MACQUARIE CORPORATE TELECOMMUNICATIONS

SUBMISSION TO AUSTRALIAN COMPETITION & CONSUMER COMMISSION

ON TELSTRA ACCESS UNDERTAKING – PSTN OA, ULLS AND LCS SERVICES

23 MARCH 2004

PUBLIC VERSION

1. EXECUTIVE SUMMARY

Macquarie Corporate Telecommunications (**MCT**) makes this submission as part of the Australian Competition & Consumer Commission (**ACCC**) public consultation process in relation to the assessment of Telstra's undertakings dated 14 November 2003.

In accordance with Section 152BV of the *Trade Practices Act* 1974 (**the Act**) the Commission must not accept an undertaking unless it is satisfied that the terms and conditions specified in the undertaking are reasonable. In determining whether the terms and conditions of the undertaking are reasonable the Commission is required to have regard to the matters set out in Section 152AH, which include consideration of whether the terms and conditions promote the long term interest of end users of the carriage services. For the reasons set out in this submission MCT believes that it is clear that the undertakings are not reasonable, are contrary to the long term interests of end users and accordingly should not be accepted by the Commission.

Of particular concern to MCT is the undertaking in relation to the Local Carriage Service (**LCS**). MCT believes that acceptance of this undertaking would not only be unreasonable and contrary to the long term interests of end users, but that acceptance of this undertaking would effectively enshrine anti-competitive conduct on Telstra's behalf and provide a disincentive to the economically efficient use of and economically efficient investment in infrastructure. MCT also has concerns about the Unbundled Local Loop Service (**ULLS**) Undertaking.

Corporate Market

It is a clear and undisputed fact that Telstra has market power in relation to the provision of the undertaking services at a wholesale level. This is particularly the case in relation to the LCS service and local access more generally. In 1998 it was estimated that, at a wholesale level Telstra supplied 99.6% of the local telephony market[1]. While there would have been some change to these figures in the interim there is no doubt that Telstra remains in a position of overwhelming market dominance as a wholesale provider of local carriage services.

For reasons which are outlined in more detail in section 2 of this submission MCT considers that there is a clearly distinct market for the supply of telecommunications services at a retail level to corporate and government customers (**Corporate Market**). The Corporate Market is clearly distinguished from the retail market or markets for the

---

[1] Australian Competition and Consumer Commission *Declaration of Local Telecommunications Services* July 1999. Telstra retail services accounted for 94% of this figure and other retailers resupplying Telstra services accounted for 5.6%.

provision of telecommunication services to residential and small business customers. This distinction is clear from both the supply and demand characteristics of the provision of services to these customers. Perhaps the clearest distinction can be seen from the fact that corporate and government customers typically acquire telecommunications services using formal or informal tender procedures and require and receive from providers individually tailored pricing packages which are often bundled with account management and tailored billing services. On the supply side the distinction is clearly observable from the fact that almost without exception retail providers target one or other market exclusively, or target the separate markets by means of distinct business units.

Bundling of Products

A significant characteristic of the Corporate Market is that these customers acquire telecommunications services in a bundle. Typically corporate and government customers will acquire a bundle of telecommunications services including local calls, long distance and international calls, fixed to mobile calls and line rental. The bundle may also include other services such as mobile and data. While many of the inputs into these bundles (for example, long distance and international calls) are subject to effective competition at the individual wholesale product level, local calls and line rental are not.

In addition to being the dominant supplier of local carriage services at a wholesale level, Telstra is also dominant in the supply of bundled telecommunications services (including local calls) to corporate and government customers at the retail level and fights aggressively to maintain and defend this position.

Direct Costs

Telstra's underlying costs of providing local calls to corporate and government customers are substantially below its costs of providing local calls to other customer types. This is due both to the fact that corporate and government customers are predominantly located in CBD and metropolitan areas and also due to the fact that corporate and government customers typically have a dramatically shorter call duration in relation to local calls. This lower cost base for the provision of local calls to corporate and government customers is clearly reflected in Telstra's retail pricing to such customers. Telstra typically charges a rate for local calls to retail customers in the Corporate Market which is approximately two thirds or less of the local call tariff price for local calls for residential and small business customers (ie between 9c and 14c for corporate and government customers as compared to 20c for residential and small business customers).

Single price

At a wholesale level, Telstra refuses to provide an LCS price which differentiates between corporate and government customers and other customer types. This results in a price squeeze on Telstra's retail competitors in the corporate market and enables Telstra to leverage its market power at the wholesale level in order to maintain its dominance of the Corporate Market at the retail level and to stifle effective competition in this market.

Telstra's traditional refusal to provide a competitive wholesale price for the provision of local carriage services to corporate and government customers is perpetuated in the Undertaking by the fact that the undertaking sets out a single LCS price which is not disaggregated either geographically or by reference to retail market. Such an approach is manifestly unreasonable and contrary to the long term interests of end users.

Final Determination

While the Undertaking superficially appears to adopt the pricing posited by the commission in its *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services* October 2003 (**the Final Determination**) the Undertaking, in fact, differs dramatically in impact to the Final Determination for two significant reasons:

- The prices proposed in the Final Determination were stated to form an "upper bound" for negotiation between the parties;

- The Final Determination specifically noted and acknowledged that pricing agreements would vary to take account of individual commercial and economic circumstances.

In combination, these two elements provide sufficient flexibility to allow for a wholesale price which distinguished between supply of LCS for the Corporate Market and supply of LCS for other markets.

Acceptance of the Undertaking would effectively destroy any incentive on Telstra to participate in meaningful negotiations with its wholesale competitors. [redacted]

[redacted]

In formulating its Undertaking it would have been open to Telstra to provide a differentiated LCS price for supply to the Corporate Market. However, it chose instead to use the mechanism of the Undertaking to perpetuate its anti-competitive behaviour of leveraging its power in the wholesale market for the supply of LCS to provide it with an anti-competitive advantage in the Corporate Market.

Efficient use of and investment in Infrastructure

Telstra's behaviour, and if accepted, the Undertaking, has the effect of discouraging efficient use of and investment in infrastructure. Australia has in recent years seen new entrant telecommunications provider collectively invest in excess of $2 billion in telecommunications infrastructure. Many of these operators have either collapsed or experienced significant financial difficulty[2].

The behaviour of Telstra in leveraging its wholesale market power in relation to bottleneck services to provide it with a competitive advantage in retail markets, including the Corporate Market, has been a significant contributor to the inability of new entrant operators, who have made significant investment in infrastructure, to establish successful businesses. This behaviour continues to act as an impediment to the efficient use of existing infrastructure and as a discouragement to future infrastructure investment.

ULLS

The Commission issued a Competition Notice to Telstra on 19 March in relation to the price squeeze produced by its retail broadband pricing. This impacts both on the wholesale price offered by Telstra for xDSL services and on the viability of Telstra's ULLS pricing set out in the Undertaking. In the circumstances, it would clearly be unreasonable for the Commission to accept ULLS Undertaking.

2. CORPORATE MARKET

The supply of telecommunications services to corporate and government customers has many features which distinguish it from the supply of telecommunications services to residential and small business customers. These differences are discussed further in the report by Frontier Economics which is set out as Attachment A. Of particular note are the following:

2 *Painful Sell Off Looms for Telecoms* Sydney Morning Herald, June 30, 2003

- Corporate customers are sophisticated consumers. They typically obtain telecommunications services either by conducting a competitive tender process or by obtaining services from a number of potential suppliers;

- All responses to tender which are submitted by potential suppliers to corporate customers are inevitably tailored to the need of the individual customer and the pricing is individually tailored rather than being a published tariff rate;

- Corporate customers frequently engage intermediaries such as telecommunications consultants in order to assist them to assess the offerings of potential providers. These intermediaries are frequently remunerated by reference to savings which they are able to obtain for the customer from the successful provider;

- Corporate customers for telecommunications services demand and receive individual account management services and tailored value added services such as customised bill configuration or reporting; and

- Corporate customers demand and receive substantial discounts from published tariffs.

