Report 3

Telstra's compliance with the price control arrangements: 2001–02

Contents

1 Summary

The Australian Competition and Consumer Commission (ACCC) considers that Telstra has complied with its price control obligations under the 2001 ministerial determination subject to one caveat detailed below. There is however a disparity of views between Telstra and the ACCC in relation to the measurement of price movements, the extent of carry-over in relation to the second basket of services and Telstra's application of the ACCC's methodology for determining compliance with the ministerial determination. This may have implications for Telstra's compliance with the determination in future price cap periods.

The ACCC's concern arises because Telstra has used general ledger (GL) revenue and standard pricing information to infer usage (demand) for calculating price movements of line rental products in the first and second baskets. But this does not give a measure of demand. While the ACCC prefers wherever possible to use the publicly audited GL revenue data in calculating price movements, these data cannot be used for measuring demand.

The independent auditor also noted this and concluded that Telstra's use of implied services in operation (SIO) figures for line rentals cannot be independently validated as an accurate reflection of the actual SIO. Without independent confirmation the auditor could not satisfy itself about the accuracy of the price movements and Telstra's compliance with the price movement cap for the first and second baskets of services.

Telstra supplied demand data from its management information system (MIS—the standard source of demand data within Telstra for internal and external purposes) that enabled the ACCC to calculate price movements in the second basket. The ACCC believes the price movement for line rentals for the year under report is higher than that reported by Telstra. It estimates prices have risen by 12.92 per cent for line rentals rather than the 9.5 per cent reported by Telstra. On the basis of the ACCC estimate, Telstra would still comply with the price caps in the first and second baskets but the carry-over into 2002–03 in the second basket is negligible. Given the substantial price increases for line rentals that have occurred in 2002–03, Telstra's compliance for 2002–03 could be placed under some doubt.

Telstra is required to follow the methods and procedures specified in the ACCC methodology. Given the ACCC considers it impossible to derive demand data from the GL, Telstra has breached its price control obligations. This breach is central to the possibility of a more substantive breach of the 2002 determination in the 2002–03 price cap year, should there be no carry-over from 2001–02.

Telstra contends that its reporting method is valid and has raised concerns about the methodology and its application. The ACCC considered Telstra's concerns but does not agree with their substance and is not convinced they are impediments to Telstra properly complying with all of its price control obligations.

The ACCC believes this report fulfils the recommendations stemming from the previous year's report to the minister in implementing a more robust and transparent method of measuring price movements. Price movements are based on the average price over the last three months of the applicable price-cap years; a specific yield calculation is specified as an alternative method for measuring price movement. To enhance consistency Telstra must use GL revenue data (as far as possible) when calculating price movement using the yield method.

2 Background

Under Part XIB, Division 12, paragraph 151CM(1)(b) of the *Trade Practices Act 1974*, the Australian Competition and Consumer Commission (ACCC) must report to the minister for Communications, Information Technology and the Arts on the adequacy of Telstra's compliance with price control arrangements.

The price control arrangements affecting Telstra for the 2001–02 financial year are set out in the *Telstra Carrier Charges—Price Control Arrangements, Notification and Disallowance Determination No.1 of 2001* (the determination). Under the determination the ACCC has to ascertain if Telstra has complied with the price control arrangements. Compliance is a condition of Telstra's carrier licence.

2.1 A summary of price control arrangements

In summary, the price control arrangements apply to one overall basket and three sub-baskets of services as discussed below.

The first, overall, basket comprises connections,[1] line rentals, local calls, trunk calls,[2] international calls,[3] domestic and international leased lines and digital cellular mobile telephone services. This basket is subject to a price cap of CPI–5.5 per cent. The price cap means that Telstra can change the individual prices of these services within the price cap, but the aggregate price of all services in the price cap basket has to decline by 5.5 per cent annually in real terms (that is, net of inflation). If, for example, the consumer price index (CPI) increases by 3.5 per cent, the nominal price of the basket has to decline by 2.0 per cent.

The second basket, comprising line rentals and local calls, is subject to a price sub-cap of CPI–0 per cent, while local call charges cannot exceed 22 cents per call. Consequently, any increase in line rental charges in excess of the CPI have to be balanced by a reduction in local call charges.

The third basket, comprising connection services, is also subject to a price sub-cap of CPI–0 per cent. This means that the overall revenue-weighted price for these services must not rise in real terms in the financial year.

1 Connections require establishing the supply of a standard telephone service at a location required by the person requesting the service. It does not include the supply and connection of a telephone handset or other customer equipment.

2 Trunk calls include STD calls (Telstra's brand name for its fixed network domestic long distance call service), fixed-to-mobile calls, community calls and pastoral calls. They do not include international or local calls.

