



**Submission by AAPT Limited to the Australian Competition
and Consumer Commission in response to *Review of Telstra
Price Control Arrangements - Discussion Paper*, dated
January 2010**



Introduction

1. AAPT Limited (**AAPT**) welcomes the opportunity to comment on the Australian Competition and Consumer Commission's (the **Commission's**) January 2010 discussion paper reviewing Telstra's retail price controls (**RPCs**).
2. AAPT considers that there are three possible recommendations the Commission could make to the Minister on how to deal with Telstra's RPCs from 1 July 2010:
 - allow the current RPCs to expire;
 - extend the expiry date of the current RPCs without change to their structure;
or
 - establish a new set of RPCs to apply from 1 July 2010 with changes made to the structure, eg a change in the composition of the baskets and/or the relevant allowable percentage change in price.
3. AAPT acknowledges that RPCs have played an important role within telecommunications regulatory regimes around the world, however, AAPT considers that over time they have become increasingly less relevant, almost to the point where they are now starting to appear anachronistic.
4. This shift in relevance was recognised in the UK (the birth place of RPCs) almost four years ago when Ofcom allowed BT's RPCs to lapse despite an acknowledgement by Ofcom that BT still retained significant market power in retail markets. Ofcom concluded at that time that regulatory intervention should be instead focussed on wholesale regulation.



5. AAPT believes that a continued reliance on price controls is inappropriate today and that attention should be instead focussed on addressing the current issues with wholesale regulation, particularly where regulated wholesale services are being supplied at prices well in excess of cost.

6. AAPT does not believe that the current Telstra RPCs have any real impact on the level of competition, availability, choice or quality of products or the level of investment decisions in telecommunications markets today. Consequently, AAPT is minded to suggest that the Commission recommend to the Minister that the current Telstra RPCs be allowed to expire on 30 June 2010. However, given the current significant changes mooted for the industry, ie the imminent passage of the Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009 (the **Telecommunications (C&CS) Bill**) and the rollout of a FTTP network by NBN Co, AAPT would certainly understand if the Commission adopted a more cautious approach by recommending to the Minister that the current Telstra RPCs be extended (without change) for a short period, say two years.

History of retail price controls

7. RPCs were originally designed to protect consumers by reducing prices when competitive pressures alone were too weak to bring about this outcome. They were first introduced back in 1984 by Ofcom in the UK and their acceptance and use has grown around the world since that time. They were first introduced in Australia in 1989 and they have remained part of the Australian regulatory landscape with the current Telstra RPCs recently extended out to 30 June 2010.

8. However, there has been a growing recognition in more recent times that RPCs have become increasingly less relevant. For example, in July 2006 (almost four years ago) Ofcom allowed BT's RPCs to lapse altogether in recognition of a greater increase in competition in the retail market and this was despite the

acknowledgement by Ofcom that BT still retained significant market power in retail markets¹.

9. Ofcom concluded that regulatory intervention should now be focussed on wholesale regulation (emphasis added):²

Ofcom's decision

5.15 In reaching a conclusion concerning the expiry of the RPC, Ofcom has balanced the consequences of BT's continued market power in these markets with its view of the extent to which other factors – chiefly competitive pressure and other regulation – limits BT's ability to set excessive prices.

*5.16 Ofcom considers that allowing expiry of BT's retail price controls but underpinned by BT's assurances and supported by an extensive communications campaign meets the requirements set out in Sections 3 and 4 (above). The interests of consumers will be served by their increased awareness of the choices available and **with increasing competition engendered by appropriate wholesale regulation**. This in turn should lead to new services greater choice for consumers and further reductions in retail prices.*

10. AAPT agrees with Ofcom that the emphasis should be placed on wholesale regulation because that is where the real gains can be made in the promotion of competition and consequently where better outcomes for consumers can be achieved.
11. Given this shift in focus away from RPCs in jurisdictions such as the UK, AAPT considers that it would be inappropriate to contemplate an expansion in scope of the current Telstra RPCs, eg by way of the introduction of a separate fixed to mobile (**FTM**) price cap.

¹ Retail Price Controls Explanatory Statement, Ofcom, 19 July 2006

² Retail Price Controls Explanatory Statement, Ofcom, 19 July 2006, page 31



Current state of competition

12. In general terms, the current Telstra RPCs apply the following price caps on Telstra's fixed voice services through until 30 June 2010³:
 - 0% local calls, trunk calls (national LD and F2M), international calls and line rental⁴;
 - CPI% on basic residential line rental products;
 - CPI% on basic business line rental product; and
 - CPI% on connection services.
13. The Commission notes in the discussion paper that to the extent that price controls are considered necessary in markets where market discipline does not constrain Telstra's market power, it follows that in an effectively competitive market there is no need on efficiency grounds to maintain price controls⁵.
14. AAPT agrees that RPCs are not needed in a competitive retail market. However, AAPT does not believe that the converse necessarily applies, ie a retail market which is not competitive does not necessarily mean that RPCs are needed. AAPT considers that appropriate wholesale regulation is the better regulatory intervention device to focus on in these circumstances.
15. The Commission also notes in the discussion paper that in finalising the 2009 MTAS pricing principles it noted a lack of pass-through of reductions in

³ Telstra Carrier Charges – Price Control Arrangements, Notification and Disallowance Determination No.1 of 2005

⁴ The price of local calls must also not exceed 22 cents per call

⁵ Discussion paper, page 13



wholesale mobile termination rates to retail FTM call rates despite significant falls in the regulated indicative price of MTAS⁶.