Residential or small business consumers of telecommunications services by contrast:

- select from standard, tariffed offerings from potential providers;

- do not receive individually tailored quotes or service offerings from potential providers;

- seldom, if ever, engage intermediaries to assist them to select telecommunications providers;

- do not receive individual account management services;

- do not receive tailored value added services; and

- seldom, if ever, receive discounts off tariffed rates.

These market dynamics are discussed further in the report set out as Attachment B. The contrast in these characteristics clearly indicate that there is low level of substitutability between the telecommunications service offerings provided to corporate and government customers and those provided to residential and small business customers. This in turn indicates that there is a distinct market for the provision of telecommunications services to corporate customers. This is confirmed by the way in which Telstra and others approach the provision of telecommunications services to these customers. Both the price and non price characteristics of Telstra's offerings to corporate and government customers are clearly distinct and distinguishable from its offerings to small business and residential customers.

Telstra's Business Line Plus and Business Line Complete Plans are promoted only to small business customers and mirror the plan structure and promotion of Telstra's residential Homeline Plus and Homeline Complete Products.

In addition, providers typically have either separate business units to address the retailing of services to the corporate market or, as in the case of MCT, chose to focus exclusively on that market.

3. BUNDLED SERVICES

A defining characteristic of the product dimension of the Corporate Market is the prevalence of "bundled" services. Experience shows that virtually no corporate and government accounts are obtained without the ability to deliver a full suite of fixed voice services. That is line rental, local, national long distance, international, inbound and fixed to mobile services are offered as a bundle.

In addition, it is with increasing frequency that customers also require fixed voice services to be bundled with both mobile voice services and/or data services.

There is an increasing prevalence of corporate customers using a formal or informal tender process to determine which telecommunications provider it will ultimately contract with. These tenders inevitably require respondents to provide a full bundle of services[3].

Telstra charges even its mid-sized corporate customers a retail rate for local calls that is well below the wholesale price at which it provides the same services to other carriage service providers. As shown in the spreadsheet set out in Attachment D, the discounted retail rates charged by Telstra are not provided at the expense of increased prices for other services in the bundle, (ie. there is no cross-subsidisation).

Telstra wholesale services are the key input to the downstream retail business packages offered by other competitors in the corporate market. In the majority of cases there is no

---

[3] See also Attachment B.

feasible substitute available for the wholesale LCS and line rental services acquired by MCT and others from Telstra.

4. DIRECT COSTS

As noted above, the market for the provision of telecommunications services to corporate customers exhibits many different characteristics from that of the residential and small business user market. In particular, there are two features which are of specific relevance to the provision of LCS to end users in the Corporate Market:

- The vast majority of corporate customers are located in CBD or Metropolitan areas. Based on the ACCC's figures for PSTN O/T services in 2003/2004, Telstra's PSTN costs in CBD areas are 36% below its average costs and its costs in Metropolitan areas are 25% below it's average costs. Attachment C illustrates that of the [redacted] PSTN lines acquired by MCT from Telstra, [redacted] are in metropolitan areas and [redacted] in CBD areas.

[redacted] The average call duration for local calls made by corporate customers, and therefore the costs which Telstra incurs in providing these services, is very substantially lower than the average used by the ACCC for the purposes of the Final Determination. There is evidence, calculated in relation to a wide cross section of corporate customers over a substantial period, that the average LCS call duration for those customers is approximately [redacted] minutes. [redacted]

The combined significance of these two factors is that the cost base for Telstra in providing LCS calls to corporate customers is far lower than the average across Telstra's customers.

It is possible to extrapolate Telstra's costs of providing LCS to corporate customers using the figures produced by the ACCC in the Final Determination. Taking the approach of doubling the PSTN O/T charge to equate to both ends of a local call. This approach in fact produces an over-estimate of Telstra's costs in providing the LCS service. This is because the PSTN O/T costs include elements for transit switching and transmission which are not, in fact, utilised in the provision by Telstra of LCS. However, this approach would produce the following conservative (i.e. artificially high) cost estimates for the provision by Telstra of LCS to MCT's customer base:

TSLRIC ++ COST OF LCS TO MCT CUSTOMERS	
2003/2004	[redacted]
2004/2005	[redacted]
2005/2006	[redacted]

The calculation of these figures is set out in detail in Attachment C.

4.1 Customer locations

Larger corporate and government customers are generally located in urban and CBD areas of capital cities and larger regional towns. As a result, Telstra's costs of supplying key wholesale inputs (such as local calls and line rental) are substantially lower than is the case for residential customers.

4.2 Call duration

Telstra's costs of providing local calls to corporate customers are also dramatically influenced by the far shorter call duration which is typical of corporate customers. MCT has clear evidence which is set out in Attachment C that the average call duration for local calls made by its corporate customers is approximately [redacted]. MCT understands that the average call duration for local calls across Telstra's whole customer base is approximately 6 minutes.

In spite of the difference in its cost base, Telstra makes no distinction at a wholesale level between pricing for the corporate market and small business/residential customers. At a retail level, however, the pricing it offers for corporate customers is dramatically different to that for residential customers.

In relation to the non-CBD areas, there is an almost total reliance on accessing Telstra wholesale services to meet the overall needs of the corporate customer. Accordingly, in all but the largest capital cities' CBD areas, Telstra controls access to the necessary inputs through the vertical stages of production of end-user telecommunications services. Even in these CBD areas, alternative infrastructure and substitutes for key services are only available on a very limited basis in certain areas and buildings.

4.3 Cost of substitute services

It is informative to note that a number of competitors to Telstra offer wholesale services which are equivalent to the LCS (where customers are directly connected to that competitor's network). The average charge for these services from alternate providers (based on services either currently being acquired by, or offered, to MCT) is approximately [redacted]. This rate consistent with that expected from the application of a cost based pricing approach together with a reasonable mark-up.

MCT also notes that Telstra's own wholesale ISDN local call rate when coupled with the average call duration of MCT's customers produces a cost per call of approximately [redacted]. The costs for the provision of local calls over ISDN are the same or higher than those for the provision of local calls over PSTN. This provides another clear indication that the wholesale price offered by Telstra does not represent a competitive and realistic commercial offering.

We note that the Undertaking Price represents a mark-up of at least [redacted] over Telstra's conservatively estimated (ie over-estimated) costs on a TSLRIC++ basis.

4.4 Avoidable cost approach

Telstra retail rates for the provision of LCS to corporate customers range from 7 cents to 12 cents. The ACCC in its Final Determination takes the view that Telstra's retail costs associated with providing local calls are approximately 6.57 cents per call.

These figures are consistent with MCT's view that Telstra's costs of providing LCS to corporate customers are in the vicinity of 5 cents per call. For example, if one takes a mid-point between the upper and lower range of the retail prices referred to in Attachment D, one is left with a figure of [redacted] cents as a retail rate for the provision of a local call to a corporate customer. The subtraction of retail costs of 6.57 cents produces a figure of [redacted] cents. That is, an underlying cost figure which is consistent with the cost estimates based on the PSDN O/T costs set out in Attachment C and the wholesale prices offered by alternative providers.

4.5 Competition in the corporate market

We note that Telstra has frequently put forward the view to the ACCC that a high level of competition and potential competition exists in relation to the provision of telecommunications services to corporate customers and other customers located in CBD and metropolitan areas. This view has received some support in the past from the ACCC, notably in the de-declaration of LCS in CBD areas. However, it appears to MCT that such a view is entirely inconsistent with the fact that Telstra charges a wholesale price for LCS which:

- is markedly out of kilter with (i.e. more than twice as high) product offerings from competitors which are potentially substitutable for the Telstra LCS service; and
- bears no relation to Telstra's underlying costs of providing the service.

