Competitive
Carriers'
Coalition Inc

Submission on Draft Indicative Prices for PSTN OT Service

August 2006

Introduction

The Competitive Carriers' Coalition is an industry association representing the interests of non-dominant telecommunications carriers operating in the wholesale, retail, fixed, mobile, fixed line and wireless voice and data markets in Australia.

All members of the CCC have invested in competitive infrastructure, to a total value of more than $4 billion.

The CCC welcomes the opportunity to comment on the ACCC's indicative prices for the PSTN OT service. It has commissioned external analysis of other aspects of the Commission's draft decisions in relation to WLR and LCS from Frontier Economics. This work is submitted separately.

Appropriateness of PSTN Rate

The CCC is concerned that the Commission, in proposing a headline rate of 1 cpm, has departed from the price path it has previously indicated on the basis of apparently unsubstantiated projections of traffic volumes from Telstra that understate the true volume of traffic carried over some relevant network elements.

In its 2003 indicative pricing determination, the ACCC was of the view that the Access Deficit should have been fully removed by the end of the 2005/06 period and that the headline rate should therefore have reduced to 0.7cpm at that time.

It is the CCC's understanding that the Commission's decision to maintain the headline rate in its indicative price guidance at 1 cpm is based on its acceptance of Telstra's arguments that its call volumes have fallen significantly, not a belief that the access deficit continues to exist. However, the CCC believes that there is evidence that Telstra has overstated the impact of any falls in PSTN volumes by failing to take account of the impact of increases in other traffic when modeling costs on its network.[1]

Marsden Jacob Associates, in an analysis previously provided to the Commission, summaries the issue as such:

> *Given that the core network modeled by Telstra only includes demand related to an outdated circuit switched technology, and only includes leased line traffic, it is inappropriate to artificially understate the service volumes on the basis that traffic currently using the PSTN may migrate to other (ATM or IP or mobile)*

[1] Section 3 MJA Comments on ACCC's Discussion Paper. Telstra Undertakings for the PSTN Originating and Terminating and LCS Access services 27 June 2006

networks. Although traffic may be falling in the PSTN network total traffic across all networks and all services is likely to be rising.

So, although traffic may be decreasing for PSTN, the ability to generate revenue is preserved because of increasing demand for other services that use the same assets. The total net revenue effect may be zero (or even positive) and assets are not stranded because they are increasingly used to provide other services.

The CCC is aware that the Commission has separately concluded that it can not rely on Telstra network modeling and is in the process of commissioning an independent network model.

Further, the CCC submits that there is recent evidence from Telstra's latest financial reports that indicates that even Telstra's own estimates of PSTN volume declines, made in 2005, have not been realized. In fact, Telstra claims to have significantly slowed the volume decline.

Telstra's annual results announcements released in August 2006 indicated that PSTN traffic volume declines were slowing, and were less dramatic than Telstra's previous estimates. Telstra reported an annual decline of 6.7% in PSTN products revenues for the financial year, split between a 7.6% decline in the first half and a 5.8% decline in the second half. It also reported that much of this revenue had been offset by growth in other access platforms, including broadband, which uses much of the same network infrastructure as PSTN. (see above).

The CCC further submits that the Commission has taken insufficient account of the impact on access seekers of the decision to depart from the prices it had previously indicated. Access seekers have been anticipating for three years that the headline rate of PSTN interconnect in 2006/07 would reflect the final removal of the Access Deficit Charge and would therefore fall to 0.7cpm. In effect, the industry has priced into its forward cost estimates the prices that the Commission has previously indicated it would regard as appropriate.

The rationale for the Access Deficit Charge, by the Commission's own account, has expired and this has given rise to an expectation among access seekers that the Commission would deliver on the lower prices that it indicated would result from its final removal. The CCC submits that the conservative approach that has been taken by the Commission to allow the slow removal of the ADC over a period of three years has been financially advantageous to Telstra. It is noteworthy that over this same period, Telstra has been able to selectively reduce retail line rental prices and increase wholesale prices to the extent that the Commission intervened with a competition notice earlier this year in relation to local services pricing. This trend is also in evidence in Telstra's annual results, which shows 18% growth in Telstra's wholesale segment margins at a time of falling profitability for its retail business segments. If the access deficit was not being fully recovered, it is difficult to understand how Telstra could have pursued these actions.

The Commission has previously expressed its concerns about the impact of regulatory shock on access providers when it introduced a price glide path to move the indicative price of the MTAS toward a cost reflective basis.

In all the circumstances outlined above, a departure from the price path indicated by the Commission in 2003 has the potential to have a significant regulatory shock effect on the competitive market by increasing the cost to access seeker above that which they legitimately expected, based on previous Commission guidance.

The burden arising from the departure from previous model price terms is entirely borne by access seekers. In turn, this effective wholesale price rise proposal will undermine business plans already in place with access seekers. As the Commission is well aware, these business plans centre around infrastructure investments for which interconnection with Telstra's PSTN is a central input. Departure from previous access pricing guidance and effectively increasing access benchmark rates by over 40% [i.e. from 0.7c to 1c?], will undermine the confidence that CCC members have in emerging infrastructure investment.

On the other hand, given the scale and scope of Telstra to over-recover its costs associated with wholesale services, any adverse impact on Telstra arising from a maintenance of their own previous Undertaking rates would be significantly less proportional than the rate impact on access seekers.

This proposed effective access price rise is occurring at a time when the competitive industry is under historically high levels of pressure from Telstra. For Telstra, the Commission's decision to depart from its previous guidance delivers a substantial windfall gain. For access seekers, the departure delivers a regulatory shock and large financial penalty.

Conclusion and Contact

The CCC submits that in the absence of independently-verified evidence that Telstra's total traffic over its network has (and will continue to) decline, and that the decline will increase the TSLRIC of PSTN O/T in a known and predictable way, the Commission should disregard Telstra's claims for the purpose of setting indicative prices for PSTN O/T. In comparison, the Commission and the industry have done extensive work in relation to the access deficit over a period of several years in order to arrive at a considered conclusion that it no longer exists. Hence it is appropriate that the AD be removed from all access charges including PSTN O/T. On the other hand, until Telstra provides substantiated evidence to support its claims about reduced network traffic and such evidence has been properly scrutinized by the ACCC and subject to industry consideration and comment, that it is completely inappropriate to include this in any access charge calculation.

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