16. In Addition, the Commission notes that after the 2009 MTAS pricing principles determination that it commissioned Analysys Mason to provide a report that benchmarked and researched international regulatory approaches to FTM pass-through and conducted a welfare model to estimate social welfare effects between different regulatory scenarios. The results of that research indicated that the absence of regulation of FTM calls leads to an increase in retention margins in a number of benchmarked countries including Australia, ie regulating FTM pass through (for example through price cap regulation) would have a positive impact on overall social surplus⁷.

17. AAPT agrees that Telstra has substantial market power in the FTM market but does not consider that this justifies the creation of a separate FTM price cap as contemplated by the Commission because:
 - a RPC is not an effective instrument to control Telstra's market power in the FTM market;
 - the imminent passage of the Telecommunications (C&CS) Bill will result in the introduction of appropriate measures which will have a significant impact on Telstra's market power; and
 - imposing a separate price control on FTM without simultaneously moving MTAS pricing down to the cost of supply will simply hurt service providers (like AAPT) trying to compete in the FTM market and in the greater fixed voice market.

⁶ Discussion paper, page 14

⁷ Discussion paper, page 14 and 15



18. Consequently, AAPT considers that the state of competition in the fixed voice market does not provide any signal to either retain or remove existing RPCs nor does it provide a signal that a new separate FTM market RPC is needed. AAPT considers that the state of the competition in the fixed voice market simply indicates that the Telecommunications (C&CS) Bill is urgently needed.

Impact of price controls on competition

19. The Commission notes in the discussion paper that price controls may have an important impact on the extent and type of competition that develops in telecommunications markets, eg new entrants are attracted to a market by the prospect of financial return that is commensurate with risk and below cost pricing brought about by price controls would discourage entry in some markets⁸.
20. The Commission also notes that the current state of competition in markets within which local telecommunications services (line rental and local calls) are provided could potentially be influenced by price control arrangement, eg a degree of quasi-facilities based competition has emerged in low cost regions (eg CBD and metro areas) but considerably less facilities based competition has appeared in higher cost regions⁹.
21. The Commission, however, also acknowledges that there could be a variety of reasons for the nature and extent of facilities based competition that has developed which are not related to the retail price control arrangements, eg access prices or other input costs might be prohibitively high¹⁰.

⁸ Discussion paper, page 16

⁹ Discussion paper, page 16

¹⁰ Discussion paper, page 16



22. AAPT agrees that it is certainly possible to design RPCs which would have an adverse impact on the development of competition in markets which is why care should be taken in the design of the RPCs to avoid any such impact. However, AAPT considers that the current Telstra RPCs have had effectively a neutral impact on competition in retail markets, unlike wholesale regulation which has had a significant impact (eg the declaration of the ULLS).

Impact of price controls on availability, choice, quality and price

23. The Commission notes in the discussion paper that price controls:
- can have a direct impact on the retail price of particular telecommunications services, eg the current RPCs provide for a maximum price for local calls¹¹;
 - could have an impact on quality, eg if the price cap is too low then a supplier may be prevented from maintaining its quality of service, although the Commission acknowledges that there is nothing to guarantee that the same firm would not reduce quality for service in the absence of a price control¹²; and
 - could potentially affect the availability and choice of telecommunications services, eg price controls that require pricing to be below cost may discourage efficient facilities based entry and therefore reduce the potential for alternate suppliers to offer competing services¹³.
24. AAPT accepts that it is possible to design RPCs which have an adverse impact on markets which is why care should be taken in the design of RPCs, however,

¹¹ Discussion paper, page 17

¹² Discussion paper, page 17

¹³ Discussion paper, page 17



AAPT considers that the current Telstra RPCs have had effectively a neutral impact on availability, choice and quality.

25. AAPT also accepts that the current Telstra RPCs on local calls and line rental products have to some extent had an impact on the price of these services, although only to a very limited degree because the wide spread use of bundling has resulted in local calls and line rental products being priced at levels way below the specified price caps.

Impact of price controls on efficient investment decisions

26. The Commission notes in the discussion paper that there may be a number of tensions between facilities based entry, investment and price controls, eg facilities based entry may be artificially restricted by RPCs¹⁴.
27. AAPT accepts that it is possible to design RPCs which would have an adverse impact on facilities based entry and investment which is why care should be taken in the design of the RPCs, however, AAPT considers that the current Telstra RPCs have had virtually no impact on facilities based entry and investment and that it is wholesale regulation which has had the most significant and positive impact in these areas (eg the declaration of ULLS).

Form of next price control arrangements

28. The Commission notes in the discussion paper that careful consideration needs to be given to the bundle of services to be covered by a cap and that if the bundle provides too little flexibility then opportunities to rebalance will be limited while

¹⁴ Discussion paper, page 18



bundles which provide too much flexibility may give rise to the potential for anti-competitive abuse¹⁵.

29. The Commission also notes that historically the Telstra RPCs have been overly generous with price caps imposing only minor price reduction relative to actual price reductions observed in retail markets¹⁶.
30. AAPT agrees with both of these observations and suggests that the reason why the caps appear generous is because competition has worked to a degree to reduce prices. AAPT considers that further improvements in wholesale regulation would lead to even greater reductions in retail prices.
31. The Commission then notes that competition is still patchy in some geographical areas in the fixed voice market with competition still heavily reliant on regulatory mechanisms, consequently, the Commission concludes that there may still be a need for price control mechanisms¹⁷.
32. AAPT agrees that competition is still patchy and dependent on regulatory mechanisms, however, AAPT considers that the conclusion which should flow from this is that wholesale regulation mechanisms are therefore still needed and in fact need to be improved upon through reforms such as those detailed in the Telecommunications (C&CS) Bill.

¹⁵ Discussion paper, page 19

¹⁶ Discussion paper, page 19

¹⁷ Discussion paper, page 20