These factors together would suggest that contrary to Telstra's assertions, Telstra does not face substantial competition in the provision of these services and that high barriers to entry exist to the provision of alternative services. They also suggest that Telstra has such a high degree of power in the market that it is able to set the prices without needing to consider the price of potential alternative offerings.

5. RETAIL PRICING

MCT competes actively with Telstra at the retail level in the provision of telecommunications services to corporate customers. As a result it has developed a detailed understanding of the way in which Telstra approaches the pricing of telecommunications services including LCS to corporate and government customers. It is abundantly clear that, while Telstra maintains a headline unbundled rate of 20 cents per local call for business customers, few if any of Telstra's corporate customers in fact pay this rate or anything remotely approaching it. Market intelligence gathered by MCT and detailed in Attachment D indicates that the local call rates offered by Telstra on a retail basis to even small to mid size corporate customers range from 14.5 cents to 9 cents per call. These customers in some instances pay a line rental charge which is slightly above that offered with Telstra's unbundled product. However the impact of this increased line rental on a per call basis is insignificant (ie. less than 0.5 cents per call). An illustration of Telstra's retail pricing approach is detailed in Attachment D.

We also note that the rates offered by Telstra on other call types in conjunction with this bundle are invariably lower than the comparable rates in Telstra's standard tariffs.

The combined effect of Telstra's aggressive retail pricing approach to corporate customers for telecommunications services and Telstra's unwillingness to provide access to LCS on a commercially reasonably rate is likely to have the effect, if it continues unchecked, of substantially lessening competition it is clearly unreasonable for the Commission to accept an Undertaking that would perpetuate such behaviour.

5.1 Direct connection and local call override

The ACCC notes in the Determination that Telstra has raised with it its concerns about the use of local call override. This generally involves the programming of customers' PABX equipment so that it inserts an override code prior to dialling a local call and the local call is subsequently provided using PSTN originating and terminating access. Telstra has expressed concern about growth in the use of this solution. The increasing prevalence of this practice is, of course, hardly surprising given the large and growing disparity between the underlying cost to Telstra of providing local calls to corporate customers and the wholesale price at which Telstra is offering to supply these services to customers such as MCT.

6. IMPACT ON COMPETITION

Pursuant to Section 152AB(e) one of the key objectives to be considered by the Commission in determining whether or not a particular thing promotes the long term interests of end users, is the objective of encouraging the economically efficient use of, and economically efficient investment in, the infrastructure by which listed carriage services are supplied. In the period since deregulation of the telecommunications industry in July 1997 the Commission has, quite properly, placed very substantial emphasis on investment in infrastructure and the encouragement of facilities based competition. However, experience since 1997 has clearly demonstrated that investment in infrastructure and the establishment of alternative facilities is not sufficient for sustainable competition.

This period has seen very substantial investment in infrastructure by companies such as Nextgen, Uecomm, PowerTel, Comindico, FlowCom to name but a few. These companies have collectively invested in excess of $2 Billion in telecommunications infrastructure. However, many of these companies have collapsed or failed to succeed to the extent expected. Without exception they have been harshly judged by the capital markets[4]. While these companies and other new entrants have collapsed, posted huge losses or struggled to break even, Telstra has posted consistent EBITDA results of between $8 and 10 Billion per annum[5]. The reason that these new entrants have struggled to achieve a return on their investments is that they have failed to build an adequate customer base to achieve viable traffic volumes on their respective networks. From this it is plain that the real issue which needs to be overcome in order to create viable and sustainable competition in the telecommunications sector in Australia is the creation of an adequate degree of mobility in the customer base.

---

4 Painful sell off looms for Telecoms, Sydney Morning Herald, June 30 2003

5 www.telstra.com.au/communications/shareholder/financial_summary.cfm

The range of different services required by customers for telecommunication services continues to increase, as does the importance of innovative service offerings such as IP VPN, voice-over IP and third generation mobile services. As the diversity of telecommunication services increases it also becomes increasingly unlikely that a single vertically integrated supplier will be the most efficient provider of all of the services required by a given customer. As new networks are developed many have differing focuses or specialisations and different network providers are likely to be most efficient at providing a particular type of service. Vertically integrated providers however are restricted to providing services to their customers over their own networks whether or not their network is the most efficient at providing a given service. When combined with the inevitable requirement of customers to acquire telecommunication services in integrated bundles to avoid the excessive cost and complexity of acquiring different services from different providers, it can be seen that the existence of a dominant vertically integrated provider has the potential to act as a significant constraint on the efficient utilisation of infrastructure.

It also has the potential to act as a very significant discouragement for further investment in infrastructure as the market and potential infrastructure investors perceive the difficulty of attracting customers away from the vertically integrated incumbent unless they are able to compete effectively in providing all aspects of the bundle of telecommunications services required by potential customers.

This situation is greatly exacerbated where, as is the case in relation to LCS, a vertically integrated operator such as Telstra is able to leverage its advantage as the virtual monopoly provider of LCS at the wholesale level to constrain competition in the retail market. That is, because Telstra is able to obtain a significant price and cost advantage in the provision of LCS to the Corporate Market as compared to its competitors, even where Telstra is not the most efficient provider of other services in the bundles it is able to leverage its advantage in one product to divert traffic and revenue away from potentially more efficient providers of other elements of the bundle.

This also has the effect of denying access to end users to new and innovative product offerings. So long as Telstra can leverage its competitive advantage in the supply of bottleneck services to maintain its market position, there is little or no incentive on it to innovate, and it is able to restrict the uptake of innovative services offered by others.

One example of this restriction on the provision of innovation services can be observed from the fact that, in Hong Kong, xDXL speeds of 6 Mbit/s second are offered routinely. However, xDSL speeds available over the Telstra network are limited to below 2 Mbit/s second.

The role of intermediaries

Intermediaries, such as Macquarie Corporate Telecommunications, play a vital role in a modern sophisticated telecommunications market. Many mechanisms have been established and regulatory structures put into place to ensure that customers are able to access the most efficient and cost-effective provider of any given telecommunication service. These mechanisms include call over-ride codes, multi-carrier pre-selection and number portability. Each customer is theoretically empowered by the telecommunications regime to select the most efficient or otherwise attractive provider of each of the range of telecommunication services which it acquires. For instance, a corporate customer might choose to acquire:

- in-bound services from Carrier 1 because of its high quality intelligent network,
- IP VPN services from Carrier 2 because it has developed a sophisticated and secure IP network;
- long distance IDD and fixed mobile calls from Carrier 3 because it has negotiated the most advantageous rates with international operators;
- local calls from Carrier 4; and
- mobile calls from Carrier 5.

Even for the largest and most sophisticated acquirer of telecommunications services it is unlikely to be time or cost-efficient for that customer to perform the necessary analysis to determine who is the most appropriate provider of each of these services. In addition, the cost of performing such research and analysis together with the operational cost and disadvantages of dealing with multiple suppliers means that such an approach is impractical.

Intermediaries, however, who aggregate traffic from many customers obtain a competitive advantage for themselves and provide a service for their customers by selecting the most efficient wholesale provider of each service type and by acquiring services for its customers from that efficient provider. The economies of scale arising from the large number of customers and the large traffic volume which is dealt with by the intermediary make it cost-effective for it to do so. Intermediaries are forced by their business model to become highly efficient at sourcing individual services from the most efficient provider of that service. Intermediaries thus perform a vital role in the operation of a competitive telecommunication market both because they are able to divert traffic to the most efficient service provider thus maximising the economically efficient use of infrastructure but they also act to facilitate economically efficient investment in infrastructure.

As noted above, the most problematic issue for new entrant facility based operators is obtaining access to customers and traffic volumes. Customer inertia and the market power of incumbent operators make it difficult for new entrant operators to acquire customer base and traffic volume sufficiently rapidly to begin to recoup an adequate return on their investment. This is particularly the case where the new entrant is forced to rely on acquiring individual retail customers. However, the existence of intermediaries in the market creates the potential for new entrant operators to acquire traffic volume quickly and economically without the crippling marketing expense and time delays which are involved in building a retail customer base.

