

SUBMISSION IN RESPONSE TO THE DISCUSSION PAPER ON FUTURE ACCESS PRICING APPROACHES FOR PSTN OTA, ULLS AND LCS

Submission by Telstra Corporation Limited

A APPROACH TO INDICATIVE PRICES

- 1 This response to the Commission's Discussion Paper dated September 2002 in relation to the Future Access Pricing Approaches for PSTN, ULLS and LCS ("**the Paper**") is designed to address more particularly how the Commission may determine indicative prices for the three services identified in the Paper. The submission does not address the detail of the methodology or formula which may be applied in determining those prices. Telstra will make submissions on these matters as part of that later stage. Accordingly, this response does not address particular access prices nor the detailed approach to the setting of such prices. Telstra understands that these matters will be explored at a later stage in the process proposed by the Commission, once the Commission determines the high-level methodology to be used to determine indicative prices.
- 2 Given that the Commission is likely to be required by legislation to publish model terms and conditions, including prices for the services which are the subject of the Paper ("**the Relevant Services**"), it is essential that the prices published be derived using an appropriate approach. Failure to do this would only lead to further disputes and arbitrations between commercial parties, and compromise any utility which might otherwise be achieved by the model terms and conditions. Situations might also develop of one party insisting on the Commission's published prices whilst the other asserts that they are inappropriate, or where both parties reject the Commission's published views.

A1 Prices to be determined based on TSLRIC

- 3 Given the debate as to the appropriate prices for the Relevant Services in the context of undertakings and arbitrations, Telstra accepts that the prices for domestic PSTN originating and terminating access ("**PSTN OTA**") and unconditioned local loop service ("**ULLS**") will be set on the basis of total service long run incremental costs ("**TSLRIC**") together with an allocation of common costs and indirect costs, such as organisational costs. Telstra submits that the price of local carriage service ("**LCS**") should likewise be set on the same basis.

- 4 In order to ensure that investment in the PSTN in Australia continues (whether that investment is in the form of an alternate PSTN to Telstra's PSTN or by way of upgrade or extension of the existing Telstra PSTN), investors must have an expectation that the efficient costs of building and maintaining the PSTN will be recovered from prices paid for the services provided over the PSTN (**"PSTN Services"**). To do otherwise will make it difficult to attract investment in the PSTN thus causing a loss of both social and economic benefits from such investment and, more generally, from the operation and use of the PSTN. Those benefits include the value consumers place on PSTN Services, including the value of end users being able to contact other end users with whom they wish to communicate. Accordingly, prices of the Relevant Services should be set at the efficient costs of those services. Furthermore prices set at efficient costs will create appropriate incentives for access seekers to choose to build infrastructure if they are more efficient at doing so than the access provider.
- 5 The burden of recovering efficient costs ought to be borne equally by the Relevant Services as acquired by access seekers and by the use of the underlying facilities by the access provider, in this case Telstra. Otherwise the costs of the PSTN Services faced by the access provider and an access seeker would be different. If the access seekers do not bear their proportion of the efficient costs of providing the services, then they could take the market on the basis of a cost advantage rather than because they are more efficient. This would also prevent the access provider from recouping all of the efficient costs of the investment because sales of Relevant Services alone, at prices which did not reflect an equitable distribution of costs, could not generate sufficient revenues to ensure overall cost recovery.
- 6 In addition, prices for each of the Relevant Services ought to be determined on a consistent basis. To do otherwise could cause:
- (a) usage of the various services to shift from less costly to more costly ones which are priced below efficient cost, even though that may not be the efficient outcome; and
 - (b) the non recovery of all costs of providing the PSTN.
- 7 Given that the prices for PSTN OTA and ULLS are set on the basis of TSLRIC plus an allocation of common and indirect costs, in order to enable recovery of all of the efficient costs of the PSTN, as measured on a TSLRIC basis, the price of LCS ought also to be set

on the same basis. Failure to do this will result in Telstra being unable to recover the efficient costs of providing the PSTN, and will send inappropriate investment and build/buy signals to access seekers, thereby resulting in the inefficient use of infrastructure – a result which cannot, on any view, be consistent with the long-term interests of end users. Telstra has already experienced the commercial impact of the arbitrage opportunity created by the Commission applying different bases for regulated prices to LCS and PSTN OTA – an opportunity which the Commission should be seeking to discourage, rather than encourage, in order to facilitate recovery of efficient costs of the access provider overall.

