Australian
Competition &
Consumer
Commission

Local carriage service and wholesale line rental - final pricing principles and indicative prices for 2008–2009

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1. Introduction

1.1 Background

Under Part XIC of the *Trade Practices Act 1974* (Act), the Australian Competition and Consumer Commission (ACCC) is responsible for arbitrating access disputes about access to particular declared services, and for assessing access undertakings relating to access to such declared services. One of the prime issues that arises under these processes is the determination of an appropriate access price.

Section 152AQA of the Act requires the ACCC to determine, in writing, principles relating to the price of access to declared services. The pricing principles determination may contain price-related terms and conditions (indicative prices) relating to access to the declared service. The ACCC must make such a determination at the same time as, or as soon as practicable after, the ACCC declares a service. The ACCC is also required to publish a draft determination, invite submissions on the draft and consider any submissions received, before it makes a final pricing principles determination.

The ACCC must have regard to its pricing principles determination if it is required to arbitrate an access dispute in relation to the same declared service.[1] However, the pricing principles are not binding on the ACCC, and parties to arbitrations are still able to address the ACCC on the relevance and applicability of the principles having regard to the circumstances of their particular dispute. The ACCC considers that, although a party may argue against the principles being applied to its particular case, pricing principles may help guide commercial negotiation of access by providing greater certainty as to the ACCC's views on reasonable access prices.[2]

The purpose of this guide is to inform industry and other interested parties of the pricing principles and indicative prices that are likely to guide the ACCC when considering an access dispute or assessing an undertaking in relation to pricing for access to the local carriage service (LCS) and wholesale line rental (WLR) service. A draft pricing principles and indicative prices guide was released on 30 April 2008 for consultation. Interested parties were required to make submissions on the report by 14 May 2008. In accordance with the ACCC's timeframe, submissions were received from Telstra and the Competitive Carriers' Coalition. Submissions were also received from Primus Telecom (Primus) on 19 May 2008 and AAPT on 20 May 2008 (Appendix 3). These submissions have been considered and reflected where appropriate in drafting the final pricing principles and indicative prices for the LCS and WLR service.

1 Section 152AQA(6) of the Act.

2 See *Trade Practices Amendment (Telecommunications) Bill 2001*, pp. 10, 18.

1.2 Role of Access Pricing Principles

In July 1997, the ACCC published *Access Pricing Principles: Telecommunications — a Guide* (*Access Pricing Principles*). The purpose of the *Access Pricing Principles* was to advise the telecommunications industry and other interested parties about the principles that are likely to be relevant in assessing undertakings or in arbitrating access disputes. It set out the following broad principles:

- the access price should be based on the cost of providing the service
- the access price should not discriminate in a way which reduces efficient competition
- the access price should not be inflated to reduce competition in dependent markets, and
- the access price should not be predatory.

In the *Access Pricing Principles*, the ACCC noted that when determining a cost-based price, it would generally seek to determine the Total Service Long-Run Incremental Cost (TSLRIC) of providing the service. It also noted that the applicable approach would be assessed on a case-by-case basis for each service.

1.3 The declared services

The LCS has been declared and provided since 1999.[3] In April 2002, the ACCC released pricing principles and indicative prices for LCS because it considered the TSLRIC methodology was not appropriate for this service at that stage. The ACCC indicated it would be likely to adopt a retail-minus methodology to determine an access price in the event of a LCS access dispute or when assessing a LCS undertaking. The retail-minus methodology determines the LCS price by subtracting retail costs from the retail price of a local call.

In October 2003, the ACCC released its *Final Determination for Model Price Terms and Conditions of the PSTN, ULLS and LCS services*. The ACCC specified retail–minus access prices for the LCS for 2003-2004 and 2004-2005 because of a LCS declaration and pricing principles review which was still pending.[4]

In 2006 the ACCC conducted the *Local Services Review*, which considered the declaration of LCS and WLR.[5] On 28 July 2006, the ACCC released the *Local services review—final decision* in which the ACCC decided to continue the declaration of the LCS for a period of three years, and to declare the WLR service for three years. At the same time, the ACCC published the draft pricing principles determination and indicative prices for both services for consultation.[6]

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[3] ACCC, *Local services review—final decision*, July 2006, p. 45.
[4] ACCC, *Final Determination —Model Non-price Terms and Conditions,* October 2003.
[5] ACCC, *Local services review—final decision*, July 2006.
[6] ibid., p. 7.