This phenomenon is clearly illustrates by the arrangements put in place between PowerTel and Macquarie Corporate Telecommunications in 2001. Prior to the time at which that deal was done PowerTel had been working to build a retail customer base for a period of some years to utilise its network built at a cost of some $400 Million. The deal between PowerTel and MCT however had the effect of immediately more than doubling the volume of traffic on the PowerTel network and providing Macquarie Corporate Telecommunication's customers with access to PowerTel's technologically advanced network.

Corporate customers are particularly important to the establishment of effective competition in the telecommunication sector given that they generate significant traffic volumes.

Telstra's behaviour in relation to its wholesale pricing of LCS limits the ability of operators like MCT to divert traffic volume to the most efficient infrastructure based provider of a given telecommunications service. This behaviour would be perpetuated by the Undertaking and acceptance of the Undertaking would accordingly run counter to the objective of encouraging the efficient use of, and investment in, infrastructure for the provision of listed carriage services.

7. STATUTORY CRITERIA

In forming the view that the proposed LCS charges are unreasonable, MCT has had regard to the range of matters set out in subsection 152AH(1) of the *Trade Practices Act* 1974 (**the Act**), as follows:

*Whether the terms and conditions promote the long-terms interests of end-users (**LTIE**) of carriage services or of services supplied by means of carriage services;*

MCT considers that acceptance of the undertakings, in particular as they relate to LCS and ULLS would be contrary to the long term interests of end users because:

- it would distort competition in the market for the provision of telecommunication services to Corporate and Government Customers.

- it would inhibit competition in the provision of broadband service and undermine the use of ULLS to provide broadband services.

The legitimate business interests of Telstra and its investment in facilities used to supply the UT Services;

Telstra continues to dominate the telecommunications sector in Australia and to effectively leverage its bottleneck position in relation to key services to damage potentially more efficient providers in competitive service. This behaviour is reflected by the fact that Telstra continues to report massive profits while efficient new entrants which have invested heavily in state of the art infrastructure struggle to make a return on their investment. Acceptance of the undertakings will perpetuate this cycle.

The interests of all persons who have rights to use the UT Services;

Effective competition in the supply of key inputs to the corporate and government sector is essential to the long term interests of end users as it effects not just the corporate and government sector. In the absence of effective competition for the provision of these inputs, inefficient costs are also passed on to other consumers.

Acceptance of the undertakings would perpetuate a price squeeze on providers such as MCT in relation to the supply of LCS to Corporate and Government Customers. This results in a distortion of competition and disadvantages access seekers such as MCT relative to the Telstra retail business units with which they compete.

The direct costs of providing access to the UT Services;

The costs to Telstra of the provisions of LCS to MCT for on supply to Corporate and Government Customers are in the vicinity of [redacted] or below per call. This is due to the comparatively short call duration of calls made by Corporate and Government Customers and the fact that they are generally located in lower cost areas. This cost is comparable to the price charged by alternative wholesale providers (where such services are available) and with the rate that would be derived from applying a RMAC approach to Telstra's prevailing retail rate to Corporate and Government Customers.

8. ULLS

As the Commission is aware, since the submission by Telstra of the Access Undertakings in November 2003, there have been significant developments across a range of telecommunications markets in relation to both wholesale and retail xDSL services.

In particular, on 25 February 2004 the Commission issued an Advisory Notice to Telstra (Pursuant to s.151AQB(1) of the Act) in relation to a price squeeze caused by Telstra's retail pricing of broadband services. This was followed by the issuing of Competition Notice on 19 March 2004. MCT considers that the price squeeze in question relates not only to the wholesale supply of xDSL services by Telstra but also to the supply of ULLS services by Telstra to Access Seekers. Accordingly, the acceptance of the Undertaking in relation to ULLS would perpetrate the price squeeze and is clearly contrary to the long term interests of end users.

MCT notes that the Commission's enquiries and consultations with industry in relation to this matter are continuing. MCT is actively participating in these consultations and devoting considerable resources to assisting the Commission. Accordingly, MCT reserves the right to make further submissions in relation to the issues raised by this matter.

Since mid 2003, MCT has been engaged in significant business planning to assess the commercial viability of deploying a DSL network over the ULLS. However, the viability of such infrastructure investment is undermined by Telstra wholesale rates for the L2TP service at less than $29 dollars (which in itself is subject to a price squeeze as a result of Telstra's recently announced retail pricing). In effect, there is a "price squeeze" between the ULLS undertaking price and Telstra's wholesale and retail rates for the end user service that MCT would seek to compete with. The consequence of such a price squeeze is that users of the declared service or potential users that have rights of access will be effectively prevented from using the ULLS as there will be no commercial incentive to offer DSL services via an access seeker's own facilities during the period of the Undertaking.

At present, xDSL services are the dominant technology that utilises the Unbundled Local Loop core service and indeed they are likely to remain so for the period June 2003 to June 2006[6]. As such, any consideration by the Commission of the ULL Core service Access Undertaking (the ULL Undertaking) will have to address the developments in related

[6] Telstra's ULLS Undertaking of November 2003 is proposed to relate to the 2003/04, 2004/05 and 2005/06 financial years.

telecommunications markets including the abovementioned developments in relation to the wholesale and retail prices of broadband services.

Neither the Commission's Model Price terms and conditions of the core services released October 2003, Telstra's ULL Undertaking nor the Assessment of Telstra's Core Services Undertakings – Preliminary view paper of 12 December 2003 have addressed any of the matters noted above. Furthermore, it is clear that the above developments are of a kind that the Commission is required to have regard to under the "reasonableness" criteria in section 152AH of the Act.

ATTACHMENT A

Defining markets appropriate for Ministerial Direction to investigate competition between Telstra and access seekers who offer services to corporate customers

<u>Commercial in confidence</u>

Report prepared for Macquarie Corporate Telecommunications

9 February 2004

Frontier Economics Network

Frontier Economics Pty Ltd is a member of the Frontier Economics network, which consists of three separate companies based in Boston, London and Melbourne. Each company is independently owned and legal commitments entered into by any one company do not impose any obligations on other companies in the network. All views expressed in this report are the views of Frontier Economics Pty Ltd.

Disclaimer

None of Frontier Economics Pty Ltd (including the directors and employees) make any representation or warranty as to the accuracy or completeness of this report. Nor shall they have any liability (whether arising from negligence or otherwise) for any representations (express or implied) or information contained in, or for any omissions from, the report or any written or oral communications transmitted in the course of the project.

Table of Contents

1. INTRODUCTION

1.1 Ministerial Direction

On 19 June 2003, the former Minister for Communications, Information Technology and the Arts, Hon Senator Richard Alston, issued the ACCC with the *Australian Competition and Consumer Commission (Accounting Separation – Telstra Corporation Limited) Direction (No. 1) 2003* (the Direction) under Part XIB of the *Trade Practices Act.*

The Direction is not concerned with facilities-based competition; its subject matter is the competitive environment that is faced by those who on-sell to corporate business customers services that are purchased wholesale from Telstra. Clause 9(1) of the Direction states that the Commission must report on competition between Telstra and access seekers who are supplied wholesale services by Telstra and who on-sell these services to 'the corporate segment of the business customer group'. The clause directs the Commission to competition in a segment of the retailing of telecommunications services.