3 International calls include direct dial and operator assisted calls.

The fourth basket comprises five fixed-line services (connections, line rentals, local calls, trunk calls and international calls) consumed by the lower 50 per cent of residential customers by spending.[4]

The price sub-cap for the fourth basket means that the overall revenue-weighted price for these services must fall by 1 per cent, in real terms, in the financial year.

The price-cap for the relevant basket in the 2001–02 financial year was taken to have been varied by the unexercised amount of the price cap for the 2000–01 financial year.

Telstra is required to report to the ACCC in relation to its compliance with the price control arrangements, within three months after the end of the financial year in which a price-cap applies.

The determination also provides for a number of other price-caps to a range of services.

- The revenue-weighted average untimed local call price for residential and charity customers in non-metropolitan Australia in the 2001–02 financial year is not to exceed that for metropolitan Australia by more than 0.4 per cent.
- The revenue-weighted average untimed local call price for business customers in non-metropolitan Australia in the 2001–02 financial year is not to exceed that for metropolitan Australia by more than 0.4 per cent.
- The price for untimed local calls is not to increase above 22 cents for calls made from a residential or business phone, and 40 cents for calls made from a public phone, except in the case of discount plans when a customer may on occasion be required to pay more than 22 cents per local call.
- Line rentals for lowest-billed residential customers must not increase in a way that their average bill increases in real terms, without prior consent of the ACCC.
- Telstra must notify the minister in advance if it intends to alter charges for directory assistance services. The minister can disallow the proposed changes if they are considered not to be in the public interest.

4 Lower 50 per cent is estimated on the basis of telephone bills.

3 Methodology for determining revenue-weighted price movements

Under subclause 9(6) of the determination, price movements are to be calculated using a methodology established by the ACCC in consultation with Telstra: *Methodology for administration of the Telstra carrier charges price control arrangements* (the methodology).

The methodology was revised for the 2001–02 period, as foreshadowed in last year's report. Among other things the revision focuses on the methods used for measuring:

- price movements
- revenue weighting individual price movements
- net yield in circumstances when application of the standard price method becomes difficult.

The methodology also introduces a new measure for the effect of the GST on local call prices.

It also introduced the appointment by the ACCC of an independent auditor, in consultation with Telstra. Formerly the independent auditor was appointed by Telstra. Costs incurred in the conduct of the audit are borne by Telstra.

3.1 The revised methodology for measuring price movements

The previous methodology defined price movement as the percentage change between the following:

- revenue calculated from usage in the current period, at the price applicable at the end of the preceding period less flexi plan discounts given in period 1
- revenue calculated from usage in the current period, at the price applicable at the end of the current period, less discount resulting from specials in period 2 and flexi-plan discounts given in period 2.

This methodology had a number of shortcomings, particularly:

- the term 'end of period' was vague and needed to be clearly defined
- while revenue foregone for specials in period 2 was deducted from the gross revenue in period 2, it was not deducted from gross revenue in period 1, therefore any price reduction would have been over-stated.

The revised methodology provides a robust and transparent way to measure movement for a single product, which can be aggregated with price changes of other products in the basket using revenue weights of the component services in a basket. Moreover, the methodology defined 'price applicable **at the end of period**' as the price that prevailed in the last three months of periods 1 and 2, thus removing the ambiguity regarding the length of period over which the price should be calculated.

The ACCC recognises that an average of the final three months of the price cap period would not completely remove the problems associated with the ambiguous term 'end of period'. In particular, Telstra could potentially comply with the price cap obligations by increasing prices in the middle of the year and then lowering them at the end of the year. However, under the 2001 determination, the change to a three-month average gave the best method for providing consistent price movement calculations across all services.

The government has already introduced the use of an annual average approach in the 2002 determination. This follows advice from the ACCC. The ACCC considers that the annual average approach will:

- provide a basis for a simpler and more transparent methodology for measuring price movements
- help to eliminate opportunities to manipulate price movements
- provide consistency between the methodology for measuring price movements and measuring local call pricing parity that was already being calculated on the basis of annual differences in the revenue-weighted average price
- harmonise the methodology for price movement measure with the methodology involved in the measure for CPI movements
- harmonise the annual price movement calculations for Telstra's price control report with the price movements calculated for the Division 12 report (*Changes in the prices paid by consumers for telecommunications services*) under paragraph 151CM(1)(a) of the Act.

3.2 Method for revenue weightings for price movements

The revenue weight in the previous methodology was derived from revenue calculated from usage in the current period, at the price applicable **at the end** of the preceding period. This did not conform with section 9(1) of the determination that requires that 'the movement in price of each product is weighted by the revenue derived from that product in the price-cap year against the revenue derived from the relevant basket in that year'.

The 2001–02 methodology satisfies this requirement.

3.3 Methodology for measuring changes in net yield

The 2000–01 methodology provided that, when application of the standard price method becomes difficult, an alternative method of gross yield could be used to measure price movements. However, the methodology did not specify how to calculate yield, meaning the results could be manipulated and biased.

