

RG 110902
13 November 2009

Mr Michael Cosgrave
Group General Manager
Communications Group
Australian Competition and Consumer Commission

By email

michael.cosgrave@acc.gov.au

Dear Michael,

Setting Indicative Prices for Fixed Services

Macquarie Telecom Pty Limited (“**Macquarie**”) is very concerned that the Australian Competition and Consumer Commission (“**ACCC**”) is considering rolling over the 2008-09 indicative prices for fixed services until 31 December 2010.¹ Such action will be materially disadvantageous for access seekers who have already reached arrangements with Telstra which adopt prices that are lower than the 2008-09 indicative prices. Moreover, for the ACCC to be considering such action is an indictment of the ACCC’s attempts to determine indicative prices for fixed services which has become a debacle. This letter sets out relevant background to Macquarie’s concerns with the ACCC’s proposed action and proposes an alternative way forward which will provide much needed constructive pricing guidance to the industry and likely promote more effective competition.

Background

In August 2009, the ACCC published draft pricing principles and indicative prices for fixed services.² The Draft Decision was greatly anticipated by the industry for several reasons:

- the pricing principles and indicative prices would in part be based on the Analysys cost model commissioned by the ACCC that *inter alia* applies for the first time a cost based pricing methodology in respect of LCS and WLR for which services indicative prices were previously based on a retail-minus-retail-cost (“**RMRC**”) pricing principle;
- indicative prices were expected to fall across the board with expectations promulgated by the ACCC including expectations set out in a letter from the ACCC to Telstra dated 6 April 2009;³ and
- the critical price guidance that the Draft Decision would provide to access seekers in attempting to secure “commercial agreements” with Telstra.⁴

¹ As proposed in a letter from Robert Wright (reference M2008/638-03) 27 October 2009 (“**Wright Letter**”).

² Draft pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS, ACCC, August 2009, (“**Draft Decision**”).

³ Letter from Michael Cosgrave (reference M2006/275) 6 April 2009.

⁴ The desire for access seekers like Macquarie to strike “commercial arrangements” with Telstra prior to the finalisation of regulated prices ought not be seen as the product of achieving a “fair bargain”. On the contrary, and

However, as it is well known, the Draft Decision was released more than three weeks after the 2008-09 indicative prices expired. Moreover, the Draft Decision was released after some access seekers entered into quasi commercial negotiations with Telstra on setting terms for the supply of fixed services. Consequently, access seekers were severely disadvantaged in such negotiations because without the ACCC's indicative prices to provide guidance, the access seekers were deprived any possible negotiating leverage.

Based on the expectation that the ACCC's indicative prices for fixed services would be decreasing, Telstra offered - and access seekers accepted - prices which are lower than the 2008-09 indicative prices. Subsequently, these prices were locked into contractual agreements. Many such agreements will expire on 30 June 2010.

It is now almost three months since the ACCC's Draft Decision was published. There is little industry consensus for the draft indicative prices that it provides. The Draft Decision has attracted many criticisms from access seekers which include:

- a large increase in the ULLS price which was completely unexpected and contrary to previous pricing signals;
- reductions in prices for PSTN OTA and LCS which because of an adjustment path are not as great as they could and should be or as great as the ACCC had previously signalled;
- a two-tiered pricing structure for ULLS when a four tiered pricing structure would be more appropriate;
- no Zone B price for WLR; and
- insufficient weighting applied to benchmark prices in informing the final access prices.

Macquarie believes that these criticisms are not insurmountable. The Draft Decision is a clear step forward and with some refinements would be acceptable to access seekers.

The ACCC now finds itself in a difficult situation - a situation that it alone has created. The ACCC commissioned the Analysys cost model, created industry expectations about price movements and failed to deliver indicative prices when they were needed. Amid industry criticisms of the Draft Decision, the ACCC's proposed solution as expressed in the Wright Letter is to abandon its efforts of the previous eighteen months and to simply roll over the 2008-09 indicative prices until 31 December 2010. In effect, it is to pretend that all of the arguments that the ACCC made about the need for change and action are no longer relevant.

It should also be noted that Macquarie considers that it was not appropriate for the ACCC to express its roll over proposal in the context of the ULLS LSS joint hearing. Such action reflects poor judgement by the ACCC. Macquarie believes that the roll over proposal should have been expressed in the context of the ACCC's draft pricing principles and indicative prices inquiry ("**PPD inquiry**"). That is, at the very least, the Wright Letter should have been addressed to all interested parties in the PPD inquiry and should not have been confined to

as articulated in numerous submissions to the ACCC, Macquarie never possesses adequate countervailing bargaining power to that of Telstra to arrive at a truly "commercial" deal. Such arrangements are "accepted" by Macquarie out of necessity to achieve certainty for business planning purposes. This is exacerbated by the history of delay by the ACCC in finalising regulated processes to the point that Macquarie has reluctantly forgone the likely future benefits of regulated rates and accepted less advantageous Telstra offers on the basis of price and planning certainty. Clearly Telstra is the beneficiary of this flawed process.

the parties involved in the ULLS LSS joint hearing.

