

**Optus Supplementary Submission in response to the ACCC's Draft Decision on Telstra's
2008 ULLS Undertaking**

Europe Economics paper

Public Version

March 2009

- 1.1 Optus wishes to submit the attached paper by Europe Economics, "*Pricing Principles for the Unconditioned Local Loop Service (ULLS) in Australia, The Conceptual Framework*", which proposes a new method for determining efficient, pro-competitive prices for access to the ULLS. Both confidential and public versions of the paper are attached.
- 1.2 Optus submits that the Europe Economics paper is relevant to the ACCC's assessment of Telstra's 2008 ULLS Undertaking. It provides further support for the finding that the pricing methodology applied in Telstra's TEA model over-estimates the forward-looking efficient cost of ULLS service provision. In particular, it is relevant to the ACCC's finding that the trenching costs included in the TEA model are not reasonable.
- 1.3 The pricing methodology applied by the TEA model is likely to over-estimate forward-looking efficient costs because it assumes that:
- prices for all assets should include replacement costs, which is not an appropriate assumption for assets likely to be made redundant by the NBN, and
 - it assumes that an efficient new entrant would rebuild ducts and trenches, which would not be an efficient form of competition.
- 1.4 Further, even if the model did correctly estimate efficient costs, it would be unlikely to provide an efficient build/buy signal in circumstances where it is highly unlikely that an operator would build a new access network.

Assets likely to be made redundant by the NBN

- 1.5 Optus notes that as a result of the introduction of the National Broadband Network (NBN), demand for the services of Telstra's ULLS will be significantly affected and a large proportion of Telstra's local loop assets (eg, the copper between the exchange and the pillar) will no longer be used. This fact has implications for the efficient cost of service provision and is therefore a relevant fact to take into account in assessing the TEA model's approach to network cost estimation. According to Europe Economics:¹

"those Telstra assets made redundant by the NBN will not be needed in the long term, so it is not realistic or efficient to calculate their prices as if they would"

- 1.6 In order to take account of this issue Europe Economics proposes the following adaptation to the TSLRIC+ method of calculation:²

¹ Europe Economics, 2009, *Pricing Principles for the Unconditioned Local Loop Service (ULLS) in Australia, The Conceptual Framework*, p.16

² Europe Economics, 2009, *Pricing Principles for the Unconditioned Local Loop Service (ULLS) in Australia, The Conceptual Framework*, p.24

“The costs of using those of Telstra’s assets expected to be made redundant by the NBN, would be estimated as the costs that would be incurred by an efficient operator in maintaining and repairing the existing assets in a serviceable state for the limited time for which they will be in use - including an appropriate rate of return on the investment that had been made but not including the cost of replacing the assets.”

- 1.7 Consequently, Optus submits that the values for network costs in the TEA model which relate to network assets that will be made redundant by the NBN are likely to exceed forward-looking efficient costs.

Ducts

Optus submits that the cost of laying cable using Telstra’s trenches and ducts and paying an appropriate price for their use is significantly lower than the cost of excavating and constructing new trenched ducts. For example, the current charge for access to ducts, including tunnels, payable by Optus to Telstra is **CiC**.

- 1.8 Optus considers that the most efficient mode of entry for a hypothetical fixed line network operator involves the use of existing ducts and trenches. Given the difficulty and high cost of construction of new trenches, it would be more realistic and more efficient for a hypothetical fixed line network operator to enter the market by renting space in the existing ducts and/or trenches instead. According to Europe Economics:³

“an efficient new entrant would be able to use Telstra’s trenches and ducts, paying an appropriate price for their use, rather than having to re-build or replace them.”

- 1.9 It follows that it is inappropriate for duct costs in the TEA model to reflect the cost of excavating and constructing new trenched ducts. According to Europe Economics:⁴

“if the prices that Telstra is permitted to charge for the use of its ULLS assets, including the trenches and ducts, are set on the basis of what a hypothetical new trench-digging entrant would have to charge, these prices will be significantly higher than those that would be needed to cover the efficient costs of using Telstra’s assets”.

- 1.10 In order to take account of this issue Europe Economics proposes the following adaptation to the TSLRIC+ method of calculation:⁵

“The cost of using the remaining assets, i.e., those assets that are likely to be used in the long term, would be estimated as the long-run costs of an efficient new entrant allowed to make use of the existing ducts and trenches in return for an appropriate payment to the owner. This is likely to give a lower cost estimate than calculating the cost of the unrealistic prospect that the ducts and trenches would be replicated with new ducts and trenches, as in traditional TSLRIC+ calculations.”

- 1.11 Consequently, Optus submits that the duct costs in the TEA model are likely to exceed forward-looking efficient costs.

³ Europe Economics, 2009, *Pricing Principles for the Unconditioned Local Loop Service (ULLS) in Australia, The Conceptual Framework*, p.16

⁴ Europe Economics, 2009, *Pricing Principles for the Unconditioned Local Loop Service (ULLS) in Australia, The Conceptual Framework*, p.19

⁵ Europe Economics, 2009, *Pricing Principles for the Unconditioned Local Loop Service (ULLS) in Australia, The Conceptual Framework*, p.24

Build/buy signalling

- 1.12 The following criticism of the pricing method used in the TEA model was made by Europe Economics:⁶

“LRIC models have been developed partly in order to provide an efficient ”build/buy signal”, i.e., to calculate a level of charges under which a new entrant operator would build its own core network if, and only if, it is more efficient to do so than to pay for the use of the incumbent operator’s network.

However, in a situation where it is highly unlikely that an operator would build a new access network the necessity to provide a build/buy signal is not clear, and in these circumstances it would be more appropriate to set the lowest price levels for access that would cover forward – looking costs and provide a reasonable return on existing assets.”

- 1.13 Optus notes that a key finding of a comprehensive study of Next Generation Access (NGA) carried out by WIK on behalf of the European Competitive Telecommunications Association (ECTA) was that:⁷

“For most of the national territory, once a first mover has deployed fibre-based NGA, it will not be profitable for another firm to replicate that infrastructure.”

- 1.14 That report noted that:⁸

“The economics of FTTx do not support multiple replication of the access network sufficient to achieve effective competition.”

- 1.15 Consequently, Optus submits that even if the TEA model did correctly estimate efficient costs, it would be unlikely to provide an efficient build/buy signal, and therefore would not encourage efficient investment in infrastructure.

⁶ Europe Economics, 2009, *Pricing Principles for the Unconditioned Local Loop Service (ULLS) in Australia, The Conceptual Framework*, p.21

⁷ J. Scott Marcus, March 2009, Submission to the Select Committee on the National Broadband Network, Senate of Australia, p.1.

⁸ WIK, *The Economics of Next Generation Access*, p.XXI