better reflect international benchmarks; and
 - iii) the ULLS indicative price for the period commencing 1 July 2010 should be set at a price which places greater emphasis on international benchmarks.

Three years is too long

8. AAPT urges the Commission to reconsider the period over which it intends to set pricing principles and indicative prices. AAPT considers that three years is too long given:
 - a) the recognition by the Commission that TSLRIC+ based pricing methodology is inappropriate for services displaying enduring bottleneck characteristics; and
 - b) the proposed new access determination powers proposed for the ACCC.
9. There is likely to be an eight year transition period to the National Broadband Network (NBN)¹. AAPT considers that imposing a pricing methodology that is recognised, even by the Commission², to be possibly inappropriate for three of those eight years (as the draft decision purports to do) is something that should be avoided at all costs.
10. The Commission has acknowledged in recent pricing and regulatory decisions that is open to consider other pricing approaches and has specifically flagged the possibility of 'locking in' some of the inputs to the cost estimates of certain services, eg the value of the assets used to provide the services (ie the regulated asset base (RAB)³).

¹ Page 1, draft decision.

² Page 2, draft decision.

³ Page 2, draft decision.

11. The Commission notes that the two main reasons for considering alternate pricing approaches are that:⁴
 - a) it is not clear that the build/buy rationale for TSLRIC+ pricing remains as strong given that Telstra's copper customer access network (**CAN**) appears to display enduring bottleneck characteristics, rather than being a network likely to be bypassed through technological and market developments; and
 - b) locking in some of the inputs can provide greater regulatory certainty to both access seekers and access providers.
12. In the draft decision, the Commission also notes that its approach to access pricing has been guided by the principles set out in the Access Pricing Principles: Telecommunications – a Guide (Access Pricing Principles), July 1997 (the **Guide**) which has a particular focus on TSLRIC pricing because of the expectation that there is real potential for infrastructure based competition, ie that telecommunications infrastructure may not be an enduring bottleneck⁵.
13. The Commission acknowledges that this was based on the expectation that the cost of technology would rapidly decline so that access seekers would be able to deploy their own infrastructure to compete with incumbents in downstream retail markets⁶.
14. However, as noted by the Commission in the draft decision, the cost of replacing the largest components of fixed line telecommunications networks, eg copper cables, ducts and trenches have in fact been increasing in price⁷.
15. AAPT agrees with the Commission's conclusion that Telstra's CAN is an enduring bottleneck and not a network subject to competitive bypass⁸.

⁴ Page 2, draft decision.

⁵ Page 15, draft decision.

⁶ Page 15 and 16, draft decision.

⁷ Page 16, draft decision.

16. Despite concluding that TSLRIC+ may no longer be appropriate to send efficient build-or-buy signals, the Commission has formed a view in the draft decision that it should adopt TSLRIC+ pricing principle for all six fixed services for the next three years⁹.
17. AAPT considers that it is difficult to see how the above analysis is reflected in the Commission's draft decision. Given the conclusion that TSLRIC+ may well be no longer appropriate, AAPT is perplexed as to why the Commission then proceeded to reaffirm its use for a three year period.
18. AAPT recognises that the Commission has not yet formed a view on which form of RAB to use but AAPT considers that a period of one whole year should provide sufficient time to reach a conclusion on this matter.
19. The Commission notes in the draft decision that in the event of significant changes in the regulatory environment such as might be associated with the NBN during the term of these prices, the Commission would be open to reconsidering both the pricing principles and the indicative prices for these services¹⁰.
20. AAPT considers that the recent tabling in Parliament of the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 (the **2009 Telco Bill**) represents just such a significant proposed change. While the 2009 Telco Bill is yet to pass through both houses of Parliament, there is a clear intention on the part of the government to introduce imminent and significant changes to the current telecommunications regime, including the introduction of the additional powers for the Commission to make access determinations¹¹.

⁸ Page 16, draft decision.

⁹ Page 18, draft decision.

¹⁰ Page 2, draft decision.