1.4 The 2006 pricing principles determination

In November 2006, the ACCC released the final pricing principles determination and indicative prices for LCS and WLR for 2006 and 2007 (*2006 Pricing Principles Determination*).[7] In the *2006 Pricing Principles Determination* the ACCC stated that a retail-minus-retail-cost (RMRC) approach should be adopted until such time as a robust cost model is available.[8] The ACCC also proposed indicative prices based on the RMRC approach for both services for the 2006-2007 period. The final 2006–2007 indicative prices for LCS and WLR are set out below:

Final indicative prices for LCS 2006–2007[9]

	Local Calls
Telstra Retail Prices	20c ex GST
Unit Avoidable Retail Costs	2.29c/call
GST Adjustment	0.21c
Indicative Price	17.92c

Final indicative prices for WLR 2006–2007[10]

	HomeLine Part	**BusinessLine Part**
Telstra Retail Prices	$29.05	$31.77
Unit Avoidable Retail Costs	$5.93/mth	$5.93/mth
Indicative Price	$23.12	$25.84

7 ACCC, *Pricing principles and indicative prices: local carriage service, wholesale line rental and PSTN originating and terminating access service – Final Determination and Explanatory Statement,* 29 November 2006.

8 ibid., Appendix B.

9 ACCC, *Pricing principles and indicative prices: local carriage service, wholesale line rental and PSTN originating and terminating access service- Final Determination and Explanatory Statement,* 29 November 2006, p. 12.

10 ibid.

2. The relevant legislative criteria

The object of Part XIC of the Act is to promote the long-term interests of end-users (LTIE) of carriage services, or of services provided by means of carriage services.[11] This will be achieved, in part, through establishing the rights of third parties to gain access to services that are necessary for the competitive supply of services to end-users.

An important part of the access regime is the terms and conditions of access (including the price or a method for ascertaining the price). Under Part XIC of the Act the ACCC cannot make a telecommunications access code or accept an undertaking unless satisfied that the terms and conditions specified are reasonable.[12] In determining whether terms and conditions are reasonable, regard must be had to the following matters:

- whether the terms and conditions promote the LTIE
- the legitimate business interests of the carrier or carriage service provider concerned, and the carrier's or carriage service provider's investment in facilities used to supply the declared service concerned
- the 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
- the economically efficient operation of a carriage service, a telecommunications network or a facility.[13]

The above list is not an exhaustive list of matters to which regard may be had.[14]

When arbitrating access disputes the ACCC must have regard to the same matters. In addition, when making a determination with respect to an access dispute, the ACCC must take into account the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else.[15]

[11] Subsection 152AB(1) of the Act.
[12] The ACCC must also ensure that the terms and conditions in the telecommunications access code, in undertakings and any arbitration determination is consistent with any Ministerial pricing determination in place. See section 152CH of the Act.
[13] Subsection 152AH(1) of the Act.
[14] Subsection 152AH(2) of the Act.
[15] Paragraph 152CR(1)(e) of the Act.

3. Pricing principles

3.1 Introduction

As outlined in the *Local Services Review,*[16] the ACCC considers that there are two main pricing principles for pricing declared services—the RMRC approach and the cost-based approach.

RMRC is a 'top-down' approach which takes the retail prices paid for the declared service and deducts the avoidable costs of retailing the service to end-users to calculate an access price. A cost-based approach, in comparison, is a 'bottom-up' approach which models the costs of the various network elements necessary for use in the service (and also, typically, allocates common costs).[17] Where the retail service and wholesale service are the same product, and where retail prices are strictly cost-based, the two pricing approaches will lead to (approximately) the same access price.

The TSLRIC+ approach can be best considered by breaking the concept into the following components:

- 'Total service' refers to the cost of production of an entire service, not to the cost of a particular unit. The cost is usually expressed on a per-unit basis by dividing total costs for the service by the number of units supplied.

- 'Long run' refers to a period where all factors of production can be varied, as opposed to the short run, where the amount of at least one factor of production is fixed.

- 'Incremental costs' refers to the additional costs of supplying the service over and above the situation where the service was not supplied, assuming that the scale of all other production activities remains unchanged. The concept refers to costs which can be attributed solely to the production of the service. In practice, it has been expanded to include indirect and overhead costs (TSLRIC+).

However, the approaches will more often lead to divergent access prices. Of particular relevance are the following two scenarios:

- If retail prices are held below costs (which may be the case due to the government's retail price control regime), a RMRC approach will lead to lower access prices than a cost-based approach.

- If retail prices are above total (wholesale + retail) costs, the access seeker will make some level of economic profit. An RMRC price will be higher than cost-based prices because it will reflect this level of economic profit. The access provider will accordingly retain these profits from the RMRC price at the expense of access seekers and/or access seekers' end-user customers. A cost-based approach would not preserve this profit.

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16 ACCC, *Local Services Review— final decision,* July 2006.

17 The ACCC has typically chosen to apply the Total Service Long Run Incremental Cost (TSLRIC) approach when applying a cost-based pricing methodology.

The relative levels of price and cost are a crucial factor in determining whether a RMRC or cost-based pricing approach is the most appropriate under the statutory criteria in the Act.

3.2 The TSLRIC methodology

TSLRIC measures the incremental or additional cost the firm incurs in the long term in providing the service, assuming all of its other production activities remain unchanged.

TSLRIC represents an estimate of the costs that an efficient firm would incur in providing the service over the long run. As mentioned, these costs can be specific to the particular service or include additional costs 'common' to a range of services (i.e. TSLRIC+). Common costs are the costs incurred in the provision of a group of services, which are not avoided unless the production of all services ceases.