Under the 2001–02 methodology the price movement for a component in a basket of services is defined as a percentage change between the following:

- yield calculated from post-discounted revenue and usage (demand) for respective component services for the last quarter of the price cap year
- yield calculated from post-discounted revenue and demand for respective component services for the last quarter of the financial year immediately preceding the price cap year.

Each component service in the baskets will be weighted by post-discounted revenue. That is, the post-discounted revenue for a service component in the price cap year divided by the post-discounted basket revenue for the price cap year.

3.3.1 Use of GL data instead of sample data

Previously Telstra would conduct two sample surveys which were used to establish yields at the end of the previous financial year and at the end of current financial year. The 2001–02 methodology requires Telstra to calculate yield on the basis of data from the general ledger (GL), as far as possible. In practice, for reasons detailed herein, this has meant the use of GL revenue data and demand data from the management information system (MIS).[1] However, in the case of the fourth basket, two sample surveys will be required, one at the end of each of the two periods. The size and structure of the sample must represent demand patterns and conform to standard statistical principles.

3.4 Methodology for measuring GST effect

The previous methodology did not specify how to measure the effect of the GST on prices. The revised methodology provides that where prices are capped by a CPI-based escalation that escalation should be adjusted to take into account the inflationary effect of New Tax System changes in 2000–01, as estimated by the Commonwealth Treasury.

1 The demand data are to be sourced from the MIS as the GL does not provide this information.

4 Auditing of Telstra's price control report

4.1 Audit process and requirements

Under clause 9 of the methodology, Telstra must provide a final, independently audited report to the ACCC, providing full details of its compliance with the price cap requirements, within three months after the end of the price cap period.

The objectives (as set out in the audit guidelines in Attachment B of the methodology) of the audit are to determine whether:

- Telstra has met ACCC requirements as specified in the methodology
- the ACCC can rely on Telstra's information in undertaking its regulatory obligations
- Telstra has exercised consistency in applying the methodology specifications to its data capture systems.

In this respect the auditor is required to form an opinion about:

- whether Telstra has complied with the procedures and policies set out in the methodology
- the accuracy and completeness of the information produced by Telstra within the structure of the methodology
- whether Telstra has followed a structured approach in its compliance with the methodology and whether an audit trail exists.

The revised methodology provides that the independent auditor is to be appointed by the ACCC, so that it may be directly involved in establishing the plan and approach to the conduct of the annual audit as well as having direct access to the auditor's independent advice. The cost of audit will be borne by Telstra as before.

The process undertaken by the auditors (Alexander and Spencer) was thorough, detailed and clearly of a depth and scope beyond that formerly undertaken during Telstra's previous price control audits under the former audit arrangements, and to a standard that firmly satisfies the requirements of the methodology.

4.2 Audit results

The auditor found that Telstra had complied with its obligations under the methodology and determination, but with one key and marked qualification.

Yield for line rentals is calculated by dividing total revenue for line rentals by the services in operation (SIO) for line rentals over the last quarter of each financial year. However, Telstra has calculated the SIO figure 'by dividing total revenue for line rentals by the published tariffs for line rentals, resulting in an implied services-in-operation figure for line rental'.

By using this implied figure, Telstra 'does not exceed the price movement cap for any of the baskets of services as outlined in the determination and methodology.' Importantly, however, Telstra advised the auditor that it 'does not consider the implied number of services … to be an estimate of the actual number of services in operation'.[1] While the auditor was ultimately able to obtain SIO data from Telstra's MIS for the three months of the final quarter of each of 2000–01 and 2001–02, Telstra warned the auditor that 'the MIS counts … cannot be used to provide a useful or robust check…'.[2]

The auditor noted that:

- the ACCC and Telstra differ on their interpretation of the methodology to be applied in complying with the Telstra price control arrangements
- the implied SIO figure for line rentals cannot be independently validated as an accurate reflection of the actual services in operation for line rentals
- without independent confirmation it (the auditor) is unable to satisfy itself about the accuracy of the price movements (using the imputed SIO method) and Telstra's compliance with the price movement cap for the first and second baskets of services.

In addition the auditor's report found substantial room for improving the processes and systems Telstra uses to develop and produce its price control report, and the auditing process. The auditor raised these issues in a set of recommendations to Telstra. These recommendations will be used by the ACCC as a basis for ensuring ongoing improvements to the audit process.

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1 Email to Alexander & Spencer on 20 February 2003; reproduced in a letter to the ACCC of 27 March 2003.

2 Email to Alexander & Spencer on 20 February 2003; reproduced in a letter to the ACCC of 27 March 2003. Using these data and Telstra's reported net revenues to calculate the yields for the two quarters reveals an increase of 12.92 per cent, substantially in excess of the 9.5 per cent increase reported by Telstra.

