16 June 2006

PUBLIC VERSION

Mr John Bahtsevanoglou
Australian Competition and Consumer Commission
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Melbourne Victoria 3000

By email: john.bahtsevanoglou@accc.gov.au

Dear Mr Bahstsevanoglou

VODAFONE SUBMISSION TO TELSTRA'S UNDERTAKING FOR THE PSTN ORIGINATING AND TERMINATING AND LCS ACCESS SERVICES

Vodafone welcomes the opportunity to comment on Telstra's undertaking for the PSTN Originating and Terminating and LCS Access Services Discussion Paper issued by the Australian Competition and Consumer Commission (the Commission) on May 2006. This response broadly follows the structure of the discussion paper.

Vodafone believes that Telstra's undertaking for PSTN Originating and Terminating Access (PSTN OTA) services and LCS access service are not reasonable.

Section 152AH of the *Trade Practices Act, 1974* outlines that the Commission cannot accept an undertaking unless it is satisfied that the terms and conditions specified are reasonable. Regard must be had to:

- 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;
- Legitimate business interest 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;
- Interests of persons who have rights to use the declared service concerned;
- The direct costs of providing access to the declared service concerned;
- The operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility; and

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- The economically efficient operation of a carriage service, a telecommunications network or a facility.

Vodafone disagrees with Telstra that the Commission can assess the reasonableness of the proposed prices of an undertaking by applying the following three principles:

- Full cost recovery and no more;
- Encouraging efficient use of the network; and
- Maintaining competitive neutrality.

The three principles do not cover all of the statutory criteria and are weighted towards the interest of the access provider, Telstra.

The long term interests of end users, or the interests of person's who have the right to use the declared services, are not promoted by Telstra's undertaking, which is structured as a pricing package of PSTN OTA and LCS services.

Vodafone believes this package approach is not consistent with TSLRIC pricing, which should be based on the cost of a particular service rather than cost recovery across more than one service. In this way the undertaking cannot be considered reasonable.

> Telstra states:*that it is not possible to assess the proposed price for LCS in isolation from the proposed prices for PSTN OTA. For example if it were determined that the LCS rate should be lower than proposed by Telstra, then the PSTN OTA rates would need to increase to ensure full cost recovery on a competitively neutral basis across all services*[1]*.*

Vodafone is concerned that Telstra has structured the pricing of access to the services in a manner which disadvantages operators who require PSTN OTA services only, namely facilities based operators, including mobile operators. Telstra has reduced the cost of LCS by 32 per cent from the 2005-06 prices and effectively doubling the headline rate price of PSTN OTA services from 2005-06 undertaking prices.

[1] Telstra, *Telstra's submission in support of its undertakings* , 22 March 2006, paragraph 10

Telstra states that *undertaking prices provide substantial margin for access seekers providing the full bundle of PSTN*[2]. This is not the case for operators who require PSTN OTA services only. It appears that Telstra, in proposing to set prices in such a manner, is discriminating against a particular class of access seekers and is attempting to discourage facilities based competition. It certainly seems that the significant shift in the pricing balance between resale services and interconnection services indicates a preference for one type of competition compared with another. If Telstra is allowed to proceed with such a scheme, competition and innovation in telecommunications will be significantly diminished.

The undertaking is based on the PSTN Ingress and Egress (PIE) II model, which has previously come under criticism from the Commission and other carriers. Vodafone shares the continuing concerns of the Commission in regards to the PIE II model. In particular Vodafone notes the concern that the model lacks transparency and that there may be insufficient allocation of common network element costs to other than PSTN services[3]. This would have the effect of overstating the costs of providing the services that are proposed to be covered by the Undertaking and understating the costs for services provided by Telstra that are either not regulated or have not yet been formally assessed. We also note that it is not possible to "validate" any of the outputs of the PIE II model by comparing it with information derived from RAF data. The reason for that is that the RAF data suffers from similar allocation problems.