Telstra is vertically-integrated in producing a full-range of telecommunications services – including retailing services. But most of its competitors in the retailing function are not facilities-based producers or are only facilities-based producers of a small part of the range of services that they offer to their customers. Instead, they acquire most, or all, of these services from Telstra and compete with Telstra in the provision of retail services. The Direction requires the Commission to report on this form of competition:

> The ACCC must monitor, and prepare a report for the Minister on, competition in the telecommunications industry in relation to the corporate segment of the business customer group and, in particular, competition in that segment between Telstra and access seekers who are supplied wholesale services by Telstra.[7]

In November 2003, the Commission released a Discussion Paper, *Competition in the Corporate Customer Segment of the Telecommunications Market,* in which it invited comment on the definition of markets that might best facilitate the analysis that is required by the Direction. The Commission asks: "In general, are the boundaries outlined in the market definition indicative of the market for corporate customers? (p 11) It also asks: "Do you agree with [the proposition] that the Commission's previous approach to reporting telecommunications markets is appropriate for the corporate customer segment?" (p 12)

[7] Quoted in ACCC, *Competition in the Corporate Customer Segment of the Telecommunications Market,* An ACCC Discussion Paper, November 2003, p 5.

Macquarie Corporate Telecommunications has requested Frontier Economics to write a short report that responds to these questions. This is that report.

1.2 This Report

The Report approaches the question of appropriate market definition in the following way. Section 2 looks at the retailing function. The Commission has analysed telecommunications retail competition in the past; and it has (quite appropriately) distinguished facilities-based competition from competition in the retailing of those services. Although the Commission has made this distinction, it has stopped short of defining separate markets for retailing of telecommunications services. Section 3 argues that the Commission's traditional reluctance to define separate retail markets no longer reflects the nature of retail competition in the market place.

In the recent past, specialist retailers have emerged whose business consists of providing the complete range of the telecommunications needs of a corporation. That is, complementarities of demand seem to be driving these retailers to offer the complete range of telecommunications services that businesses require. These developments suggest that the Commission should amend its traditional approach to defining the markets in which retailers of telecommunications services compete. Section 4 then deals with the issue of whether retailing to corporate customers should be analysed in a separate market from retailing to other categories of customer. Finally, section 5 presents our conclusions.

2. THE RETAILING FUNCTION

2.1 How is the retailing function organised?

A standard problem in the economics of antitrust is how (if at all) the activities of multi-product enterprises should be partitioned into separate markets for the purposes of analysing competition. One clue that should guide the analyst is the way in which the businesses themselves are organised. If they commonly organise themselves into particular divisions or business units, that pattern of organisation is likely to reflect the way those businesses see patterns of competition in the industry.

The retailing function within telecommunications is to put together packages of services that target particular groupings of customers. One might expect that competition in various markets will cause incumbents to become increasingly oriented to the needs of customers. Competition (in Australia and abroad) has enabled the emergence of specialist retailers who devise packages of services that meet customer needs. It has also caused facilities-based service providers to reorganise themselves from product-based divisions into customer-based divisions. In particular, they have developed specialist retailing divisions which offer integrated packages to groups of customers to match competition from the specialist retailers. This form of reorganisation to reflect patterns of competition should be reflected in the market definitions adopted by the Commission.

Consider the activities and business structure of the principal Australian retailers.

Telstra

Telstra has a retailing arm known as Business & Government. It is organised into four business units: small business; business; large corporate & multinational; and government. These business units provide integrated solutions for various categories of business customer. They do not purchase and resell wholesale services other business units within Telstra. Rather, they put forward packages of Telstra services for their different categories of business customer.

Optus

Optus has established a division known as Optus Business. It delvers voice, data and IP services to business, corporate and government clients. Optus Business has nine business units. Three of these aim to provide integrated solutions to business customers: Government & Key; Corporate Business; and Commercial & Engineering. Government & Key targets government departments and agencies and the top 100 corporate customers. Corporate Business targets medium to large corporate and business customers. Commercial & Engineering targets SME business customers.

Primus

Primus claims to offer a complete suite of integrated services – all on one bill; and it targets SME customers: “Primus will stay away from the top 100 corporate market, as this will continue to be the domain of Telstra and Optus. It is concentrating on the more profitable SME market. In the past this market has not been a strong focal point, but this is set to change. The major message here is that the company can offer total business solutions, mainly based on bundled Internet data and voice products. Despite that, the business market, which is composed of only 2% of customers, delivers 33% of revenue.”[8]

---

[8] Primus Telecommunications Australia doc, Paul Budde Communication Pty Ltd, 10/10/2003, 2.02 PM.

Macquarie Corporate Telecommunications

MCT targets corporate and government customers. It claims to provide "total solutions for voice, data and on-line business, with more products than both major carriers combined. Our customers can select from Australia's broadest range of products to find the most suitable solution to their needs."[9]

AAPT

The new CEO of AAPT, Jon Stretch was previously vice-president of AT&T in Europe which he reorganised from product-focussed divisions into customer-focussed divisions. He has introduced some reorganisation in AAPT with the same aim. This includes the merger of the company's separate small business and big business divisions.[10]

In addition to these well-known providers, there are some small-scale providers such as the following:

National Telecoms Group

NTG provides integrated telecommunications solutions to SMEs: "Its bundled solutions include PABX systems, voice and data carriage, least-cost routing platform, unified billing, IT integration, Internet, VPNs and other services."[11]

People Telecom

People Telecom is a specialist retailer. "The company utilises carrier networks, equipment suppliers and other providers, including Telstra, Optus, AAPT, Request and Ozhosting.com; repackages the services under its own brand and provides consolidated billing, an online account management service and enhanced customer services."[12]

It is clear from these descriptions of their retailing activities that retailing of telecommunications services to businesses are undertaken either by specialist retailers or by specialist business units within the large carrier companies. Each of these organisations claims to provide an integrated range of services to cater for the special telecommunications needs of its clients.

---

9 Macquarie Corporate Telecommunications, *Corporate Profile*.

10 Katrina Nicholas, "AAPT's new boss keeps the focus on customers", *Australian Financial Review*, 10/09/2003, p 16.

11 National Telecoms Group (NTG), Paul Budde Communication Pty Ltd, 10/10/2003 3.33 PM.

12 People Telecom Ltd doc, Paul Budde Communication Pty Ltd, 10/10/2003 3.22 PM.

2.2 ACCC Analysis of Retailing Competition

The Commission has been somewhat ambivalent in its definition of retail markets since the introduction of full competition in 1997. Although it has frequently had cause to analyse retail competition, it has always been reluctant to state that it conducting this analysis within the context of a retail market.

The July 1999, *Declaration of local telecommunications services,* contains an extensive discussion of principles of market definition as applied to telco markets. Different services are discussed; competition in the retailing of those services is assessed; but the Commission stops short of saying that its analysis takes place within the framework of a retail market.

The Commission's remarks about local telephony services are representative. The Commission notes that 'the main form of competitive activity' in the local telephony services market is the re-supply of Telstra's services:

> These services are supplied by service providers such as Cable & Wireless Optus, AAPT, Macquarie Corporate Telecommunications, Switch, RSLCom and Primus. That is, Telstra supplies local call services to service providers that then re-supply the services and add retail activities such as billing and customer care services.[13]

Although the Commission is happy to assess degrees of competition at the retail level, it is reluctant to commit to the view that the field of this competition should be called a market. The reason for this reluctance can readily be understood: the dominant player (Telstra) is vertically integrated through its functions of service provision and retailing:

> The fixed local telephony services market involves the supply of local call and line rental services by service providers to end-users. Telstra is a fully-integrated service provider, whereas other service providers tend to be less integrated or only operate at the retail level. In examining the impact of declaration on competition the Commission's inquiries were concerned with the supply of services to end-users and, accordingly, the Commission did not form a view as to whether wholesale transactions would occur within this market.[14]

Although Telstra remains vertically integrated, patterns of vertical integration among other providers are quite complex. As was noted in the previous section, many retailers are vertically integrated into the provision of some facilities-based service. However, the patterns of vertical integration differ markedly among the various retailers.

---

13 ACCC, *Declaration of local telecommunications services*, July 1999, p 59.

14 *Ibid*, p 44.