To estimate costs, a forward looking approach is adopted. Given that TSLRIC is a long-run cost measure, the time horizon is sufficient so that all necessary investments can be replaced. Thus, the cost of efficient forward-looking investment in long-lived assets required to produce network services is included in TSLRIC+, even if some or all of the investment will become sunk once in place.

The ACCC has used TSLRIC-based pricing to price other declared services (e.g. the Domestic Public Switched Telephone Network Originating and Terminating Access (PSTN OTA) services). In general, it considers such pricing to be appropriate for services:

- that are well developed
- that are necessary for competition in dependent markets
- where the forces of competition or the threat of competition work poorly in constraining prices to efficient levels.[18]

According to the *Access Pricing Principles*, an access price based on TSLRIC would be consistent with the price that would prevail if the access provider faced effective competition, and would usually best promote the LTIE. A TSLRIC-based access price would:

- promote efficient entry and exit in dependent markets since prices are based on long-term costs
- encourage economically efficient investment in infrastructure by providing for a normal commercial return on efficient investments in infrastructure
- provide for the efficient use of infrastructure, as access prices are based on the long-term value of the resources embodied in that service
- provide incentives for access providers to minimise the costs of providing access by using best-in-use technology compatible with existing network design to measure cost
- allow efficient access providers to fully recover the costs of producing the service, and promote the legitimate business interests of the access provider

[18] ACCC, *Access Pricing Principles: Telecommunications – a Guide*, 1997, pp. 27-28.

- inhibit the access provider from discriminating in favour of one access seeker over another (unless the discrimination is based on differences in costs).[19]

3.3 Retail-minus methodology (RMRC)

Under a retail-minus methodology, the access price is determined by deducting the access provider's retail costs from the retail price for a given service.

This methodology has been expressed in a number of ways. Sometimes, it is expressed as 'retail-minus avoidable costs' and in other instances as simply 'avoidable costs'. Avoidable costs are regarded as costs that an access provider would avoid, or could avoid, if it ceased provision of retail activities completely in respect of the service in question (e.g. local calls).

On some occasions, a distinction is made between avoidable costs and avoided costs. Avoidable costs are the costs that an access provider could avoid if it ceased retail operations completely, whereas avoided costs are those costs that the access provider *actually* avoids when it ceases retailing to the end-users who are now supplied by its competitor.

What is sought to be measured is the average retail cost of supplying a particular service (e.g. local calls). In this regard, the definition of avoidable costs provides a means of estimating retail costs. Telstra, in an earlier submission, stated:

> …the avoidable cost standard sets a wholesale discount by reference to assumed costs which would be saved by an access provider if it ceased retailing altogether, whereas in the real world Telstra supplies local calls for resale in circumstances where it will, regardless of whether resellers purchase service from it for resale, incur significant fixed costs. [20]

The ACCC acknowledges that the terminology 'avoidable costs' is capable of creating the impression that the access provider can avoid those costs, when in reality this may not occur. Consequently, the ACCC has chosen to express the methodology as 'retail–minus–retail–costs'.

Finally, the ACCC notes that, in a competitive market in the absence of retail price regulation, the retail-minus price and TSLRIC-based price should converge.

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[19] ACCC, *Access Pricing Principles: Telecommunications – a Guide*, 1997, pp. 29-30.

[20] Telstra, Submission 1 September 2000, as quoted in ACCC*, Local Carriage Service pricing principles and indicative prices Final Report (Revised),* April 2002, p. 11.

4. 2008 Pricing Principles for LCS and WLR

4.1 Pricing Principles for LCS and WLR

This section explains the ACCC's proposed pricing principles determination for the LCS and WLR service (together the 'declared services'). Section 152AQA(2) of the Act outlines that a pricing principles determination made by the ACCC may also contain price-related terms and conditions relating to access to the declared service.

Following the *2006 Pricing Principles Determination,* the ACCC commenced development of a fixed network cost model. The ACCC's development of the fixed network cost model is ongoing and the model has not yet been finalised. Without a robust cost model available to it at this time, the ACCC proposes to issue pricing principles and indicative prices for the period 2008-2009, which is consistent with the RMRC approach enunciated in the *2006 Pricing Principles Determination*. The ACCC considers that the indicative prices for the LCS and WLR for 2008–2009 will be transitional in nature and will stay in place while the ACCC completes its development of the fixed network cost model.

In April 2008 the ACCC released the *Draft pricing principles and indicative prices for local carriage service and wholesale line rental (Draft 2008 Pricing Principles)*. Interested parties were invited to make submissions by 14 May 2008. As previously stated, these submissions have been considered and reflected where appropriate in drafting the final pricing principles and indicative prices for the LCS and WLR service.

