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Dear Alison

Telstra Corporation Limited - Response to the Commission's draft pricing principles for LCS and WLR dated April 2008

The Commission's draft pricing principles

In its Draft Pricing Principles and Indicative Prices for Local Carriage Service and Wholesale Line Rental of April 2008 (**2008 Draft Pricing Principles**), the Australian Competition and Consumer Commission (**Commission**) has, in effect, sought to extend the operation of the pricing principles established under its 2006 Pricing Principles Determination.¹

In its 2008 Draft Pricing Principles, the Commission states:

The ACCC's development of the fixed network cost model is ongoing and the model has not yet been finalised. Without a robust cost model available to it at this time, the Commission proposes to issue draft pricing principles and indicative prices for the period 2008-2009, which is consistent with the RMRC approach enunciated in the 2006 Pricing Principles Determination. The Commission considers that the indicative prices for the LCS and WLR for 2008-2009 will be transitional in nature and will stay in place while the ACCC completes its development of the fixed network cost model.

The Commission has sought to apply the 2006 retail minus average retail costs (**RMRC**) methodology, but with updated data inputs, in order to calculate the relevant indicative prices for 2008-2009.

¹ ACCC, Pricing Principles and Indicative Prices Local Carriage Service, Wholesale Line Rental and PSTN Originating and Terminating Access Services, Final Determination and explanatory Statement, 29 November 2006.

Telstra's response to the Commission's draft pricing principles

Telstra has already previously provided its views on the 2006 pricing principles methodology and maintains its views on the approach that were set out in Telstra's response to those principles and that methodology at the time.² Telstra sees no need to reiterate those views in this response.

Telstra maintains that the approach that would better serve the long term interest of end users, would be for the Commission to use information provided by Telstra to arrive at principles which come far closer to an efficient cost, Total Service Long Run Incremental Cost (TSLRIC) approach.

The Commission's approach is also failing to reflect the legitimate business interests of Telstra and its access seeker customers because the current RMRC approach keeps local call prices relatively high in order to keep WLR pricing relatively low. This is at odds with the prevailing industry preference to move towards a subscription based pricing model, generally evidenced by a higher line rental fee and lower per call charges.

A subscription pricing model is also the more economically efficient way to price WLR and LCS. Because of the high costs of the line, and an environment of declining PSTN call volumes, there should be greater flexibility to price the variable aspect, that is, the LCS service, at an efficient rate.

The subscription based pricing approach is also the preferred market approach. This model has been used in the majority of access arrangements Telstra has negotiated commercially with access seekers who purchase WLR and LCS services. The low number of access disputes in relation to the LCS and WLR services is evidence that the commercial approach is meeting access seeker's legitimate business interests in a way that the Commission's indicative pricing structure does not.

Further, Telstra maintains its earlier arguments that any interim approach should ensure that Telstra fully recovers its efficient costs of providing the WLR and LCS services. As Telstra has demonstrated in its recent ULLS undertaking, the cost of providing telecommunication lines remains high.³

In Telstra's view, the 2008 Draft Pricing Principles would price WLR at a rate that still does not allow Telstra to recover its efficient costs of providing that service.

Input errors in calculating indicative prices

Telstra understands that the Commission had not intended to make any changes in its 2008 Draft Pricing Principles to the RMRC methodology it employed in setting the 2006 indicative prices. However, in refreshing the 2006 RMRC methodology with the updated inputs the Commission appears to have made certain input errors in executing the calculations to arrive at the current draft indicative prices. A description of these errors is set out in the confidential attachment to this letter.

Telstra believes that the input errors outlined in the confidential attachment are merely oversights by the Commission in applying the updated volume and cost information and are

² See arguments set out in "Telstra's Submission in Response to the Australian Competition and Consumer Commission's Final Determination in the Declaration Inquiry for the ULLS, PSTN OTA and CLLS, dated July 2006 and the Australian Competition and Consumer Commission's Final Decision in its Local Services Review Dated 2006", 11 September 2006 and "Telstra's Submission in Response to the Australian Competition and Consumer Commission's Draft Indicative Prices for Wholesale Line Rental and Local Carriage Service", 9 November 2006.

³ In its March 2008 ULLS Undertaking, Telstra submitted that based on the Telstra Efficient Access TSLRIC model the TSLRIC+ price for lines in Metropolitan (band 2) would be \$49.27 per month. Based on the relationship between metropolitan line costs and non metropolitan (regional and rural) line costs, this estimate provides strong evidence that the Commission's draft indicative prices significantly understate the true efficient (TSLRIC) costs of supplying WLR services.

not intended to reflect any departure from the methodology used under the 2006 Pricing Principles.

Corrections

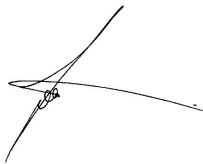
The following table shows the difference between the prices published by the Commission and the prices that should apply if the corrected inputs are used in the Commission's RMRC calculation for 2008/09:

Indicative Price	Residential		Business	
	Published	Corrected	Published	Corrected
LCS	17.96c	17.37c	17.96c	17.37c
WLR	\$27.58	\$25.57	\$25.90	\$26.93

While Telstra maintains its objections to the overall approach, Telstra submits that at the very least the 2008/09 indicative prices for LCS and WLR should be calculated using the corrected inputs as set out above.

If you have any questions about this letter, please contact Adrian Virdun on (02) 9298 5941.

Yours sincerely



Tony Warren
Executive Director Regulatory Affairs
Public Policy and Communications

Confidential Attachment

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