

**Optus Submission to**

**ACCC**

**on**

**Review of Telstra Price Control Arrangements**

**February 2010**

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## 1. Overview

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- 1.1 The retail price control (RPC) regime has been imposed on Telstra's retail prices for over 20 years with the underlying intention of protecting consumers from excessive prices during the transition toward effective competition. Many retail telecommunications markets in Australia were not effectively competitive, stemming from a lack of competition in the wholesale market - that is, Telstra's ownership of the ubiquitous fixed-line local access network.
- 1.2 Whilst Telstra still retains its dominant position in fixed line services there has been investment in new infrastructure and entry of competing wholesale and retail providers. Notable market developments over the last 5 years include the following:
  - Increase in the number of retail and wholesale service providers;
  - Fixed-to-mobile (FTM) substitution in the voice telephony market;
  - Growth in wireless technologies;
  - Significant reduction in service prices;
  - Competition in metropolitan areas; and
  - New legislative reforms that will address the wholesale access regime and streamline the dispute resolution process
- 1.3 These developments imply that the original rationale for RPCs is no longer valid and there is a strong case for their removal. If they are not removed completely, at the very least they should be relaxed as the continued application of a restrictive price control regime will only stifle and distort future investment decisions to the detriment of competition and the long-term interest of consumers
- 1.4 Enhanced competition, as opposed to Government imposed price caps, is the best way of delivering improved outcomes for consumers. However it is important to recognise that competition in the fixed-line market rests heavily on access regulation. The way to facilitate enhanced competition is therefore to focus regulation on the wholesale access level and not the retail level.
- 1.5 Optus notes that although the level of competition has increased in the past 20 years, the wholesale market structure and associated regulatory framework are still subject to a number of serious deficiencies. It is this area of the market where the Commission should focus its intervention to facilitate the delivery of improved outcomes for consumers.
- 1.6 This submission is structured into the following sections:
  - Section 2 briefly reviews the purpose of the price controls;

- Section 3 provides an overview of the current state of the retail and wholesale telecommunications market, illustrating the increased level of competition;
- Section 4 outlines the economic rationale for removing retail price caps; and
- Section 5 outlines a number of reform options.

## 2. Background

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### *Description of the RPCs*

- 2.1 The retail price control (RPC) regime has been imposed on Telstra's (or that of its predecessors) retail prices since 1989, with the underlying intention being to protect particular groups of end-users from excessive prices during the transition toward effective competition in the retail and wholesale markets.
- 2.2 The current price control arrangements apply to Telstra until 30 June 2010 and set limitations (i.e. price caps) on allowed price increases for various baskets of services. Included services are line rental, connection charges and calls (local, long distance and international).

### *Purpose of the RPCs*

- 2.3 The RPC regime is intended to limit Telstra's use of its market power by preventing it from setting prices at monopoly levels for services where competition is not yet fully developed.
- 2.4 The specific objectives that the price control arrangements were intended to achieve including the following:
  1. To allow Telstra greater freedom to rebalance line rentals while protecting consumers from 'rate shock' caused by excessively rapid rebalancing;
  2. To promote efficiency in markets not yet effectively competitive and the passing on of benefits to consumers;
  3. In accordance with Government policy, to protect low-income consumers from any adverse effects of line rental increases;
  4. To ensure that consumers in rural and remote areas share in the benefits from greater competition in telecommunications; and
  5. To meet other equity objectives.<sup>1</sup>
- 2.5 In applying this legislation the ACCC has previously noted that there are two broad objectives of price control arrangements, that is:
  - To promote the efficient pricing of telecommunications services, and
  - To achieve certain social policy objectives.<sup>2</sup>

### *Background to the current inquiry*

- 2.6 The Minister for Broadband, Communications and the Digital Economy directed the Commission to hold a public inquiry about the nature of price