- 8 Ideally, each PSTN Service would cover its incremental costs, with all PSTN Services together covering the common costs which their provision entails. In practice, Telstra accepts that regulatory and other constraints on the prices that can be charged for particular PSTN Services may prevent a particular PSTN Service from covering the costs that would normally be allocated to it. As a result, some PSTN Services may need to contribute less than they otherwise would towards the costs of providing them, while others may need to contribute more. What is important is that the charges for all PSTN Services sold by an investor in the PSTN cover the total efficient costs of the PSTN which an investor incurs, and that the right incentives are sent to access seekers to encourage efficient investment in infrastructure by ensuring that they bear the efficient costs of the provision of services by the access provider. The Commission has made it clear that efficient costs in this context are to be measured on the basis of TSLRIC.
- 9 Telstra believes that, ideally, the price of the LCS should be determined on the basis of TSLRIC of providing the service to access seekers plus an allocation of common and indirect costs. Having said this, Telstra acknowledges that the price of local calls sold by Telstra to its retail customers is subject to a legislative price cap. Accordingly, if the Commission wishes to ensure that the supply of LCS is at prices below those caps, then the prices of PSTN OTA and Telstra's non-local PSTN Services need to recover the common costs which would ordinarily be attributed to the LCS and Telstra's local call services. Only in this manner will the recovery of the efficient costs of PSTN be possible.
- 10 Annexure A calculates the efficient cost of providing LCS based on the Commission's TSLRIC methodology for the 2001/02 year. Although Telstra does not agree with those estimates of costs, comparing these costs with prices set by the Commission in accordance with the Commission's retail minus avoidable cost ("**RMAC**") methodology shows that

the RMAC price set will not permit recovery by Telstra of the efficient costs of its investment in the PSTN.

- 11 Therefore, setting the price of LCS on the basis of RMAC, without at the same time allowing for the unrecovered efficient costs of the LCS and retail local calls to be allocated to and recovered from the prices for PSTN OTA and Telstra's non-local PSTN Services, is plainly inconsistent with full cost recovery against a TSLRIC benchmark. Precluding full cost recovery in this manner is inefficient because it will cause distortions to both consumption patterns and investment levels within the industry. The proposal to adjust the LCS prices set in Year 1 on the basis of RMAC approach will only increase those distortions.
- 12 Furthermore, setting prices of LCS on the basis of RMAC (again, without allowing the unrecovered efficient costs of the LCS and retail local calls to be recovered elsewhere) is inconsistent with the statutory criteria. Section 152CR of the Trade Practices Act ("**the Act**") sets out matters to which the Commission must have regard when making a final determination in an arbitration. Section 152AH of the Act sets out those same matters to which the Commission must have regard when determining whether the terms and conditions of an undertaking are reasonable. Those matters include consideration of whether the terms promote the long-term interests of end-users ("**LTIE**") of "*carriage services*" or of "*services supplied by means of carriage services*".
- 13 Generally, access seekers do not offer local calls as an unbundled service. Instead, they offer local calls as part of a bundle together with at least national and international long distance and fixed to mobile call services. In this respect, in the context of its consideration of Telstra's application for exemption from the declaration of LCS in certain CBD areas¹, the Commission noted:

*"... there would appear to be an increasing tendency for local calls to be supplied as part of a bundle of fixed line services - consisting of line rental, local calls, long distance calls, and fixed-to-mobile calls."*²

- 14 This is consistent with the Commission's reason to declare the LCS in the first place. In its paper in July 1999, the Commission noted that one of the main motivations for

¹ See Future Scope of the Local Carriage Service Declaration - Discussion Paper II, dated March 2001.

² At page 11

declaring the LCS was to “enable service providers to supply customers with ‘one bill’ for local and long distance telephony services”³.

15 Telstra submits that it is incumbent upon the Commission to consider the impact on LTIE in any market for “carriage services” or “services supplied by means of carriage services” which may be affected by the price of LCS. In view of the above, this at least extends to considering the impact on:

- (a) competition in; and
- (b) the economically efficient use of infrastructure and economically efficient investment in infrastructure by which,

preselectable PSTN Services which are bundled with resold local services are supplied. Given this, the RMAC approach is inconsistent with all of the statutory criteria whereas a price based on TSLRIC plus an allocation of common and indirect costs is consistent with all such statutory criteria. Annexure B sets out an assessment of both pricing approaches against the statutory criteria in support of this conclusion.