5 Telstra's compliance with the price control arrangements in the 2001–02 financial year

5.1 Telstra's compliance with the price control arrangements—summary and issues

Telstra provided its 2001–02 price control report to the ACCC as required on 30 September 2002, detailing its compliance with the price control arrangements. After assessing the report the ACCC informed Telstra that it considered the report did not conform with the methodology. Telstra had calculated price movements by using management information system (MIS) revenue data for some services and general ledger (GL) revenue data (or a mixture of the two) for other services. This was despite detailed advice and direction from the ACCC on the process and procedures Telstra must follow to comply with the methodology, requiring use of consistent data sources across all services in calculating price movements.

Consequently the ACCC informed Telstra it was in breach of its obligations under the 2001 determination and directed it to comply with the methodology by resubmitting a revised report by 31 October 2002 that conformed to the 2001–02 methodology. Telstra supplied a 'supplementary' report on that date and it is this report that the ACCC has assessed for Telstra's compliance with its price control obligations.

5.1.1 Summary

The ACCC considers Telstra has complied with its price control obligations under the 2001 ministerial determination subject to one caveat detailed below. There is however a disparity of views between Telstra and the ACCC in relation to the measurement of price movements, the extent of carry-over in relation to the second basket of services and Telstra's application of the ACCC's methodology for determining compliance with the ministerial determination. This may have implications for Telstra's compliance with the 2002 determination in future price cap periods.

The ACCC's concern arises because Telstra has sought to use general ledger (GL) revenue and standard pricing information to infer usage (demand) for calculating price movements of line rental products in the first and second baskets. However, this does not give a measure of demand. While the ACCC prefers wherever possible to use the publicly audited GL revenue data in calculating price movements, these data cannot be used for measuring demand.[1]

1 The use of this method was only made known to the ACCC in December 2002, after extensive inquiries of Telstra. It emerged then that Telstra had been using this method since its 2000–01 report.

The independent auditor also noted this and concluded that Telstra's use of implied SIO figures for line rentals cannot be independently validated. Consequently, without independent confirmation, the auditor was unable to satisfy itself about the accuracy of the price movements (using the implied SIO method) and Telstra's compliance with the price movement cap for the first and second baskets of services.

Telstra supplied demand data from its management information system (MIS, the standard source of demand data within Telstra for internal and external purposes) that enabled the ACCC to calculate price movements in the second basket. The ACCC believes the price movement for line rentals for the year under report is higher than that reported by Telstra. It estimates prices have risen by 12.92 per cent for line rentals compared with the 9.5 per cent reported by Telstra. On these figures Telstra would still comply with the price caps in the first and second baskets but the carry-over into 2002–03 in the second basket is negligible. Given the substantial price increases for line rentals that have occurred in 2002–03,[2] Telstra's compliance for 2002–03 could be placed under some doubt.

Telstra is required to follow the methods and procedures specified by the ACCC in its methodology. Given the ACCC considers it is impossible for Telstra to seek to derive actual demand data from the GL, Telstra has breached its price control obligations. This is not to say Telstra has deliberately sought to produce beneficial outcomes, as using MIS demand data does not systematically bias the measurement of price movement in any particular direction.[3] However, this breach is central to the possibility of a more substantive breach of the 2002 determination in the 2002–03 price cap year, should there be no carry-over from 2001–02.

Telstra's 2001–02 price control compliance report shows that the price-cap of CPI–5.5 per cent for the first basket of services and the price sub-caps of CPI–0 per cent for the second basket have been met. According to the report the line rental charge has increased by 9.5 per cent during the 2001–2002 financial year in both baskets. As already noted, however, the ACCC is of the view that this price increase is likely to be less than that which would result from the proper application of the methodology. This view is reinforced by the fact that Telstra has reported a significantly larger increase of 16.6 per cent in the price of line rentals for the fourth basket during the 2001–02 financial year.

The ACCC confirms that Telstra has complied with the CPI–0 per cent price-cap for the third basket and CPI–1 per cent for the fourth basket. Telstra has also complied with the metropolitan/non-metropolitan pricing parity requirement for residential, charity and business customers.

2 Line rental for Homeline Complete, Telstra's standard retail residential package, was increased by 10.1 per cent in 2002–03 (another 7.3 per cent increase scheduled from 1 July 2003). The 2002 ministerial determination, which covers the 2002–03 price-cap year, places a CPI + 4 per cent price cap on the relevant second basket.

3 For example, Telstra's method resulted in a price movement for line rental in 2000–01 of 16.4 per cent, which is only slightly lower than the increase calculated using MIS demand.

It is noted that the overall price decline would have been more pronounced for most baskets but for the substantial increase in line rentals. The report shows that the line rental charge has increased by 9.5 per cent during the 2001–02 financial year, which accounted for a weighted average increase of 2.2 per cent for the first basket and a 5.9 per cent increase for the second basket. The increase in line rentals for the fourth basket was as high as 16.6 per cent, contributing a weighted average price increase of 9.2 per cent.

