MODEL PRICE TERMS AND CONDITIONS FOR PSTN, ULLS AND LCS

ACCC DISCUSSION PAPER – APRIL 2003

PRIMUS SUBMISSION - APRIL 2003

Background

The Australian Competition and Consumer Commission ("the Commission") is required to determine non-binding model terms and conditions of access for each of the "core" services including price related terms.

In April 2003 the Commission released a discussion paper detailing its work to date in relation to access prices for core services. The Commission has called for submissions on this paper.

Primus is pleased to have the opportunity to comment.

Context of submission

In addition to the Commission determining model price terms and conditions for the core services, Primus notes that there are several other inquiries being undertaken concurrently, all of which relate to price and non-price terms and conditions for access to core services. Notably these include the Commission's work on establishing non-price model terms and conditions, a review of the access deficit and in particular assessment of Telstra's undertakings.

All of these inquiries include a significant number of overlapping and related issues.

Primus has made submissions to the Commission on its review of the access deficit and is in the process of preparing a submission on Telstra's undertakings and the Commission's inquiry into key performance indicators for non-price terms and conditions. This submission will draw upon Primus' submissions to these other inquiries.

Primus therefore in particular refers the Commission to Primus' submissions on the access deficit review and the discussion paper "Future Access Pricing Approaches" as part of the Commission's consideration of this submission.

Primus' views expressed in this submission are subject to what Primus submits in its assessment of Telstra's undertakings which it expects will be a more comprehensive analysis of the issues which the model price terms and the undertakings have in common.

Summary

Primus submits that, for the purpose of indicative pricing, that:

- an access deficit does not exist and that access seekers should not be required to fund any such deficit including via access pricing;

- a scorched earth approach should be considered when modelling a forward looking network;

- to the extent that Telstra's PIE II model is to be used, that it be on the basis that it is subject to further analysis and that the Commission is not obliged to continue using that model;

- a TSLRIC approach based on a forward looking methodology be used for setting indicative prices for PSTN and ULLS;

- a retail minus avoidable cost (RMAC) model be used for setting indicative prices for LCS, and;

- inputs to the model should be consistent with a forward looking approach.

First and foremost Primus submits that whatever indicative price terms and conditions the Commission determines, that they must be considered in exactly that context. That is, they are indicative only for the purposes of guiding industry in commercial negotiations. To that end they should not be considered in any way as final indicative price terms and that it will be open to the Commission to review them at any time according to industry developments and current information and data.

Primus believes that considering indicative price terms in this context is particularly important at this time when these first indicative prices are being determined within a climate where several other inquiries and investigations are being undertaken which will all, to some degree, impact upon price terms and conditions for access to core services. Therefore Primus believes that this first set of indicative prices to be determined by the Commission should be considered as preliminary or initial indicative prices. These preliminary indicative price terms could then be reviewed by the ACCC once it has had the benefit of considering the more comprehensive submissions that will be made to the other related inquiries, in particular the assessment of Telstra's undertakings.

Therefore given the limited time frame, multiple overlapping concurrent processes and uncertainties of outcomes in relation to other inquiries, Primus supports the Commission publishing a range of indicative prices as opposed to a definitive price point for each of the core services.

Specific Comments

Scorched Earth vs Scored Node Approach

The discussion paper incorrectly states that in its submission to the Commission's discussion paper "Future Access Pricing Approaches", that Primus argues for a scorched node approach. In that submission Primus expressed the view that given the development of non-circuit switched networks such as those based on IP technology, that the Commission should reconsider adopting a scorched earth approach for the purposes of determining access prices.

As Primus stated in its earlier submission it is concerned that the Commission is focusing on current access pricing and network models rather than taking a more long term view and that consideration should be given to likely future network models such as those based upon IP architecture.

Several licensed carriers are building and implementing non-circuit switched based networks. These networks can be up to half the cost of traditional circuit switched based networks and will clearly be more efficient and will therefore substantially reduce the cost of access. Primus therefore believes that consistent with the LTIE objective and the need to base access pricing upon forward looking methodologies, that this type of network architecture should be considered.

This would mean that whereas to date a scorched node approach has been adopted based on a minor modification of Telstra's existing circuit switched network, that a move to a fundamentally different network architecture would require consideration of a scorched earth approach.

Choice of Model – PIE II

Primus agrees with the Commission that until there has been a proper evaluation and full analysis of Telstra's PIE II model that use of that model for the purposes of indicative pricing should be considered as preliminary only and in no way should bind the Commission to adopt the PIE II model as the model to be used in the future.