16 Accordingly, Telstra submits that the price of LCS should preferably be set on the basis of TSLRIC plus an allocation of common and indirect costs. If however the LCS price is to be limited in some way because of the existence of the price cap on the supply of local calls by Telstra to its retail customers, then the Commission must ensure that the efficient costs of providing LCS and retail local calls, which cannot be recovered, are recovered through the provision of other PSTN Services.

17 Once the Commission decides on an approach to the setting of LCS prices in accordance with the statutory criteria, Telstra would welcome the opportunity to comment upon that approach. Of course, Telstra will comment in detail on any proposal (both for setting the prices for LCS or any adjustments to that price) in the next round of the process.

A2 Model to be used

18 The Commission has suggested that for the purposes of setting indicative prices on the basis of TSLRIC:

- (a) a new model could be developed by the Commission;

³ See Final Report, Declaration of Local Telecommunications Services, July 1999, Section 8.1.1.

- (b) the n/e/r/a/ model could be updated;
- (c) Telstra's new model could be adopted; or
- (d) the existing n/e/r/a model could be used.

19 Any model that is used to set indicative prices for the services ought to be a model based on best in use network technology. For that reason the existing n/e/r/a model is inappropriate in its current form. Telstra has, however, developed a new PIE II model that is based on current best in use technology and incorporates advances in modelling techniques since the time that the n/e/r/a model was developed. As the model has already been developed, there will be no time delay or costs associated with development of a new model or attempting to update the n/e/r/a model. The PIE II model is also more appropriate in assessing the cost of services than any other model that has previously been used in the Australian context (including the n/e/r/a model and the PIE model) because:

- (a) it is based on best in use technology as at 1 June 2002;
- (b) it calculates the efficient costs of the network using actual customer locations rather than estimates of average distances between customer locations and the nearest telephone exchange;
- (c) it is more detailed than the other models that have been developed and therefore more accurately reflects the conditions of supply of the services within Australia;
- (d) many of its inputs can be varied by the user, thus making it very flexible and able to accommodate different views.

Telstra accepts that the PIE II model would need to be the subject of industry consultation prior to it being relied upon to set indicative prices and is willing to make it available for this purpose. Any such scrutiny would, of course, have to be subject to Telstra approving the personnel who would review the model and those personnel signing appropriate undertakings to protect any of Telstra's confidential information and intellectual property embodied in the model. For example, Telstra would be concerned to ensure that the model is not available to persons engaged in commercial negotiations in respect of the supply of the Relevant Services, or to those persons whose role includes marketing activities.

20 Telstra will provide detailed submissions in relation to the appropriateness of the PIE II model in the next stage of this process.

A3 Inputs into the Model

21 Telstra agrees that the inputs into the model ought to be ex ante. However, the inputs ought to be based on the most up to date and best information that is available. Failure to ensure this will simply result in indicative prices which are inaccurate, and therefore highly misleading, thereby leading to a great deal of confusion within the industry. It would also mean that there would be little value in the indicative prices themselves attempting to “guide” the market as to the appropriate prices payable. For that reason, the inputs determined by the Commission in respect of prior years are neither accurate nor appropriate for either the 2002/03 year or any other years following that year.

22 Furthermore, Telstra does not agree:

- (a) with the methodology for setting the WACC adopted by the Commission; or
- (b) that an access provider does not face asymmetric risks for which it needs to be compensated as is suggested by the Commission.

Telstra will make further submissions in relation to these and other individual inputs in the next phase of this process.

A4 Adjustments for future years

23 The Commission has suggested that it could set indicative prices one year, three years or five years in advance. If prices are set for more than one year in advance, the Commission has suggested three alternative approaches, being:

- (a) to use an economic cost model to reset price in each year;
- (b) to use a cost model to establish a starting point period price to which an adjustment factor can be applied in the following years;
- (c) to make adjustments to prices determined by the Commission in years prior to 2002/03.