In the second basket the increase in line rentals has more than offset the decrease in local call charges. However, as reported by Telstra, the balance between the two price movements was not large enough to exceed the price-cap.

The large increase in line rentals indicates that a significant rebalancing is taking place, although declines in local call prices have been substantially less than would have been required in the absence of a large carry-over.

5.1.2 Issues

Telstra has raised a number of concerns with the ACCC about the methodology and its application by the ACCC under the 2001 determination. These concerns include Telstra's contentions that

- there is no consolidated revised and approved methodology available to Telstra or the independent auditor
- the methodology was provided too late in the year (2002) for Telstra to take account of the changes it contained
- Telstra's use of GL revenue data to obtain line rental demand does not contravene the price control arrangements as it is within the methodology's specification that GL data be used 'as far as possible'
- the methodology did not produce outcomes that Telstra considered reasonable proxies for the actual price movements of services.

In respect to the last point, Telstra believes that its initial report provides a more accurate representation of price movements than the supplementary report and should be the report by which Telstra's compliance is judged. Telstra points to a large difference in the price change for mobile services between the original and the supplementary reports as a result of what it believes is a mismatch between the revenue and demand data used to calculate the price movements.

The ACCC has sought relevant data, information and explanation from Telstra to assist it to understand these concerns and to better assess Telstra's price control report for compliance. After extensive consultations with Telstra, the ACCC's view is that Telstra's concerns do not validly impede the proper application of the methodology.

Consolidated methodology. Telstra is concerned that it and the independent auditor did not have access to a final, consolidated methodology from which the price control report could be produced and assessed. A single methodology was drafted and supplied to Telstra. Extensive consultations with Telstra have taken place on its application. During that process the ACCC has provided clear, timely and unambiguous notice and direction (with full documentation) about the changes made in the 2001–02 methodology and subsequent refinements and clarifications. The independent auditor also had full access to all relevant documents and correspondence pertaining to the production of its audit report and the proper performance of its duties. However, the ACCC's task of providing timely direction was not assisted by Telstra providing important information well after the methodology had been provided to Telstra. For example, the ACCC was only made aware by Telstra in September 2002 that Telstra could only obtain demand data from its MIS database as the GL database did not capture this data.

Timeliness of methodology. Telstra was thoroughly consulted and was well aware of the ACCC's approach to the methodology from a very early stage in the process. The ACCC began consulting with Telstra on the 2001–02 methodology in June 2001. The ACCC found it difficult to finalise because of delays beyond its control. The ACCC considers that Telstra had sufficient notice of the changes to make any necessary adjustments to its data systems. Telstra was supplied with the draft methodology in April 2002 and the final at end-May 2002 but did not raise any principal concerns until late August 2002.

Telstra's method for calculating line rental price movements. Telstra does not accept that its reported price movements for line rentals are inconsistent with the methodology, contending that its implied method of calculating the number of SIO in determining line rental yield is a valid and robust method. However, Telstra has been unable to satisfy a number of concerns about the use of this method. In particular Telstra has been unable to adequately explain:

- the substantial growth in SIO numbers in 2001–02, which is contrary to the steady or falling trends indicated by other available sources[4]
- the volatility in SIO numbers from month to month, contrary to Telstra's own comments on the normal stability of line numbers from one period to the next
- why Telstra uses a method that it itself admits cannot be considered as an estimate of the actual SIO count (actual number of lines)
- why line rental is the only service where Telstra does not use MIS demand data in calculating price movements.

The ACCC considers that GL derived demand figures for line rental do not measure the number of lines, cannot be used in the calculation for line rental demand and therefore cannot be used to calculate price movement for line rental.

[4] The higher the growth in the number of the services in operation in the price cap year the smaller the rise in prices for line rentals that is produced in that year.

Data mismatch issue. The ACCC does not accept that Telstra's initial report provides a more accurate representation of price movements than the supplementary report. The initial report extensively uses MIS revenue data which, in contrast to GL revenue data used in the supplementary report, have not been audited and are incomplete in that they do not contain any measure of line rental revenues. In the case of mobile and other call services, Telstra does not match MIS revenue exclusively with MIS demand data in its preferred initial report. Telstra has in fact used a mixture of GL and MIS revenue data which contradicts Telstra's contention that GL revenue data and MIS demand data cannot be matched. Mobiles is also the only service that produces any substantial difference in price movements between the two reports, with seven of the eight services in the baskets indicating similar price movements.[5] Both observations do not support the contention of a data mismatch in the 'supplementary' report.

