PRIMUS®
TELECOM

Submission by Primus Telecom

in response to the
ACCC's Draft Report on

Pricing Principles and Indicative Pricing for Fixed Line Services

1. Executive Summary

1.1. Primus Telecom (Primus) welcomes the opportunity to comment on the Australian Competition and Consumer Commission's (ACCC's) draft *Pricing Principles and Indicative Prices for Fixed Services* (draft position paper). The communications industry has been anticipating activity on this front from the ACCC for some time now, and as the ACCC is aware, the pricing for these services has a significant impact on competition in the telecommunications sector.

1.2. Since publication of the ACCC's draft position paper the Government has announced regulatory reform measures that have overtaken the ACCC process. The ACCC's current approach to price setting, and the proposed pricing itself, has effectively been sidelined. Primus submits the ACCC will have to take into account this shift in policy direction when settling its views on its draft position paper.

1.3. The shift in approach to price setting is timely given the Analysys cost model has now been demonstrated as a flawed basis for regulatory price setting. It is clear the proposed TSLRIC+ based pricing will not improve the prospects for competition. And more fundamentally, as the ACCC has conceded, the build/buy rationale for TSLRIC+ has not materialised, and is unlikely to materialise. This fatally compromises the reliability of the TSLRIC+ methodology to deliver on the objectives of Part XIC of the Trade Practices Act 1974 (the Act). Over reliance on the Analysys cost model at this time to establish pricing would appear to be tantamount to regulatory negligence

1.4. That said, given the present circumstances, Primus submits the ACCC should, on balance, move to settle pricing for 2009/10 (year 1). The industry would benefit from guidance on this pricing. Primus submits there is no need to settle views on pricing for 20010/11 (year 2) or 2011/12 (year 3) ahead of the passing of the regulatory reform measures, which will provide an opportunity for the ACCC to establish some long term pricing guidance going forward. To establish pricing for years 2 and 3 at this time based on a flawed methodology would not be in the interests of competition or consumers.

1.5. That said, Primus has taken the opportunity to examine the pricing proposed by the ACCC and makes the following comments:

- The proposal to increase ULL prices so significantly is quite perverse given that ULL has been accepted as the driving force for competition. The proposed pricing will not improve the conditions for competition.
- Band 1 ULL pricing is proposed to increase by 350% over the next 3 years. This will have a significant detrimental impact on the market. The ACCC should at the very least establish a specific glide path to address price shock for Band 1 ULL pricing.
- The ACCC should give further guidance in relation to WLR Zone B pricing. Currently the industry is unable to reach agreement. The ACCC should take into account that Telstra receives a subsidy for these services, and that a wholesale price point that promotes competition and delivers on consumer interests would have to be positioned below the retail pricing currently available in the market.
- The ACCC has clearly not given due regard to international benchmarks when determining the proposed draft pricing.
- The ACCC has appeared to disregard the objectives set out the Trade Practices Act 1974 (the Act) in relying on the cost model outputs without sufficiently taking into account market impacts and commercial realities.

1.6. Primus has also taken the opportunity to examine the Analysys cost model in more detail and makes the following comments:

- The ISDN demand assumptions are incorrect, and are based on inflated assumptions concerning migration to VOIP.

- The model assumes a requirement to support ADSL and BRI across all copper pairs in the network. However there is no obligation for either service to be delivered to every subscriber.

- The model has not included revenue from other users of duct space, such as Telstra in respect to its HFC network and other competing carrier deployments.

- The assumptions concerning copper cable life are not accurate and the ACCC should refer to international benchmarks on this.

1.7. Primus asks the ACCC to revisit its pricing in light of these concerns. Indeed, in light of these concerns and the legislative reforms recently announced, Primus submits the ACCC should fundamentally reconsider its approach to pricing, and ensure future pricing is consistent with the competition and consumer interest objectives set out in the Act. These objectives are not achieved under the current pricing proposals. Primus notes that in light of the regulatory reform measures, until the ACCC moves away from TSLRIC+ and settles long term pricing based on a more acceptable and appropriate methodology, uncertainty will remain a deterrent to workable competition in the communications industry.