24 Telstra submits that the last alternative is inappropriate because:

- (a) the prices in previous years have been set using a model based on outdated technology; and
- (b) the prices will have been set too long ago for the prices in the future periods to be reliable.

25 Telstra submits that if indicative prices are set by the Commission at TSLRIC plus an allocation of common and indirect costs, they ought to be set for only one year at the beginning of each year.

26 Setting prices for more than one year in advance will make it necessary to rely on projections of inputs more than one year into the future. The further into the future that projections are made, the more unreliable and uncertain they are. This will apply whenever projections are used, whether they are used as an input into a model or an input into any adjustment made outside of any model. The greatest uncertainty in making projections relates to predictions of traffic volumes and, in particular in present circumstances, the rate of migration of traffic off the PSTN and on to other networks such as the broadband network. If the rate of migration turns out to be inaccurate and traffic migrates to other networks at a rate faster than anticipated, the access provider is unlikely to recover the efficient costs of investment in the PSTN. This places a considerable and ultimately unnecessary risk on the access provider and hence must increase costs. Such an outcome, for reasons set out above, is both inefficient and contrary to the statutory criteria. In contrast, setting the price every year using traffic projections at the beginning of the year can reduce the risk that arises from forecast error.

27 Telstra also submits that the price ought to be set by running the PIE II model each year. Making adjustments to a starting point price leads to unnecessary risks. For example, the impact on costs depends on the geographic distribution of the changes in traffic. That distribution is difficult to capture in a single parameter. Thus, using single parameters to capture changes in traffic will increase the inaccuracy of the forecast of costs. Running the model for each year will more accurately capture changes in costs and thus minimises that risk.

28 An adjustment factor could, of course, be developed to take account of the distribution of changes of traffic. However, such a parameter would be almost as complicated as the model itself. This is because the parameter would necessarily involve a series of weights, the granularity of which would need to be as detailed as the information in the model.

The development of such an adjustment would take significant time and involve substantial cost. Given that the model could be re-run easily, it would be more timely and less costly to simply re-run the model for each of the years under consideration.

- 29 The Commission has expressed concerns that running a model in each period with updated parameters will not deliver timely outcomes. This is not the case. In fact, time and costs are likely to be saved by re-running the PIE II model to estimate prices in future years. For example, each year a range of parameters would need to be adjusted in the model such as the cost of the equipment, the WACC and the traffic volumes. The parameters which would be adjusted each year could be agreed at the outset. Once it is agreed how these ought to be derived, updating them would be a swift and inexpensive exercise. Accordingly, nothing is gained by performing adjustments on the price outside of the model. On the other hand, accuracy is sacrificed, and the potential to mislead the market as to likely prices is heightened.
- 30 If, in spite of the above, the Commission considers it more appropriate to adjust the first year price using an adjustment mechanism, Telstra will provide comments on that mechanism in the next stage of the process.

A5 Common Costs recovery

- 31 Telstra welcomes the Commission's recognition of the importance of ensuring the recovery of the PSTN Customer Access Network ("CAN") costs. Non-recovery of those costs would mean the non-recovery of the efficient costs of the PSTN which would lead to the inefficiencies and distortions set out above.

- 32 The need for full recovery of the losses imposed by price controls has been widely recognised internationally. The economic principles underpinning that need are clear and are directly linked back to the statutory criteria. As Dr William Tye states in a paper presented at the Regulations and Competition Conference entitled "*Competitive Neutrality: Regulating Interconnection Disputes in the Transition to Competition*"⁴:

"The [Trade Practices] Act therefore permits the ACCC to consider a wide variety of factors in arbitrating access disputes. It has wisely determined that the interests of end users, Telstra and competitive carriers are best balanced by establishing interconnection charges that achieve effective competition, while permitting Telstra to pursue its legitimate business interests in achieving revenues adequate to recover the costs of an efficient supplier of domestic PSTN

⁴ On which the Commission's staff provided comments.

originating and terminating services and a risk-adjusted return on the PSTN assets.

The Commission's pricing methodology properly started with the 'direct costs of providing access to the PSTN services'. Apart from any legal requirements, this is appropriate because all parties have a strong interest in the incumbent supplier (Telstra) recovering the costs of an efficient supplier of interconnection services. While there may be disputes over the details of measuring these costs, the requirement follows as a matter of basic economic regulatory principles (as well as, of course, the relevant governing Act).