In addition, the ACCC considers that varying the methodology after the end of the applicable price cap period would in effect be allowing a regulated entity to apply ex post a method that could produce for it more favourable price movements than from applying the issued, ex ante methodology. The ACCC had been willing to consider the use of MIS revenue data as long as they were consistently used across all services for the calculation of price movements and were capable of being audited. As Telstra did not apply the necessary consistency in its initial report, the ACCC considered the use of MIS revenue data when GL data are available would be contrary to ensuring that the opportunity to manipulate price changes was minimised and transparency maximised. The reporting of price movements for price control purposes based upon revenues and yields derived from MIS data would also be inconsistent with Telstra's other public reporting which is largely based on general ledger data.

5.2 An overview of the revenue-weighted price movements for Telstra's services

Figure 1 shows the size of the revenue-weighted price movements for each of the Telstra services subject to the price control arrangements and the size of the overall revenue-weighted price movement for these services (the first basket). The revenue-weighted price movements illustrate, for each service, their contribution towards the overall revenue-weighted price movement. In the 2001–02 financial year the overall revenue-weighted price declined by 2.7 per cent compared to a 3.9 per cent decline in the previous year.

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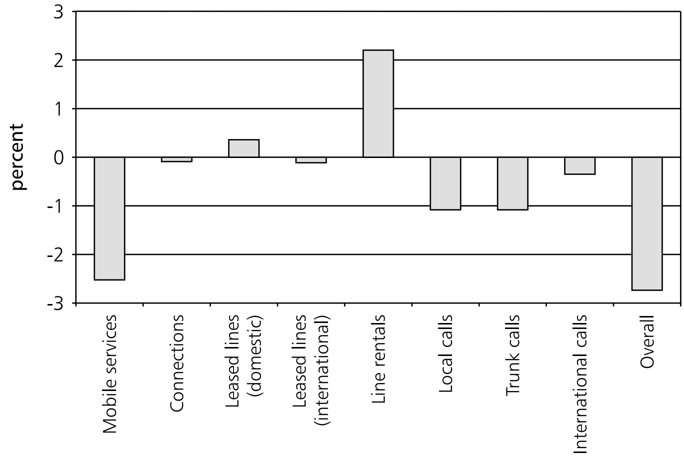
5 The supplementary report recorded slightly lower decreases for local calls and international calls. For local calls the change was from –9.0 per cent to –7.6 per cent, making the decrease closer to (but still greater than) that claimed in Telstra's 2001–02 annual report, where it is reported that these prices 'decreased by an average of 6.7 per cent in fiscal 2002' (p. 69).

Figure 1 **Telstra's revenue-weighted price movements in the 2001–02 financial year**



5.3 Telstra's compliance with the price-cap for the first basket

The determination provides that the revenue-weighted price movement of the first basket (containing all services subject to price control arrangements) must not exceed CPI –5.5 per cent. This basket includes connections, line rentals, local calls, trunk calls, international calls, domestic leased lines, international leased lines and cellular digital mobile telephone services. The following evaluation is based on the assumption that Telstra's estimate of the increase in line rentals is correct.

In the 2000–01 financial year the GST-adjusted CPI increase was 3.5 per cent.[6] As a result Telstra would have been required to reduce its overall revenue-weighted prices by 2.0 per cent (3.5 per cent–5.5 per cent) in the 2001–02 financial year. However, a carryover of 3.8 per cent was available from the previous financial year. Consequently, Telstra could increase the weighted-average price for the first basket by 1.8 per cent without exceeding the price cap. As indicated in table 1 the weighed-average price has actually decreased by 2.7 per cent. Accordingly, Telstra has reduced the weighted-average price for the first basket by 4.5 per cent more than required to meet its obligation under the 2002 determination. This will have implications for the carry-over credit Telstra can take forward for the first basket in the 2002–03 financial year.

Table 1 illustrates that Telstra's overall reduction in revenue-weighted prices was 2.7 per cent, which was 4.5 per cent more than was required to meet its requirement under the 2001 determination.

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6 The CPI, expressed as a percentage, for the weighted average of the eight Australian capital cities, for the financial year immediately preceding the price cap year, that represent the aggregate price movement in the all-groups basket as published by the Australian Bureau of Statistics.

Table 1. Telstra's compliance with the price cap for the first basket

Service	Price movements (%)	Revenue weights	Weighted price movement (%)
Digital cellular mobile telephone services	–9.0	0.282	–2.5
Connections	–6.5	0.016	–0.1
Domestic leased lines	+15.7	0.022	0.3
International leased lines	–37.9	0.003	–0.1
Line rentals	+9.5	0.230	2.2
Local calls	–7.6	0.142	–1.1
Trunk calls	–3.9	0.271	–1.1
International calls	–10.7	0.033	–0.4
Overall		**1.000**	**–2.7**
CPI			3.5
CPI–X			–2.0
Carryover from 2000–01			3.8
Carryover to 2002–03			**4.5**

The largest contribution to the decrease in the price of the overall basket for the financial year 2001–02 was made by mobile telephone services. The price of mobile telephone services fell by 9.0 per cent which contributed to a decrease of 2.5 per cent in the overall basket price in 2001–02. The decline in the price of mobile services, significant as it is, was considerably less than the 14.2 per cent decline in 2000–01.

