

Telstra's Access Undertaking for Domestic PSTN Originating and Terminating Access, Unconditioned Local Loop Service and Local Carriage Service, dated 14 November 2003

Submission by PowerTel Limited

PowerTel Limited (**PowerTel**) welcomes the opportunity to comment on the Australian Competition and Consumer Commission's (**the Commission's**) paper titled *Assessment of Telstra's core services undertakings – preliminary view*, dated 12 December 2003 (**preliminary assessment**) on Telstra's access undertakings for Domestic PSTN Originating and Terminating Access (**PSTN O/T**), Unconditioned Local Loop Service (**ULLS**) and Local Carriage Service (**LCS**) services, dated 14 November 2003 (**November 2003 access undertakings**).

PowerTel, along with other members of the Competitive Carriers Coalition (**the CCC**), commissioned Access Economics, Gibson Quai and Gilbert & Tobin to prepare submissions on Telstra's previous access undertakings for PSTN O/T, ULL and LCS services (**undertaking services**), dated 9 January 2003 (**January 2003 access undertakings**). In addition to those submissions, PowerTel made its own submission on the January 2003 access undertakings.

Given that there is little difference between the January 2003 access undertakings and the November 2003 access undertakings, other than the proposed prices for the undertaking services, PowerTel refers the Commission back to these submissions in their entirety.

Please also find attached to this submission, in Appendix 1, the information requested by the Commission, in a letter to PowerTel dated 5 March 2004, relating to PowerTel's interconnect call profile with Telstra (ie calls, minutes and geographic breakdown).

Some of the information in this submission is commercial-in-confidence and as a result PowerTel will provide a non-confidential version of this submission for posting on the Commission's website.

Executive summary

PowerTel:

- considers that Telstra is using the November 2003 access undertakings as a damage control tool to lock in prices for the undertaking services at the upper bound specified in the Commission's final determination on model price terms and conditions for the PSTN O/T, ULLS and LCS services, dated October 2003 (**final determination**); and

- has serious concerns about the Commission’s preliminary assessment that the terms and conditions in the November 2003 access undertakings:
 - satisfy the relevant standard access obligations (SAOs);
 - are reasonable; and
 - that as a consequence they should be accepted.

Specifically, PowerTel considers that:

- the absence of substantive non-price terms and conditions in the November 2003 access undertakings make it impossible to assess whether the undertakings are consistent with the SAOs or whether they are reasonable;
- the Commission’s conclusion that the November 2003 access undertakings are reasonable because the prices proposed in the undertakings line up with the prices specified in the final determination is flawed because this would mean that the Commission is agreeing to allow the indicative prices which were developed using a model that the Commission itself recognised as being flawed to be converted into prices which are effectively binding; and
- in any event:
 - the PSTN O/T and ULL prices determined by the Commission in the final determination were developed using Telstra’s PIE II model when it would have been more appropriate to use an independently developed cost model; and
 - the PSTN O/T prices determined in the final determination were too high because they included an ADC even though the Commission concluded that the ADC should be removed from PSTN O/T prices.

Consequently, PowerTel urges the Commission to reject the November 2003 access undertakings.

Telstra is using the November 2003 access undertakings as a damage control tool

Telstra, in its document titled *Telstra’s Submission in Support of its Undertakings dated 14 November 2003*, stated that the November 2003 access undertakings were lodged with the Commission for the purposes of providing increased regulatory certainty¹:

¹ Page 2 Telstra’s Submission in Support of its Undertaking dated 14 November 2003

“ Telstra has given the Undertakings with the primary objective of providing both the industry and itself with increased regulatory certainty over future prices for the UT Services. ”

PowerTel rejects this explanation and submits that Telstra is using the November 2003 access undertakings as a damage control tool by trying to:

- turn the upper bound prices specified by the Commission in its final determination into a price floor; and
- prevent any further downward movement in price of the undertaking services other than those already specified in the final determination.

Conversion of upper bound prices to a price floor

The indicative prices specified in the Commission’s final determination are non-binding. However, if a dispute about terms and conditions of access arises between Telstra and an access seeker, the Commission’s arbitration determination is expected to reflect the indicative prices.