4.2 Industry views on draft pricing principles – RMRC methodology

Telstra

Telstra submits that a TSLRIC approach to pricing principles would better serve the LTIE. To this end, Telstra submits that the ACCC should use information from Telstra to arrive at principles which come far closer to an efficient cost, TSLRIC approach.[21]

Telstra submits that the ACCC's approach in the *Draft 2008 Pricing Principles Determination* fails to reflect the legitimate business interests of Telstra and its access seeker customers because the current RMRC approach keeps local call prices relatively high in order to keep WLR pricing relatively low. Telstra submits that the *Draft 2008 Pricing Principles Determination* prices the WLR at a rate that does not allow Telstra to recover its efficient cost of providing this service.[22]

Telstra also submits that the ACCC's approach is at odds with the prevailing industry preference to move towards a subscription based pricing model, with a higher line rental fee and lower per call charges. Telstra submits that a subscription based pricing approach is also

[21] Telstra, *Submission on the draft 2008 pricing principles*, p. 2.
[22] ibid.

the preferred market approach and has been used in the majority of access arrangements which it negotiated commercially.[23]

Telstra further submits that the low number of access disputes in relation to the LCS and WLR services is evidence that the commercial approach is meeting access seekers' legitimate business interests in a way that the ACCC's indicative pricing structure does not.[24]

Primus Telecom

Primus submits that in the absence of an appropriate cost model, it supports the RMRC methodology to determine indicative prices.[25]

Competitive Carriers' Coalition (CCC)

The CCC points out that it had previously warned the ACCC that the methodology it employed to calculate the retail minus benchmark created an incentive and ability for Telstra to raise rivals' costs while reducing its prices for equivalent retail services. The CCC submits that it would have expected the ACCC to be monitoring the evidence of developments in basic access markets.[26]

The CCC notes the ACCC's view that RMRC prices exceed cost based prices, particularly for WLR and that the proposed increased WLR pricing is inconsistent with the objects underlying the ACCC's indicative pricing powers.[27] The CCC argues that the proposed pricing will not guide commercial negotiations closer to the ACCC's view on reasonable access pricing, but will instead discourage access seekers from lodging access disputes because of the likely and significant cash flow impacts from the ACCC imposing an interim determination at the presently proposed indicative prices.[28]

The CCC further submits that the ACCC's intention to replace the RMRC methodology once it has completed work on its own network cost model does not justify the continued application of a flawed methodology.[29] The CCC urges the ACCC to progress the development of its cost model as quickly as possible,[30] but expresses doubt that the proposed model will be completed or put into practice in 12 months so as to coincide with the term of the proposed indicative prices.[31]

AAPT

AAPT submits that in the absence of an independently developed cost model, it has little choice but to support the ACCC's decision to continue the interim approach of the RMRC methodology. AAPT urges the ACCC to bring the development of an independent cost model to a conclusion as a matter of urgency.[32]

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23 ibid.
24 ibid.
25 Primus, *Submission on the draft 2008 pricing principles*, p. 1.
26 Competitive Carriers' Coalition, *Submission on the draft 2008 pricing principles*, p. 2.
27 ibid., p. 3.
28 ibid.
29 ibid.
30 ibid., p. 4.
31 ibid., p. 3.
32 AAPT, *Submission on the draft 2008 pricing principles*, p. 2.

AAPT considers that the ACCC has set indicative prices for WLR and LCS at levels way above cost for many years, and that this is reflected across the industry with access seekers often agreeing to prices for these services with Telstra which bear no resemblance to the indicative prices set by the ACCC and a distinct absence of arbitrations involving WLR and LCS over the years.[33]

4.3 The ACCC's views

The pricing principles established in the previous review noted that a RMRC principle should be maintained as an interim pricing approach.[34]

The ACCC previously noted that the decision between a RMRC pricing principle and a cost-based pricing principle was not clear-cut. In particular, the choice between the two principles depended significantly on the relativity between retail prices for the local call, line rental products and the cost of providing the LCS and WLR products. In particular the ACCC noted:

- if costs are below the RMRC access price for the service, then a cost-based approach would be more likely to be reasonable
- if RMRC access prices are below costs, then a RMRC approach would be more likely to be reasonable.

The ACCC considers that in the absence of a suitable industry cost model for both the LCS and WLR capable of producing reliable cost estimates and the ACCC's development of its own fixed network services cost model it is not appropriate to adopt cost-based pricing principles at this stage. The ACCC notes that Telstra's TEA model is not currently capable of calculating a TSLRIC price of WLR. The model is restricted to Band 2 ULLS pricing.

The ACCC considers that once it has developed its fixed network cost model and is capable of producing reliable cost estimates, it would seek to implement a cost-based pricing approach. The ACCC fixed network services cost model should be available for a public consultation process by the fourth quarter of 2008, although it may not be finalised for use until early 2009. While the choice between RMRC and cost based pricing approaches is closely balanced on an assessment of the statutory criteria, the ACCC notes that the evidence presented to the previous declaration review suggested that retail prices and RMRC access prices currently exceed cost-based prices, particularly for WLR.

