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## Review of Telstra Price Control Arrangements

Macquarie Telecom Pty Limited (“**Macquarie**”) appreciates the opportunity to comment on the review of the price control arrangements which apply to Telstra that is being undertaken by the Australian Competition and Consumer Commission (“**ACCC**”).<sup>1</sup> Macquarie has set out herein its general comments on retail price control arrangements followed by its responses to the questions raised in the Discussion Paper.

### General Comments

Macquarie is a strong advocate of competitive retail markets and lower prices for consumers. Macquarie believes that the best way for this to be achieved is via appropriate policy and regulatory intervention in upstream (wholesale) markets. Ensuring that competitors have access to wholesale services on fair terms and conditions will allow competitive service providers to compete effectively with an integrated Telstra. This in turn will enable market forces to set retail prices.

Further, Macquarie believes that if the wholesale market is working effectively, i.e., that competitive service providers have access to the wholesale services that they demand and are supplied as required and at appropriate prices, there should be no need for retail price controls to ensure lower consumer prices. That is, any remaining price controls in downstream markets would only be justified to achieve specific social policy objectives.

As acknowledged in the Discussion Paper, retail price controls as they apply to Telstra are designed to protect consumer interests by ensuring that retail prices are not excessive given Telstra’s market power. While this is an important policy objective, retail price controls do not promote competition *per se*. Macquarie submits that the evident failure of effective competition to emerge in fixed telecommunications services is primarily a result of a sub-optimal sector structure. That is, Telstra is an integrated retail / wholesale operator and, as such, has no incentive to act as a willing wholesale service provider. The deep seated problem with sector structure is of course being addressed by the Commonwealth’s NBN policy under which NBN Co will be a “wholesale only” operator and Telstra will be functionally

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<sup>1</sup> ACCC, Review of Telstra Price Control Arrangements - Discussion Paper, January 2010 (“**Discussion Paper**”)

(if not structurally) separated. It is also being tackled through the regulatory reforms set out in the Competition and Consumer Safeguards Bill which is presently before the Federal Parliament.

In this context, there are fundamental limitations on the extent to which retail price controls can drive competition and address Telstra's market power. Macquarie is concerned that retail price controls may in fact harm competition if they result in a margin squeeze. This would occur, for example, if retail prices were to decrease while wholesale prices remain unchanged. As such, Macquarie cautions that possible changes to the current retail price control arrangements must not harm competitive service provision.

#### Responses to Discussion Paper Questions

This section responds to each of the questions set out in the Discussion Paper. For ease of reference, each question is reproduced in *italics* followed by Macquarie's response.

*Are any of the current price controlled markets now sufficiently competitive to warrant the removal of price controls on the relevant telecommunications service?*

No. The current price control arrangements apply to range of services provided by Telstra which use its fixed network or PSTN. Price controls have been applied to Telstra's fixed services because Telstra has historically been the sole supplier of such services and since market liberalisation began in the late 1980s, competition has not yet fully developed.

It is evident that competition in fixed network services is not sufficient to relax the fixed network service price control arrangements which apply to Telstra. In particular, Macquarie notes that despite it being more than 10 years since market liberalisation, Telstra has a fixed services revenue based market share of 71.9 *per cent*<sup>2</sup> which of itself demonstrates that competition has not developed in this market.

Telstra has market leadership (if not dominance) in Australia's markets for fixed, mobile, Internet and Pay TV services. As such, Macquarie considers that there is a considerable risk that Telstra could set excessive retail prices for fixed network services. As this would be detrimental to the interests of consumers, Macquarie is of the view that price control arrangements should continue to apply to Telstra's fixed network services. However, such price controls could be gradually removed as other regulatory interventions are implemented. Such interventions may include:

- the functional (or structural) separation of Telstra;
- empowering the ACCC to set up-front prices for wholesale services; and
- resolving on fair terms the current problems with the pricing of fixed access services.

Price controls for particular social policy objectives such as to provide protection for low-income consumer groups, would be retained.

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<sup>2</sup> JP Morgan, Australian Telecom Sector in 2008, 16 April 2009, pg 13



*Having regard to the level of competition, are there any telecommunications services that should be subject to price controls that are not within the scope of the current arrangements?*

No. Macquarie believes that the scope of the current price control arrangements should not be expanded to include other services such as fixed broadband services and mobile services. Macquarie reiterates its view that effective regulation in upstream markets is the best way to ensure competitive retail markets and lower consumer prices.

*What impact, if any, have the current price control arrangements had on the development of competition in telecommunications markets?*

The retail price controls protect consumer interests by ensuring that Telstra does not set excessive prices for fixed network services. As such, the retail price controls are not intended to promote competition *per se* thus there should not be an expectation that the price control arrangements would, on their own, develop competition.

There are two inescapable facts:

- retail price controls have applied to Telstra's fixed line services since market liberalization began in the late 1980's; and
- competition has failed to develop in the fixed services market.

These facts suggest that retail price controls, in and of themselves, have had a negligible impact on the development of competition. However, Macquarie is of the view that it is more the case that the price controls have protected consumer interests and that fixed service competition has failed because of a sub-optimal sector structure.

*What affect do the current price control arrangements have on the availability and/or choice of telecommunications services?*

Macquarie believes that the current price control arrangements have ensured that fixed services, in particular line rental and local call charges have become increasingly affordable for Australian consumers. In particular, the price controls have protected the interests of consumers by ensuring that Telstra does not set excessive retail prices.

