



**Submission by AAPT Limited
to
the Australian Competition & Consumer Commission
in response to
Telstra's Core Services Undertaking
dated 14 November 2003**

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1. Introduction

AAPT Ltd (**AAPT**) welcomes the opportunity to comment on undertakings lodged by Telstra Corporation Ltd (**Telstra**) with the Australian Competition and Consumer Commission (the **Commission**) on 14 November 2003 (the **Undertaking**). The Undertaking relates to domestic PSTN originating and terminating access services, unconditioned local loop services and local carriage services (together the **core services**).

On 9 January 2003, Telstra lodged undertakings with the Commission in relation to the core services (the **January 2003 undertaking**). AAPT provided detailed submissions to the Commission in response to the January 2003 undertakings.

AAPT notes that, in considering the Undertakings, the Commission intends to have regard to relevant information provided during the course of its consideration of the January 2003 undertaking and encourages parties to make submissions by reference to any previous submissions.¹ Accordingly, AAPT wishes to refer the Commission to its previous submissions in relation to the January 2003 undertaking. These include:

- AAPT submission dated 9 July 2003 on the *Access Deficit Contribution Aspects*;
- CoRE research paper dated 23 July 2003, *Comparing TSLRIC and TELRIC*;
- CoRE research paper dated 25 June 2003, *Competitive Neutrality in Interconnection Pricing*;

¹ Australian Competition and Consumer Commission, *Assessment of Telstra's core services undertakings – preliminary view*, 12 December 2003, at p 1.

- CoRE research paper dated 25 June 2003, *Evaluating Telstra's Undertakings for CAN Cost Recovery*;
- AAPT's *Submission to the ACCC* on Telstra's undertaking, August 2003; and
- CoRE Research, *Reducing PSTN Interconnection Charges Will Lower Retail Telecommunications Prices: A Response to Telstra's Submission*.

This submission will not repeat AAPT's previous submissions on the understanding that the Commission will have regard to AAPT's previous submissions.

AAPT wishes to address three issues in this submission. These are:

1. the access deficit contribution (**ADC**) component of PSTN interconnect;
2. the basis for consideration and any acceptance of Telstra's undertaking;
and
3. the extent to which the undertakings constitute a genuine offer.

2. Access Deficit Contribution

2.1 The Commission's approach to ADC

The Commission considered the ADC in detail during the process that led to the Commission's final determination for model price terms and conditions of the core services (the **model price terms and conditions determination**).² During that process, the Commission sought industry and consumer views on the ADC. Ten submissions were made by various industry participants, and all except Telstra either opposed or questioned the continuation of the ADC.³

The Commission concluded that:

² Australian Competition and Consumer Commission, *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003.

³ Australian Competition and Consumer Commission, *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003, p 42.

the inclusion of an ADC is not necessary for Telstra to recover the [access deficit], and that a proper application of the relevant criteria to the currently available information does not support the inclusion of an ADC within PSTN O/T prices.⁴

...

Overall, the Commission considers that, while there is a strong case for removing the ADC and moving to TSLRIC+ pricing, this change should be implemented over a three year transitional period.⁵

The transitional period is to conclude at the end of the 2005-2006 financial year.

2.2 Inclusion of the ADC in the Undertaking

In its submissions to the Commission on this issue, AAPT strongly opposed the inclusion of the ADC in access prices.⁶ AAPT welcomed the Commission's rejection of ADC as a matter of principle, but submitted that a shorter phase out period was required. It argued that the most appropriate policy would be to completely remove the ADC from access prices 12 months from the date of issue of the Commission's Draft Determination of 18 June 2003.⁷

AAPT continues to oppose the inclusion of any ADC component in access pricing, and to oppose a lengthy period for the phasing out of the ADC component. AAPT refers the Commission to AAPT's previous submission where the arguments against the lengthy phase-out time were discussed in detail.⁸ In particular, AAPT reiterates its

⁴ Australian Competition and Consumer Commission, *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003 at p 62.