The second largest contribution to the decrease in the overall basket price was made by local calls and trunk calls. The price of local calls decreased by 7.6 per cent, contributing 1.1 per cent to a decrease in the overall basket price. By contrast, the decrease in the price of trunk calls by 3.9 per cent contributed 1.1 percentage points to the overall price decrease because of its relatively higher importance in the overall basket.

The favourable impact of declines in mobile, local and trunk call prices on the aggregate price movement was offset by the significant increase in line rentals, which increased by 9.5 per cent and contributed to a 2.2 per cent increase in the aggregate price level. Consequently, the price of the full basket decreased by only 2.7 per cent. In other words, the price for the basket as a whole would have increased in the 2001–02 financial year without the significant decrease in the price of mobile, local call and trunk call services.

The price of domestic leased lines has increased significantly by 15.7 per cent during 2001–02. However, because of its small share in the total basket revenue, its impact on the overall price movements for the first basket was minimal at only 0.3 per cent.

The price of international leased line services decreased by more than three times the rate of local calls and trunk calls combined. However, because of its low revenue weights, international leased lines contributed only 0.1 point to the 2.7 percentage points decrease in the overall basket price.

Similarly, the decrease in the price of international calls by 10.7 per cent contributed only 0.4 percentage points to the total fall in the overall basket price because of its relatively lower importance in the overall basket.

The carry-over to the 2001–02 financial year was at a substantially higher level of 3.8 per cent. Were it to be determined on the same basis, the carryover to the 2002–03 financial year increased to 4.5 per cent.

5.4 Telstra’s compliance with price sub-caps for the second basket

The second basket comprises line rentals and local calls. The overall revenue-weighted price movement for these services must not exceed CPI–0 per cent.

The CPI applicable to the 2001–02 reporting period was 3.5 per cent. In addition Telstra was entitled to use a carryover of 1.6 per cent from the 2000–01 financial year. As a result Telstra was required not to increase its overall revenue-weighted price by more than 5.1 per cent (3.5 per cent–0 per cent + 1.6 per cent).

Table 2 illustrates that, according to Telstra’s report, the revenue-weighted price decrease in local call charges was more than offset by the revenue-weighted price increase in line rentals. However, Telstra was able to meet its price sub-cap. The overall revenue-weighted price increase of 3.0 per cent was 2.1 per cent lower than what Telstra was entitled to charge under the price sub-cap.

The table also shows that the carryover has significantly increased from 1.6 per cent to 2.1 per cent between the 2000–01 and 2001–02 financial years.

As previously noted in this report, though Telstra did not follow the methodology in the calculation of line rental, the ACCC believes that Telstra has complied with its price control obligations with respect to the price sub-cap of the second basket. This view is based on an increase in line rentals of 12.92 per cent (using demand data from Telstra’s MIS). An unweighted increase of 12.92 per cent translates to a weighted increase of 5.1 per cent, just the amount allowed under the CPI–0 per cent price cap given the carry-over of 1.6 per cent from 2000–01. On this basis there is therefore no carry-over amount into 2002–03.

Table 2. Telstra's compliance with the price sub-cap for the second basket

Service	Price movements (%)	Revenue weights	Weighted price movement (%)
Line rentals	+9.5	0.618	+5.9
Local calls	–7.6	0.382	–2.9
Overall		**1.000**	**3.0**
CPI			3.5
CPI–X			3.5
Carryover from 2000–01			1.6
Carryover to 2002–03			**2.1**

5.5 Telstra's compliance with price sub-caps for the third basket

The third basket comprises connections. The overall revenue-weighted price movement for this service must not exceed CPI–0 per cent.

The CPI applicable to the 2001–02 reporting period was 3.5 per cent and a carryover of 4.3 per cent was available from the 2000–01 financial year. As a result Telstra was required to not increase its overall revenue-weighted price by more than 7.8 per cent (3.5 per cent–0 per cent + 4.3 per cent).

Table 3 illustrates that the revenue-weighted price for connections declined by 6.5 per cent. This being added to Telstra's unused entitlement of 7.8 per cent provides a carryover of 14.3 per cent to the 2002–03 financial year.

Table 3. Telstra's compliance with the price sub-cap for the third basket

Service	Price movements (%)	Revenue weights	Weighted price movement (%)
Connections	–6.5	1.000	–6.5
Overall		**1.000**	**–6.5**
CPI			3.5
CPI–X			3.5
Carryover from 2000–01			4.3
Carryover to 2002–03			**14.3**

5.6 Telstra’s compliance with price sub-caps for the fourth basket

The fourth basket comprises fixed-line services consumed by the lower 50 per cent of residential customers: connections, line rentals, local calls, trunk calls and international calls. Under the price control arrangements the overall revenue-weighted price movement for these services must not exceed CPI–1 per cent.