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<sup>1</sup> *Telstra Carrier Charges - Price Control Arrangements, Notification and Disallowance Determination No. 1 of 2002, Telecommunications (Consumer Protection and Service Standards) Act 1999*

<sup>2</sup> ACCC, *Review of Telstra's price control arrangements*, Final report, February 2005, page 13.

control arrangements that should apply to Telstra from July 2010 to 30 June 2012. The review is designed to be an interim measure as pricing policy for the subsequent period of transition to the new NBN will be considered in a separate review:

*“I direct the ACCC to have regard to the intention that price controls for legacy telecommunications retail services will remain in place for a further two years, during which time consideration will be given to the impact the transition to the new National Broadband Network environment will have on pricing policy.”*

- 2.7 The ACCC has been direction to report back to the Minister by 12 March 2010.

### **3. The current state of the wholesale and retail markets**

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- 3.1 Whilst Telstra continues to be the dominant supplier of fixed voice services in both wholesale and retail markets, the opening of Telstra's local copper loop to competition has stimulated investment in fixed line voice and broadband services by encouraging carriers to move away from resale-based access and install their own infrastructure
- 3.2 The market has been opened up via investment in new infrastructure and entry of competing wholesale and retail providers, and consumers benefited with improved quality of service, increased competition, lower prices and greater innovation.
- 3.3 In this section Optus details the current state of the wholesale and retail markets noting recent market developments since the last RPC review, including;
- An increase in the number of retail and wholesale service providers;
  - Fixed-to-mobile (FTM) substitution in the voice telephony market;
  - Growth in wireless technologies;
  - Significant reduction in service prices; and
  - Competition in metropolitan areas.
- 3.4 Accompanying these market changes the Government has proposed new legislative reforms to address the wholesale access regime and streamline the dispute resolution process.
- 3.5 Optus believes that in aggregate these developments illustrate that competition has developed at the retail level such that the price controls can now be removed.
- 3.6 However it is important to note that this competition relies heavily on there being effective access regulation. In this regard the present regulations are still subject to a number of serious deficiencies. Although such issues are outside the specific scope of this review, the wholesale market is relevant as it is a closely related market. It is also relevant as the existence of an effective wholesale market and/or access regime would mitigate the need for controls at the retail level.
- 3.7 Optus therefore submits that in making the case for the removal of RPCs on the back of increased competition, the Commission needs to continue its process of reform in wholesale market.

#### **Developments in the retail market**

- 3.8 Although Telstra continues to retain substantial market power in the retail market, it is clear that new entrants have made some inroads into this space. Last year, in reviewing Telstra's Wholesale Line Rental (WLR) Exemption application, the ACCC noted the increase in competition in the retail market:

*“Telstra remains the dominant supplier of retail fixed voice services...However, there has been an increase in competition in downstream retail fixed voice, evidenced by the recent trend of strong take-up of ULLS and a decreased market share for Telstra in retail fixed voice”*<sup>3</sup>

- 3.9 The degree of entry is further evidenced in Table 1 as the total number of fixed-line telephony providers is fast approaching that of broadband providers.

**Table 1: Number of service providers in Australia (as at June 2009)**<sup>4</sup>

<b>Service</b>	<b>Number of providers</b>
Fixed-line telephony	391
VoIP	287
Internet service providers (ISPs)	638
DSL service providers	529
ADSL2+ service providers	148
Fixed wireless service providers	233
Mobile wireless service providers	54
Satellite broadband service providers	47

*Substitution to mobile*

- 3.10 The way in which customers acquire voice telephony services in the consumer market is changing. FTM substitution is becoming increasingly prevalent and reducing the demand for fixed-line services. Optus considers that there has been much less substitution in other markets, with consumers in the broadband and business markets still preferring to acquire fixed-line services.