2. The ACCC should focus on the statutory objectives

2.1. The ACCC has stated that by publishing these draft prices it is aiming to give direction on a reasonable starting point for negotiations between Telstra and its wholesale customers. The reality is however that the draft pricing has had the opposite effect. Some matters have not been sufficiently addressed and in the absence of guidance agreement can not be reached (WLR zone B), while for other matters the ACCC draft pricing is out of kilter with industry understanding and expectations to the extent the parties are just simply unable to reach agreement (ULL).

2.2. The ACCC notes in its draft paper that in reaching its decision it must have regard to the long term interests of end users (LTIE). In considering the LTIE the ACCC has regard to the extent to which something would promote competition, any-to-any connectivity and encourage efficient use and investment in infrastructure. It is clear that in current market circumstances any pricing decisions should be essentially influenced by the object of promoting competition. Any–to-any connectivity is less of an issue at this time, and as well recognised, Telstra is already substantially overcompensated for the costs of operating the customer access network such that sufficient investment will be maintained even in light of significantly lower access pricing. In the current environment investment can only be fostered through lower and more competitive access pricing.

2.3. It is concerning that the ACCC has not given due regard to the competition objectives set out in the Act in reaching its draft views on pricing. After 10 years of deregulation Telstra still commands approximately 90% of the industry profits. This clearly signals a failure of competition policy to date. In recognition of the failure of regulatory policy to date to deliver workable competition, the industry and the Government have over recent months sent a clear message to the ACCC that it should fundamentally refocus its objectives to better align decisions with the objects of the Act. While the recently announced regulatory reforms can be seen as a vote of dissatisfaction, the ACCC now has an opportunity to reconsider its approach and to correct the mistakes of the past. The key driver for these fixed services pricing decisions must be to promote competition. That is the only outcome that will be serve the long term interests of end users.

3. The proposed ULL pricing will depress competition

3.1. Of particular concern to Primus is the proposed draft pricing for ULL. It is difficult to understand why the ACCC is proposing to substantially increase pricing given ULL has traditionally been the driving force for competition. Primus and others in the industry have invested significantly over the past decade to establish high speed broadband networks, and the ULL service has been critical to fostering competition for Australian consumers and businesses. Primus is deeply concerned that the ACCC would propose a decision that effectively penalises Primus and others for pursuing a pro-competition ULL based build strategy.

3.2. The proposed ULL price increases, which in some cases represent an increase of over 350% over 3 years, will clearly impact on competition and investment. In some cases the proposed increases could prove fatal to the competitive process, as retail prices are increased and/or industry participants withdraw from sections of the market. The proposed pricing seems remarkably perverse given that it comes in the face of clear failure of workable broadband competition to yet evolve. It is difficult to understand how the ACCC could conceive the proposed ULL pricing could improve the prospects for competition.

The ACCC has previously established bands 1-4 or ULL, where most metropolitan areas and larger regional towns fell into Band 2 which has seen significant ULLS deployment across most sites, with only a few sites deployed in Band 3. In its draft position paper the ACCC has for the first time raises a proposal to only have two zones Zone A and B. While there may be some merit in reducing the number of Bands, Primus has a concern that Zone A as proposed has been made too broad in encompassing 85% of lines.

3.3. From Primus' detailed business modelling, deployment over ULLS will only occur across geotypes 1-6, with the minor exception of up to 20 additional sites from geotypes 7-10. This has been modelled with the assumption a one large access seeker with a broadband market share around 20%, ULLS pricing based on the existing Band 2 price, and the assumption that cost-effective backhaul is available.

If Zone A were to include Geotypes 7-10 as the ACCC suggests, then the average price of ULLS for access seekers will act to distort investment and competition:

i) A higher ULLS price will reduce the number of exchanges in Geo-Types 1-6 where ULLS based-competition will be viable; and

ii) A higher ULS price will inflate retail prices for end users across Zone A, where ULLS competition does occur.

iii) Primus is unable to identify any offsetting benefits in including Geotypes 7-10 in Zone A. It would be good if the ACCC good state a reason.

iv) Primus suggests that Zone A only contain geotypes 1-6, rather than geotypes 1-10. Competition is based on ULLS is only likely in geotypes 1-6.

