



Submission by AAPT Limited (9 March 2012)

to

**Australian Competition and Consumer Commission
Draft final access determination for the domestic
transmission capacity service, dated December 2011**

PUBLIC VERSION



Introduction

1. AAPT Limited (**AAPT**) welcomes the opportunity to comment on the Australian Competition and Consumer Commission (**ACCC**) Draft final access determination for the domestic transmission capacity service (**Draft DTCS FAD**), dated December 2012.
2. AAPT acknowledges and commends the ACCC's efforts to date in progressing the process for setting meaningful DTCS price terms, which has already resulted in lower transmission prices that are likely to promote competition. Nevertheless, AAPT has observed that some of the Draft DTCS FAD pricing generated by the Final Regression Model still, contrary to the aim of the domestic benchmarking approach, does not accurately reflect pricing that currently exists in competitive areas of the market.
3. AAPT has previously stated that it supports the principle of a domestic benchmarking approach to transmission pricing and agrees that prices in competitive areas for competitive services provide for a reasonable indication of the prices that would prevail in other areas should they be competitive (but in fact are not). However, following a review of the ACCC's Final Regression Model and the inconsistent pricing it generates, AAPT is concerned that the Final Regression Model suffers from some irregularities.
4. This suggests to AAPT that the ACCC needs to make further adjustments to the model. In addition, AAPT considers that the problems experienced by the ACCC in obtaining a reliable pricing from a regression model is an indication that the domestic benchmarking approach adopted by the ACCC may not (on its own) be a sufficient nor appropriate method for setting regulated transmission pricing in the long term. In light of this, AAPT considers it prudent for the ACCC to consider initiating a movement towards the adoption and development a cost-based model, in line with the method employed in the context of the other declared fixed line services.



Executive summary

5. Although the Draft DTCS FAD pricing for non-competitive regional routes are lower than existing contract prices (as was the industry expectation), the Draft DTCS FAD pricing for services in areas known to be more competitive are significantly higher than what AAPT has been able to obtain. In particular, AAPT has found that for the 2Mbps services in shorter metro routes, the Draft DTCS FAD pricing mean an increase [Start c-i-c] [End c-i-c] above the prices at which AAPT currently acquires those services from Telstra. Refer to confidential Attachment A for further details. These services make up a large part of the transmission services acquired by AAPT from Telstra.
6. AAPT notes that the higher Draft DTCS FAD pricing is likely to discourage competition and in turn be detrimental to the long term interests of end users (LTIE). AAPT therefore assumes that this is an unintended outcome of the Final Regression Model and should signal to the ACCC that the data points on which it has relied may need to be reviewed and adjusted, including factoring in negotiated discounts and the fact that information collected by the ACCC is currently out of date. In addition, AAPT considers that the Final Regression Model should be adjusted to neutralise the impact of the higher prices existing in competitive areas by placing more weight on the lowest, most competitive prices which are likely to be closest to efficient cost-based pricing.
7. AAPT also considers that the Final Regression Model still substantially fails to take into account the downward trend of transmission pricing. In the current market, the price of transmission services has been decreasing at a significant rate as a result of changing market factors including, among other things, the increased demand for higher bandwidths, the changing nature of transmission services being acquired, the improvement of the quality of microwave transmission, the uptake of 4G technology and the availability of NBN backhaul. Unless this steep decline in transmission pricing is accounted for in the Final



Regression Model, any “constant” pricing set in the DTCS FAD will always be playing “catch-up” with market rates. In light of this, AAPT considers it is crucial for the ACCC to:

- incorporate a price reduction mechanism to reflect the downward trend of backhaul pricing;
 - provide a review process to assess DTCS FAD pricing against the most current market information available; and
 - consider adopting a more robust cost-based model, to satisfy the ACCC and industry that DTCS service providers (particularly Telstra) are not in a position to extract excessive monopoly rents from access seekers.
8. AAPT also has serious concerns about Telstra ability’s to take advantage of the exempt DTCS routes which could effectively allow Telstra to re-balance its overall transmission charges to a point higher than the ACCC determined price. The more ability Telstra has to manipulate its pricing, the less ability access seekers will have to compete and pass on the benefits of DTCS FAD pricing to end users. One way to address this is to ensure that DTCS FAD pricing is based on the lowest, most competitive pricing available in the market. The closer that DTCS FAD pricing can come to efficient cost based pricing, the less “wriggle room” there will be for Telstra to manipulate the pricing outcomes by “rebalancing” its pricing. AAPT considers that the ACCC should seek to address this issue in the DTCS FAD or in the alternative, the ACCC should consider removing the exemptions altogether in its next review of the DTCS declaration. In addition to the confidential Attachments to this submission [Start c-i-c]
- [Redacted]
- [Redacted]
- [Redacted]
- [Redacted]
- [End c-i-c]



Draft DTCS FAD pricing does not accord with competitive pricing

9. One of the obvious inconsistencies observed by AAPT in reviewing the ACCC's Final Regression Model is that the Draft DTCS FAD pricing it generates is significantly higher than the pricing currently paid by AAPT for a substantial proportion of the transmission services acquired by AAPT from Telstra. [Start c-i-c]
- [Redacted]
- [Redacted]
- [Redacted]
- [End c-i-c]
10. Given the accepted view that the current contract prices being charged by Telstra are already inflated well above costs (which the considerably low DTCS FAD pricing for the regional routes confirm), AAPT can only assume that the above is an unintended anomaly. In AAPT's view, there are at least four reasons (ie irregularities) for this, namely:
- (i) as set out in paragraph 6, in averaging of prices, the ACCC should place more weight on the lowest, most competitive prices which are likely to be closest to efficient, cost-based pricing;
 - (ii) the ACCC is still relying on out-dated market information;
 - (iii) the negotiated discounts have not been sufficiently factored in; and
 - (iv) the ACCC has failed to take into account the rapid decline in transmission pricing.
11. **Out-dated market information** - The ACCC has acknowledged that much of information it has collected early on in this DTCS FAD process (and relied upon) is likely to be out dated. Subject to the collection of more current information, AAPT considers that the Final Regression Model needs to be adjusted to factor this in. [Start c-i-c]

[Redacted]
[Redacted]
[End c-i-c]

12. **Discounts** - AAPT understands that the ACCC has found it difficult to factor in whole of business discounts and as such they are not likely to be properly captured in the Final Regression Model. AAPT acknowledges these difficulties but considers that, given a benchmark approach has been adopted, the ACCC should seek to factor in all discounts which industry has been able to obtain in competitive areas. To assist in this exercise, AAPT has set out in confidential Attachment B the term discounts it currently receives for transmission services acquired from Telstra.

13. [Start c-i-c]
[Redacted]
[Redacted]
[Redacted]
[Redacted]

14. [Redacted]
[Redacted]
[Redacted]

15. [Redacted]
[Redacted]
[Redacted]
[End c-i-c]

16. **Rapidly declining transmission prices** – As noted at paragraph 7 above, there is a clear market trend indicating that backhaul pricing has rapidly declined and



will continue to drop further. To avoid the DTCS FAD price terms being rendered redundant, the ACCC needs to, in the short term:

- Include a “push-down” factor (analogous to an uplift factor) in the Final Regression Model to reflect the downward trend. According to industry’s experience, transmission pricing has been dropping at a rate of 20% each year for the last few years. There is every indication that this downward trend is likely to continue.
 - Provide for a review process on the first anniversary of the DTCS FAD to assess DTCS FAD pricing against the most current market information available.
17. In the longer term, the ACCC should consider adopting a more robust cost-based building block approach to setting DTCS price terms. AAPT suspects that even though the Final Regression Model has substantially reduced prices in some areas, the model will only be a mechanism to reduce the amount of monopoly rent that can be extracted, rather than have the effect of preventing or removing the ability to do so altogether. AAPT considers that only cost-based access pricing will truly curtail an incumbent’s ability to extract excessive monopoly rents from access seekers.
18. In the interim, AAPT considers that the Final Regression Model is a good starting point provided the ACCC reviews and adjusts the model to take into account the issues set out at paragraphs 9 to 16 above. In addition AAPT would argue that, given that some of the DTCS FAD pricing is substantially above cost-based pricing, there is no need to include a scaling parameter of 1.102 to correct for Jensen’s inequality.