The Commission's analysis of competition within a field that is not called a market is odd because, as the Tribunal famously noted in *QCMA:* "We take the concept of a market to be basically a very simple idea. A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them."[15]

Of course, patterns of competition change over time; and so market definitions that may be relevant at one point of time may cease to be relevant at some other juncture. Nevertheless, the Commission has continued to analyse retail competition without committing itself to the proposition that, for some purposes at least, it may be appropriate to call the field of retail competition a market.

This is evident from the ACCC's 2001-02 telecommunications reports. *Telecommunications competitive safeguards* contains the Commission's assessment of the progress of competition in various markets. The markets are defined with respect to particular categories of service; and there is no distinction between (wholesale) facilities-based markets and (retail) markets in which services are provided to customers. Despite this reluctance to define separate facilities-based and retail markets, the Commission analyses (within a particular service market) facilities-based competition and the drivers of wholesale prices are analysed independently of the drivers of retail prices.

There is a particular reason why, in response to the Direction, the Commission should define a retail market or markets: it is the most appropriate way to comply with the request of the Direction. The Direction requires the Commission to analyse competition at the retail level. As was noted in section 1.1 of this Report, the Direction requires the Commission to analyse competition at the retailing level among retailers (and Telstra) who provide services to corporate customers. This particular problem may require the Commission to adopt market definitions that differ from those that it has used in analysing other problems. As the Commission noted in the context of applications for declaration:

> In identifying relevant markets, Part XIC of the Act does not require the Commission to take a definitive stance on market definition. Furthermore, over time, declaration itself might affect the dimensions of these markets, particularly in relation to the function dimension. Accordingly, market analysis under Part XIC should be seen in the context of shedding light on how declaration would promote competition rather than in the context of developing 'all purpose' market definitions.[16]

That is, the Commission can define a market or markets that facilitate the analysis of competition that the Commission is required to undertake: the analysis of competition at

15 (1976) ATPR 40-012, p 17,247.
16 ACCC, *Declaration of local telecommunications services*, July 1999, p 30.

the retail level. We agree with the Commission, that it may well be appropriate to utilise different markets depending on the issue that the Commission is required to consider.[17]

3. COMPLEMENTARITIES IN THE RETAILING FUNCTION

3.1 Principles

A common function for retailers in a variety of industries to collect packages of goods or services that will be attractive to the buyers whom they service. This is not a new observation; it was made by Alfred Marshall in *Industry and Trade:*

> The chief functions of middlemen generally are however those of studying the wants of consumers, and the resources of producers; and bringing the two into connection: these functions are important even in regard to the minor requisites of business. But they are almost indispensable in regard to household goods, clothing, etc. For such things must commonly be seen before purchase: and they must be delivered in small quantities to innumerable consumers, often on credit.[18]

This function of retailers in dealing with multiple supplier markets and presenting packages to products or services for retailers has been recognised in the various grocery cases before the Tribunal and the courts. That is, the wholesaler and/or retailer offer their customers a range of products because those customers want to purchase a range of products within the one retail outlet. So competition is analysed in a retail grocery market or in a vertically-integrated grocery market that combines both wholesale and retail functions. The courts and Tribunal have not sought to analyse competition for separate markets for the retailing of milk, the retailing of canned food, or the retailing of shoe polish. They analyse competition among supermarkets because all supermarkets retail a large range of items; and they do so because of complementarities in demand.

A similar issue arose in the *Queensland Wire* litigation in characterising the secondary market in which BHP's purpose could be analysed. The various judgments by the High Court discuss whether that market should be characterised as a star picket market or whether it should be characterised as embracing the full range of rural fencing products (embracing fence posts, wire and other products). Mason CJ and Wilson J preferred to define a rural fencing products market:

> Although Pincus J's finding of an impermissible purpose with regard to excluding the appellant from the star picket post market is adequate to support the finding of

---

17 Maureen Brunt makes the same point in her market definition paper: "'Market Definition' Issues in Australian and New Zealand Trade Practices Litigation" (1991), reprinted in her *Economic Essays on Australian and New Zealand Competition Law,* Kluwer, 2003, pp 185-38, at pp 230-4.

18 Alfred Marshall, *Industry and Trade,* 1st ed 1919, quoted from 3rd ed 1920 p 278.

an infringement of the section, that market is not the most informative one on which to focus. Pincus accepted that "there are great advantages accruing to BHP as a participant in the rural fencing market, by virtue of its being the sole domestic supplier of star pickets" and that "[t]hose advantages … extend well beyond being relatively free from price competition in selling star pickets". The evidence regarding the importance to BHP of being the only supplier of the full range of rural fencing products indicates that it is in the market for rural fencing products where those advantages lie and where BHP's market power is being extended.[19]

The effect of complementarities in demand (or supply) on market definition was dealt with squarely by the Tribunal in the Sydney Airport decision. The Tribunal noted that complementarities in demand or supply were not sufficient to lump goods or services together within the one market. It was also necessary that the complementarities be of a kind that would require most businesses to provide that range of goods or services among which those complementarities were strong:

> The Tribunal was struck by the parallels here with the provision of railway track and train services. Though in the past usually vertically integrated, track services and the running of passenger or freight trains can be, and increasingly are, provided separately. As such, they operate in functionally distinct markets, even though there is perfect complementarity between them. To put it another way, these complementarities do not appear to give rise to economies of joint consumption or joint production that dictate the services must be performed within the same economic entity.

This issue has been considered in the economics literature. The view of that literature is that complementarities (in demand or production) require special forms of co-ordination among businesses. But this co-ordination can take place by means of contract (as is common between apiarists and orchardists) or within an enterprise (as is common in the manufacture of right and left shoes).

In a world of competitive markets, the key factor that determines whether the co-ordination should take place within or across enterprises is that of efficiency. In particular, if the necessary co-ordination can most efficiently be undertaken within an enterprise, the complementarity will be performed within the one economic entity. But if the necessary co-ordination can most efficiently be undertaken across enterprises by means of contract, the complementarity can be achieved in multiple enterprises. So the partitioning of activities into separate markets should ultimately be determined by the relative costs of co-ordinating across those activities by means of contract and compared with co-ordination across those activities within an enterprise.[20]

---

19 (1989) ATPR 40-925 p 50,011.

20 Oliver Williamson has (famously) termed this distinction that of markets versus hierarchy. See O E Williamson, *Markets and Hierarchies,* Free Press, 1975. The point of the above few paragraphs was argued in a highly-influential paper: David Teece, "Economies of Scope and

3.2 Activities of telecommunications retailers: how they are organised

The description of the organisation of the retailing of telecommunications services in section 2.1 above emphasised that the business units that offered retail services to business customers stressed that the services they offered were integrated and the fact that the services were invoiced on a single bill. That is, there are no strong complementarities in supply; but there are strong complementarities in demand and, furthermore, these complementarities in demand are of the kind that all retailers who sell these services to businesses offer a very large range of services.[21]

This leads to the overwhelming conclusion that competition in retailing should not be analysed in separate retailing markets for each separate service. Rather, as with many retailing functions, one of the key roles of the retailer is to secure packages of products or services that will suit the particular needs of the groups of customers whom the retailers elect to target. A key dimension to the way in which retailers compete is in devising packages of products/services that best meet the needs of the customers whom they seek to serve. That is, the emergence of businesses or divisions within larger businesses that specialise in devising packages of offerings that suit particular groups of customers is driven by economic efficiency. It is a characteristic of organisation that is likely to continue.

The complementarities in demand that have forced telecommunications businesses to reorganise according to customer groupings can be analysed separately from the ways in which the prices of these bundles are set. Grocery retailers offer their customers packages of products that are purchased together; but the pricing of a bundle of groceries is usually equal to the sum of the prices of the same products if they are purchased separately. The pricing of bundles of telecommunications products is one issue; but the organisation of the retailing function according to customer type is a feature of retailing in many different industries.