4. The ACCC has largely disregarded benchmarking

4.1. The draft prices have not been recognised against international benchmarks. It is quite clear that the ACCC has erroneously overlooked the benchmarking data in deference to reliance on a flawed TSLYRIC+ methodology.

5. Glide Path

5.1. The ACCC has not been consistent with its application of the glide path. In some cases the ACCC has proposed a glide path where it was not required, while in other cases the ACCC has not imposed a glide path where it is required.

5.2. For PSTN OTA the ACCC has proposed pricing that is higher than the Analysys model and international benchmarks. Furthermore, it's clear there will be no price shock in relation to this pricing, in the event it was confirmed. The ACCC has indicated 0.7 c/min for some time now, but has been late in implementing this. To further delay the reduction would be unnecessary and tantamount to a change of direction. It should be implemented immediately.

5.3. Similarly, the ACCC has proposed LCS charges that do not require a glide path. Primus understands the proposed pricing will not impose any significant impact on Telstra. Indeed, the proposed glide path is more likely to lead to Telstra making a short term windfall from this service due to the

transitional pricing proposed by the ACCC. The ACCC should not establish a glide path for this pricing.

5.4. As noted above, the ACCC is proposing significant increases for band 1 ULL services. Increases of this magnitude will have a significant impact on access seekers. Primus submits the ACCC should reconsider a glide path to accommodate this shock. Particularly given that access seekers will have to consider how to absorb this impact and make decisions about passing these costs onto customers.

6. The ACCC must improve the access to the Wholesale Line Rental Service

6.1. The ACCC has proposed a Zone A draft indicative price of $23.30 for 2009-10, but has not proposed a Zone B draft price. The ACCC has however provided details of the estimate of costs to provide WLR Zone B services. The ACCC must provide guidance on the Zone B indicative pricing. In the absence of that guidance the industry will not be able to reach agreement with Telstra. The ACCC should ensure that any Zone B indicative pricing is established at rates that are less than the more popular retail pricing benchmarks currently in place. It is only with sufficient margins that competition will emerge in rural and regional areas. As the ACCC is aware, Telstra is subsidised to provide these services.

6.2. Indeed, it may be that the ACCC may be inclined to establish a uniform price for the WLR service, at a rate more aligned with the international benchmarks. Primus would suggest a rate closer to $21 per service per month. There is certainly no evidence that such a wholesale rate would have significant impact on Telstra. However it would serve to promote much needed competition. Primus submits the ACCC is justified to differentiate the approach to WLR and ULL services, given the existence of a long standing line rental price control which is set on a uniform level. This essentially determines a price cap and resale competition could only be enhanced in the event WLR prices were sufficiently below this price cap.

7. Matters that need to be addressed in respect to the Analysys cost model

ISDN Demand Assumption (Cost.xls, tab Inputs Demand):

7.1. ISDN (both PRI and BRI) is forecast by Analsysy to fall rapidly from 14 Bn to 3 Bn minutes/yr, mostly in the next 3 years. When questioned as to why Analysys advised that this was due to customers migrating from ISDN to VOIP services.

7.2. Primus submits that this migration will not occur nearly so rapidly as ISDN and SIP are effectively a common competitive market for business voice access, and there will be little retail pricing incentive offered by carriers to motivate a migration. This is because the majority of the cost of delivery is the SHDSL access service, not the signalling protocol being used over the top which is a trivial cost component. Consequently SHDSL competiveness will drive service pricing, not VOIP or ISDN providers if this upper layer was disaggregated. In the case of ISDN the only additional cost versus SIP delivery is modest, being for an ISDN IAD. With no service price differentiation, customers are likely to leave what they have in place, being ISDN, as a migration to IP-capable PBX cannot be justified.