The ACCC also considers that moving towards a future implementation of a cost-based pricing approach is appropriate for the following reasons:

- greater consistency with pricing of other access services
- widespread industry support for a cost-based model
- greater relevance for the pending development of the cost model, and

33 ibid.
34 ACCC, *Local Services Review— final decision,* July 2006, p. 58.

- certainty for industry about future pricing.

The ACCC notes Telstra's comment relating to current industry commercial practice of negotiating subscription based access arrangements and the low number of access disputes. The ACCC commends the industry for negotiating commercial agreements without the need to resort to arbitral processes.

4.4 Conclusion on pricing principles for LCS and WLR

The ACCC's view is to continue to adopt an interim RMRC pricing approach for the 2008–2009 period, consistent with the *2006 Pricing Principles Determination*. The ACCC will seek to implement a cost-based pricing approach for the LCS and WLR service once its fixed network cost model is complete.

5. Indicative prices for LCS and WLR for 2008–2009

5.1 Background

The indicative prices and model price terms and conditions are designed to provide guidance to access providers and access seekers involved in negotiating the terms and conditions of access to services, particularly as they would be taken into account by the ACCC in any arbitration of access disputes. They can also act as a guide to parties considering providing access undertakings to the ACCC for particular services.

Indicative prices provide this guidance by giving parties an idea of the ACCC's views on the appropriate pricing for the declared service.

However the ACCC notes that indicative access prices set out in a determination are non-binding on parties to arbitrations or undertaking assessments. While the ACCC would ordinarily see these access prices as appropriate in a general sense, it must look at specific issues raised by the parties in particular arbitrations or undertakings, on their individual merits. As such, there will remain potential for an arbitration determination or an approved undertaking to depart from the indicative prices.

5.2 Industry views

In addition to comments on general pricing principles, parties made specific submissions concerning inputs used to calculate indicative prices for the LCS and WLR. A central theme was the ACCC's use of the GST inclusive price of Telstra's HomeLine Part, as opposed to the GST exclusive price, which is consistent with its approach in relation to Telstra's BusinessLine Part. In addition, the CCC, Primus and AAPT submit that Telstra's HomeLine Part price was not an appropriate benchmark to use for the calculation of indicative prices.

Telstra

Telstra submits that the ACCC has mistakenly used the GST inclusive retail price of Telstra's HomeLine Part product and that the correct figure is the GST exclusive price.[35]

Telstra also highlighted certain input errors in the ACCC's calculations for the draft indicative prices.[36] These input errors were as follows:

- the unit avoidable retail costs for both services reflected attempted calls as opposed to connected calls
- the ACCC did not deduct installation costs from the product and customer costs.

[35] Telstra, *Submission on the draft 2008 pricing principles (confidential version)*, p. 4.
[36] ibid.

After considering Telstra's submissions, the ACCC is of the view that some adjustment to the draft indicative prices is appropriate. As such, the unit avoidable retail costs have been amended to reflect the volume of connected calls, as opposed to attempted calls. Furthermore, there has been a deduction of installation costs from product and customer costs. This adjustment is consistent with the approach expressed by the ACCC in the *Local Services Review—Final Decision.*[37]

CCC

The CCC submits that Telstra's WLR and LCS access seekers are subsidising ever-increasing discounts which Telstra retail offers to customers in the form of bundled products.[38] The CCC further submits that in allowing this situation to occur, the ACCC has failed in its duty to consumers and competitors.[39]

The CCC submits that it can see no evidence in the ACCC's discussion paper that it has sought to determine if price movements of the HomeLine Part and BusinessLine Part products are consistent with price movements of Telstra's other retail basic access offerings.[40]

Primus

Primus submits that the HomeLine Part service bears no relationship with the bundle of services made actively and commercially available by Telstra and other industry competitors.[41] Primus argues that although historically there may have been an argument to support the selection of the HomeLine Part service as the retail benchmark, the realities of price movements, consumption patterns and the competitive interface demonstrate that the HomeLine Part service is now largely irrelevant in the minds of consumers, Telstra and other service providers.[42]

Primus submits that LCS is also subject to a similar benchmarking issue as HomeLine Part calls are 22 cents while the more popular HomeLine Complete calls are 20 cents. Primus submits that the indicative price in the *Draft 2008 Pricing Principles Determination* sets the benchmark for LCS calls 2 cents above Telstra's typical retail price.[43]

Primus further submits that Telstra has no interest or incentive in marketing or selling the HomeLine Part services, but rather, clear incentives to encourage its customers onto bundled plans where it can be guaranteed increased revenues through various locked-in calling charges. Primus considers that one of the motivations behind Telstra's decision to increase the retail price for the HomeLine Part service in October 2007 while the pricing of other bundles largely stayed the same was to drive the remaining customers off this legacy service.[44]

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37 ACCC, *Local Services Review- final decision,* July 2006, p. 81.
38 Competitive Carriers Coalition, *Submission on the draft 2008 pricing principles*, p. 2.
39 ibid., p. 3.
40 ibid.
41 Primus Telecom, *Submission on the draft 2008 pricing principles*, p. 1.
42 ibid., p. 3.
43 ibid., p. 2.
44 ibid., pp. 2-3.

