

**Macquarie Corporate Telecommunications Submission in response to the ACCC  
Discussion Paper on the need for PSTN Access Service Pricing**

**February 2003**

Macquarie Corporate Telecommunications (MCT) welcomes this opportunity to comment on the ACCC's Discussion Paper.

**Key Issues**

While the discussion paper is presented in a structured form and poses a number of questions for respondents, MCT believe there are really three key issues in the paper:

1. Is the notion of an access deficit appropriate, and if so should PSTN access service pricing include a contribution to that deficit (i.e. an ADC).
2. If an ADC is to be included in PSTN access service pricing, how should the access deficit be measured.
3. If an ADC is to be included, how should the access deficit be allocated across services, and in particular be allocated to PSTN access services.

This report is structured around these three issues rather than around the specific questions posed by the ACCC. However, each question posed by the ACCC is dealt with by one of these issues.

**The Notion of an Access Deficit**

As defined, the access deficit relating to the provision of the basic access service arises from the imposition of price controls and the consequent shortfall faced by Telstra in not being able to directly recover the relevant line costs from retail customers. In considering the access deficit, account must be taken of the USO arrangements which provide for an industry supported scheme to fund the supply of basic access to "uneconomic" customers.

The USO arrangements define "uneconomic" customers in terms of basic access together with all PSTN call services supported by basic access. By way of contrast the access deficit, as defined, relates only to PSTN lines and does not include any PSTN related services. Hence any cross-subsidy relationship between basic access and any other PSTN services is purely notional.

*Range of services*

Basic access is a particular use of the CAN, and is the dominant access service using the CAN. Other non-PSTN services using the CAN include ISDN, digital data access

services for the carriage of other data services such as frame relay and ATM, and a range of DSL services. Thus in considering the relevant line costs of providing basic access it is necessary to take into account all other such uses of the CAN to ensure that the relevant line costs are “efficient” and include all economies of scale and scope that arise within the Telstra CAN. In this respect, it is likely that without basic access the provision of a CAN for these other uses would be at greater unit cost than a single CAN providing all services.

#### *PSTN profitability and investment*

The ACCC comments on Telstra’s PSTN profitability, with and without the ADC, are noted. As well, even with a WACC below that claimed by Telstra for the PSTN the profitability of the PSTN is maintained.

The ACCC comments on investment in the PSTN are also noted.

It is clear that, even without an ADC and with a reduced WACC, Telstra’s PSTN would still be highly profitable and investment would not be impaired. For the reasons stated above, this analysis should be extended to take into account those other services which use the CAN, and to determine whether above normal profits are also generated by such non-PSTN services. Only by doing so would the full potential benefits of sharing the CAN between PSTN and non-PSTN services be taken into account.

#### *Competitive neutrality*

The ACCC’s comments on whether Telstra charges itself an ADC and on transfer pricing are noted. From this analysis it can be concluded that:

- ❖ Telstra is able to recover its contribution to the access deficit from any of its other services (PSTN and/or non-PSTN), particularly in markets where it may have market power and is able to set prices above “efficient” levels.
- ❖ On the other hand competitors have to pay an ADC directly on PSTN access, while having no power in other markets from which to fund the ADC. The consequence of this is that the ADC charge must flow through to competitors’ end-prices for services which depend upon PSTN access.

For these reasons the current, and proposed, ADC charging on PSTN access is not competitively neutral.

#### *Summary*

The access deficit, as defined, is not specifically related to any other services (PSTN or non-PSTN). It is clear from the ACCC’s analysis that Telstra has sufficient scope to fund any such deficit from its own activities without an ADC being charged to PSTN access services.

Given the profitability of Telstra's PSTN services and the likely profitability of non-PSTN services using the CAN (such as those listed above), together with Telstra's market power and ability to price above "efficient" levels, then the LTIE objective of promoting competition is more likely to be achieved if PSTN access pricing does not include an ADC. For these reasons, the following ACCC comment (last sentence section 6.2) is endorsed:

***If Telstra is able to recover its efficient line costs without the addition of any further contribution to access prices above efficient costs (including relevant indirect costs) and in a way which does not otherwise distort efficient competition and investment outcomes, then the addition of an ADC or other surcharge is unlikely to be justified under the statutory criteria.***

### **Measuring the Access Deficit**

If, however, the ACCC determines that the primary LTIE criteria justify an ADC, that the legitimate business interests of Telstra outweigh the interests of those CSPs using PSTN access, and that a service specific ADC should be charged to PSTN access, then the issue arises as to how to measure the access deficit.

#### *Line costs*

In respect of calculating the "efficient" line costs associated with basic access the following comments are relevant:

- ❖ Use of a computerised model such as PIE or n/e/r/a is appropriate so long as such a model is based on the correct technology and network architecture, and is able to calculate "efficient" line costs. A forward-looking analysis, consistent with TSLRIC for calculating "efficient" call conveyance costs, is preferred.
- ❖ For the reasons set out above, any such model must take into account the full range of services (PSTN and non-PSTN) using the CAN<sup>1</sup>.
- ❖ It is likely that the results from such a cost model will be driven by certain key operational assumptions and data values (e.g. the WACC). These should be determined by the ACCC to ensure they properly reflect the LTIE criteria.

Since the purpose of any cost model is to determine "efficient" line costs, all of the CAN (PSTN and non-PSTN) must be modelled. It is insufficient simply to model the PSTN as a stand alone network since this is not the reality of Telstra's network operations.