7.3. The assumption that 80% of current ISDN minutes will migrate to VOIP within 3 years is overly aggressive and should be reconsidered. Primus suggests that most PBX's today are TDM-based, but still have long and useful lives over which they will continue to use BRI and PRI ISDN. Carriers, if moving their core network to VOIP, can continue to support ISDN customers indefinitely via IAD's. Primus has already adopted this approach for ISDN delivery, and commonly sells ISDN and SIP access at similar discounts to meet customer demand.

7.4. Primus estimates that less than 1% of the business access market has moved to VOIP in the period from when broadband and VOIP have been available in Australia. Broadband has been available from Telstra via ADSL since 2000, and VOIP has been widely available from around the same date. Primus launched ADSL and HDSL/SHDSL services before Telstra. History shows that business migration to VOIP is very slow.

7.5. Even if a significant portion of the ISDN market migrated to VOIP, these minutes should be expected to continue to attract Telstra PSTN OTA charges, as

i) there is no interconnect accounting capability to charge differently for PSTN OTA versus VOIP minutes in any of the carrier networks, and

ii) Telstra will not supply VOIP interconnection. VOIP calls must today be interconnected via the common Telstra IGS switch infrastructure also used for PSTN calls. Until VOIP interconnect is agreed to be made available by Telstra as the PSTN OTA provider, VOIP minutes should not be excluded from the cost model or it has no basis in fact and Telstra would be over-compensated.

Copper Gauges

7.6. The model assumes a requirement to support ADSL and BRI across all copper pairs in the network. However, and in fact there is no obligation for either service to be delivered to every subscriber.

7.7. BRI (Basic Rate ISDN) should not be a requirement on all lines, as the Digital Data Service Obligation (DDSO) was recently revoked. Furthermore, even while the DDSO was in place it only required that in areas where BRI was available it would remain so. It has never been required to deliver BRI on all lines. The BRI column for line gauge should be removed. This will remove the requirement for a heavier gauge than the PSTN service requires, on longer lines.

7.8. ADSL should not be considered a requirement on all copper lines, as there is no such requirement in existence. Further Telstra may not be prepared to entertain such a costly performance requirement being established. Including ADSL as a performance requirement on all lines causes heavier copper gauge to be required to many users. If this performance requirement were to be accepted, several issues should be dealt with:

i) Telstra has not designed its network historically to the heavier gauges to support ADSL on longer lines, so would be overcompensated for something that does not exist.

ii) If heavier gauges to support ADSL was considered essential, then the incremental expenditure the cost needed for the "heavier gauge" to support ADSL should be treated as a rolling new-build over a prolonged period matching the new build timeframe reality. This is because the costs to deploy heavier gauges for ADSL will not happen immediately, and if it was costed as being immediate Telstra would gain windfall profits from this decision, by being compensated for assets and capital that will not been expended for decades to come. However ADSL is new and could not have been anticipated as a requirement 25 years ago, so we have a dislocation in the network planning cycle and its regulation. The suggested 25 years of upgrade expenditure as the copper network is naturally replaced does not contradict TSLRIC, to the extent that this expenditure is instead recognised as a prolonged upgrade that is being adopted subsequent to the initial PSTN "scorched earth" network build, in that we are taking a longer term model that includes a technology dislocation both before and after the ADSL rule adoption, to more closely reflect reality. This approach is supported by the ACCC's view on page 19 of the Draft Pricing Principles paper, August 2009, wherein it is their view that: "costs not faced by Telstra in building it's access network to be excluded, e.g., costs of breaking and reinstating concrete".

iii) if Telstra were to be paid by access seekers to the funding of heavier copper gauges, this would be incongruous if Telstra chose not to deploy ADSL-capable gauges when extending its network. An undertaking should be sought from Telstra before this "cost overhead" can be accepted as a reasonable design principle.