¹¹ Proposed changes to Division 4 of Part XIC of the TPA.

21. Setting pricing principles and indicative prices now for three years as proposed in the draft decision creates expectations that they will apply for the three years when it is clear that that may not be the case. AAPT considers that a better approach is to set pricing principles and indicative prices for 1 year only and to make it clear that pricing principles and indicative prices are at a cross roads. This would avoid setting expectations when there is a high degree of likelihood that things may change within a year.
22. Consequently, AAPT strongly urges the Commission to only set pricing principles and indicative prices for each of the fixed services for 1 year, ie up to 30 June 2010, although AAPT notes that a longer period could be contemplated for LSS where only the specific costs of supply are relevant.

Cost model estimates and international benchmarks

23. AAPT supports the use of the Analysys model and the Commission's specific cost model to set indicative prices for the fixed services but only when the cost model estimates are validated by international benchmarks.
24. Where the cost model estimates are significantly greater than international benchmarks, AAPT considers that less weight should be given to the cost model estimates and more weight should be given to international benchmarks when setting indicative prices for the fixed services.
25. AAPT considers that the need for this approach is quite pronounced with respect to the Analysys cost model in particular which produces a single number cost estimate after completing extremely complex calculations based on hundreds of inputs some of which produce different cost estimates when varied by even the smallest of amounts. AAPT, via the competitive carriers coalition (the CCC), has tabled submissions with the Commission from an industry expert suggesting

that the cost estimates produced by the Analysys model should be significantly reduced.

26. AAPT considers that this approach is more likely to be the in the LTIE than the approach adopted by the Commission in the draft decision where it seems clear that the cost model estimates have been given primacy irrespective of how they compare to international benchmarks.
27. AAPT considers that wholesale prices for the fixed services that are above international benchmarks will necessarily translate into higher prices to end-users and as a result Australian businesses, for example, will be less able to compete internationally.
28. As seen from the table in Attachment 1, AAPT considers that WLR and ULLS cost estimates are not validated by international benchmarks, while LCS, PSTN OTA and LSS cost estimates are validated by international benchmarks.
29. Consequently, AAPT considers that in the case of WLR and ULLS where cost estimates are around 50% higher than international benchmarks that less weight should be given to these cost estimates and more weight should be given to international benchmarks. AAPT considers that this approach will lead to better outcomes for residential and business end-users across Australia.

WLR

30. AAPT notes that the Analysys model produces the following cost estimates for WLR for 2009-10¹².

	Zone A	Zone B
Analysys estimate 2009-10	\$23.26	\$67.72

¹² Page 31, draft decision.

31. International benchmarking, on the other hand, provides a geographically averaged benchmark of \$20.51 for a comparable WLR product¹³.
32. The Commission proposes a Zone A draft indicative price for of \$23.30 for 2009-10 but decides against proposing a Zone B draft indicative price. However, AAPT considers that when the Commission gives details of the cost estimate, even though it does not actually set an indicative price, it is in effect establishing a pseudo indicative price and there is a very real risk that Telstra will simply base its WLR Zone B negotiations with access seekers on the Analysis cost estimate of \$67.72.
33. AAPT considers that the Commission should abandon the proposed two zone pricing structure for WLR in favour of a national price set at the current draft indicative price for Zone A, ie \$23.30. AAPT considers that this approach is in the LTIE because:
 - a) a national price of \$23.30 represents a moderate reduction in current indicative prices for WLR towards international benchmarks, although access seekers would still in fact be paying almost 14% higher than international benchmarks which are currently at \$20.51 pm. Table 4.1 of the Analysys international benchmarking study, dated 18 Aug 2009 (**Analysys International Benchmarking Study**), provides the WLR benchmarking prices (in AUD) for 11 European countries. On inspection, it seems that Ireland could be considered an outlier and if Ireland is excluded, the Commission's proposed \$23.30 pm represents the highest figure among the remaining 10 countries;
 - b) the retail price of line rental services is set at a national level through price control mechanisms and so it makes sense that the wholes price should also be set on a national basis;

¹³ Page 31, draft decision.