In the final determination, the Commission described these indicative prices as being an upper bound²:

“In this Final Determination, the Commission considers it would be important to specify a single rate which would effectively form the upper bound in any further negotiations. ”

Telstra has adopted these indicative prices in its November 2003 access undertakings but PowerTel questions why Telstra would choose to do this.

When negotiating access to the undertaking services with access seekers, Telstra will be able to insist on the prices specified in the November 2003 access undertakings (should they be accepted) knowing that if the matter went to arbitration that the Commission could not make a binding decision that was inconsistent with the November 2003 access undertakings. Telstra will have no incentive (unless it is in its own commercial interests) to negotiate terms and conditions which differ from those contained in the undertaking and as a result, the upper bound prices specified in the final determination effectively become floor prices.

PowerTel has had some experience negotiating prices for acquisition of the undertaking services with Telstra following the release of the Commission’s final determination but has been unsuccessful in negotiating prices below the upper bound prices specified in the final determination despite the fact that PowerTel:

- c-i-c; and
- c-i-c.

² Page 4, Model price terms and conditions for the PSTN O/T, ULL and LCS services – final determination, date October 2003

Based on this experience, it is clear to PowerTel that it is Telstra's intention to treat these prices as a floor as opposed to an upper bound.

Acceptance of the November 2003 access undertakings will simply allow Telstra to pursue this approach with even more vigour.

Preventing any further downward movement on price

The indicative prices specified in the final determination can be reviewed by the Commission at any time. This flexibility is extremely important as it may be necessary to respond, for example, to:

- a sudden drop in the costs of supplying the undertaking services due to new efficiencies resulting from, for example, a new technological innovation;
- a sudden downward movement in price for similar services in other markets around the world;
- a sudden significant drop in the retail price for a particular service which results in a vertical price squeeze for one of the undertaking services which is a wholesale service used as an input for that retail service. PowerTel believes that such an event occurred recently when Telstra suddenly and dramatically reduced its retail ADSL prices without making any adjustments at the wholesale level which resulted in vertical price squeeze on the wholesale price of the ULL; and
- a change of thinking on the applicability of the PIE II model, following a more thorough analysis of the model by the Commission and the industry as a whole, to inform the Commission of the broad quantum of network costs associated with the PSTN and ULLS.

By lodging the November 2003 access undertakings which incorporate the Commission's indicative prices, Telstra is simply seeking to avoid the possibility of a review of the indicative prices by the Commission.

PowerTel considers that Telstra is attempting to convert the indicative prices determined by the Commission in its final determination into prices that are effectively binding because once the Commission accepts the undertaking, the Commission is required, in an arbitration, to make a determination that is not inconsistent with the undertaking.

PowerTel has serious concerns about the Commission's preliminary assessment

PowerTel has serious concerns about the Commission's preliminary assessment that the access undertakings should be accepted. The Commission's view seems to be based on the fact that:

- the terms and conditions are not inconsistent with the SAOs; and
- the prices proposed in the November 2003 access undertakings are reasonable on the basis that they are essentially the same as those specified in the Commission's final determination.

PowerTel considers that the absence of substantive non-price terms and conditions in the November 2003 access undertaking make it impossible to assess whether the undertakings are consistent with the SAOs or whether they are reasonable.

In addition, PowerTel considers that the conclusion that undertakings are reasonable on the basis that they line up with the indicative pricing specified in the final determination is flawed as this would mean that the Commission is agreeing to allow the indicative prices which were developed using a flawed model to be converted into prices which are effectively binding.

In any event, PowerTel considers that the indicative prices determined by the Commission in its final determination are in themselves flawed for the reasons outlined below.

There is not enough detail to assess whether the undertakings are consistent with the SAOs or whether the terms and conditions are reasonable

The Commission has essentially adopted the approach that if the terms and conditions are not inconsistent with the SAOs then the Commission is likely to regard them as being consistent with the SAOs³:

“The Act does not detail a specific approach to be adopted for assessing whether the terms and conditions in an undertaking are consistent with the access provider's SAOs. In this regard, the Commission finds it useful to consider whether the terms and conditions specified in an undertaking raise any inconsistencies with the SAOs. That is, if the terms and conditions are not inconsistent with the obligations, the Commission is likely to regard them as being consistent with the obligations.”