- 3.11 In the past the ACCC has been sceptical of the amount of fixed-to-mobile (FTM) substitution occurring in the voice telephony market, however it has noted that it considers it will be a growth area in the future. When it considered the consumer-grade voice market in Telstra’s WLR Exemption Application it came to the following conclusions:

*“The ACCC is of the view that mobile services are only in a relatively small percentage of cases an effective substitute for fixed line services. A report recently released by ACMA entitled Fixed-mobile Substitution and Fixed-mobile Convergence in Australia supports the ACCC’s views that while a degree of substitutability of mobile services for fixed services is becoming apparent at the margins, prospects for convergence of fixed and mobile*

<sup>3</sup> ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications*, Final Decision and Class Exemption, August 2008, page 5

<sup>4</sup> ACMA, *ACMA Communications Report 2008/09*, page 31



*services are low in the short-term. However, the ACCC is actively monitoring consumer behaviour and preferences in this regard.”*<sup>5</sup>

- 3.12 Although there is limited data on the degree of FTM substitution occurring in the market, anecdotal evidence suggests that it is becoming increasingly prevalent.
- 3.13 Telstra’s latest financial results highlight that approximately 30,000 subscribers left Telstra's fixed retail broadband services in the last six months over 2009, a fall of 2.3 per cent from the same period last year.<sup>6</sup> Whilst it is not clear whether these subscribers chose to forgo a fixed-line service as they took up a mobile service instead, Optus considers this was the most likely outcome. One analyst recently suggested that mobile phone only households already make-up around 8 per cent of the market, and this could potentially be trending up to as high as 20 per cent by the second half of 2010.<sup>7</sup>
- 3.14 The degree of FTM substitution is important because it shows that, increasingly, mobile phones and fixed-line phones are competing with each other in the same (or similar) market(s) as consumers are starting to consider the devices as substitutes. This is important in terms of the RPC review because if one accepts that mobile and fixed-line services are active in similar markets, then it is clear that the relative prices between the services will impact upon the level of consumer demand for each product.
- 3.15 Consumer-level mobile plans are already putting competitive pressure on the price of fixed-line services, and acting as an upper limit on retail prices.
- 3.16 Graph 1 illustrates that the overall basket of mobile service prices have been consistently in decline, in the last 4 years alone dropping by over 14 per cent.

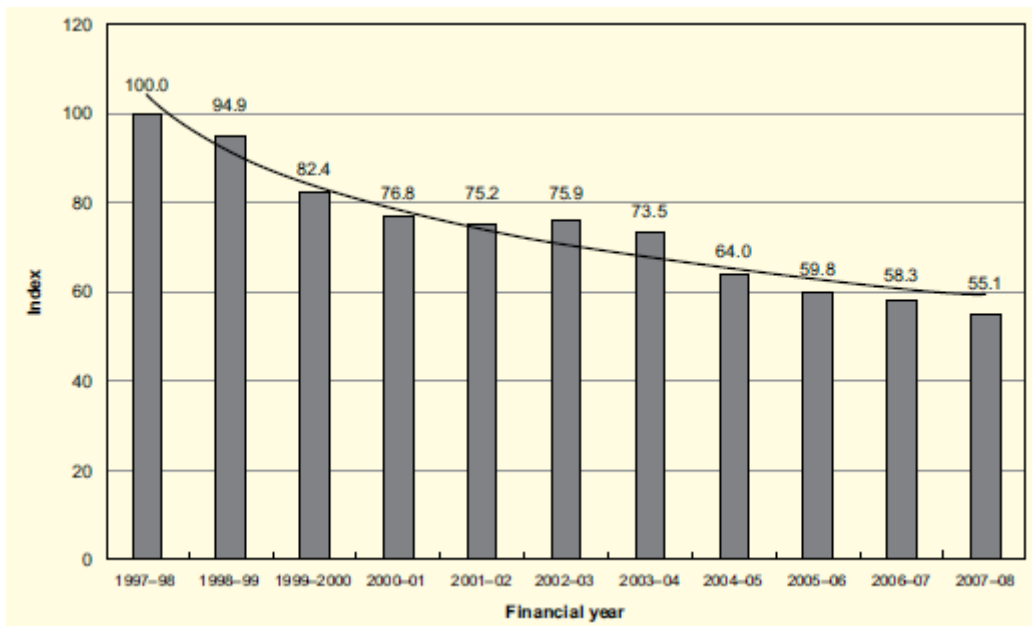
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<sup>5</sup> ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications, Final Decision and Class Exemption*, August 2008, page 46.