Further, Telstra bases the price terms and conditions of the bundled undertaking on outputs from the PIE II model, which was built to cover the period 2000-01 to 2004-05. Telstra has updated the PIE II model to estimate the cost of the Inter – Exchange Network (IEN) in 2006-07 and 2007-08 by updating three parameters:

1. Physical volumes;
2. Weighted Average Cost of Capital; and
3. Changes in the replacement cost of assets.

Vodafone offers the following comments on the first two parameters.

<u>Physical Volumes</u>

[2] Ibid
[3] ACCC Telstra Undertaking for the Originating and Terminating and LCS Access Services discussion paper May 2006

Telstra argues that increased prices for PSTN OTA service has been driven mainly by declines in traffic volumes on the PSTN, in particular declines in local and national long distance volumes[4]. These volumes are taken from Telstra's annual reports and Telstra Forecasting System ("TELFOR") from 2004-05 Quarter 4. Interestingly, these numbers do not include other carrier minutes. Vodafone observes that rather than local and long distance volumes being declining services industry wide, consumers are using alternatives to Telstra services to make IDD and STD calls, including using calling cards and other operators to make these calls. Given these observations, Vodafone holds that such changes to Telstra volumes represent a competitive market, and such behaviour of itself does not justify the significant increase in PSTN OTA being sought by Telstra.

However, it seems that Telstra is being highly selective in its depiction of its network utilisation. For example, it is unclear as to whether Telstra has presented volume estimates for 2006-07 / 2007-08 Voice over Internet Protocol (VoIP) to fixed line calls. It is reasonable to expect that this call type is increasing, which would partially outweigh some decrease in local voice, STD and IDD call types. Also, there is no apparent correlation between the purported decline in call volumes and the increase in PSTN OTA pricing that Telstra is seeking.

While it may be the case that demand for some traditional services has diminished, it is also undoubtedly true that other services – including DSL and other data services – have increased significantly, and will continue to do so. These services also rely on the existence of the PSTN. Again, it is unclear how Telstra has accounted for these volume shifts.

In relation to the PSTN and mobile call traffic, Telstra does not present figures for mobile-to-fixed calls alone. Instead Telstra estimates a 2.4 per cent decrease from 2006-07 to 2007-08 for fixed-to-mobile and mobile-to-fixed calls[5]. However, Telstra's half yearly financial statement shows that fixed-to-mobile minutes increased by 1.3 per cent based on the volume of minutes Telstra experienced from 31 December 2004 to 31 December 2005[6]. No information is provided in this report on the number of mobile-to-fixed minutes Telstra terminates.

[CIC] Lastly, Vodafone agrees with the Commission, that Telstra's argument where declining volumes on the PSTN increase the cost of the IEN, is self fulfilling. If trends such as growth in VoIP to VoIP and fixed to mobile substitution occur, volumes on the PSTN will continue to decline and therefore the cost of the PSTN will continue to rise. A broader policy concern is whether PSTN access seekers should be subsidising a declining service for Telstra through increased prices for PSTN OTA. Vodafone does not believe that regulatory measures such as PSTN OTA should support such subsidisation.

[4] Telstra, *Telstra's submission in support of its undertakings*, 22 March 2006

[5] Telstra, *Telstra's submission in support of its undertakings*, 22 March 2006, para 48

[6] Telstra, *2005-06 Half Yearly Financial Highlights*, 9 February 2006

Weighted Average Cost of Capital (WACC)

Vodafone notes the issues associated with WACC estimates and notes the common arguments around asymmetric risk for WACC for regulated services. However Telstra's one standard deviation approach significantly over states the regulatory risk that may exist in miscalculating the point estimate of the WACC.

[CIC] Vodafone notes that the Commission did not allow a mark up on the WACC point estimate in the previous review of Telstra's PSTN undertaking based on Telstra's asymmetric risk argument[7]. Vodafone believes that no miscalculation mark up is necessary for the supply of PSTN services.

As outlined above, Vodafone believes that Telstra's undertaking is not reasonable. The pricing structure of the undertaking is substantially detrimental to operators, such as Vodafone, that require PSTN OTA services only.

Yours Sincerely

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Attachment

[CIC]

[7] Australian Competition and Consumer Commission, Assessment of Telstra's undertaking for PSTN, ULLS and LCS Draft Decision, October 2004, pg 92