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<sup>1</sup> It should be noted that Table 3 of Telstra's *Annual Report 2002* indicates that the published figure for basic access line numbers "excludes basic access lines for our internal use". Such lines must be included in any cost modeling. On the revenue side of the access deficit calculation these lines should be charged at a fully imputed business line rental.

### *Other costs*

The ACCC (section 5.2.1) raises the issue of definition and whether the access deficit should be measured on the basis of fully allocated costs and revenues or attributable costs and revenues.

As stated above, the access deficit can not be directly related to any other specific services and hence any attribution of the access deficit to a specific service is arbitrary. On top of this, the allocation of organisation-level or indirect costs to the access deficit is simply a further arbitrary element.

If the ACCC is to adopt a fully allocated cost approach, it would need to ensure all of the matters discussed above are properly addressed. If not, then it would be more appropriate to adopt an attributable cost approach.

### *Price controls*

At sections 5.1 and 5.2.3 of its discussion paper the ACCC comments on the price control arrangements.

The price(s) at which basic access revenue is calculated should be the maximum price Telstra could charge under the price controls, taking full account of all past failures to exercise the maximum price under previous price controls<sup>2</sup>. In this way, any decision by Telstra not to charge the maximum price is to Telstra's account.

The discussion paper indicates that the ACCC “has not seen any persuasive evidence” that Telstra is underpricing basic access. This should be a matter of fact the ACCC could readily establish by comparing historical actual price increases with maximum permitted prices (already published annually by the ACCC in its report on Telstra's compliance with the price control arrangements, but not cumulated over the whole of the period of the operation of price controls). MCT should encourage the ACCC to collate and publish in a single source this annual data together with the cumulative data.

The ACCC also suggests that under current price controls and maximum pricing, any access deficit would be “comfortably” eradicated within five years. This raises the question whether the access deficit is a long-term issue or whether it is simply one of transition. This is relevant to the consideration of the time frame appropriate to the long-term interests of end-users.

### **Allocating the Access Deficit**

Should the ACCC determine that the access deficit is to be allocated to specific services then it must determine the basis for that allocation.

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<sup>2</sup> This impacts the starting price(s) to which current and future price controls apply. Failure to exercise the maximum price under earlier price controls simply lowers the starting price, resulting in a higher access deficit.

### *Allocation*

To date, the ACCC has determined that the ADC is to be calculated on the basis of a 50:50 allocation between PSTN calls and minutes (including PSTN access). In the discussion paper the ACCC indicates this allocation is somewhat arbitrary, as would be any other combination of calls and minutes.

Arising from the definition of the access deficit, any revenue shortfall in basic access occurs on a line basis. Consequently, if a service specific approach is to be adopted to calculating the ADC it would appear more appropriate to allocate the access deficit on a line basis rather than on a calls/minutes basis. For example, the average ADC per line could be calculated and CSPs acquiring PSTN access could pay an ADC on each pre-selected line.

The ACCC also raises the possibility of an allocation based on an “inverse-elasticity” approach. While this has some theoretical merit it requires reliable estimates of price elasticities. If the ACCC was to pursue this approach, such elasticities should be estimated on the basis of retail demands (as noted by the ACCC), and must correspond to current and actual retail services in Australia.

### *Local call surcharge*

The notion of the “local call surcharge” arises from Telstra’s claim that the price controls on local calls mean that local call revenues can not cover both TSLRIC call conveyance costs and the ADC proposed by Telstra.

The views of the ACCC on this matter are fully supported. The following comments are intended to support these views:

- ❖ Local calls should not be viewed as a single homogeneous product. Rather, there are two types of local calls – voice and dial-up ISP. They have very different average call lengths, different hourly distributions and use different combinations of network elements<sup>3</sup>. Further, Telstra appears to differentially price voice calls<sup>4</sup>.
- ❖ Consequently, it is likely that the price(s) of voice local calls readily cover the TSLRIC of such calls plus the current ADC. However, it is also likely that the price(s) of dial-up ISP calls do not cover the corresponding TSLRIC plus the ADC.

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<sup>3</sup> MCT’s experience is that voice calls average less than 2 minutes. It is MCT’s understanding that the majority of voice calls involve business customers and subsequently occur during business hours, whereas the majority of dial-up ISP calls involve residential customers and occur outside business hours. In regard to network elements, most voice calls are likely to involve the use of basic access at both ends whereas dial-up ISP calls only involve basic access at the originating end.

<sup>4</sup> It would be expected that most LNC (local neighbourhood) calls are voice. As well, the differential prices for business customers are clearly for voice calls.

- ❖ If Telstra is concerned about the overall price of local calls covering TSLRIC plus the ADC, it should direct this concern to the source of the problem, i.e. dial-up ISP calls. Any shortfall should sought to be recovered from the beneficiaries of these calls, and not from unrelated call services such as PSTN access. Apart from the A-party end-users, the beneficiaries of dial-up ISP calls are the ISPs themselves<sup>5</sup>. Since most ISPs are directly connected to the Telstra network, Telstra has the opportunity to recover the “local call surcharge” through network connection charges and internet interconnection services. Given the overall profitability of the PSTN, as identified by the ACCC, it is possible that Telstra is already adopting this approach.

These reasons add to those contained in the ACCC discussion paper and reinforce the view that there is no justification for any “local call surcharge” to apply to PSTN access pricing.

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<sup>5</sup> It is understood that Telstra operates the largest ISP and therefore gains most from dial-up ISP calls.