<sup>6</sup> Telstra, *3<sup>rd</sup> Quarter Financial results - Investor Briefing Pack*

<sup>7</sup> The Australian, *Wireless internet eats into ‘fixed’ broadband market*, Mitchell Bingemann and Stuart Kennedy, 12 February 2010.

**Graph 1: Index of mobile service prices (1997 to 2008)** <sup>8</sup>



3.17 The price of consumer-level mobile phone services will continue to exert competitive pressure on the price of fixed-line services especially as consumers become more confident with using mobile services.

*Actual prices are lower than those required by the price caps*

3.18 Analysis of service prices demonstrates that competitive forces, as opposed to regulation, have been the main driver behind lower retail service prices seen in the market.

3.19 Evidence presented by the Commission shows that service prices have fallen below the limit instigated by the caps (refer to table 2). Since 2005 the price movement for basket 1 was capped at a total of -4.4 per cent over the period. However, it is clear that the cap placed little (if any) downward pressure on retail prices as the actual prices were 4.7 per cent lower than the cap.

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<sup>8</sup> ACCC, *Telecommunications competitive safeguards for 2007–2008 - Changes in the prices paid for telecommunications services in Australia 2007–2008*, page 125

**Table 2: Comparison of price control arrangements for Basket 1<sup>9</sup>**

<b>Year</b>	<b>Capped price movement</b>	<b>Actual price movement</b>	<b>Differential</b>
2005-06	-1.6%	-4.4%	-2.8%
2006-07	-1.3%	-4.2%	-2.9%
2007-08	-1.1%	-0.1%	+1.0%
<b>Total</b>	<b>-4.0%</b>	<b>-8.7%</b>	<b>-4.7%</b>

3.20 Prices in the retail telephony markets have been falling due to amount of competition in the market – that is, a large number of retail providers competing vigorously for market share. For example In regards to broadband services there are now over 23 ISPs able to provide broadband services to 2757 ESAs throughout the country.<sup>10</sup> At the same time competition has been further enhanced by developments in alternative (lower cost) technologies, such as mobile calling services and the emergence of internet protocol (IP) services (e.g. VoIP calling).

3.21 These developments illustrate that the CPI-X per cent regime is now outdated and should be removed as it not responsible for generating benefits for retail consumers.

### **Developments in the wholesale market**

3.22 Telstra retains monopoly ownership of the local copper loop, and there are a total of 9.37 million voice lines (wholesale and retail) provided over Telstra's network which account for 85 per cent of all fixed voice lines in Australia.<sup>11</sup>

3.23 Notwithstanding this, Optus and other carriers have made investments in various forms competing infrastructure. For example the construction of HFC networks, fibre rings in CBD areas and transmission tails to large business customers. Furthermore the access regime has allowed competitors to enter the market through a number of means including:

- Resale entry: reselling Telstra's infrastructure and services with their own branding (e.g. the use of the WLR service);
- Facilities-based entry: construction of competing infrastructure (e.g. mobile, WiMax and HFC networks); and
- Mixed-infrastructure based entry: utilising Telstra's infrastructure but also investing in elements that compete with Telstra's network (e.g. use of the ULLS, leased transmission lines).

<sup>9</sup> ACCC, *Review of Telstra Price Control Arrangements*, Discussion paper, January 2010, page 20.

<sup>10</sup> ACCC, *Telecommunications competitive safeguards for 2007–2008 - Changes in the prices paid for telecommunications services in Australia 2007–2008*, page 14.