⁵ Australian Competition and Consumer Commission, *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003 at p 65.

⁶ AAPT Ltd, *The Need for an ADC for PSTN Access Service Pricing, Submission to the ACCC by AAPT Limited*, February 2003; AAPT Ltd, *Access Deficit Contribution Aspects, Submission to the ACCC by AAPT Limited*, dated 9 July 2003.

⁷ AAPT Ltd, *Access Deficit Contribution Aspects, Submission to the ACCC by AAPT Limited*, dated 9 July 2003 at p 48.

⁸ AAPT Ltd, *Access Deficit Contribution Aspects, Submission to the ACCC by AAPT Limited*, dated 9 July 2003 at pp 40-48.

submission that there is no justification for allowing Telstra to continue to earn a profit well above a reasonable commercial return on PSTN during the ADC phase-out.⁹

AAPT accepts that the Commission's inclusion of an ADC component in the model price terms and conditions determination provides the benchmark for any arbitration. However, AAPT does not accept that it is appropriate for the ADC component to be included in an undertaking. Telstra has not chosen to give an undertaking that adopts the model terms and conditions (in the manner described in s152BS(4) of the *Trade Practices Act 1974* (Cth) (the **Act**)). Rather, it has chosen to specify the terms and conditions in the undertaking (in the manner described in s152BS(3) of the Act). In this situation, there is no requirement that the undertaking mirror the model price terms and conditions determination. AAPT submits that the Commission should not accept an undertaking in which Telstra seeks to continue to earn its unjustifiable profits on the ADC component during the life of the Undertaking.

3. Telstra's submission in support of the Undertakings

3.1 Telstra's submission on costs

In Telstra's submission in support of the Undertaking, Telstra has criticised and by implication challenged the Commission's model price terms and conditions determination.

Telstra states that there is a 'broad consensus that prices for PSTN OTA and ULLS should approximate long run efficient costs.'¹⁰ Telstra goes on to argue that its PIE II methodology for determining costs is more accurate than the Commission's assessment of costs. It submits that the PIE II model demonstrates that Telstra's costs in providing the core services are higher than:

- the prices currently prevailing in the telecommunications industry;

⁹ AAPT Ltd, *Access Deficit Contribution Aspects, Submission to the ACCC by AAPT Limited*, dated 9 July 2003 at p 41.

¹⁰ Telstra Corporation Ltd, *Telstra's Submission in Support of its Undertaking dated 14 November 2003* at p 2.

- the prices in the Commission's model price terms and conditions determination; and
- the prices in the Undertaking which mirrors the model price terms and conditions undertaking.¹¹

The Commission considered Telstra's submissions on its costs and the PIE II model in detail during the process that led to the model price terms and conditions determination.¹² The Commission's model price terms and conditions determination indicates 'the Commission's views as to what constitute[s] fair terms and conditions of access to these services', taking into account the reasonableness criteria under Part XIC of the Act and submissions made by all parties.¹³ However, Telstra clearly indicates in its submission in support of the Undertaking that it does not accept the Commission's model price terms and conditions determination.¹⁴

AAPT is concerned that any acceptance by the Commission of the Undertakings could be seen as an implicit acceptance of the arguments and criticisms of the model price terms and conditions determination made by Telstra in its submission in support of the Undertaking. In particular, AAPT is very concerned about any perceived agreement with the assertions made by Telstra about its costs.

AAPT does not want Telstra to be able to argue, at any time in the future, that in accepting the Undertaking the Commission accepted the submission's argument that the prices in the Undertaking and the model price terms and conditions determination are below cost prices. Any such perceived agreement by the Commission that the currently proposed prices are below cost prices would be a valuable public relations

¹¹ Telstra Corporation Ltd, *Telstra's Submission in Support of its Undertaking dated 14 November 2003* at pp 2-4.

¹² Australian Competition and Consumer Commission, *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003.

¹³ Australian Competition and Consumer Commission, *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003, p1.

