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Dear Michael

Model price terms and conditions for PSTN, LCS and ULLS

Optus is grateful for the opportunity to provide comments on the ACCC's draft determination on model price terms and conditions (including indicative prices) for PSTN, LCS and ULLS. We believe the content and timing of the ACCC's decision on indicative prices will have a significant bearing on our commercial negotiations with Telstra.

In the ACCC's paper, it indicates that it could reconsider elements of its position on the indicative prices depending upon receiving commitments from Telstra. This provides considerable commercial uncertainty. Optus recommends that the final determination states clearly and publicly a deadline for receipt of those commitments.

This letter provides Optus' comments in response to the draft determination for each service.

PSTN

In its draft determination, the ACCC has proposed a price path for PSTN access that is initially higher than what was expected but declines at a faster rate than was previously modelled. This is apparently based on the ACCC's draft decision to remove that access deficit contribution (ADC) on PSTN in a shorter period than would be expected based on Telstra's line rental rebalancing.

Optus is heartened by the ACCC's acceptance of the fact that the current ADC approach distorts competition in downstream markets for international, long distance and fixed to mobile call services (page 46). Optus welcomes any approach to remove the ADC in a shorter period.

However, Optus does not believe that the price path proposed by the ACCC in its draft determination achieves the objective of lessening the distorting effect of the ADC. This can be seen by comparing the rate at which the ACCC is proposing the ADC be removed and the rate at which it was previously modelled to be removed. The table below compares the two scenarios and shows that in net present value terms the level of access deficit paid by access seekers to Telstra will in fact be greater under the ACCC's proposal.

ADC glide path	2003/04	2004/05	2005/06	2006/07	2007/08	**NPV**
ACCC proposal to remove ADC by 2006/07	0.55	0.45	0.3	0	0	**1.17**
Existing path for removal of ADC based on Telstra rebalancing	0.41	0.31	0.21	0.12	0.03	**0.96**

In effect, this means that access seekers (and hence consumers of long distance services) would be worse off under the ACCC's proposal and Telstra would be considerably better off. Optus believes that this is entirely inconsistent with the long-term interests of end users and inconsistent with the ACCC's view that the ADC should be removed in a shorter time period.

In its draft determination the ACCC indicates that, whilst it favours the immediate removal of the ADC, it must balance this against the legitimate commercial interest of Telstra, which has business plans based on currently negotiated or previously determined rates. Optus does not believe that increasing the ADC recovery in 2003/04, 2004/05 and 2005/06 is necessary to satisfy Telstra's commercial interest. Its plans would logically have been based on the existing glide path for the ADC. Optus therefore believes that indicative rates for these years should, at most, be based on the existing path for removing the ADC, and the ACCC should no longer accept any ADC by 2006/07.

Whilst Optus understands that the ACCC would like to encourage access undertakings for PSTN access, its current proposal has a serious detrimental impact on the commercial interests of access seekers.

Optus believes that the ACCC has also given too much consideration to deals entered into by other parties. This is not a relevant consideration and fundamentally conflicts with the principle that the access regime should support diversity within commercial agreements.

The ACCC should also recognise in its final determination the impact of its indicative prices on access seekers with PSTN call lengths that differ from the average. These differences will have a significant impact on the trend in PSTN rates paid by access seekers as a result of the indicative prices released by the ACCC. Specifically, the ACCC's contention that "even though the access prices would initially be higher than if calculated on the basis of the current ADC, they would still be lower that (sic) the access prices currently negotiated commercially or previously determined" (page 50) may not hold.

Optus believes that these concerns could be addressed by the ACCC including a statement in its final determination which indicates that, subject to the proposed indicative prices not improving the rates paid by a specific access seeker, the ACCC would encourage a uniform reduction in existing prices over the next 3 years to remove any ADC. This will help to ensure that the ACCC's objectives are met, without adversely impacting specific access seekers.

PIE 2 model and other PSTN issues

Optus continues to have material concerns with the underlying architecture, assumptions and methodologies contained in the PIE 2 model. To the extent that it is being used at this time to present non-binding indicative prices, it may be appropriate for the ACCC to use this model. However, we believe the ACCC's final determination should retain the possibility for the model to be amended (and hence the indicative prices to be adjusted) if a binding decision is to be made. Optus is presently undertaking a detailed assessment of the PIE 2 model and will present its analysis to the ACCC in due course.