<sup>11</sup> ACCC, *Telecommunications competitive safeguards for 2007–2008 - Changes in the prices paid for telecommunications services in Australia 2007–2008*, page 30

3.24 Despite the number of options available to potential entrants, competition has been greatest where facilities-based entry has occurred. Optus, as Telstra's main competitor in fixed telephony, has competed aggressively where it has access to facilities-based infrastructure through either its wireless (mobile, satellite) or fixed (HFC, ULL, fibre) networks. The problem is that the majority of the addressable market can only be serviced by accessing Telstra's local loop and in this respect Telstra continues to dominate.

3.25 The majority of competition has been driven by via take-up of the WLR and ULLS services. Evidence presented by Telstra in its WLR Exemption Application illustrated that Telstra's dominance in retail services, whilst still evident, is waning in some locations:

*"Telstra has stated that the level of competition in the 371 ESAs, the subject of the July exemption applications, is evidenced by Telstra's lower retail market share in fixed line services relative to its national average (namely, 75 per cent for basic access services in the exemption areas, as compared with a national average of 80 per cent). In addition, Telstra notes that since March 2004, the total number of SIOs serviced by Telstra's PSTN (retail and wholesale) has fallen by 8 per cent in the 371 ESAs, as compared with a decrease of 4.5 per cent for the rest of the network."*<sup>12</sup>

3.26 However, Optus agrees with the ACCC's conclusion that such data only illustrates that there has been a degree of 'quasi-competition'. That is, despite their investment in alternative infrastructure firms are still heavily reliant on Telstra to provide the basic layer(s) of service for their products. The ACCC made the following comments:

*"...while the upstream market remains concentrated (with Telstra remaining the dominant supplier of services at this level), the market is becoming more competitive as investment in DSLAM and MSAN infrastructure grows."*<sup>13</sup>

*"...the ACCC found that there were sufficient alternatives to the LCS and WLR to provide a constraint on Telstra's pricing for these two services. These alternatives included competing infrastructure and the ULLS."*<sup>14</sup>

3.27 It is therefore important to temper one's view on the level of competition by taking into account the wider picture. For example, when degree of entry is analysed on a national basis it is clear that competition has been concentrated almost exclusively in metropolitan and urban areas (i.e. Bands 1 and 2). Competition in the provision of local loop services is weakest in areas where costs faced by potential entrants are much higher (i.e. rural areas of Bands 3 and 4) which is also where the USO regime maintains Telstra's dominance in service provision.<sup>15</sup> As at June 2008, competitors were only in 521 of the total

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<sup>12</sup> ACCC, Final Decision and Class Exemption, Telstra's local carriage service and wholesale line rental exemption applications, public version, August 2008, page 69.

<sup>13</sup> ACCC, Final Decision and Class Exemption, Telstra's local carriage service and wholesale line rental exemption applications, public version, August 2008, page 96.

<sup>14</sup> ACCC, *Telstra's local carriage service and wholesale line rental exemption applications, Final Decision and Class Exemption*, August 2008, page 33

<sup>15</sup> ACCC, *Telecommunications competitive safeguards for 2007–2008 - Changes in the prices paid for telecommunications services in Australia 2007–2008*, page 14.

5069 ESAs.<sup>16</sup> Even where competition exists it is clear that this is based on regulated access to Telstra's facilities.

