Future Access Pricing Approaches for PSTN, ULLS and LCS

ACCC Discussion Paper – September 2002

Primus Submission – October 2002

Background

As part of its draft Telecommunications Competition Bill, the Government proposes to implement legislative amendments which will require the ACCC ("the Commission") to develop indicative pricing for particular declared services.

In anticipation of this, the Commission released a discussion paper ("the paper") seeking comment on a range of alternate proposals for the setting of indicative prices.

Primus is pleased to have the opportunity to comment.

Primus' submission

As the Commission's paper confirms, access pricing is particularly important and raises complex economic and network modelling issues.

Indeed Primus considers that the matter requires substantial analysis and consideration, such that more time than that allowed by the Commission for comment is necessary in order to properly consider the matter. In addition the paper discusses the use of network models (for example the PIE model) which many interested parties would not be familiar with and therefore would find difficult to comment on without further information and time.

Primus welcomes the Commission's early action on this issue. However whilst Primus notes that the Commission considers this as *"a first step"*[1] and that *"these issues will be taken up more directly in the next stage of the process"*[2], it is concerned that industry is given adequate time and sufficient information in order to fully consider the issue and provide comprehensive input to the Commission. Primus presumes that the next stages of the process will allow for that.

In that context Primus' comments in this submission are preliminary only and limited largely to the "in principle" issues raised in the paper. They are also subject to further submissions Primus may wish to make once the Commission moves into the next stages of the process.

[1] Page ii of the Commission's paper
[2] page ii of the Commission's paper

Primus' preliminary views

Need to take a long term view

Primus considers that the issue of future access pricing models is a crucial one for the success and long-term viability of a competitive industry.

In this context of long-term importance, Primus is concerned that the Commission's paper focuses on current access pricing and network models rather than taking a more long-term view. Primus considers that some attention must be given to possible and likely future network models such as those based upon internet protocol (IP), architecture.

Further to this, Primus considers that the paper too readily dismisses a scorched earth approach. Whilst there was justification for basing an access pricing model on a scorched node approach, when it was developed several years ago, Primus considers that that this approach should be revised in light of technological developments since that time.

The Commission makes passing reference to the need to include a technology factor in any adjustment formula[3] that may be applied. However Primus considers that greater importance needs to be attached to this and that the impact of technology needs to be a key determinant in the structure of the base model as well as being used in any adjustment formula.

Primus recognises that developing "an optimal network profile"[4] up front may protract the process but believes that the benefits in doing so will outweigh the costs.

Subject to Primus' comments regarding the need to take a long term view, Primus agrees with the Commission that any access pricing model for PSTN and ULLS type services should be based upon a TSLRIC approach.

The arguments supporting a TSLRIC approach are well known, understood and accepted and therefore Primus will not restate them in this submission. Primus believes this is an issue no longer open to debate.

[3] page 17 of the Commission's paper
[4] page 17 of the Commission's paper

Access deficit and universal obligation

Primus also believes that the paper does not give adequate consideration to the access deficit issue and universal service obligation.

Primus is of the view that there are inconsistencies between current access pricing models, the access deficit and the model used for calculating the cost of the universal service obligation. Access pricing, the access deficit and contributions to universal service costs are, in Primus' opinion inextricably linked. Therefore it is important that in deciding future access pricing network models, that due consideration is also given to these issues because they all have an impact on the price access seekers pay for services provided and/or supplied by access providers. For example, Primus contends that to the extent that an access deficit exists, that Telstra's gross receipts from USO contributions should be included as part of Telstra's revenue thus reducing the access deficit.

Primus would also contend that to the extent that an access deficit exists, that in line with the object of enhancing allocative efficiency and having proper regard to demand sensitivities, that 100% of the access deficit should be allocated to end use minutes.

In particular Primus strongly believes there is an urgent need to thoroughly review the access deficit. Primus is not confident that the regulator has a clear understanding of the existence and/or quantification of the access deficit, nor is the ongoing assessment and consideration of the access deficit transparent to the industry. For example it is unclear as to how the access deficit is reassessed each time Telstra rebalances access and call charges.

There also remains substantial differing opinion within the industry on the issue of the access deficit.

Because of the significant impact the access deficit has on access seekers (i.e. the access deficit contribution) it is critical that it is accurately identified and quantified as part of determining future access pricing models and indicative pricing.

Commercially negotiated outcomes

Primus also reiterates its concern about the view held by some that "commercial negotiation" is a real option when seeking competitive outcomes between access seekers and access providers. Primus notes that the Commission's paper is predicated upon its desire for commercial outcomes.

Primus still considers that access seekers are largely in a "take it or leave it" position and that this stems from the fact that access seekers by and large have little if any bargaining power when dealing with the incumbent access provider.

To that extent the ACCC should not consider that indicative pricing will necessarily lead to access providers submitting either reasonable undertakings or creating a more realistic climate for genuine commercial negotiations.