The CPI applicable to the 2001–02 reporting period was 3.5 per cent and a carryover of 1.7 per cent was available from the 2000–01 financial year. As a result Telstra was required to not increase its overall revenue-weighted price by more than 4.2 per cent (3.5 per cent – 1 per cent + 1.7 per cent).

Table 4 illustrates that the revenue-weighted price decreases in call services to residential customers were offset by the revenue-weighted price increase in line rentals for residential customers. However, a significant carryover of 1.7 per cent from the previous financial year meant that Telstra was able to meet its price sub-cap. The overall revenue-weighted price increase of 3.0 per cent was 1.2 per cent lower than Telstra’s entitlement of 4.2 per cent.

Table 4. Telstra’s compliance with the price sub-cap for the fourth basket

Service	Price movements (%)	Revenue weights	Weighted price movement (%)
Residential connections	–6.6	0.021	–0.1
Residential line rentals	+16.6	0.552	+9.2
Residential local calls	–14.9	0.209	–3.1
Residential trunk calls	–12.8	0.197	–2.5
Residential international calls	–22.3	0.021	**–0.5**
Overall		**1.000**	**3.0**
CPI			3.5
CPI–X			2.5
Carryover from 2000–01			1.7
Carryover to 2002–03			**1.2**

It is noted that the price movements reported for line rentals, local calls, trunk calls and international calls differ between the first and fourth baskets. This is related to differences in customer segments included in the baskets (the first basket includes residential and business customers but the fourth basket includes the lower-spend 50 per cent of residential customers only) and also reflects the different methodologies and data sources applied.

5.7 Telstra's compliance with the metropolitan/non-metropolitan pricing parity

The determination requires that price reductions in Telstra's untimed local calls in geographic areas with effective competition flow on to customers in areas where competition may not yet have developed.

In the 2001–02 financial year Telstra complied with these requirements, with the revenue-weighted-average untimed local call prices for residential, charity and business customers in non-metropolitan areas not exceeding those for the respective customer segments in metropolitan areas in the 2000–01 financial year. This is illustrated in table 5.

Table 5. Metropolitan/non-metropolitan pricing parity: untimed local calls

Market segment	Metropolitan average price 2000–01	Non-metropolitan average price 2001–02
Business	0.184	0.161
Residential/charity	0.176	0.148

5.8 Telstra's compliance with the requirement to notify the ACCC of line rental increase, for residential customers, greater than CPI

The determination requires that the ACCC must consent to a proposed increase in residential line rental charges that is greater than the CPI. Before consenting to the increase the ACCC must be satisfied that Telstra has available, or will have available at the time the increase takes effect, products which, if taken up by affected customers, would ensure that the average telephone bill of low-bill residential customers[2] does not increase by more than the CPI.

In the 2001–02 financial year Telstra introduced a number of new pricing options that enable its customers to offset higher access charges against lower call charges.

Taking effect from 11 August 2001

Telstra has made the following changes to charges for HomeLine Plus customers, with respect to international calls, and Easy ½ Hour.

2 Low-bill residential customers are defined as those who are (i) preselected to Telstra 30 days before the proposed increase being notified to the ACCC and (ii) among the 10 per cent of customers with the lowest telephone bills at that time.

- For international calls the first 10 minutes involve a capped rate. The per-minute rates apply thereafter.
- For Easy ½ Hour, the first charging block is extended from 30 minutes to 60 minutes. After the first 60 minutes, normal charges will apply.

Taking effect from 1 September 2001

Telstra has changed the charge for, and the fee structure for, the Homeline Budget Plan. The Homeline Budget Rebate pricing package is targeted at customers whose total monthly bill is $25.30 or less before any discounts or rebates. The package involves a $19.90 (GST inclusive) monthly access charge, with a rebate of $2.20 (GST inclusive) line rental which applies each month that the customer's total bill is equal to or less than $23.00 (previously the package involved a $2.20 (GST inclusive) monthly fee plus $17.50 (GST inclusive)).

Taking effect from 1 September 2001

Telstra has increased the BusinessLine Plus monthly access charge from $34.95 to $36.95 (GST inclusive).

From 1 September 2001 changes were made to the existing residential line rentals and new pricing options were introduced. These options were:

- Homeline Complete, from $17.50 to $19.90
- Homeline Part, from $17.50 to $19.90
- Homeline Net, from $14.50 to $16.90

Taking effect from 1 December 2001

- The rental fee for calling number display (CND) rental touchfone has increased from $4.95 to $5.50. A CND phone lost charge of $66.00 has also been introduced.
- The EasyCall multiple number feature has increased from $52.80 to $66.00.
- The Duet–Phone and Fax Multiple Number Feature has increased from $52.80 to $66.00.

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