Even more controversial than the measurement of the cost of the domestic PSTN originating and terminating services is the 'access deficit contribution' (ADC). The possible need for such a contribution is a legacy of the historical cross subsidy inherent in low basic rates for local service, to be offset by a cross subsidy from toll services such as long distance. More recently, the AD has been imposed by price controls on Telstra.

The term 'competitive neutrality' was used to characterise various proposals in this [Australian Competition Tribunal] proceeding, often without a clear understanding of its meaning. Properly defined, competitive neutrality can be a very useful guiding principle in assessing proposed access prices, e.g., in an undertaking, or in the course of arbitration of disputes. Under the indifference corollary, competitive neutrality requires that supplying domestic PSTN originating and terminating services to competitors is neither an advantage or a disadvantage in competing in markets subject to competitive entry, i.e., the interconnection prices and rules are neutral to the outcome of the competitive fray for long-distance services and the like. Put differently, a carrier seeking to compete for long distance and the like would be indifferent between being the buyer or the seller of domestic PSTN originating and terminating services under the competitive neutrality principle.

In the cases at issue, the principle of strong competitive neutrality helps to distinguish among the proposed alternatives, so as to balance the interests of the buyer and seller of interconnection services. It is clear that the access deficit (again assuming correct measurement) is itself not competitively neutral, in that it is incurred only by the supplier of domestic PSTN originating and terminating services. There may well be a variety of sources for the revenues needed for the cross subsidy. For present purposes, I assume, however, that even an efficient supplier of access would have to charge above the costs of domestic PSTN originating and terminating services to cross subsidise the AD. Unless entrants' services are also required to cross subsidise the AD, strong competitive neutrality may be violated. In the alternative, there may be an incentive for 'uneconomic bypass', i.e., even inefficient entrants can compete effectively for long-distance services and the like because they (unlike the incumbent supplier of interconnection) would not be obligated to contribute to the AD."

33 Accordingly, to the extent that PSTN CAN costs are not recovered from revenues for the basic access product, they ought to be allocated to all of the PSTN Services, including PSTN OTA and LCS. Of course, as set out above, if the Commission is of the opinion that the price of LCS must be set below the retail local call price cap, then this must be

taken into account, with the unrecovered PSTN CAN costs being allocated to the remainder of the PSTN Services.

- 34 Telstra does not agree with the Commission's methodology for the calculation and allocation of the unrecovered PSTN CAN costs. Telstra will provide detailed submissions in relation to what it submits should be the appropriate methodology in the next phase of this process.
- 35 Furthermore, the question as to when the revenue from basic access will be sufficient to cover the PSTN CAN costs cannot be pre-judged at this stage. This would depend on the estimate of costs of the PSTN CAN which the Commission recognises will need to be re-estimated every year. Thus it cannot be ascertained, at this stage, when any deficit may be reduced to zero.

B PRICING APPROACH FOR ULLS

- 36 Again, Telstra believes that the price of the ULLS ought to be determined by calculating the efficient costs of the ULLS using the PIE II model, and then adding to that calculation the ULLS specific costs. Telstra submits that the inputs into the ULLS specific costs must be updated as part of any determination of the price for ULLS. Telstra will provide detailed submissions in relation to those inputs during the next stage of this process.

ANNEXURE A

THE COMMISSION'S ALLOCATION OF COSTS TO LOCAL CALLS

1 In calculating the price for PSTN OTA in the context of considering Telstra PSTN OTA undertaking for 1999/2000 and 2000/2001, the Commission allocated costs to all PSTN Services, including local calls. The costs allocated to local calls comprised: (1) switching costs; (2) transmission costs; and (3) a contribution to the unrecovered PSTN CAN costs. These components are examined in turn below.

A *Switching costs*

2 In calculating PSTN switching costs, the Commission estimated the total annual cost of four different types of PSTN switching equipment:

- a. IRIM;
- b. RSS/RSU;
- c. LAS; and
- d. TS.