#### *Wholesale market needs reform*

- 3.28 The wholesale market structure and the framework to regulate it are still subject to a number of serious deficiencies. Whilst these issues have been well documented and so will not be repeated in detail, there is value in summarising the issues in order to provide some context for the discussion.
- 3.29 The current regulatory regime has been highly ineffective in preventing the Telstra from exercising its market power and, to the detriment of consumers, failed to make the wholesale fixed-line market truly competitive. Specific areas that desperately need reform include Telstra's vertical integration (which causing issues such as margin squeeze and discriminatory access) and key components of the present regulatory regime (particularly the negotiate/arbitrate framework and appeals processes).
- 3.30 The problems of wholesale market and regulatory regime have their root cause in the vertically integrated structure of Telstra and the corresponding misalignment of incentives that this creates. As a dominant retail and wholesale supplier Telstra has strong incentives to act in a manner that discriminates against its competitors. Coupled with a weak regulatory system it is provided with the opportunity to act on these incentives and exploit its market power to the fullest possible extent.

#### *New reforms and tighter regulation*

- 3.31 As documented earlier the wholesale regime has resulted in poor outcomes for consumers and businesses. However, last year the Government accepted the case for reform and proposed significant changes to the regulatory landscape. There are now two pieces of reform legislation presently before Parliament.
- 3.32 The *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2009* seeks to address Telstra's monopoly hold on the industry and streamline the access regime. If passed, this Bill will change the way in which Telstra is able to interact with the market by encouraging it to voluntarily commit to structural separation, and ensuring disputes are resolved efficiently.
- 3.33 Accompanying this legislation is the *Telecommunications Legislation Amendment (National Broadband Network Measures No 1) Bill 2009*, which will allow NBN Co to collect the necessary network information to facilitate the rollout of the network. The NBN will transform the wholesale service market creating a truly level playing field as all higher-level service providers (at the retail level) will be able utilise the same access network on an equivalent basis.
- 3.34 The Commission is also undertaking a thorough review of the pricing methodology that underpins the wholesale access regime. The Fixed Service

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<sup>16</sup> ACCC, *Telecommunications competitive safeguards for 2007–2008 - Changes in the prices paid for telecommunications services in Australia 2007–2008*, page 14.

Review discussion paper recognises that telecommunications landscape has significantly changed:

*“A little over ten years on from the introduction of competition to the telecommunications sector and the release of the 1997 Pricing Principles Guide, both the telecommunications regulatory, technological and competitive landscape, and the ACCC’s experience in regulating the prices of fixed line telecommunications access services, continue to evolve...”<sup>17</sup>*

*“...the ACCC is of the view that a review of some elements of the current approach to pricing — in particular, the approach to measuring the costs of sunk infrastructure — is needed to determine whether the current approach offers the best balance of the legislative criteria.”<sup>18</sup>*

- 3.35 The Fixed Service Review seeks to determine the pricing approach that should be adopted by the industry before the NBN is constructed and ensure that in the interim period the wholesale price schedule continues to foster competition.

#### *Emerging technologies will continue to support effective competition*

- 3.36 To date there have been significant barriers to entry for the use of both wireless and DSL based technologies to serve the mass market. In the case of wireless there are significant fixed costs relating to the acquisition of spectrum and base station site, both of which have traditionally been expensive.
- 3.37 Recently prices for wireless based equipment have been declining to the extent that technological developments are making wireless an increasingly viable substitute service. DSL will continue to be the technology of choice for investment in the near term, but the economics of wireless are steadily improving. In certain circumstances, particularly remote areas, wireless platforms are already preferable to wired (copper and cable) networks.
- 3.38 The most recent market development in this space is the announcement of an urban 4G wireless network by Vividwireless. Vividwireless has announced that it will switch on its network in Perth this year, and expand to five other capital cities (Sydney, Melbourne, Brisbane, Adelaide and Canberra) within 12 months.<sup>19</sup>

#### *Impending rollout of the NBN*

- 3.39 The ACCC appears to have taken the view that it does not need to have regard to the NBN since it is still subject to considerable uncertainty.
- 3.40 Optus supports this position as it considers the Ministerial Direction makes it very clear that any changes made to the RPC should apply for a maximum of

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<sup>17</sup> ACCC, *Review of 1997 Guide to Telecommunications Access Pricing Principles for Fixed Line Services*, Discussion Paper, December 2009, page 7

<sup>18</sup> ACCC, *Review of 1997 Guide to Telecommunications Access Pricing Principles for Fixed Line Services*, Discussion Paper, December 2009, page 19.

