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INTERNATIONAL TELECOMMUNICATIONS COMPANY OF THE YEAR - BUSINESS SERVICES



30 April, 2003

Mr Ross Jones
Commissioner
ACCC (ACT)
470 Northbourne Avenue
DICKSON ACT 2602

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By Facsimile: 02 6243 1122

cc: Michael Cosgrave - ACCC (Vic) (03) 9663-3699

Dear Ross,

RE: RESPONSE TO THE ACCC DISCUSSION PAPER - MODEL PRICE TERMS & CONDITIONS FOR PSTN, ULLS & LCS

In response to the ACCC's discussion paper Model Price Terms & Conditions for PSTN, ULLS and LCS, please find following Macquarie's comments on this issue for your consideration.

The Commission's discussion paper *Model Price Terms and Conditions for PSTN, ULLS and LCS* seeks comments on a range of matters relating to the requirement that the Commission set non-binding model terms and conditions for particular "core" services. This response provides an initial set of comments from Macquarie Corporate Telecommunication (MCT) on this discussion paper.

The Commission recognises the common ground between this discussion paper and the earlier discussion paper *Telstra's Undertaking for Domestic PSTN Originating and Terminating Access, Unconditioned Local Loop Service and Local Carriage Service*. It is MCT's intention to provide a full set of comments on this earlier discussion paper once MCT has access to the Telstra confidential information, including the PIE II model, and adequate time to assess such material.

MCT has already provided a response to the Commission's discussion paper *The Need for an ADC for PSTN Access Service Pricing*, and at this time MCT has nothing more to add on the matter of the ADC to the Commission's consideration of model price terms.

MCT's comments on the model price terms for PSTN, ULLS and LCS are set out as follows, in accordance with the main matters identified in the Commission's discussion paper.

TSLRIC pricing methodologies

MCT supports the use of the TSLRIC methodology for pricing PSTN O/T and ULLS. MCT also supports the use of an economic model for calculating TSLRIC prices, provided that the model used is a correct and accurate representation of TSLRIC¹, and the adoption of an approach based on a scorched node network using forward-looking technologies.

¹ See section 4 of the Commission's discussion paper *Telstra's Undertaking for Domestic PSTN Originating and Terminating Access, Unconditioned Local Loop Service and Local Carriage Service*, where the Commission defines the component parts of TSLRIC and concludes that "...TSLRIC can be defined as the total annual cost (on an annual basis) the firm would avoid in the long run if it ceased to provide the service as a whole" (MCT emphasis).

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Use of a specific economic model

MCT notes the Commission's comments in relation to the n/e/r/a model for calculating TSLRIC prices. Accordingly, MCT has no objection to the Commission using the PIE II model for calculating TSLRIC prices, subject to the following:

- PIE II is a correct and accurate representation of the TSLRIC of PSTN O/T (and ULLS) – see comments above.
- To the extent that PIE II needs to be modified to correctly and accurately represent TSLRIC, such modifications are to be carried out by Telstra to the Commission's satisfaction.
- There is, at all times, to be full and open scrutiny of the PIE II model (including any changes) available to any interested² party; and
- The Commission either approves or determines all assumptions behind, and data inputs into, the PIE II model as appropriate.

In setting out these requirements MCT acknowledges that the intellectual property in the PIE II model resides with Telstra, and that for confidentiality reasons some restraints³ on access may be necessary.

Adjustment factor for PSTN and ULLS

MCT makes the following comments on the approach of using an economic model to determine initial year pricing with the pricing in subsequent years determined by applying adjustment factors.

Adjustment factors, while appearing to be simple, are often difficult to fully define and as a consequence may be just as complex as the alternative approach of using the economic model for subsequent years. Examples of this in the Commission's formula are the definition and calculation of the technology and output factors.

Accordingly, MCT finds merit in the Telstra suggestion that a TSLRIC model be used to set prices for all the years ahead using the best ex ante information available. Of course, if such an approach were adopted using the PIE II model, it would be subject to the provisos set out above.

Pricing of LCS

MCT generally supports the Commission's approach of using a retail-minus methodology for pricing LCS. However, in relation to business customers, and large organisations in particular, MCT notes that the TSLRIC cost of such calls is likely to be very low. Accordingly, unless the retail starting price is set appropriately, the opportunity exists for Telstra to leverage its control of the local loop to reduce competition in this sector.

The supply of services to large organisations has been recognised as a key area of competition in telecommunications, and an area in which there are significant competitive concerns.⁴ Large organisations typically receive local calls from Telstra at prices that are far below Telstra's published tariffs. Unless the retail starting price used for the retail minus calculation is able to track the effective retail price for these calls, competition in this sector will continue to be inefficiently restricted.

² As determined by the Commission if necessary.

³ Any such restraints must be reasonable, and ultimately determined by the Commission if necessary.

⁴ See for example page 3 of the Explanatory Statement to Australian Competition and Consumer Commission (Accounting Separation – Telstra Corporation Limited) Direction (No 1) 2003.

MCT notes the Commission's comments on the retail starting price and price squeeze on access seekers as a result of the fact that the current retail-minus methodology uses the 'unbundled' retail price of a Telstra local call. MCT's experience in the business sector of the retail market for local service is that few if any of the customers in this market segment acquire calls at Telstra's unbundled rate.

Telstra has pursued an aggressive bundling policy, and, as a result has been content to leave the unbundled price well above the effective market rate for local calls. MCT does not believe that there is any evidence that the bundled rates represents a cross subsidisation of the local call rate. In particular given that effective price competition generally exists in relation to the other products in the bundle, and the prices for such products are not higher when acquired as part of the bundle.

Accordingly, MCT believes that the Commission should take both 'bundled' and unbundled prices into account in determining Telstra retail price as the basis for retail-minus pricing of LCS. MCT believes that Telstra's weighted average selling price is likely to be an appropriate starting point. In addition, as noted above, the appropriate starting point also needs to be determined by reference to the market segment. Different market prices apply not only between business and residential customers, but also between large organisations (whether business or government) and smaller business customers. Unless these differences are taken into account in the setting of retail price starting points, competition in the latter two market segments will continue to be constrained.

MCT notes the Commission's comments on Telstra's retail costs, and supports the approach to this matter as outlined in the discussion paper.


In regard to the possible use of an adjustment factor to determine LCS pricing beyond the initial year, MCT restates the comments above relating to the use of adjustment factors for PSTN O/T and ULLS in so far as they relate to LCS (e.g. defining and estimating the growth in TFP).

Range of Indicative prices

While acknowledging that the 'draft' model prices, as well as the initial set of model prices themselves, are subject to change, MCT is of the view that a set of point estimates (rather than a range) of indicative prices would be preferred. The reasons for this are that point estimates are more likely to encourage commercial agreement, given that there is only a single price as a Commission benchmark, and that ranges are more likely to encourage regulatory gaming.

If you have any queries regarding this response, please call me on 03 9206 6863 to discuss.

Yours sincerely,



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National Executive, Strategy