3 The Commission's estimate of the total annual TSLRIC for each of these switching components for 1999-00 and 2000-01 were presented in the Commission's final assessment.⁵

4 To translate these total annual costs into unit costs (i.e. costs per end-use minute) the Commission divided each cost pool by the volume of traffic that used each piece of equipment. For example, in table A1.3 of the Commission's assessment, the total annual TSLRIC of the LAS was reported to be \$354 million and the number of end-use minutes that used the LAS was 224,414 million. Therefore, the unit cost of an LAS was \$0.0016 per end-use minute (ie $\$354/224,414$).

B *Transmission costs*

5 In calculating PSTN transmission costs, the Commission estimated the total annual cost of the following PSTN transmission links:

- a. IRIM-LAS;
- b. RSS/RSU-LAS;
- c. LAS-LAS; and

d. LAS-TS.

6 As with switching costs, these total annual cost pools were translated into unit costs by dividing each cost pool by the volume of traffic that used these transmission links.

7 The Commission's estimates of annual transmission costs, volumes of minutes and cost per end-use minute were presented in the Commission's final assessment.⁶

8 The Commission estimated both switching and transmission costs in cents per minute by geographic area and at the national average level. These disaggregated cost estimates are presented in the tables A1.8 and A1.9 of the Commission's final assessment.

9 The minutes of PSTN traffic used to unitise annual costs were determined by routing factors. The routing factors for each call type used in the Commission's analysis were presented in the Final NERA Report.⁷ Routing factors determined which components of PSTN equipment each call type used and hence by what volume of traffic each cost pool should be divided. For a local call, there were 3 separate routes:

a. **LAS route:** A party - IRIM/RSS – LAS - IRIM/RSS – B party

b. **Inter-LAS route:** A party - IRIM/RSS-LAS – LAS - IRIM/RSS – B party

c. **TS route:** A party - IRIM/RSS – LAS – TS – LAS - IRIM/RSS – B party

10 The Final NERA report assumed that 8% of all local calls used the LAS route, 46% used the Inter-LAS route and the other 46% used the TS route.⁸

11 In addition, the Commission assumed that, on a national average basis, 31% of all interconnect traffic was routed via an IRIM and 61% of all interconnect traffic was routed via a RSS/RSU⁹. For the remaining 8% of traffic, it was assumed that the RSS/RSU was co-located with the LAS and hence no transmission link was required.

12 Hence, by multiplying the unit costs by the routing factors, the call conveyance costs of a local call based on the Commission's PSTN calculations can be calculated. For 1999-00 this resulted in a call conveyance cost for local calls of 1.96 cents per minute and for 2000-01 a call conveyance cost of 1.79 cents per minute.

⁵ Table A1.3

⁶ Table A1.5

⁷ NERA 1999, Estimating the Long Run Incremental Cost of PSTN Access: Final Report.

13 Based on the local call durations assumed by the Commission – 7 minutes for 1999-00 and 8 minutes for 2000-01 – this results in an average call conveyance cost of 13.56 cents per call in 1999-00 and 14.06 cents per local call in 2000-01.

C Unrecovered PSTN CAN Costs (“UPCC”)

14 The UPCC was calculated by the Commission at \$1,278 million in 1999-00 and \$1,180 million in 2000-01.¹⁰

15 The Commission allocated the UPCC to interconnect traffic based on a “50:50” approach between PSTN end-use minutes and call ends. That is, the Commission calculated:

- a. the value of the UPCC that would be allocated to interconnect traffic based on call ends; and
- b. the value of the UPCC that would be allocated to interconnect traffic based on end-use minutes.

16 The Commission then added together half of (a.) and half of (b.) and took this value as being the UPCC from interconnect minutes (the Commission call this the “50:50 approach”).

17 The Commission has stated in previous assessments of Telstra’s undertaking that all call ends and minutes should make an equal contribution to the UPCC. Hence, extending the Commission’s 50:50 approach used for allocating the UPCC to interconnect minutes, the UPCC allocated to local calls was \$0.0058 cents per end-use minute in 1999-00 and \$0.0045 cents per end-use minute in 2000-01.

18 As the Commission’s modelling was based on an average local call duration of 7 conversation minutes (i.e. 14 end-use minutes) in 1999-00 and 8 conversation minutes in 2000-01, the UPCC that the Commission allocated to local calls is on average:

- (a) $\$0.0058 * 7 * 2 = \0.0798 per local call in 1999-00
- (b) $\$0.0045 * 8 * 2 = \0.0715 per local call in 2000-01

⁸ See Table 2.9

⁹ See Table 7.1 of the Commission’s final report

¹⁰ See the Commission 2000, A report on the assessment of Telstra’s undertaking for the Domestic PSTN Originating and Terminating Access Services, paragraph 7.1.3.