Primus also submits that the ACCC should consider Telstra's price cap regulation when considering benchmarks for determining indicative prices. Primus submits that since industry deregulation in 1997, Telstra's basic line rental has been subject to ACCC price cap arrangements which specify a nil increase in the price of basic line rental.[45]

Primus submits that the indicative pricing proposed by the ACCC will not guide commercial negotiations towards fair and reasonable access pricing and will, conversely, encourage Telstra to impose increased wholesale pricing, particularly with respect to WLR. Primus submits that a further impact is that access seekers are unable to lodge access disputes because of long term cash flow consequences of the ACCC making an interim determination at the proposed indicative pricing.[46]

Primus suggests that a more reasonable and acceptable approach in determining a retail benchmark would be to consider an average of local services packages and deducting retail costs from the weighted average retail price of Telstra's local services plans.[47]

Primus notes that the ACCC made a GST error in determining residential WLR pricing.[48]

AAPT

AAPT submits that the ACCC, by using HomeLine Part, BusinessLine Part and the 20 cent call rate as the retail benchmarks, has pegged WLR and LCS prices to Telstra retail prices which have no relevance. This is because few people buy HomeLine Part or BusinessLine Part as stand alone products at the retail level or pay 20 cents for local calls. AAPT argues that under the ACCC's approach, access seekers acquiring WLR and LCS services from Telstra will pay more than they should and, as a result, will not be able to compete at the retail level. [49]

AAPT further submits that there is an incentive for Telstra to increase the price of HomeLine Part, BusinessLine Part, and the stand alone price for local calls because there will be no impact at the retail level while at the same time it will lead to a higher price for WLR and LCS and inhibit the ability of access seekers to compete. AAPT also submits that Telstra has done as much in relation to HomeLine Part since the previous indicative prices were set for WLR.[50]

AAPT submits that the ACCC can rectify this problem by adopting an approach which pegs the prices for WLR and LCS to Telstra's average retail price for line rental and local calls.[51]

AAPT also points out that the ACCC appears to have incorrectly used Telstra's GST inclusive retail price to determine indicative prices for WLR and LCS when it should have used GST exclusive prices.[52]

45 ibid., p. 3.
46 ibid., p. 2.
47 ibid., p. 4.
48 ibid.
49 AAPT, *Submission on the draft 2008 pricing principles,* p. 5.
50 ibid., p. 6.
51 ibid.
52 ibid.

5.3 The ACCC's views

In taking the above-mentioned considerations into account, it is the ACCC's view that the indicative prices which should apply for WLR and LCS for the period **1 January 2008 to 31 July 2009** are as shown in Table 1.

Table 1: Indicative prices for WLR and LCS for 2008 and 2009

	Residential	**Business**
WLR	$25.57 ex GST	$26.93 ex GST
LCS	17.36c ex GST	17.36c ex GST

In response to Primus' submission concerning WLR pricing and price cap regulation of Telstra's HomeLine Part service, the ACCC notes that the Minister made a determination, *Telstra Carrier Charge- Price Control Arrangements, Notification and Disallowance Regulation Number 1 of 2005*, which expressly dealt with price cap regulation for HomeLine Part. The service falls within the second basket of services dealing with basic line rental and was subject to a price cap of CPI–CPI per cent during the first reporting period from 1 January 2006 to 30 June 2007. The service is currently subject to an annual cap of CPI. On 27 February 2006, the Minister amended the determination to include a base period price from which price movements would be calculated. This base period price was $31.95, which at the time was higher than the amount actually charged by Telstra. The maximum untimed local call price associated with these plans is set at 22 cents under the price control arrangements.

The ACCC maintains that the appropriate benchmark is Telstra's unbundled HomeLine Part service. Consistent with the ACCC's findings in the *Local Services Review*[53], the use of unbundled prices has the benefit that it affords Telstra pricing flexibility in order to respond to competition. It also addresses the possibility of access seekers engaging in 'ratchetting down', whereby they lower their retail prices below Telstra's and Telstra lowers its retail prices in response, causing the access price to fall. Ratchetting down limits Telstra's ability to compete in response to facilities–based competition as Telstra would be less likely to pursue price reductions in order to avoid passing on discounts to resale customers. It may also lead to free-riding on reductions in resale prices by access seekers who do not build their own facilities. This free-riding would be at the expense of both Telstra and other providers that have built competing infrastructure and are engaging in price competition.

The ACCC has made the necessary GST deductions from the HomeLine Part pricing.

In applying the RMRC methodology, it is necessary to deduct avoidable retail costs of line rental and local calls from retail prices to obtain the RMRC prices for the LCS and WLR. The ACCC has derived estimates of Telstra's average avoidable retail costs for these two services from retail and wholesale cost information contained in Telstra's Regulatory Accounting Framework (RAF) accounts for the first half of 2007–2008.