- c) Telstra is provided with the proceeds of the USO levy to compensate it for any financial disadvantage arising from servicing uncommercial customers, but competitors do not receive any such subsidy;
 - d) the application of a wholesale price in Zone B of around \$67 pm in a market where the retail price is half or less would appear to raise competition concerns under the Trade Practices Act (**TPA**); and
 - e) according to the Commission's own most recent competition safeguards report, the concentration of fixed line markets is extreme and becoming worse.
34. If, however, the Commission considers that the setting of a national price for WLR means that the indicative price must increase above \$23.30 pm then AAPT considers that the Commission should retain the two zone structure proposed in the draft decision. In other words, AAPT considers that \$23.30 pm is the absolute upper limit which must not be traded off in order to set a national price.
35. In terms of the financial impact to AAPT, as at the end of July 2009, AAPT had approximately *[c-i-c]*WLR services in operation (**SIOs**), with approximately *[c-i-c]* (*or almost [c-i-c]*%) of those WLR SIOs in Zone B.
36. The table below shows the impact on AAPT of three scenarios: a national WLR of \$23.30 (AAPT's preferred option), a Zone A price of \$23.30 and a Zone B price of \$67.70 (based on the Analysys model output) and a national WLR of \$32 (an assumed figure, based on a weighted average of a \$23.30 Zone A price and a \$67.70 Zone B price).

Indicative Price	Approximate Annual Spend	Impact relative to AAPT's preferred option
National price of \$23.30 <i>(AAPT's preferred option)</i>	<i>[\$c-i-c] pa</i>	<i>\$0 pa</i>
Zone A - \$23.30 Zone B - \$67.70	<i>[\$c-i-c] pa</i>	<i>[\$c-i-c] pa</i>
National WLR of \$32.00	<i>[\$c-i-c] pa</i>	<i>\$4[\$c-i-c] pa</i>

37. The impact of a decision based on these options is clearly significant to AAPT and could be as great as *[\$c-i-c] pa*, assuming no WLR growth.
38. AAPT could not sustain this sort of price increase and would need to pass on these increased costs to end-users.
39. As an alternative to a national price of \$23.30 pm for 2009-10, AAPT would be open to the Commission establishing a four band pricing structure based on the four band ULLS pricing structure advocated below.
40. Finally, while AAPT urges the Commission not to set an indicative price for WLR beyond 30 Jun 2010, if the Commission chooses to do so, AAPT considers that the Commission should set a price which places greater emphasis on the international benchmarking study and less on the Analysis model and therefore set an indicative price at around \$20.50 pm.

ULLS

41. AAPT notes that the Analysys model produces the following cost estimates for ULLS for 2009-10.

	Zone A	Zone B
Analysys estimate 2009-10	\$22.03	\$60.41

42. The Ovum International benchmarking study, dated 26 February 2009, (**Ovum International Benchmarking Study**) provides a geographically averaged ULLS benchmark price of between \$13.22 and \$16.89.
43. As with WLR, the Analysys model produces results which are significantly greater than international benchmarks. This may not be surprising given that the WLR and ULLS cost estimates are closely related. However, AAPT considers that such a difference should not be just simply ignored. Instead the differential should make the Commission question why the Analysys model produces results which are so high.
44. For the reasons detailed above, AAPT considers that it is inappropriate to set indicative prices based principally on a single number output from the Analysys model, particularly when that single number output is significantly higher than international benchmarks.
45. Figure 2.2 and 2.3 of the Ovum International Benchmarking Study provide estimates for four European countries which adopt LRIC based costing methodologies and six European countries which adopt either a Fully Distributed Cost (**FDC**), a Fully Allocated Cost (**FAC**) or an Embedded Direct Cost (**EDC**) costing methodology.