D Total cost

19 In summary, based upon the calculations above, the total PSTN costs that the Commission allocated, on average, to each local call was:

(a) $\$0.1356 + \$0.0798 = \$0.2154$ per local call in 1999-00

(b) $\$0.1406 + \$0.0715 = \$0.2121$ per local call in 2000-01

ANNEXURE B

ASSESSMENT OF UT PRICES AGAINST STATUTORY CRITERIA

Section 152AH and 152CR criteria	Cost-based pricing	RMAC based pricing
<p>LTIE objective of promoting competition in markets for carriage services or services supplied by means of carriage services</p>	<p>Resold local calls are supplied in bundles with other PSTN telephony services (line rental, long distance, fixed-to-mobile) (“bundled services”).</p> <p>PSTN OTA used to supply the bundled services are supplied at regulated prices set by reference to efficient supply costs.</p> <p>With cost-based pricing of LCS access seekers will therefore face prices for the inputs to bundled services in total reflective of cost.</p> <p>In downstream markets Telstra and access seekers are placed on an equal footing in relation to their input costs and the most efficient retailer is able to win the market.</p> <p>Cost-based access pricing also creates appropriate incentives for access seekers to choose to build infrastructure rather than compete through resale.</p> <p>Competition in upstream markets (ie facilities-based competition) for access services will therefore emerge based upon relative efficiency.</p> <p>Conclusion: Cost-based pricing promotes efficient competition in both relevant downstream and upstream markets consistently with this criterion.</p>	<p>Telstra is required to supply retail local calls at prices below efficient costs, by reason of regulatory price caps.</p> <p>RMAC-based pricing applied to Telstra therefore, by definition, must proceed from a starting point below, and therefore result in a price for LCS below, efficient supply costs.</p> <p>Access seekers therefore face a total cost for inputs to the supply of the bundled services, including resold local calls, which is below efficient cost.</p> <p>In downstream markets access seekers who are less efficient than Telstra at retailing the bundle are able to take the market on the basis of a cost advantage rather than efficiency at retailing.</p> <p>Further, in order to recover its costs Telstra is forced to mark-up its retail prices to levels above those which would emerge under efficient competition.</p> <p>Access seekers also lack appropriate incentives to build infrastructure because the access needed to supply the bundled services is priced below efficient costs, thereby delaying or foreclosing the emergence of efficiency-based competition in upstream markets.</p> <p>Conclusion: RMAC pricing delays or forecloses efficient competition in both downstream and upstream markets inconsistently with this criterion.</p>
<p>LTIE objective of encouraging economically efficient use of and investment in infrastructure</p>	<p>Cost-based pricing of LCS consistently with PSTN OTA affords Telstra a normal commercial return on efficient investments necessary to compete in downstream markets (ie for the bundled services).</p> <p>Telstra therefore has appropriate incentives to invest at efficient levels.</p> <p>The competitive neutrality as between Telstra and access seekers which arises under cost based pricing also ensures that churn occurs on the basis of relative efficiency and not pricing distortions, thereby ensuring infrastructure is utilised in the most efficient way.</p> <p>Conclusion: Cost based pricing encourages economically efficient investment and use.</p>	<p>Since an RMAC-based price results in pricing for PSTN access services which is below efficient cost, RMAC prevents the access provider from obtaining a normal commercial return on investments in the PSTN, and therefore discourages investments in infrastructure even if they may be efficient.</p> <p>Telstra is forced to mark-up services to recoup the cost shortfall thereby distorting customer demand for those services and preventing the most efficient use of the network.</p> <p>Further, the access seeker’s build-buy decision is distorted, because the choice to resell rather than build and supply is influenced by the below cost access price available, with the consequence that investment in infrastructure which otherwise would be encouraged, is turned to less efficient uses.</p> <p>Conclusion: RMAC discourages economically efficient investment and encourages inefficient use of resources.</p>