¹⁴ See also Telstra Corporation Ltd, *Telstra's Submission in Support of its Undertaking dated 14 November 2003* at p 6.

victory for Telstra and establishes a false premise from which to commence future assessments of Telstra's costs and pricing.

AAPT is sceptical of Telstra's assertion that its costs in providing the core services are higher than the prices currently prevailing in the telecommunications industry. None of the prices currently prevailing have been determined by a concluded arbitration process or otherwise imposed on Telstra. All have been voluntarily entered into by Telstra after commercial negotiations. If Telstra has been consciously selling the core services below cost this would appear to be to the detriment of shareholders and raise questions about whether the Board is fulfilling its fiduciary duties. However, it is difficult to reconcile the claim of below cost pricing with Telstra's financial results.

Ideally, AAPT would like to see an acknowledgement by Telstra of the reasoning that underlies the Commission's model price terms and conditions determination. At the very least, if the Commission accept the Undertaking, the Commission should explicitly reject the claims about below cost pricing in Telstra's submission. The Commission should make it clear that any acceptance of the Undertaking is based not on Telstra's submission but on the Commission's own independent analysis of pricing which was conducted as part of reaching the model price terms and conditions determination.

3.2 The Reasonableness criteria

Section 152BV of the Act sets out the circumstances in which the Commission must not accept an access undertaking. Subsection 152BV(2) relevantly provides that:

- (2) The Commission must not accept an access undertaking unless:
 - ...
 - (d) the Commission is satisfied that the terms and conditions specified in the undertaking are reasonable; ...

This provision (the **reasonableness criteria**) places an onus on the Commission to consider the reasonableness of an undertaking and only to accept that undertaking if the Commission is satisfied that the terms and conditions are reasonable.

Section 125AH of the Act sets out a non-exclusive list of matters that the Commission must consider in determining whether terms and conditions are reasonable. These factors include:

- whether the terms and conditions promote the long-term interests of end-users of carriage services or of services supplied by means of carriage services (s152AH(1)(a));
- the legitimate business interests of the carrier or carriage service provider concerned, and the carrier's or provider's investment in facilities used to supply the declared service concerned (s152AH(1)(b)); and
- the economically efficient operation of a carriage service, a telecommunications network or facility (s152AH(1)(f)).

AAPT submits that if it were the case, as Telstra submits, that the Undertaking prices are below cost prices, the Commission could not be satisfied that the Undertaking is reasonable, given the criteria listed above. It would not be in the long term interest of end users or carriers and carriage service providers for below cost access pricing to become an industry standard. Nor could such pricing promote the economically efficient operation of a carriage service, a telecommunications network or facility in the long term.

Therefore, if the Commission were to accept that there is merit to Telstra's argument that the Undertakings reflected below cost pricing, the Commission should reject the undertaking for failing the reasonableness criteria.

4. The undertakings as a genuine offer

4.1 Undertakings applicable to all access seekers

Sub-section 152BS(1) of the Act states that an ordinary access undertaking is:

a written undertaking given by a carrier or a carriage service provider to the Commission under which the carrier or provider undertakes to comply with the terms and conditions specified in the undertaking in relation to the applicable standard access obligations.

AAPT submits that it is implicit in this definition that the terms and conditions that the carrier undertakes to provide should be available to all access seekers once the Undertaking has been accepted. In other words, an undertaking should be a guarantee of access, which is universally available to all access-seekers, on terms at least as favourable as those in the undertaking.

4.2 Can all access seekers take advantage of the undertaking?

Telstra currently supplies services to a number of access seekers. AAPT believes that it is probable that at least some of these access seekers are already parties to contracts with Telstra which:

- provide one or more services on terms and conditions less favourable to the access seeker than the terms and conditions in the Undertaking;
- continue well into the future and overlap with at least a portion of the period of the Undertaking; and
- contain limitations on any renegotiation of the contract during the life of the contract.

Given these factors, AAPT postulates that there may be access seekers who, at least prima facie, will be unable to take advantage of the Undertaking even if the Commission accepts it.