iv) The increased in cost from the larger gauge to support ADSL compared to PSTN should be borne by the ADSL services, and not allocated to the PSTN or WLR services. In effect SSS and ULLS Category 6 (ADSL) charges would be higher than ULLS PSTN and WLR charges. This would seem fair to encourage stronger PSTN

competition via resale and PSTN on ULLS. Further, in regional areas where Telstra has a monopoly on ADSL services, it is natural that Telstra should bear the cost of increased guage within its unregulated ADSL margins. To shift the incrementally higher copper costs for ADSL onto WLR access seekers (who have little ability to recover this impost in their PSTN retail pricing) would be incorrect, whilst Telstra would still gain all of the ADSL margins from the investment decision; this would be a case of bad alignment of costs and economic signal. Furthermore it would overcompensate Telstra through double dipping, with a firstly a full return via ULLS and WLR, and then additional margin through more ADSL services being able to be deployed at high margin.

Wireless Access

7.9. Wireless is used to serve low density areas based on fixed-use of GSM. The Analysys model employs a maximum radius of a GSM cell of 25km.

7.10. Longer reach GSM is known to achieved by Telstra in some states such as Queensland if not all, using Alcatel base station equipment. Normally GSM operates with 2 TDM channels on each frequency carrier (time shared) which implies a the maximum radius of a user from a base station of 25km to allow TDM coordination of signals. However, Telstra and other carriers globally extend GSM base station range by disabling every second channel of the paired TDM channels, which removes any need for TDM time sharing, and the cell range is increased to the natural propagation limits of GSM. The base station radius in practice is understood to be 75km, and this is especially applicable to fixed installations where the subscriber can employ a directional antenna to achieve good path performance.

Other users of Duct Space

7.11. Primus has mentioned at ACCC public meetings that the model has not included other users of duct space. Primus pointed out that the model should include the following duct users who pay for FAA access.

7.12. Telstra's HFC network passes around 2.3m homes; around half of this deployment is understood to utilise duct space, with the rest being deployed overhead. Based on half implies approx 20,000 km of duct use for coax in the distribution network.

7.13. Competing carriers have deployed around 3,000 km of fibre mostly in Telstra ducts under FAA agreements (Primus estimate):

Optus	1500+ km
Pipe	400 km approx 200 exchanges
AMCOM	150 km approx 40 exchanges in Perth
Primus	150 km 30 exchanges
AAPT	150 km 30 exchanges
Nextgen (Silk)	200 km
Digital River	40 km
Verizon	40 km mostly in Sydney

7.14. When the above 23,000 km of shared use is considered in the model, the cost of services using the IEN will fall.

7.15. In addition, the impact of Telstra's HFC network on the IEN which has not been included in the Analysys model. The fibre components of the HFC network are substantial, connecting from a centralised headend in each city out to a "node" (small box on a pillar) where the fibre signal is converted to a coax signal. There will be around 50 nodes in each ESA area, given a maximum of 200 homes on each node. Each node is connected back to the headend using over 2 fibre pairs, ideally 1 pair on each of two paths for diversity. On Telstra's IEN, a single ESA will therefore require 100 fibre pairs to serve HFC Nodes, and this would be larger as multiple areas are combined towards the core of the network. These HFC fibre feed cannot be shared via optical splitters near to the nodes, or the broadband speeds will drop.

Universal Service Subsidy

7.16. The USO contribution, which is a subsidy paid on delivering rural phone services, should be removed from the more rural geo-types to calculate WLR and LCS. Otherwise Telstra is over-compensated.

Telstra install revenues

7.17. As the model sits Telstra makes windfall profits from retail install charges.

7.18. Firstly all capex or opex costs to do with the individual install or activation of PSTN, ISDN BRI and PRI and other services should be excluded from the model, as they are not part of the costs related to calculating a monthly charge. This could be staff time (a share of the entire workforce), marketing costs, transport and various loadings. A lot of Telstra's total staff hours are expected to be related to commissioning individual services.

7.19. Further, Primus suggests that Telstra's retail install charges greatly exceed its actual install cost. The charge for install on WLR should be reduced to a cost-based level.