³ Page 16, Assessment of Telstra's core services undertakings – preliminary view, dated 12 December 2003

The Commission then assessed the November 2003 access undertakings against the following requirements:

- supply, quality and fault handling, where it noted⁴:

“The Undertakings do not contain provisions specifying how Telstra will satisfy its obligations in respect of the quality and timing of fault detection, handling and rectification in respect of the Telstra services. Nor do they contain provisions relating to the commencement, refusal, suspension or termination of supply.”

- interconnection of facilities, where it noted⁵:

“The Undertakings do not contain further provisions relating to the technical and operational quality and timing of interconnection, or provisions in relation to interconnection, fault detection, handling and rectification.”

- provision, timing and content of billing information, where it noted⁶:

“The Undertakings do not contain further terms and conditions in relation to the provision, timing and content of billing information.”

In each case, the Commission concluded that the November 2003 access undertakings were not inconsistent with the SAOs and that therefore the November 2003 access undertakings were consistent with the SAOs.

PowerTel considers that the November 2003 access undertakings contain very few non-price terms and conditions and the Commission was wrong to conclude that silence on these matters means that there is no inconsistency with the SAOs and that therefore they are consistent with the SAOs.

PowerTel accepts that it may not be necessary to include all possible non-price terms and conditions in an undertaking. However, PowerTel considers that it is necessary to include those non-price terms and conditions that impact on the assessment of whether the terms and conditions specified in the undertaking are consistent with the SAOs and whether they are reasonable.

The November 2003 access undertakings are silent on a number of critical non-price terms and conditions. As a result, PowerTel considers that it is not possible to properly assess whether the November 2003 access undertakings are consistent with SAOs or whether they are reasonable.

⁴ Page 18, Assessment of Telstra’s core services undertakings – preliminary view, dated 12 December 2003

⁵ Page 19, Assessment of Telstra’s core services undertakings – preliminary view, dated 12 December 2003

⁶ Page 20, Assessment of Telstra’s core services undertakings – preliminary view, dated 12 December 2003

The undertakings should not be accepted simply because the proposed prices are in line with the Commission's indicative prices

When assessing the November 2003 access undertakings, the Commission made the following comment⁷:

“During the model price terms and conditions process, the Commission made it clear that it would consider the then lodged undertakings and model price terms and conditions simultaneously, although given statutory timeframes the model price terms and conditions were determined first. Further, the Commission indicated that its assessment of future undertakings would have regard to the model price terms and conditions.

Therefore in outlining its preliminary view, the Commission believes it is appropriate to assess the reasonableness of the proposed charges by comparing them against those outlined in the model price terms and conditions determination.”

The Commission then rejected a number of aspects of Telstra's supporting submission relating to the determination of efficient costs of providing each of the undertakings services but concluded that because the prices specified in the November 2003 access undertakings were similar to the prices determined in the final determination that the undertakings were reasonable.

In the final determination, the Commission stated⁸:

...the Commission continues to have reservations over the appropriateness of Telstra's PIE II model. This has been reinforced following feedback from industry participants which questions the model's underlying architecture, assumptions and methodologies. At this stage, and without further analysis of the model, The Commission considers that these concerns combined with the model's lack of transparency limit the extent to which it can be directly utilised in determining indicative price terms and conditions or for other regulatory purposes.

This said, given its preferred pricing approaches (as set out in sections 8, 9 and 10 below) the Commission has used the PIE II model less directly to inform itself of the broad quantum of network costs associated with the PSTN and ULLS. The Commission considers this is not unreasonable as despite the concerns noted above, its preliminary assessment of the model reveals outcomes, particularly call conveyance costs, not unlike those of the n/e/r/a model adjusted for similar periods and input values. Further the charges being determined are only indicative and will be used to guide the industry in negotiations.

⁷ Page 24, Assessment of Telstra's core services undertakings – preliminary view, dated 12 December 2003

⁸ Page 31, Model price terms and conditions for the PSTN O/T, ULL and LCS services – final determination, date October 2003

Should the Commission, set binding prices in the context of an arbitration, it would consider using Telstra's, or any other model, only after a fuller assessment of the model is undertaken and industry participants have had the opportunity to analyse its modelling framework and assumptions in more detail than has been possible in the current processes."

To summarise, despite some major concerns with the PIE II model, the Commission, when making the final determination, considered that it was acceptable to use the PIE II model because the prices being determined were only indicative and that a fuller assessment of the model would be required before deciding binding prices in an arbitration.