*Are the current price control measures that allow credits for quality improvements necessary, and if so an effective means, to ensure the quality of price controlled services can be maintained or enhanced? What alternative means should be considered?*

Macquarie believes that quality improvements in service are important to consumers and should be encouraged. The quality of service credits in the price control arrangements provide an incentive for Telstra to improve service quality. Accordingly, Macquarie supports the quality of service credits.

*What impact, if any, do the current price control arrangements have on economically efficient investment in telecommunications markets?*

It is possible that retail price control arrangements can distort investment incentives in particular markets, or market segments. Macquarie does not believe, however, that existing retail price control arrangements are having a permissive effect on investment in particular market segments. It is possible, however, that future price control arrangements could negatively impact on the incentive for access seekers to continue to invest in telecommunications infrastructure to compete with Telstra. This could be the case, for instance, if too many retail services are included in retail price control arrangements; and/or onerous retail price obligations are imposed on Telstra without corresponding (and concurrent) improvements being made to the terms and conditions upon which competitive service providers are able to acquire access to Telstra's network.

*What role, if any, do the restrictions on line rental charges have on investment in telecommunications markets? Has this changed over the course of the price control arrangements as line rental and call charges have been rebalanced?*

The incentive for competitive service providers to make investments in the provision of fixed services is a function of the available margin, i.e., the difference between the retail price and the wholesale cost. Telstra's price sets the market price which competitive service providers must follow. The level at which retail prices are set by Telstra (within the boundaries of retail price controls) is of little concern to competitive service providers provided that wholesale costs allow realistic margins. In other words, Macquarie believes that retail price controls which are driven by the pursuit of policy objectives need to be supported by responsive wholesale pricing.

*Are there any other important ways in which the current price controls impact on economically [efficient] investment in the telecommunications market?*

Macquarie has no further comment to make concerning investment in telecommunications.

*What services should be subject to price control arrangements? Submitters are asked to separately consider local access services (line rental and local calls), FTM calls and other PSTN calls types.*

Macquarie previously commented on fixed to mobile price controls in its submission to the Department of Broadband, Communications and the Digital Economy on regulatory reform.<sup>3</sup> In particular, Macquarie expressed the view that a sub-cap on the price of fixed to mobile ("FTM") calls would be desirable as a means of ensuring that a reduction in the mobile terminating access service ("MTAS") charge would be passed on to consumers. In principle, Macquarie maintains this view.

Further, and as the ACCC is well aware, Macquarie maintains its very firm view that MTAS charges ought to reflect the costs of provision of that service as determined by the ACCC's recent access pricing review. However, Macquarie wishes to emphasise that its support for the inclusion of an FTM sub-cap is on the basis that Telstra would be obliged to reduce retail

<sup>3</sup> Macquarie, Submission in Response to National Broadband Network: Regulatory Reform for 21<sup>st</sup> Century Broadband Discussion Paper, RG 060901, 3 June 2009

FTM prices only when the MTAS charge is reduced in line with the ACCC's cost modelling and not at other times.

Macquarie is concerned that Telstra's pricing of national directory assistance services (calls to 1223) may not be efficient. Calls to 1223 are free to Telstra's residential fixed line customers while Telstra's business line and mobile callers are charged 44 cents. Macquarie suggest that it would be appropriate for the ACCC to consider whether such charges should be subject to some form of price controls and if it is appropriate for different groups of customers to pay different prices for the same service.

*Should price caps apply to individual or baskets of services? How should any baskets be constructed?*

The make-up of baskets of services in a retail price control regime is inherently complex. It involves *inter alia* a detailed understanding of the prices and the underlying costs of different services and their interdependencies. Macquarie reiterates its view that retail price controls could largely be removed and indeed simplified if effective upstream regulation (such as the functional separation of Telstra) was in place.

*What efficiency improvements if any should be required by the price controls? For instance, if the price controls take the form of a CPI – X cap, what value should X be set at?*

As noted above, Macquarie is concerned that competition may be harmed if retail price controls result in a margin squeeze. This could occur if X is set too high while at the same time there is no corresponding and concurrent activity to resolve existing problems in the upstream market.

As acknowledged in the Discussion Paper, Telstra has been reducing prices by more than that which is necessary to meet its existing price control reductions. This suggests that there is no need for future price control arrangements to have a higher level of X.

Macquarie submits that if Telstra was functionally (or structurally) separated and there was effective upstream regulation, retail price controls could be simplified to a "safety net" device. If this was the case, X could be set at 0.

*Are there any areas in the current retail price control arrangements that could be streamlined?*

Macquarie reiterates that the current price control arrangements could be simplified or largely removed if Telstra was functionally (or structurally) separated and there was effective upstream regulation.

Closing

Macquarie believes that competitive retail markets and lower prices for consumers are best achieved by appropriate policy and regulatory interventions in upstream markets. While Telstra remains vertically integrated and problems persist in the upstream market, retail price controls which apply to Telstra's fixed services must remain in place. However, such controls could be simplified or largely removed if Telstra was functionally (or structurally) separated and there was effective upstream regulation.

Please do not hesitate to contact me should you have any queries on this submission. Macquarie would be pleased to elaborate on its views in a face to face discussion with staff of the ACCC.

Yours sincerely



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