The ACCC has indicated that it does not propose an adjustment factor, beyond reductions in the access deficit, to be applied to the conveyancing cost of PSTN access prices. Instead it proposes to set prices based on a re-run of the PIE 2 model using updated traffic and volume estimates. Optus notes that this is only appropriate if the starting asset values for each year are reduced in line with appropriate price trends. It is not clear that the PIE 2 model contains this functionality.

Optus does not have any material concerns in relation to the service description offered by the ACCC.

LCS

Optus maintains that a competitively neutral price for LCS is critical to competition in long distance, international and fixed to mobile call services. Optus believes that the ACCC's indicative prices for LCS distort competition in favour of Telstra and reduce access seekers' ability to discount local call services.

We will shortly provide to the ACCC a report prepared by n/e/r/a that elaborates on Optus' arguments in favour of competitive neutrality in access prices. It provides a recommendation to "apply retail minus to each of Telstra's optional local calling plans to derive a number of different LCS price structures for access seekers to choose from."

Optus fully supports this recommendation and encourages the ACCC's to adopt this approach in its indicative prices and its pricing principles for LCS.

In addition to issues around the starting price for the retail (price) minus costs approach to LCS, a precise and correct estimation of retail costs is essential in determining the correct access price. Optus maintains that the ACCC acceptance of Telstra's revised retail cost study ignores:

- The capacity for Telstra to manipulate the RAF allocations in order to minimise any estimates of avoidable retail costs derived from them.

- Telstra's ability to 'learn' through the previous adjustment process, in order to reduce the scope for such adjustments in future cost studies. For example, Telstra could respond by simply minimising its allocations to RAF retail across all products rather than simply basic access and local calls.

Optus believes there is evidence to support Telstra's capacity to adjust the RAF for the purposes of improving its LCS retail minus calculation. For example, we note that between the independently verified 1999/00 retail costs analysis and the Telstra analysis of 2001/02, Telstra retail costs have fallen by CPI – 11% per annum. Such productivity improvements are not supported by any independent analysis. In contrast, the ACCC's own methodology for rolling forward the 2001/02 retail costs to provide indicative prices for 2003/04 assumes a CPI – 5% - a much lower implied cost saving.

Whilst Optus has been provided with some confidential information on Telstra retail costs, we believe the level of disclosure will not provide sufficient opportunity for meaningful analysis of the cost allocations. We have separately written to the ACCC requesting further information to support an independent analysis. Without this information Optus would call into question the procedural fairness of using Telstra's retail cost analysis. Optus is presently reviewing the limited confidential information provided and will provide its analysis in the context of the ACCC's assessment of Telstra undertakings.

Notwithstanding this analysis, we would also request that the ACCC undertake its own analysis of Telstra's top 10 account categories to independently audit and verify that any reductions in the size of these cost categories within the basic access and local call accounts are reflected in all other RAF accounts. Any significant change in cost allocations should be investigated.

In the meantime, Optus believes that it would be appropriate to roll forward the 1990/00 retail cost study for the purposes of setting indicative prices and until such time that other parties are consulted on Telstra's retail costs. Whilst Optus holds significant reservations about using CPI as a cost basis for rolling forward retail costs (we believe average weekly full time earnings better reflects the fact that retail costs have a significant labour component), using the ACCC's own CPI – 5% measure to roll forward retail cost and set indicative prices would seem to be a reasonable compromise.

Optus also believes that:

- The full scaling up of costs in Telstra basic access and local call accounts on the basis of other RAF retail product categories remains appropriate and is the only check and balance on Telstra's RAF accounting.

- It is inappropriate to add specific wholesale cost to LCS prices. This would be a fundamental shift from the retail (price) minus cost approach that the ACCC has presently endorsed for LCS.

- A cost based calculation of a local call price should not include an access deficit charge.

- Call override is a separate issue to the pricing of LCS and has been overstated by Telstra.

ULLS

Optus welcomes the ACCC's revised approach to ULLS. The significant reductions in access prices will have a significant effect on the market for broadband services in metropolitan areas and will encourage facilities based entry and competition.

If you have any queries in relation to the submission please call me on 02 9342 9109.

Yours sincerely

Paul Fletcher
Director, Corporate and Regulatory Affairs