The avoidable retail costs for these two services in the RAF consist of organisational, product and customer costs and the cost of capital. When compared to the calculations for the draft

53 ACCC, *Local services review—final decision*, July 2006, p. 76.

indicative prices, the only adjustment made to these avoidable retail costs was to remove installation costs from the product and customer costs. Volume data for retail access line and local calls are obtained from schedule 8 of the RAF accounts.

Telstra’s avoidable costs for the first half of 2007–2008 for end-user access and local calls are shown in Table 2.

Table 2: Telstra's avoidable retail costs and volumes for end-user access and local calls, first half of 2007–2008 RAF

	End-User Access	Local Calls
4-1 Organisational ($m)	**[c-i-c]**	**[c-i-c]**
4-2 Product and Customer ($m)	**[c-i-c]**	**[c-i-c]**
Cost of Capital ($m)	**[c-i-c]**	**[c-i-c]**
Total Retail Costs ($m)	**[c-i-c]**	**[c-i-c]**
Volume (m)	**[c-i-c]**	**[c-i-c]**
Unit avoidable retail costs for line rental and local calls	**$4.84/mth**	**2.90c/call**

The charges for LCS and WLR are set out below in Tables 3 and 4 respectively; and in Part 2 of Schedules 1 and 2 to the instrument at Appendix 1.

Table 3: Indicative prices for LCS 2008 and 2009

	Local Calls
Telstra Retail Prices	20c ex GST
Unit Avoidable Retail Costs	2.90c/call
GST Adjustment	0.26c
Indicative Price	17.36c

Table 4: Indicative prices for WLR 2008 and 2009

	HomeLine Part	BusinessLine Part
Telstra Retail Prices	$30.41 ex GST[54]	$31.77 ex GST[55]
Unit Avoidable Retail Costs	$4.84/mth	$4.84/mth
Indicative Price	$25.57	$26.93

54 Telstra, *Our Customer Terms*, 11 January 2008. Accessed on 22 July 2008, http://www.telstra.com.au/customerterms/docs/hf_fixed_HomeLine.pdf, p. 23.

55 Telstra, *Our Customer Terms*, 13 February 2008. Accessed on 22 July 2008, http://www.telstra.com.au/customerterms/docs/bg_fixed_bps.pdf, p. 43.

Appendix 1. Pricing Principles Determination

TRADE PRACTICES ACT 1974

Section 152AQA

Pricing Principles for the Local Carriage Service (LCS) & the Wholesale Line Rental (WLR) Service

The Australian Competition and Consumer Commission determines, pursuant to section 152AQA of the *Trade Practices Act 1974* (Act), that the pricing principles and price-related terms and conditions specified in Schedules 1 and 2 are to apply to the following services declared by the Commission under section 152AL of the Act:

(a) the Local Carriage Service

(b) the Wholesale Line Rental Service

Note: For the effect of this determination, see subsection 152AQA(6) of the Act.

Made by the Australian Competition

and Consumer Commission on

6 August 2008

Graeme Samuel

Chairman

SCHEDULE 1 – Local Carriage Service (LCS)

Part 1 – Pricing Principles

An interim retail–minus–retail–costs (RMRC) pricing principle should be adopted until the ACCC has a robust cost model available. In implementing the interim RMRC pricing principle, the ACCC will use:

- avoidable retail costs for the LCS rather than avoided retail costs
- unbundled benchmark retail prices, and
- separate pricing of the LCS.

The ACCC will seek to implement a cost-based pricing approach once a robust cost model, capable of producing reliable estimates of costs in all geographic regions, is available.

Part 2 – Price-related terms and conditions

Indicative prices for LCS (1 January 2008 – 31 July 2009)

	Local Calls
Telstra Retail Prices	20c ex GST
Unit Avoidable Retail Costs	2.90c/call
GST Adjustment	0.26c
Indicative Price	17.36c

SCHEDULE 2 – Wholesale Line Rental (WLR) Service

Part 1 – Pricing Principles

An interim retail–minus–retail–costs (RMRC) pricing principle should be adopted until the ACCC has a robust cost model available. In implementing the interim RMRC pricing principle, the ACCC will use:

- avoidable retail costs for the WLR rather than avoided retail costs
- unbundled benchmark retail prices, and
- separate pricing of the WLR.

The ACCC will seek to implement a cost-based pricing approach once a robust cost model, capable of producing reliable estimates of costs in all geographic regions, is available.

Part 2 – Price-related terms and conditions

Indicative prices for WLR (1 January 2008 – 31 July 2009)

	HomeLine Part	**BusinessLine Part**
Telstra Retail Prices	$30.41 ex GST[56]	$31.77 ex GST[57]
Unit Avoidable Retail Costs	$4.84/mth	$4.84/mth
Indicative Price	$25.57	$26.93

56 Telstra Corporation Limited, *Our Customer Terms*, 11 January 2008, Accessed on 22 July 2008, http://www.telstra.com.au/customerterms/docs/hf_fixed_HomeLine.pdf, p. 23.