Country	Monthly Cost (PPP)	Costing Methodology
Germany	\$16.89	LRIC
Austria	\$15.20	LRIC
France	\$14.75	LRIC
Denmark	\$13.22	LRIC
LRIC Based Average	\$15.02	
Sweden	\$12.90	FDC
Italy	12.45	FDC
Finland	\$16.95	FAC
Spain	\$16.94	FAC
UK	\$15.23	FAC
Netherlands	\$12.87	EDC
FDC, FAC & EDC Based Average	\$14.56	
Overall Average	\$14.79	

46. The Ovum International Benchmarking Study concludes that that Telstra’s propose \$30pm Band 2 (which produces a weighted average price of \$28.93 pm) is higher than other countries regulated charges. Ovum also make the same conclusion taking into account population density and local loop lengths into account.
47. In addition, Ovum concludes that the current indicative prices of: \$6 for B1, \$16.60 for B2 and \$31.30 for B3 which produces weighted average price of \$15.75 are broadly consistent with most LRIC based charges in other countries.
48. AAPT is surprised that despite this analysis the Commission now proposes to significantly increase the price of ULLS to \$23.60 for Zone A over a 2 year glide path.

49. AAPT considers that the Commission should leave the indicative prices unchanged for the 2009-10 period on the basis that such an approach is supported by international benchmarks. AAPT considers that the banding structure should remain in place because averaging of prices should only be done when there is no significant difference over the geographic regions and that is clearly not the case with ULLS. AAPT notes that there are no equivalent line rental retail price controls applicable to ULLS.
50. AAPT has around *[c-i-c]* ULLS (B1: *[c-i-c]*, B2: *[c-i-c]*, B3: *[c-i-c]*) (and estimates that this equates to Zone A: *[c-i-c]* and Zone B: *[c-i-c]*). The financial impact on the proposed price increase is set out below.

Indicative Price	Approximate Annual Spend	Impact relative to AAPT's preferred option
B1: \$6.00, B2: \$16.60, B3: \$31.30 <i>(AAPT's preferred option)</i>	<i>[\$c-i-c] pa</i>	<i>\$0 pa</i>
Zone A - \$16.90 Zone B - \$61.50 (Draft indicative 2009-10)	<i>[\$c-i-c] pa</i>	<i>[\$c-i-c] pa</i>
Zone A - \$23.60 Zone B - \$62.70 (Draft indicative 2010-11)	<i>[\$c-i-c] pa</i>	<i>[\$c-i-c] pa</i>
Zone A - \$23.60 Zone B - \$62.70 (Draft indicative 2011-12)	<i>[\$c-i-c] pa</i>	<i>[\$c-i-c] pa</i>

51. The impact of a decision based on these options is clearly significant to AAPT and could be as great as *[\$c-i-c] pa*, assuming no ULLS growth.



52. AAPT could not sustain this sort of price increase and would need to pass on these increased costs to end-users.
53. Finally, while AAPT does not consider that the Commission should set an indicative price for ULLS beyond 30 Jun 2010, should the Commission chose to do so, AAPT considers that the Commission should set a price which places greater emphasis on the international benchmarking study and less on the Analysis model and should not implement a glide path upwards to a price that is clearly out of step with international benchmarks.

LCS

54. AAPT notes that the Analysys model produces the following range of cost estimates for LCS: 7.82 cents for 2009-10 to 7.81 cents for 2011-12.
55. The Analysys International Benchmarking Study provides benchmark price of between 7.06 cents and 10.56 cents.
56. AAPT notes that unlike ULLS and WLR, the Analysys model produces cost estimates that appear to be validated by international benchmarking. Consequently, AAPT is comfortable with the cost estimates that the Analysys model produces for LCS.
57. The cost estimates and the Analysys International Benchmarking Study are in stark contrast to the current indicative prices of 17.36 cents. The industry has been subject to this excessively inflated indicative LCS price for many years now and it has resulted in negotiations to be concluded where the price of WLR is traded off in order to get a lower LCS price.