7.20. This is because all of these commissioning costs are

LAS to TNS redundant capacity

7.21. The Analysys model includes 100% redundancy on route sizing providing twice the unprotected level of capacity actually needed to connect the LAS to the TNS layer of the network. This is done on the basis that this provides for a total failure of a TNS switch and all calls will still complete. Primus suggests that this is wasteful and the redundancy should be removed.

7.22. Primus' interconnect capacity is sized with zero redundancy. Other carriers are understood to do the same. Primus is not aware that Telstra provides any level of TNS switch redundancy, let alone 1+1.

7.23. Telstra tends to have more than two TNS switches in each city. Primus is connected to the following number of Telstra IGS gateway switches in each city

Sydney	5
Melbourne	5
Adelaide	2
Brisbane	3
Perth	3

7.24. Taking 100% Redundancy as a requirement, using more than two TNS switches allows the redundancy overhead to be greatly lowered:

TNS switches	overhead
2	100%
3	50%
4	33%
5	25%

7.25. However, when a TNS switch fails in a city with several TNS switches, the total capacity loss is only a small fraction of the total and as such is only a minor concern. For example in Sydney or Melbourne with 5 TNS switches, an TNS outage would only lose 20% of capacity which would only have an impact in small peak-traffic periods. As it would have no impact over most of the month, the case for full redundancy is weak.

7.26. It should be noted that with no redundant capacity on the interconnect to a TNS, the redundant LAS to TNS capacity within the Telstra network cannot be used.

7.27. Primus does not believe it is efficient to invest in spare switch capacity to cover for switch outages, if the carrier is using an appropriately robust switch supplier, which given this model is built in best practice should be assumed. Primus has had zero minutes of switch downtime since starting operations in 1996.

7.28. It is noted that a minor capacity reduction from a TNS outage is not a major performance issue compared to an outage on a LAS switch, and therefore it cannot be justified to invest in redundant TNS switch capacity.

7.29. It is also known that redundant interconnect capacity is also not maintained in New Zealand to cover for switch outages.

Copper Cable Life

7.30. The use of 25 years as the life span of copper cables appears too short. This is a key assumption in the model. From experience over more than 20 years we are aware of virtually no copper cable replacement occurring in Australia or New Zealand, with the exception of programmes to remove the very small amounts of early paper-insulated and aluminium cable, or even older cables. We suggest a lifespan of 40 years be used. It is suggested that the ACCC check what cable lifespan is assumed by its equivalent regulators in other major markets.

Bandwidth Forecast

7.31 Primus believes that the forecast for bandwidth growth in the Anayss model is too low. Primus forecasts ADSL per subscriber bandwidth to grow at a minimum 50% p.a., compounding annually, similar to what has been observed for several years.

8. Conclusion

8.1. Primus welcomes the opportunity to comment on the ACCC's draft position paper. Since publication of the ACCC's draft position paper the Government has announced regulatory reform measures that have overtaken the ACCC process, and the ACCC's current approach to price setting has effectively been sidelined. Primus asks the ACCC to revisit its pricing in light of these concerns.

8.2. That said, given the present circumstances, Primus submits the ACCC should, on balance, move to settle pricing for 2009/10 (year 1). The industry would benefit from guidance on this pricing. Primus submits there is no need to settle views on pricing for 20010/11 (year 2) or 2011/12 (year 3) ahead of the passing of the regulatory reform measures, which will provide an opportunity for the ACCC to establish some long term pricing guidance going forward. To establish pricing for years 2 and 3 at this time based on a flawed methodology would not be in the interests of competition or consumers.

8.3. Primus consider that the competition objectives set out in the Act are not achieved under the current pricing proposals, and submits that uncertainty will remain a deterrent to workable competition in the communications industry until the ACCC fundamentally revises its pricing to focus on competition and the LTIE. This is not achieved by significantly increasing ULL pricing, which is acknowledged as the key driver of competition in New Zealand. Primus submits it is extremely difficult to rationalise the proposed ULL 3 year pricing as a decision that has the potential to improve the conditions for competition.