Therefore, should the Commission decide to use the PIE II model for determining this first set of indicative prices, use of the model should be considered as a short term measure only and that continuing use of that model will be subject to further analysis including that which will be undertaken as part of Telstra's undertakings.

Approach to Setting Indicative Pricing – PSTN & ULLS

Subject to earlier comments, Primus does not necessarily oppose an approach to indicative pricing based upon application of an adjustment formula to an existing, modified or completely new model.

However Primus supports an approach which, rather than the Commission setting a specific price point, that it determine a range of indicative prices for PSTN and ULLS. Primus believes this is an appropriate approach at this point in time because until further analysis and evaluation has been undertaken of proposed models and until outcomes are known from other related Commission inquiries, in particular Telstra's undertakings and the access deficit, that setting a single indicative price point is impractical and somewhat meaningless.

Primus agrees with the Commission that indicative prices for PSTN O/T and ULLS Services should be set using a TSLRIC based model as a starting point and then applying an adjustment factor to calculate indicative prices for the following periods.

Approach to Setting Indicative Pricing – LCS

Primus supports the Commission's view that a retail minus avoidable cost (RMAC) model should be used for pricing of LCS.

As Primus indicated in its submission to the Commission's Future Access Pricing Paper it believes that the RAF should provide current retail cost data which can be used directly in determining indicative pricing for LCS as opposed to using an adjustment factor. Provision of this data should also be further facilitated through the implementation of the proposed accounting separation regime.

For some reason should the necessary RAF data not be available for this first set of indicative prices then Primus would not be opposed to an approach which uses an adjustment factor. However once appropriate RAF information is available then Primus believes that the Commission should review the indicative prices based on that information.

Primus shares the Commission's concern about basing the starting price on Telstra's unbundled retail local call service offerings. Primus believes that only using Telstra's unbundled price can lead to distortions in the actual average retail price for local call services given the range of bundled offerings Telstra makes available. These bundled packages offer varying degrees of discounts on retail local call prices and Primus believes that the Commission should take these into account when determining the starting price for the purposes of an RMAC calculation.

Primus would expect that the accounting separation regime should provide further information to assist the Commission's monitoring of this particular aspect and to support the Commission's imputation analysis which it will be required to do under the new legislation.

Primus also contends that the issue of wholesale line rental must be considered in the context of LCS indicative pricing as this has been a long term ongoing concern for access seekers because line rental is not a declared service. Primus notes that the Commission's discussion paper makes no mention of wholesale line rental and Primus would urge the Commission to include appropriate consideration of that issue as it did when it published its indicative LCS and line rental wholesale prices in April 2002.

Input Parameters to the Network Model

Primus will be making a detailed submission on model inputs and variables as part of its analysis of Telstra’s undertakings. Therefore it does not propose to discuss these in this submission.

Primus’ views on the appropriate value of the WACC is complex and believes that the level of detail required to be provided in support of its position would not be appropriate for this paper.

However because of its significance in determining access prices, Primus makes the following in principle points about the approach which should be taken to the WACC.

Primus contends that the WACC should be calculated on the basis of risk associated with the PSTN, not the risk of Telstra as a whole. The higher levels of diversifiable risk in the non-PSTN portfolio of Telstra's activities imply that WACC variables such as the betas, gearing ratio and debt margin should differ systematically between PSTN and non-PSTN activities. Overall the PSTN is likely to involve a low level of both diversifiable and non-diversifiable risk. That is the income stream for PSTN services is highly reliable.

Primus also contends that the ACCC should consider using separate asset beta values for the IEN (inter exchange network) and the CAN which would result in different WACCs for these components. Further, should an access deficit contribution be required then this would further lower risks to CAN revenue and therefore further reduce the asset beta.

Access Deficit

Primus views on the access deficit were submitted to the Commission's discussion paper " The Need for an ADC for PSTN Access Service Pricing". Primus refers the Commission to that submission for the purpose of considering indicative price terms.

To summarise, Primus contends that there is no justification for an access deficit contribution by access seekers. Therefore the Commission should exclude any ADC in its setting of indicative prices.

However should the Commission decide otherwise and that therefore an ADC adjustment factor is to be applied for the purposes of indicative pricing, then the adjustment factor should be such that it minimises the impact of the ADC upon access seekers.

In the current state of market development and competition, competition will be promoted where the imposition of any access deficit contribution has least impact upon access seekers. The nature of services provided by access seekers means they are sensitive and vulnerable to changes in prices based on call numbers rather than call minutes. Primus also contends that in line with the object of enhancing allocative efficiency and having proper regard to demand sensitivities that 100% of the AD be allocated to end use minutes.

Therefore whatever adjustment factor is used it should be applied to a starting figure based upon 100% of the AD being allocated to end use minutes.