4. ARE THERE SEPARATE MARKETS FOR RETAILING TO BUSINESS AND RESIDENTIAL CUSTOMERS?

On a number of occasions, the Commission has had to consider whether markets should be disaggregated on the basis of the type of customer. This was a key issue in the July 1999 report on *Declaration of local telecommunications services:*

---

the Scope of the Enterprise", *Journal of Economic Behavior and Organization,* vol 1 (1980) pp 223-47.

21 This is not to justify the bundling of services that is not based on efficiencies; but is, rather, based on monopoly power. See ACCC Information Paper, *Bundling in Telecommunications Markets,* August 2003.

> It was suggested during the course of the inquiry that the supply of long distance telephony services should be seen as occurring in separate markets based on the types of customers being supplied with the services. That is, there are separate markets for residential and business end-users.
>
> Information received by the Commission indicates that suppliers consider there to be different demand characteristics for residential and business customers. For example, residential customers tend to take advantage of pricing deals by using over-ride dial codes and purchase calls on a call-by-call basis, whereas business customers tend to make purchasing decisions at the time of entering into a contract with a supplier and tend to take all long distance services from that supplier. It was suggested that, therefore, suppliers have different pricing strategies for residential and business customers.
>
> It was noted that the traffic profiles for residential and business customers are different. The majority of long distance calls by business end-users are made during business hours, while the majority of long distance calls by residential end-users are made outside business hours.
>
> It was also suggested that high quality billing and account management procedures are significant considerations for business customers and that service providers respond to this in their marketing and supply procedures. Billing procedures for residential customers, on the other hand, can take the form of simple correspondence. Furthermore, it was claimed that business customers prefer to purchase long distance services and other telecommunications services from the single supplier, while residential customers are more likely to purchase long distance services and local call service from different suppliers.
>
> The above factors suggest that there may be separate residential and business markets for long distance services. Alternatively, these customers could be seen as separate segments of the same market. The Commission is of the view that, for the purposes of the inquiry, it is not necessary to take a definitive position on this issue. It decided to treat residential and business customers as segments of the long distance telephony services market.[22]

Although this passage points to various differences between residential and business customers, these differences by themselves do not imply different markets. It is common to observe segmentation within markets; and this segmentation is often more-appropriately analysed within a single market than across separate markets. The principles that should guide this decision are the same as those that were proposed in section 3.1 that should guide the decision as to the range of products to be included within the market. That is, are their complementarities (in this case, on the supply side) that cause businesses to straddle both groups of customers?

An example might be that of a cinema. Cinemas commonly offer different prices to different groups of customers; but there are strong complementarities on the supply of

[22] Pages 41-2.

seats at the cinema that cause cinemas to offer the same screenings for students and pensioners as are offered to those who pay full prices.

The same logic can be applied to the characterisation of the retailing of telecommunications services. The specialist retailers and business units within those retailers are principally organised to offer retailing services to business customers. Within those organisations, they tend to be organised by means of a three-fold division: top 100 companies and government departments; medium-sized companies; and SMEs.

It may be argued there is no 'gap in the chain of substitutes' between the telecommunications services demanded by the largest business and those that are demanded by the smallest business. It may even be argued that a small business (such as a specialist retail outlet operated by an owner-manager) may have telecommunications needs that are more modest than many households. Nevertheless, there are two reasons why the Commission should define separate retail markets for business services and possibly even a three-fold division among the retail business market at least for the purpose of this investigation:

- the retailing activities of telcos tend to be organised in this fashion and this organisation reflects the competitive demands of the (retail) markets in which they compete; and

- the Ministerial Direction asks the Commission to focus its attention to competition within 'the corporate segment of the business customer group'.

5. CONCLUSIONS

The terms of the Direction and the previous analysis of the Commission suggest that competition for the supply of telecommunications services to the corporate segment of the business customer group should be analysed within the context of a retail markets for the supply of telecommunications services to business customers. This is further confirmed by the organisation of businesses – with its mix of specialist retailers and facilities-based providers who increasingly dedicate a division or a business unit to the specialist function of providing retail services for businesses.

There are strong complementarities on the demand side for telecommunications services that are provided to businesses. These complementarities are of the kind that retailers of telecommunications services are forced to offer integrated packages through a one-stop-shop. That is, the complementarities in demand are of a kind that compel competition to be analysed within the context of one or more retailing markets. The further subdivision of the business retailing function within telecommunications companies according to the size of the business and the nature of the Ministerial Direction mean that there are two good reasons (at least within the context of this investigation) to define separate markets for the retailing of telecommunications services to (i) top 100 companies; (ii) medium-sized companies; and (iii) SMEs.

Although these definitions are the most appropriate to adopt for the task presented to the Commission by the Ministerial Direction, the reason why they are the most appropriate is, in part, the terms of the Direction itself. If the Commission were confronted with the analysis of other questions, further refinements to the definition of markets may be required.

ATTACHMENT B

[COMMERCIAL IN CONFIDENCE]

ATTACHMENT C

CONTENTS

PART 1 – CUSTOMER LOCATION

MACQUARIE CORPORATE TELECOMMUNICATIONS

TOTAL PSTN LINES - DECEMBER 2003

Area	Lines	%
CBD	[redacted]	[redacted]
Metro	[redacted]	[redacted]
Provincial	[redacted]	[redacted]
Rural	Nil	
Total	[redacted]	[redacted]

PART 2 – CALL DURATION

MACQUARIE CORPORATE TELECOMMUNICATIONS

PSTN LOCAL CALL DURATION

Date	Area	Calls	Minutes	Average Mins/Call	Comments
Feb-04 Non-Telstra	CBD	[redacted]	[redacted]	[redacted]	Non-Telstra itemised data available from billing feeds enables average call duration to be calculated. The most recent three months reflect an average duration of less than [redacted] minutes per call for approximately 80 customers and 600 PSTN lines.
	Metro	[redacted]	[redacted]	[redacted]	
	Provincial	[redacted]	[redacted]	[redacted]	
	Total	[redacted]	[redacted]	[redacted]	
Jan-04 Non-Telstra	CBD	[redacted]	[redacted]	[redacted]	
	Metro	[redacted]	[redacted]	[redacted]	
	Provincial	[redacted]	[redacted]	[redacted]	
	Total	[redacted]	[redacted]	[redacted]	
Dec-03 Non-Telstra	CBD	[redacted]	[redacted]	[redacted]	
	Metro	[redacted]	[redacted]	[redacted]	
	Provincial	[redacted]	[redacted]	[redacted]	
	Total	[redacted]	[redacted]	[redacted]	
3 Months Total Non-Telstra	CBD	[redacted]	[redacted]	[redacted]	
	Metro	[redacted]	[redacted]	[redacted]	
	Provincial	[redacted]	[redacted]	[redacted]	
	Total	[redacted]	[redacted]	[redacted]	

Date	Area	Calls	Minutes	Average Mins/Call	Comments
Oct-03 Non-Telstra	**CBD**	[redacted]	[redacted]	[redacted]	October 03 non-Telstra data was extracted for the LCS negotiation with Telstra and shows [redacted] minutes per call duration previously advised to the Commission.
	Metro	[redacted]	[redacted]	[redacted]	
	Provincial	[redacted]	[redacted]	[redacted]	
	Total	[redacted]	[redacted]	[redacted]	
Total Non-Telstra	**CBD**	[redacted]	[redacted]	[redacted]	MCT believes that the Telstra local call duration would mirror that for non-Telstra customers. This is supported anecdotally by the June 03 Telstra data below.
	Metro	[redacted]	[redacted]	[redacted]	
	Provincial	[redacted]	[redacted]	[redacted]	
	Total	[redacted]	[redacted]	[redacted]	
Jun-03 Telstra	**CBD**	[redacted]	[redacted]	[redacted]	Telstra PSTN local call itemisation for 30 lines obtained in order to resolve a customer complaint.
	Metro	[redacted]	[redacted]	[redacted]	
	Total	[redacted]	[redacted]	[redacted]	

PART 3 – PSTN O/T V LOCAL CALLS

It is useful to consider the elements that form the cost base for PSTN originating and terminating services. These services have a point of interconnection that is remote from the local switch and is provided by Telstra at one of its 66 call collection areas.