58. In fact AAPT believes that in the vast majority of cases, access seekers are not actually paying 17.36 cents for LCS and that most access seekers are paying less than 10 cents.
59. AAPT welcomes a move away from the previous RMRC approach and is comfortable that the Analysys cost estimate is reasonable. However, the Commission has formed a draft view that there should be a linear glide path: 13.30 cents for 2009-10, 10.20 cents for 2010-11 and 7.9 cents for 2011-12. The Commission justifies the glide path on the basis that it will reduce price shock.
60. AAPT considers that the ACCC has overestimated the impact of any price shock, especially given that access seekers and access providers are not buying and selling LCS at the old excessively inflated indicative price anyway.
61. AAPT considers that the Commission should adopt a steeper glide path such that the indicative price of 7.9 cents is reached in 2010-11.

PSTN OTA

62. AAPT notes that the Analysys model produces the following cost estimates for PSTN OTA: between 0.74 cpm for 2009-10 and 0.79 cpm for 2011-12.
63. The Analysys International Benchmarking Study produces a rate of between 0.75 cpm and 0.78 cpm.
64. AAPT notes that the Analysys model produces cost estimates that appear to be validated by international benchmarking. Consequently, AAPT is comfortable with the cost estimates that the Analysys model produces for LCS.



65. However, the Commission has formed a draft view that there should be a linear glide path: 0.90 cpm for 2009-10, 0.85 cpm for 2010-11 and 0.8 cpm for 2011-12. The Commission considers that this glide path is justified on that basis that it will reduce price shock.
66. AAPT considers that the ACCC has overestimated the impact of any price shock and that the Commission should adopt a steeper glide path such that the indicative price of 0.8 cpm is reached in 2010-11.

LSS

67. AAPT notes that the Commission's specific cost model produces cost estimates for LSS between \$0.94 pm and \$0.95 pm.
68. The Analysys International Benchmarking Study produces a rate of between \$0.31 pm and \$4.94 pm.
69. AAPT notes that the Commission's specific cost model appears to be validated by international benchmarking. Consequently, AAPT is comfortable with the cost estimate for LSS produced by the Commission's cost model.
70. AAPT agrees with the Commission that the industry was aware of a likely price drop for LSS and that a change from the current price of \$2.50 pm to \$1 pm (a difference of \$1.50 pm) should not be considered to result in a price shock. Consequently, AAPT considers that a glide path is not required.



Attachment 1

Fixed Service	Cost Model Estimates	International Benchmark	Is the Cost Model Estimate Validated by International Benchmarks?	Commission's Draft Indicative Price	AAPT Submission
WLR	Zone A: \$23.26 pm Zone B: \$67.72 pm Geographical average: approx \$32 pm	Geographic average: \$20.51 pm	No Analysys model estimates (geographic average) are approx 56% higher	Zone A: \$23.30 pm	Less weight should be given to cost model estimates and more weight given to international benchmarks when setting indicative prices
ULLS	Zone A: \$22.03 pm Zone B: \$60.41 pm	Geographic average: \$14.79 pm (see analysis on page 14)	No Analysys model estimates (Zone A) are approx 49% higher	Zone A: glide path to \$23.60 pm in 2011-12 Zone B: approx \$62	Less weight should be given to cost model estimates and more weight given to international benchmarks when setting indicative prices
LCS	7.82 cents (2009-10)	Between 7.06 cents and 10.56 cents	Yes	Glide path to 7.9 cents in 2011-12	The cost model estimate is supported by international benchmarks and can be relied on to set indicative prices but the glide path is too long
PSTN OTA	Between 0.74 cpm and 0.79 cpm	Between 0.75 cpm and 0.78 cpm	Yes	Glide path to 0.8 cpm in 2011-12	The cost model estimate is supported by international benchmarks and can be relied on to set indicative prices but the glide path is too long
LSS	Between \$0.94 pm and \$0.95 pm	Between \$0.31 pm to \$4.94 pm	Yes	\$1 pm	The cost model estimate is supported by international benchmarks and can be relied on to set indicative prices