Rolling over 2008-09 Indicative Prices is Not Appropriate

Macquarie strongly believes that it is not appropriate for the ACCC to roll over the 2008-09 indicative prices for several reasons. These are as follows:

- The pricing of fixed services should be considered individually and not as a group. There are significant differences among the fixed services. This is evident in their cost-volume relationships, adopted costing methodology and relative importance to access seekers. It follows that decisions about fixed service pricing should be made in respect of individual services and not as a group of services. This has been the position of the competitive industry from the time that the ACCC first proposed dealing with these services in a single review.
- In respect of [c-i-c] access seekers have reached arrangements with Telstra on prices which are lower than the 2008-09 indicative prices. Such prices were agreed on the basis of expectations promoted by the ACCC that future indicative prices would fall. Macquarie is concerned that the benefits that have been obtained in the current financial year will be lost once commercial agreements come to an end which in most cases will be in mid 2010. That is, if the ACCC rolls over the 2008-09 indicative prices until 31 December 2010, access seekers can expect Telstra to insist that such prices will be adopted in new supply agreements once current agreements come to an end. This is because Telstra with its superior market power and bargaining strength compared with the access seekers is in a position to ensure that commercial agreements reflect terms which are most favourable to Telstra. In the meantime, access seekers who did not conclude commercial contracts before the draft indicative prices now find themselves locked out of the prices prevailing in other parts of the market. In effect the ACCC has created a two-tiered quasi-regulated pricing environment through its inept handling of this matter.
- The roll over of the 2008-09 indicative prices will put access seekers in an effective price squeeze. That is, access seekers have obtained lower prices for [c-i-c] and have entered into multiple year service agreements with end customers on the basis of these lower prices. If access seekers are faced with higher subsequent input costs for these services they will not be in a position to pass on higher costs to their end customers. Those who did not conclude commercial negotiations before the draft indicative prices face an immediate price squeeze.
- If the ACCC were to roll over the 2008-09 indicative prices it would be in effect endorsing prices for WLR and LCS that are based on the RMRC pricing principle which the ACCC has indicated is inappropriate. This is a retrograde step which effectively abandons much of the ACCC's work in the previous eighteen months. Further, the proposal would entrench a pricing regime that the ACCC has recognised on a number of occasions allows Telstra to *over recover* the cost of access.

Way Forward

Macquarie believes that the ACCC should not simply roll over the 2008-09 indicative prices. Instead, Macquarie proposes that the ACCC should determine that the indicative price for each fixed service will be as per the 2008-09 indicative price provided that access seekers are no worse off ("**NWO**") compared to an existing commercially agreed price. This NWO principle means that the indicative price for a particular service for a particular access seeker will be equal to an existing commercially agreed price if the 2008-09 indicative price is higher

than the existing commercially agreed price.

Macquarie believes that it would be appropriate for determining fixed service indicative prices at this point of time on the basis of the NWO principle for a range of reasons including:

- the NWO approach considers the price of each fixed service for each access seeker individually;
- NWO based prices would be acceptable to both access seekers and Telstra on the basis that no party is any worse off;
- NWO based prices ensure that the benefits secured by access seekers, particularly in the form of lower [c-i-c] prices, are preserved; and
- NWO based prices are consistent with the long term interest of end users by preserving benefits for access seekers which if lost would threaten effective competition, i.e., if the previously gained benefits are lost access seekers will be severely financially harmed and may not be able to continue to offer services to the market.

For the avoidance of doubt, Macquarie believes that indicative prices determined on the basis of NWO based prices should apply until 31 December 2010. This timeframe provides sufficient pricing certainty for access seekers and at the same time provides sufficient time for a proactive ACCC to regain effective control over fixed service price setting under the anticipated changes to the ACCC's statutory powers.

If the ACCC decides to simply roll over the 2008-09 indicative prices, Macquarie urges that such prices apply only until 30 June 2010. This outcome would not disadvantage those access seekers which have reached commercial agreements with Telstra. However, if this shorter roll over timeframe is adopted, the ACCC must ensure that new indicative prices are in place well in advance of 30 June 2010.

In the event that the ACCC is minded to make this letter public, it would be appreciated if you could contact me to ensure that an appropriate public version of this letter is made available. In addition, Macquarie would welcome an opportunity to discuss the critically important matters raised in this letter with you. If you have any queries concerning this letter please feel free to contact me.

Yours sincerely



Chris Zull
Senior Manager - Regulatory & Government

T 03 9206 6848
E czull@macquarietelecom.com