8 November 2007

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Australian Competition and Consumer Commission
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Dear Robert

**FURTHER CONSULTATION ON DRAFT ULLS PRICING PRINCIPLES**

Optus notes that the ACCC is seeking submissions or further submissions on the draft ULLS pricing principles determination from July 2006.

While Optus lodged a submission on the draft ULLS pricing principles in 2006, we note that there have been a number of developments since that time. Accordingly, Optus wishes to take this opportunity to make further submissions on a number of issues.

This letter does not, however, provide a detailed analysis of these issues. Optus notes that it has already provided comments on all issues noted in this letter in prior submissions, including:

- submissions made to the ACCC in the context of the ACCC's consideration of Telstra's 2006-2008 ULLS Undertaking;[1]
- submissions made to the Australian Competition Tribunal in the context of Telstra's appeal of the ACCC's decision on Telstra's undertaking;[2] and
- submissions made to the ACCC in the context of Optus' dispute with Telstra on ULLS pricing.[3]

Optus refers the ACCC to these documents for its detailed submissions on all issues.

**Forward-looking pricing**

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[1] Optus (2006), Optus submission on ACCC Draft Decision on ULLS Monthly charge undertaking, July 2006; Optus (2006), Optus submission to ACCC on Telstra ULLS undertakings, March 2006
[2] **C-i-C C-i-C**
[3] **C-i-C C-i-C**

In large part, Optus agrees with the principles set out by the Tribunal in its decision on Telstra's appeal of the ACCC's rejection of Telstra's ULLS undertaking.

However, Optus believes the interpretation of TSLRIC as the measure of efficient costs places too great an emphasis on the efficiency incentives associated with new entry. Optus considers that the pricing methodology used to determine ULLS prices should not seek to recover costs that exceed the costs actually incurred by the network operator. In particular, network elements and technology choices that are protected from optimisation in the costing model should not be subject to forward looking costing if this leads to a higher cost than that which has been incurred historically. This issue was analysed in detail in a consultant's report prepared for Optus in 2003 and submitted to the ACCC.[4]

Optus also considers that the use of a TSLRIC estimate of the network in each year in which prices are set also opens the regulatory process up to gaming opportunities, in particular in relation to asset lives and asset price trends.

**The PIE II model**

Optus considers that the PIE II model as presented by Telstra is not an appropriate model for determining access prices for ULLS. Optus notes the views of the Tribunal that it: "…is not satisfied that [the PIE II model] does produce such an estimate of the efficient forward-looking costs of the CAN."[5] Accordingly, if the PIE II model is to be used to set prices then it must be subject to adjustment. The adjustments that would be required to be made to the PIE II model have been outlined in previous Optus submissions to the ACCC and also in a consultant's report submitted to the ACCC.[6]

**Weighted average cost of capital (WACC) inputs and return of and on capital**

With regard to the asset beta, Optus contends that the risks involved in operating the local customer access network are more in the nature of utility businesses (such as electricity and gas transmission assets) and lower than the risks faced in operating the PSTN.

With regard to the risk free rate, Optus believes that the ACCC should reconsider its use of a 10 year Government bond rate as the risk free rate for the purpose of estimating the cost of debt capital. Optus believes a reasonable alternative for the ACCC to consider is to match the maturity of the debt instrument with the regulatory period.

With regard to the cost of capital, Optus considers that there is no asymmetry in the social consequences of the cost of capital for the relevant asset.

With regard to the tax rate, Optus contends there is sufficient information to estimate the effective tax rate and this should be the rate adopted by the ACCC.

[4] **C-i-C C-i-C**

[5] Telstra Corporation Ltd (No 3) [2007] ACompT3 at [261]

[6] **C-i-C C-i-C**

Optus submits that the Commission should adopt a tilted annuity approach to the return on and of capital in its costing of ULLS charges.

**ULLS Specific Cost allocation**

Optus considers that ULLS specific costs should be allocated across all CAN lines, in which case (adapting the Tribunal's finding in the ULLS decision) a level playing field is achieved in respect of the costs which are specific to the ordering and provisioning of competing products such as services provided through access to the ULLS and services provided through access to Telstra's voice and data services. [7]

**Geographic averaging**

Optus submits that ULLS charges should be set on a geographically de-averaged basis, consistent with the findings of the Tribunal which rejected Telstra's proposal to average ULLS charges on the basis that such charges could not be considered to be reasonable. [8]

If you have any queries in relation to this matter please contact me on 02 80828437 or Tim Sparks on 02 80828563.

Yours sincerely

Andrew Sheridan
GM, Interconnect and Economic Regulation

[7] Telstra Corporation Limited (No 3) [2007] ACompT 3 [404]
[8] Australian Competition Tribunal, Telstra Corporation Ltd (No3) [2007] ACompT 3 - 291