Telstra’s ability to manipulate pricing

19. AAPT also has serious concerns about Telstra ability’s to take advantage of the exempt DTCS routes in much the same way that it was able to leverage the



geographic exemptions relating to the Wholesale Line Rental (**WLR**) service.¹ Before the removal of the WLR exemptions, Telstra was able to cross-subsidise lower prices in non-competitive areas by raising prices in the “competitive areas” so that the ultimately:

- it could charge an “effective” overall price which was higher than the ACCC determined price for WLR; and
- the benefits that access seekers and end users could gain from decreased regulated pricing were significantly diminished.

20. AAPT notes that in the context of the transmission services, the rebalancing is a little different but the effect is the same. [Start c-i-c]

[Redacted text block]

[End c-i-c]. Telstra is able to do this because it understands and takes advantage of the various barriers to AAPT purchasing the non-regulated competitive services from alternative suppliers, including:

- other providers products are not direct equivalents;
- other providers may not be able to offer all the speed requirements over the entire route that Telstra can;
- the difficulty for AAPT in identifying which services are regulated and not regulated based on the complexity of pricing tables and A-End , B-End analysis;

¹ Refer to AAPT’s submission on the ACCC issues paper titled “Inquiry into varying the exemption provisions in the final access determinations for the WLR, LCS and PSTN OA services”, dated 14 October 2011.



- the difficulty for AAPT in building a networked solution based on multiple suppliers; and
 - Telstra retail's ability to selectively compete on price in these competitive areas at the retail level.
21. Accordingly, AAPT urges the ACCC to consider how Telstra's ability to manipulate prices can be addressed in the DTCS FAD or in the alternative, the ACCC should consider removing the DTCS exemptions altogether in its next review of the DTCS declaration.
22. AAPT does not consider that removal of the DTCS exemptions would have any negative impact on the LTIE as the DTCS FAD price terms would effectively act as a cap on transmission prices. That is, if a service is regulated but is arguably competitive, there is no detriment to the LTIE because access seekers are likely to seek to contract with access providers for those services on a commercial basis at prices which are lower than the DTCS FAD pricing. In contrast, if a service is exempted but is actually non-competitive, there is likely to be significant detriment to the LTIE as explained above.

Conclusion

23. For the reasons set out above, AAPT considers that the ACCC should in the short term, review and adjust the Final Regression Model to address the irregularities observed by AAPT to take into account:
- that it is more appropriate to weight any averaging of data towards the lowest, most competitive prices which are likely to be closest to efficient cost-based pricing;
 - that the market data relied upon is out dated,



- discounts negotiated by industry, including discounts for services and installation in exchange of longer term contracts; and
 - rapidly declining transmission pricing by including a price reduction mechanism (ie push-down factor) within the model.
24. In addition, AAPT considers the ACCC should remove the scaling parameter of 1.102, as such a correction is not required.
25. In the longer term, the ACCC should:
- provide for a review process on the first anniversary of the DTCS FAD to assess the price terms against the most current market information available; and
 - move to adopt a cost-based building block model for pricing the DTCS.



**Attachment A - Comparison between Telstra pricing and Draft
DTCS FAD pricing**

[Start c-i-c]

[Redacted content]

[Redacted content]

[Redacted content]

[End c-i-c]



Attachment B - Discounts provided by Telstra

[Start c-i-c]

[Redacted text block]

[Redacted text block]

[Large redacted text block]

[End c-i-c]