57 Telstra Corporation Limited, Our *Customer Terms*, 13 February 2008, Accessed on 22 July 2008, http://www.telstra.com.au/customerterms/docs/bg_fixed_bps.pdf, p. 43.

Appendix 2. Explanatory statement

EXPLANATORY STATEMENT

Pricing Principles for the Local Carriage Service (LCS) & the

Wholesale Line Rental (WLR) Service

Trade Practices Act 1974

Legislative Provisions

In April 2005, the Australian Competition and Consumer Commission (ACCC) initiated the *Local Services Review*, which considered the declaration of the local carriage service and the wholesale line rental service, in accordance with subsection 152ALA(7) of the *Trade Practices Act 1974* (Act). As a result of that inquiry, the ACCC decided in July 2006 to continue the declaration of the LCS for a period of three years and to declare the WLR service for three years, pursuant to section 152ALA of the Act.

In November 2006, the ACCC made a pricing principles determination for the LCS and WLR service relevant for the 2006–2007 period in accordance with section 152AQA of the Act. In August 2008, the ACCC made the pricing principles determination for the LCS and WLR (the Determination) relevant for the 2008–2009 period.

The LCS is used by service providers to supply local calls to end-users. It allows competitive entrants to resell local calls without deploying substantial alternative infrastructure.

The WLR service allows access seekers to resell the basic line rental that allows an end-user to connect to the traditional voice network, make and receive voice calls, and have a telephone number.

Subsection 152AQA(1) of the Act provides that the ACCC must, in writing, determine principles relating to the price of access to a declared service. Subsection 152AQA(2) of the Act provides that the determination may also contain price-related terms and conditions relating to access to the declared service.

Subsection 152AQA(6) of the Act provides that the ACCC must have regard to the determination if it is required to arbitrate an access dispute under Division 8 of the Act in relation to the declared service even though the pricing principles are not binding on the ACCC. Parties to arbitrations are still able to address the ACCC on the relevance and applicability of the pricing principles to the circumstances of their particular dispute.

The Determination is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

Purpose

The purpose of the Determination is to inform industry and other interested parties of the principles that are likely to guide the ACCC when considering an access dispute or assessing an undertaking in relation to pricing for the LCS and WLR.

Background

The ACCC declared the LCS in August 1999.[58]

In July 2006, the ACCC issued its final decision following its *Local Services Review* in which it decided to continue the declaration of the LCS and declare the WLR for a period of three years. In November 2006, the ACCC made final pricing principles and indicative prices for LCS and WLR relevant for the 2006–2007 period.[59]

In April 2008, the ACCC issued draft pricing principles and indicative prices for the 2008–2009 period. After reviewing submissions from interested parties, the ACCC decided to issue final pricing principles and indicative prices for the 2008–2009 period. The ACCC's analysis regarding the pricing principles applicable to the LCS and WLR service are set out in the ACCC's *Local carriage service and wholesale line rental—final pricing principles and indicative prices for 2008–2009*, available on the ACCC's website at www.accc.gov.au.

Regulation Impact Statement

The Office of Best Practice Regulation (formerly the Office of Regulation Review) advises the ACCC that a Regulation Impact Statement is not required for determinations made under section 152AQA.

Consultation

Before making a pricing principles determination, the ACCC is required by subsection 152AQA(4) to publish a draft determination, invite interested parties to make submissions and consider any submissions received.

On 30 April 2008 the ACCC released the *Draft Pricing Principles for the local carriage service and wholesale line rental – a guide* for comment. Interested parties were provided two weeks within which to make submissions. The ACCC received submissions from Telstra, the Competitive Carriers' Coalition, Primus and AAPT.

The ACCC has taken all of these submissions into account in making the Determination.

Commencement of Determination

The Determination commences on the day after registration.

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58 ACCC, *Declaration of local telecommunications services*, Inquiry Report, July 1999.

59 ACCC, *Pricing principles and indicative prices for local carriage service, wholesale line rental and PSTN originating and terminating access services*, November 2006.

Notes on the Determination

The ACCC's principles relating to the price of access to the LCS and WLR service are set out in Schedules 1 and 2 of the Determination.

They state that an interim retail–minus–retail–cost (RMRC) pricing approach should be applied to the LCS and WLR service for the 2008–2009 period.

Under a RMRC methodology, the access price is determined by deducting the access provider's avoidable costs of retailing a given service to end-users from the retail price paid for that service.

The ACCC will seek to implement a cost-based pricing approach once a robust cost model, capable of producing reliable estimates of costs in all geographic regions, is available.

Schedules 1 and 2 also set out the indicative prices for LCS and WLR for the 2008–2009 period.

Appendix 3. Submissions from interested parties

Submissions to 2008-2009 draft pricing principles and indicative prices guide (April 2008)

Telstra	14 May 2008
Competitive Carriers' Coalition	14 May 2008
Primus Telecom	19 May 2008
AAPT	20 May 2008