In the case of the PSTN originating service, the call is originated at telephone A, is switched across the local switch (LS) and a transit switch (TS) and is delivered to a point of interconnection (POI). This is shown in Figure 1, below.

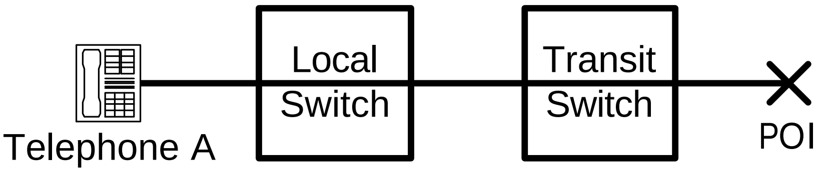

Figure 1 – PSTN originating service

In the case of the PSTN terminating service, the call is collected from a POI, switched across a TS and an LS and terminated at telephone B. This is shown in Figure 2, below.

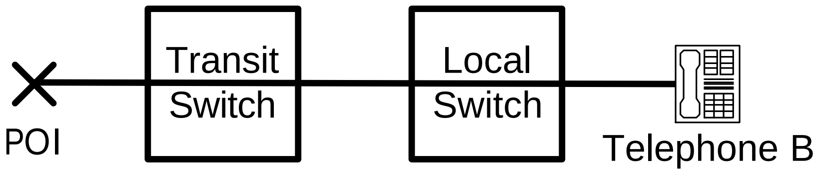

Figure 2 – PSTN terminating service

There are two mechanisms by which a local call can be established.

The first is when the LS for telephone A is distinct from the LS for telephone B. In this case, the call originates from telephone A, is switched across LS A, is switched across the TS, is switched across LS B and terminates on telephone B. This occurs in the case of 75% of metropolitan local telephone calls and 50% of regional local telephone calls.[23]

[23] Telstra press release, 26 February 2000 at http://telstra.com.au/communications/media/mediareleases_article.cfm?ObjectID=4501

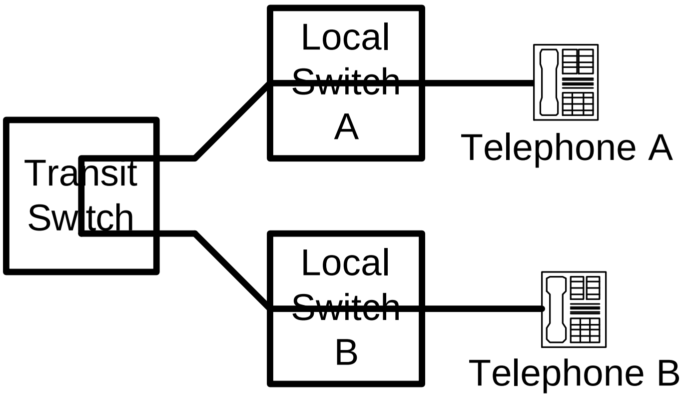

Figure 3 – Local call switch via a transit switch

The second case is when the LS for telephone A is the same as the LS for telephone B. In this case, the call originates from telephone A, is switched across the LS and terminates on telephone B. This occurs in the case of 25% of metropolitan local telephone calls and 50% of regional local telephone calls.[24] A service from Telstra known a "Neighbourhood Call" offer a reduce tariff local call service, if only a single local switch was involved in the establis hment of a call.

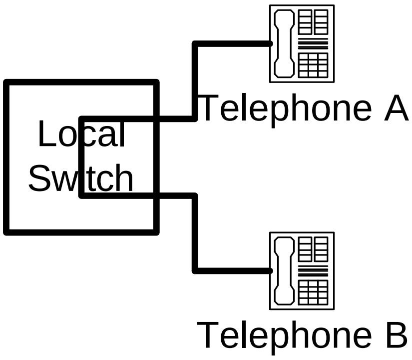

Figure 4 – Local call switch via a local switch

In determining the costs for PSTN terminating and PSTN originating service, the elements of the cost are:

- Access network;
- LS cost per minute;
- Transmission between LS and TS; and
- TS switch cost per minute.

[24] Telstra press release, 26 February 2000 at http://telstra.com.au/communications/media/mediareleases_article.cfm?ObjectID=4501

The cost of a local call switched via a transit switch is:

- Access network x 2;
- LS cost per minute x 2;
- Transmission between LS and TS x 2; and
- TS switch cost per minute.

That is, in the case of local calls switched via a transit switch (75% of metropolitan local calls) is the cost of a PSTN originating service plus a PSTN terminating service less the TS switch cost per minute.

The cost of a local call switched via a transit switch is:

- Access network x 2; and
- LS cost per minute.

That is, in the case of local calls switched via a local switch (25% of metropolitan local calls) is the cost of a PSTN originating service plus a PSTN terminating service less:

- the TS switch cost per minute x 2;
- Transmission between LS and TS x 2; and
- LS cost per minute.

That is, the cost of a local call is always lower than the aggregated cost of a PSTN originating service and a PSTN terminating service, and in 25% of cases (more in non-metropolitan areas) the cost is significantly less.

PART 4 – TSLRIC OF LOCAL CALLS TO CORPORATE MARKET

Year	Area	Percentage of Customers	Call Duration	Flagfall	Per minute rate	Local Call Cost Equivalent	Weighting
2003-04	CBD	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
	Metro	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
	Provincial	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
		[redacted]	[redacted]				[redacted]
2004-05	CBD	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
	Metro	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
	Provincial	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
		[redacted]	[redacted]				[redacted]
2005-06	CBD	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
	Metro	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
	Provincial	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
		[redacted]	[redacted]				[redacted]

The table above shows the estimated costs of the provision by Telstra of LCS to corporate customers in different areas. The estimated costs are calculated using the figures produced by the ACCC in its Final Determination and by doubling the PSTN O/T charge to equate to both ends of a local call.

ATTACHMENT D

RETAIL CHARGES FOR CORPORATE CUSTOMERS

This attachment sets out analysis undertaken by Macquarie in relation to offers made, or pricing provided to a sample of seven customers.

If requested, Macquarie is prepared to provide the Commission with the details of the customers involved. MCT has been informed that Telstra won these accounts on price issues and not non-price considerations.

There are a number of critical issues to note when reviewing this data:

1. The customers involved are medium sizes corporates in terms of their geographical reach, telecommunications spend and public profile. Put simply, they are typical mid sized Australian firms.

2. Volume commitments to be reached to achieve discounts are not a "stretch" in relation to existing volumes. Indeed in a number of cases, you will see that volumes to reach to achieve discounts are less than there existing call profiles. Accordingly, there is no "economy of scale" type factors that allow per unit cost savings to Telstra to flow to the customer through achieving the target – the customer is essentially receiving discounts to existing usage.

3. There is no cross subsidisation apparent in relation to the pricing of each service. By comparing the rates offered with the Telstra SFOA rates, all offerings are considerable below SFOA. Accordingly, there is no "over" standard rate charging to offset the "under" charging.

4. Notwithstanding the fact that Telstra incurs dramatically reduced 'retail' costs when providing services on a wholesale basis, these retail rates for F2M, local call and long distance are in many cases below the wholesale prices Macquarie receives from Telstra. The Telstra retail spend of these customers is range of [redacted]. Macquarie's annual spend with Telstra wholesale is in excess of [redacted].

5. To compete with Telstra in relation to offers of the type detailed in the attachment, MCT is forced to cross subsidise from other products and services not only the inflated wholesale price charged by Telstra for these key, bottleneck inputs but also the retail costs attributable to these services incurred by MCT in providing the services.

ATTACHMENT E

[COMMERCIAL IN CONFIDENCE]