In addition, the Commission stated⁹:

... the Commission has used the following factors as specified in Telstra's PIE II model for the purposes of informing itself in relation to the quantum of network costs for PSTN and ULLS:

- *routing factors;*
- *traffic and service volume estimates;*
- *network provisioning;*
- *asset prices and lives;*
- *operation and maintenance costs; and*
- *indirect (organisational level) costs.*

Since the Draft Determination, the Commission has benefited from industry views on many of these inputs. Some industry participants expressed concern that the Commission accepted these inputs. For example, AAPT submitted that many of these inputs are inappropriately specified. Optus and the Competitive Carriers Coalition also noted that a number of inputs will lead to an overestimation of costs.

Given the limited amount of time available to publish the Determination, and since the Commission has only used the PIE II model to establish the broad spectrum of costs associated by the PSTN and ULLS, the attached Determination continues to be informed by these inputs.

In other words, the Commission, when making the final determination, considered that it would be appropriate to accept without question a number of input values because it was running out of time to more thoroughly analyse the inputs and because the pricing being derived was only indicative.

⁹ Page 35, Model price terms and conditions for the PSTN O/T, ULL and LCS services – final determination, date October 2003

PowerTel considers that Telstra is attempting to convert the indicative prices determined by the Commission in its final determination into prices that are effectively binding. This is because once the Commission accepts the undertaking, the Commission is required, in an arbitration, to make a determination that is not inconsistent with the undertaking. By recommending that the undertaking be accepted, the Commission is effectively agreeing to the indicative prices derived using a model which the Commission itself recognised as being flawed to be converted into prices which are effectively binding. This is something which the Commission itself considered would be inappropriate.

The PSTN O/T and ULL indicative prices specified in the final determination are flawed

PowerTel considers that the PSTN O/T and ULL prices determined by the Commission in its final determination were developed using Telstra's PIE II model when it would have been more appropriate to use an independently developed cost model. In addition, the PSTN O/T prices determined in the final determination were too high because they include an ADC even though the Commission concluded that the ADC should be removed from PSTN OT prices.

The indicative PSTN O/T prices in the final determination should have been developed using an independently developed cost model

As indicated in the PowerTel submission on the Commission's draft determination on model price terms and conditions for the PSTN O/T, ULLS and LCS services (**draft determination**), PowerTel does not agree with the Commission's use of the PIE II model to determine the TSLRIC of PSTN O/T and ULLS services because:

- Telstra has developed the PIE II cost model as a tool to help it further its own commercial interests by claiming the costs of providing these services are higher than they actually are;
- the PIE II model is not a true TSLRIC model as it adopts a scorched node instead of a scorched earth approach; and
- there are a number of significant flaws with the PIE II model (each of which were addressed in PowerTel's and the CCC's submission to the Commission on Telstra's January 2003 access undertaking).

PowerTel considers that the Commission should adopt a cost model that nurtures competition not one that rewards inefficiency, is in the LTIE and which can not be criticised for its lack of independence and transparency. This can only be achieved through use of an independently developed cost model.

The indicative PSTN O/T prices in the final determination are too high because they include an ADC

PowerTel considers that the Commission correctly concluded in the final determination that it was difficult to justify the continued need for an ADC on PSTN access charges and that it should be removed.

However, the Commission also concluded that the ADC should not be immediately removed¹⁰:

“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. This would balance the competing interests in the LTIE and reasonableness criteria by amongst other things promoting a more stable regulatory environment for both Telstra and access seekers.”

Consequently, the Commission decided on a phasing out of the ADC over a 3 year period (2003/04 to 2005/06).

As indicated in the PowerTel submission on the draft determination, in deciding to phase out the ADC over 3 years, PowerTel considers that the Commission has given greater weight to Telstra’s commercial interests than to the promotion of competition and efficiency (ie the LTIE). PowerTel refers the Commission back to the PowerTel submission on the Commission’s draft determination in its entirety.

The industry has fought for many years now to have the AD properly defined. The Commission now recognises and agrees with these arguments but has chosen not to act to rectify the problem immediately and will instead gradually rectify the problem over time because it is concerned about Telstra’s commercial interests.