Assuming there are such contracts as those described above, acceptance of the Undertaking will raise difficult issues about whether the Undertaking or the pre-existing agreements have primacy. This could lead to lengthy and costly disputes between Telstra and access seekers as to whether access seekers have a right to renegotiate their contracts if they wish to obtain the terms guaranteed by the Undertaking.

If the pre-existing agreements are found to take precedence over the Undertaking, and effectively prevent access seekers from taking advantage of the terms of the Undertaking, the Undertaking itself is of little value.

AAPT believes that Telstra should guarantee as part of the Undertaking that the Undertaking is available to all access seekers, regardless of any current contracts they may have with Telstra. This would ensure that the Undertaking is genuinely universal in application, as AAPT submits the legislation intends. It would also remove doubt in

the industry and lessen the likelihood of costly disputes about the relationship between pre-existing contractual terms and the Undertaking.

If Telstra currently provides access to most access seekers on terms as favourable or better than those in the Undertaking, this requirement would not impose any practical burden on Telstra, since it is unlikely that many parties will seek to renegotiate their contracts with Telstra on the basis of the Undertaking. However, if Telstra currently provides access to most access seekers on terms less favourable than those in the Undertaking and Telstra refuses to renegotiate with those access seekers, this suggests that Telstra is not genuine in its commitment to the Undertaking.

AAPT submits that unless Telstra guarantees as part of the Undertaking that all access seekers, including those with pre-existing contracts, have the option of renegotiating their arrangements with Telstra to bring them in line with the Undertaking, the Undertaking is of minimal value other than as a public relations exercise for Telstra. It will not provide any greater certainty for the industry as a whole than is already provided by the model price terms and conditions determination, and should be rejected by the Commission.

5. Conclusion

Subsection 152BU(2) states that after considering an undertaking, the Commission must either accept the undertaking or reject the undertaking. As mentioned above, s152BV(2) of the Act sets out that the Commission must not accept an access undertaking unless certain conditions are met. However, there is no positive obligation on the Commission to accept an undertaking just because all of the conditions listed in s152BV(2) are met.

AAPT submits that there is therefore no presumption of acceptance of an undertaking in the Act. AAPT believes that the Commission should only accept an Undertaking that promotes the object of Part XIC of the Act: to promote the long-term interests of end-users of carriage services or of services provided by means of carriage services.¹⁵

¹⁵ *Trade Practices Act 1974* (Cth) s152AB(1).

One factor relevant to determining whether a thing promotes the long-term interests of end-users is whether that thing will promote competition in markets for listed services.¹⁶

AAPT submits that the Telstra Undertaking does not promote competition and consequently does not promote the long-term interests of end-users. The continued presence of an ADC component in the pricing allows Telstra to continue to earn an unjustifiable profit on the PSTN aspect of the core services. The failure of Telstra to guarantee that the Undertaking terms and conditions will be available to all access seekers, regardless of existing contractual arrangements, means the Undertaking is of limited value. There is also a danger that an acceptance of the Undertaking will be seen as an acceptance of Telstra's submission that its current core services pricing is below cost.

The Commission has already undertaken rigorous consideration of the appropriate terms and conditions, including price, for core services. This assessment culminated in the modal price terms and conditions determination, which provides a valuable benchmark for access providers and access seekers in their dealing with one another and in the determination of any access disputes that may arise. In a circumstance where the Undertaking merely adopts the Commission's model prices without accepting the Commission's methodology and is not a genuine offer to all access seekers, it provides no advance in regulatory certainty.

Accordingly, AAPT submits that the Commission should reject the Undertaking. However, if the Commission does decide to accept the Undertaking, the Commission should:

- clearly state that its acceptance of Telstra's Undertaking does not indicate any acceptance of Telstra's supporting submission, particularly as that submission relates to allegedly below cost pricing; and
- require Telstra to guarantee that the Undertaking terms and conditions will be available to all access seekers regardless of their current contractual arrangements with Telstra; ie will be of universal application.

¹⁶ *Trade Practices Act 1974* (Cth) s152AB(2)(c).