While indicative pricing is intended to provide incentives for parties to reach commercial agreement the Commission should not be fooled into believing that this will be an inevitable outcome and that therefore indicative pricing will become a less important tool in access pricing regulation.

Use of current models – PSTN and ULLS

To the extent that a future access pricing model could be based upon an existing model such as n/e/r/a, Telstra's PIE or Optus' model, Primus agrees with the Commission that where possible use of existing models is desirable.

However as stated earlier Primus is concerned that all of the models in existence (which it is aware of) are largely based upon today's network technology and architecture as opposed to technologies such as IP networking which today must be considered a real and viable option.

Primus has concerns about the currency of the n/e/r/a model and believes that subject to further detailed analysis is most likely outdated. Similarly the extent to which the PIE model could be used cannot be determined until it is made available for industry consideration.

In any event Primus would emphasise the importance of the "forward looking" objective regardless of whether the approach is to adopt, modify or develop a new model.

Approach to setting indicative pricing – PSTN and ULLS

Subject to earlier comments, Primus at this early stage does not necessarily oppose an approach to indicative pricing based upon application of an adjustment formula to an existing or modified base model. Similarly, Primus does not necessarily oppose a CPI-X calculation as part of such an adjustment formula.

However Primus also sees merit in the option of running the base model for each regulatory period because, amongst other reasons, a greater degree of accuracy and certainty would be achieved. Primus considers that both options depend upon how the base model is developed. That is, whether it is a modified existing model or an entirely new ground up development. For example if a new model is developed then it may well be more efficient to run it for each regulatory period and that an adjustment approach may be unnecessary.

Primus reserves its position subject to further consideration of the approach to the base model.

Approach to setting indicative pricing – LCS

Primus agrees with the Commission that a retail minus avoidable cost model be applied to indicative pricing for LCS, at least while current retail price controls apply.

Primus however does not agree that it is necessary to apply an adjustment factor to LCS indicative pricing when the RAF should provide current retail cost data which can be used directly. Further to this Primus would expect that the provision of this data will be further facilitated through the implementation of the proposed accounting separation regime being proposed by government.

Primus also contends that the issue of wholesale line rental needs to be considered in the context of LCS indicative pricing as this has been a long term ongoing concern for access seekers who currently have no regulatory recourse in the event commercial negotiations with the access provider fail. Primus believes that the indicative pricing regime is an opportunity to provide incentives to access providers to offer access seekers wholesale line rental on genuine and reasonable price terms.

Timing

Primus believes that the timing of the publication of indicative pricing is to a degree dependant upon which approach is taken to the setting of the indicative prices. If an adjustment formula is adopted then it may be more appropriate to publish indicative prices 3 years in advance for each regulatory period. On the other hand if the model is run for each regulatory period then perhaps indicative prices should be published only one period in advance.

The issue of timing can be determined once the approach has been settled.

Proposed accounting separation regime

Primus believes that the proposed accounting separation regime can also contribute to the setting of indicative prices in so far as it should provide a sanity check to ensure that Telstra (as the access provider) is providing core services to itself on the same price terms as it provides those services to access seekers.

Primus would encourage the ACCC to make full use of the proposed accounting separation regime for the purposes of indicative pricing.

Indicative pricing vs arbitrated price

Primus is concerned with the Commission's statement that it would not be bound by any indicative pricing in the event that it is required to arbitrate a dispute in relation to that service.

Whilst Primus appreciates that an arbitration is an entirely separate exercise, it would expect the Commission to have regard to any indicative pricing when conducting an arbitration otherwise the exercise of setting indicative prices seems rather pointless. This would similarly apply to a situation where the Commission gives an "advisory opinion".

Model inputs and the ACCC position on pricing principles

Until a TSLRIC model is selected for the indicative pricing, Primus is unable to form a view on the input parameters such as WACC, for the model.

Having said that Primus makes the following general comments.

Primus rejects the contention that regulated firms should be compensated for loss of an option to defer investment due to regulation or for unfavourable risk asymmetries. Primus therefore rejects the argument that a real option value should be included in the cost of capital.

The option value could be seen as a non diversifiable risk which could be included in the cash flows but should not impact the cost of capital.

In any event Telstra is the incumbent operator of the network and has historically committed capital to the provision of PSTN services. An efficient operator in this position would not defer investment. Telstra is also subject to service obligations which, in effect, require it invest in the network infrastructure.

Also, as the task is to identify the WACC for PSTN and not Telstra as a whole company, Primus considers that the WACC should be defined in respect of the particular services using the CAN on one hand and the IEN on the other. Since the TSLRIC modelling separates the CAN and the IEN, it is appropriate to consider separate WACCs for each aspect of the network that better reflects the risks associated with each element of the network.

Primus would wish to make further submissions on the WACC and other input parameters as part of the next stages of this inquiry.