Section 152AH and 152CR criteria	Cost-based pricing	RMAC based pricing
LTIE promoting any-to-any connectivity	<p>Since cost-based pricing encourages economically efficient investment in networks by both access provider and access seeker, the safe and reliable provision of carriage services is maintained and any-to-any connectivity thereby promoted.</p> <p>Conclusion: Cost based pricing promotes any-to-any connectivity.</p>	<p>Since RMAC discourages economically efficient investment in network infrastructure, both by Telstra and the access seeker, the safe and reliable provision of carriage services could be compromised, thereby endangering any-to-any connectivity in the longer term.</p> <p>Conclusion: RMAC could endanger any-to-any connectivity in the longer term.</p>
Legitimate business interests of the provider / carrier and the provider's / carrier's investment in facilities	<p>The consideration of legitimate business interests of the access provider should not be limited to interests in relation to the declared service, but more broadly.</p> <p>From this perspective, cost based pricing for the access services used by access seekers to compete with Telstra for the bundled services in downstream markets will ensure that Telstra earns a normal commercial return on its investment in the PSTN, consistently with its legitimate business interests.</p> <p>Conclusion: Cost based pricing takes account of the access provider's legitimate business interests.</p>	<p>An RMAC based price, when taken together with cost based prices for PSTN OTA which is used to supply other PSTN Services in bundles with resold local calls, results in a total price for the relevant complex of access services which is below efficient cost.</p> <p>RMAC therefore places the access provider in a situation where it cannot obtain a normal commercial return on efficient investment inconsistently with its legitimate commercial interests.</p> <p>Conclusion: RMAC does not take account of the access provider's legitimate business interests.</p>
Interest of access seekers	<p>The interests of access seekers needs to be considered in the context of the access seekers' commercial interests in the broad sense, and not narrowly by reference only to the input costs and revenues from the declared service.</p> <p>From this perspective, the access seekers' interests is properly understood as its interest in securing a normal return on the complex of PSTN based services, including resold local calls, over which competition is occurring at the retail level.</p> <p>An access seeker who is equally or more efficient than Telstra can secure a reasonable return on its investment under cost based prices for all relevant input services, including LCS.</p> <p>Conclusion: Cost-based pricing takes account of access seekers' interests.</p>	<p>Pricing LCS at RMAC while allowing access seekers to obtain PSTN OTA at TSLRIC:</p> <ul style="list-style-type: none"> (a) puts access seekers at a cost advantage overall; (b) enables the access seeker to selectively choose between resale and local call override at TSLRIC. <p>Therefore access seekers will be able to win market share even if they are less efficient than the access provider.</p> <p>Conclusion: RMAC goes well beyond the legitimate commercial interests of access seekers.</p>
Direct costs of providing access	<p>The cost-based pricing approach advocated by Telstra would base access prices on efficient costs (ie costs which would be incurred in a market subject to effective competition), and therefore by definition cannot permit recovery of compensation in excess of such costs.</p> <p>Conclusion: Cost-based pricing covers the direct costs of providing access.</p>	<p>An RMAC based price would not permit Telstra to recover even its efficient costs of providing the access sought by access seekers to supply the full bundle of PSTN telephony services.</p> <p>Conclusion: RMAC fails to cover direct costs of providing access.</p>
Safe and reliable operation of a carriage service, a telecommunications network or a facility	<p>Since cost-based pricing encourages economically efficient investment, it will enable the access provider to maintain the safety and reliability of the operation of its PSTN infrastructure and services provided over the PSTN.</p> <p>Conclusion: Cost based pricing maintains safe and reliable operation of the PSTN.</p>	<p>Since RMAC discourages economically efficient investment, the safety and reliability of the PSTN infrastructure could be compromised.</p> <p>Conclusion: The safe and reliable operation of the PSTN could be compromised under RMAC.</p>
Economically efficient operation of a carriage	<p>Since cost based pricing encourages economically efficient investment and use, it is consistent with the economically efficient operation of networks,</p>	<p>Since RMAC discourages economically efficient investment and use, it could compromise the economically efficient operation of telephony</p>

Section 152AH and 152CR criteria	Cost-based pricing	RMAC based pricing
service, a telecommunications network or a facility	including competitors' networks. Conclusion: TSLRIC is consistent with the economically efficient operation of the PSTN.	infrastructure, including competitors' infrastructure. Conclusion: RMAC could compromise the economically efficient operation of the PSTN.