Telstra is one of the most vertically integrated telecommunications companies in the world and continues to be the dominant wholesale and retail supplier of telecommunications services in Australia, including local, national, long-distance, international and mobile telephony, dial-up and broadband Internet, data, printed and on-line directories and pay TV (through its 50% ownership interest in Foxtel). The extent of Telstra’s dominance of the sector is demonstrated by the fact that it receives almost 60% of total industry revenue, which is almost four times the revenue of Optus, its nearest rival, and over 90% of total industry profits.

PowerTel considers that a stable regulatory environment is a good objective but not when it comes at the expense of a level playing field with direct impact on the ability of competing service providers to properly compete and with negative flow on effects for the LTIE.

¹⁰ Page 65, Model price terms and conditions for the PSTN O/T, ULL and LCS services – final determination, date October 2003

PowerTel urges the Commission to reject the access undertakings

PowerTel considers that the Commission's preliminary assessment that the November 2003 access undertakings should be accepted is flawed.

Acceptance of the November 2003 access undertakings would mean agreeing to the indicative prices which were developed using a flawed model being converted into prices which are effectively binding.

Consequently, PowerTel urges the Commission to reject the November 2003 access undertakings.

Appendix 1

Actual 2000 NO DATA FOUND

| Call Area | Completed PSTN Intra CCA Interconnect Calls | Minutes of PSTN Intra CCA Interconnect Calls |
|------------------|--|---|
| CBD | | |
| Metro | | |
| Provincial | | |
| Rural | | |
| Total | 0 | 0 |

| | |
|---|--|
| Average PSTN Intra CCA Interconnect Call | |
|---|--|

Actual 2001 NO DATA FOUND

| Call Area | Completed PSTN Intra CCA Interconnect Calls | Minutes of PSTN Intra CCA Interconnect Calls |
|------------------|--|---|
| CBD | | |
| Metro | | |
| Provincial | | |
| Rural | | |
| Total | 0 | 0 |

| | |
|---|--|
| Average PSTN Intra CCA Interconnect Call | |
|---|--|

Actual 2002 (Feb+ May + Nov * 4)

| Call Area | Completed PSTN Intra CCA Interconnect Calls | Minutes of PSTN Intra CCA Interconnect Calls |
|------------------|--|---|
| CBD | c-i-c | c-i-c |
| Metro | c-i-c | c-i-c |
| Provincial | c-i-c | c-i-c |
| Rural | c-i-c | c-i-c |
| Total | c-i-c | c-i-c |

| | |
|---|--------------|
| Average PSTN Intra CCA Interconnect Call | c-i-c |
|---|--------------|

Actual 2003 (Feb+ May + Nov * 4)

| Call Area | Completed PSTN Intra CCA Interconnect Calls | Minutes of PSTN Intra CCA Interconnect Calls |
|------------------|--|---|
| CBD | c-i-c | c-i-c |
| Metro | c-i-c | c-i-c |
| Provincial | c-i-c | c-i-c |
| Rural | c-i-c | c-i-c |
| Total | c-i-c | c-i-c |

| | |
|---|--------------|
| Average PSTN Intra CCA Interconnect Call | c-i-c |
|---|--------------|

Estimate 2004 (February figure/ 20 working days in February * 253 working days in the year)

| Call Area | Completed PSTN Intra CCA Interconnect Calls | Minutes of PSTN Intra CCA Interconnect Calls |
|------------------|--|---|
| CBD | c-i-c | c-i-c |
| Metro | c-i-c | c-i-c |
| Provincial | c-i-c | c-i-c |
| Rural | c-i-c | c-i-c |
| Total | c-i-c | c-i-c |

| | |
|---|--------------|
| Average PSTN Intra CCA Interconnect Call | c-i-c |
|---|--------------|

Estimate 2005 (5% Growth on 2004)

| Call Area | Completed PSTN Intra CCA Interconnect Calls | Minutes of PSTN Intra CCA Interconnect Calls |
|------------------|--|---|
| CBD | c-i-c | c-i-c |
| Metro | c-i-c | c-i-c |
| Provincial | c-i-c | c-i-c |
| Rural | c-i-c | c-i-c |
| Total | c-i-c | c-i-c |

| | |
|---|--------------|
| Average PSTN Intra CCA Interconnect Call | c-i-c |
|---|--------------|