<sup>19</sup> iTnews, *Vividwireless reveals five-city expansion plans*, Roy Crozier, 10 February 2010 - refer to <http://www.itnews.com.au/News/166843,vividwireless-reveals-five-city-expansion-plans.aspx> (accessed on 10 Feb 2010).

two years. This makes it clear that any changes to the RPC regime are purely a transitional arrangement that will be re-evaluated once the rollout of the NBN commences.

#### **4. The RPC regime should be reformed**

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- 4.1 The RPC regime is intended to limit Telstra's use of its market power by preventing it from setting prices at monopoly levels for services where competition is not yet fully developed
- 4.2 It is appropriate the RPC regime is reviewed at this time as the case for continuing RPCs has become weak. In this section Optus argues that the price control regime needs to be reformed because:
- The price controls have not resulted in the economic benefits which they were originally designed to achieve;
  - The retention of price caps will mean that firms cannot price services efficiently thereby harming allocative efficiency and discouraging investment; and
  - Price controls risk creating a regulatory 'price-squeeze' that will distort competitive dynamics of the market.
- 4.3 Failing to reform the RPC will carry the risk of distorting both consumer consumption and the future investment decisions of carriers (both Telstra and its competitors) leading to a reduction in economic welfare.
- 4.4 Optus also that highlights that whilst it is appropriate for the Commission to now remove the 'upper-layer' of regulation (i.e. retail price control) it should continue to intervene and apply strong regulations in the wholesale market as it is still subject to a number of serious deficiencies that are yet to be resolved (e.g. Telstra's vertical integration and the regulatory regime).

#### **Purpose of the RPCs**

- 4.5 The RPC regime was intended to limit Telstra's use of its market power by preventing it from setting prices at monopoly levels for services where competition is not yet fully developed. The limits imposed by the RPCs were also meant to provide an important safety net function in regards to social policy goals.
- 4.6 Optus considers that in the last 6 years since the previous review, the case for continuing RPCs has become increasingly weak. Retaining the price controls in their current form carries the risk of over-regulating the retail sector with the effect of distorting both consumer consumption and the investment decisions of carriers (Telstra and competitors).

#### **Role of the RPC**

- 4.7 Retail price controls have been used by the Commission to ensure efficient pricing outcomes in telecommunications markets and achieve social policy objectives. Specifically, the objectives of the price control arrangements as listed in Government policy are to:



- (a) promote efficiency in markets not yet effectively competitive and pass on the benefits to consumers;
  - (b) protect low-income consumers from any adverse effects of line rental increases;
  - (c) ensure rural and remote customers share in benefits from greater competition;
  - (d) allow Telstra to gradually rebalance line rentals; and
  - (e) meet other equity objectives.<sup>20</sup>
- 4.8 The economic rationale for using price controls is that they are designed to promote the efficient pricing of services through replicating competitive market conditions. Price controls have also been used to pursue social policy objectives such as ensuring telecommunications are accessible to all of the community. For example, ensuring that services are affordable to lower income groups and consumers in remote locations.
- 4.9 In a monopoly market, a profit-maximising supplier will have an incentive to price services above cost as, by definition, in a monopoly market there is no competitive pressure on prices and so they can be set at whatever level the market will bear. The supplier will therefore be able to extract super-normal profits from this market at the expense of consumer welfare (higher prices).<sup>21</sup> Price controls such as CPI-X caps help to prevent such welfare losses by regulated the prices charged by the monopoly providers.
- 4.10 The downward pressure that price controls place on service prices may also be used to encourage suppliers to produce their services more efficient. Under a CPI-X control, if the cap is set effectively, firms will have an incentive to achieve cost efficiencies so that although the service price is lower their total revenue is not impacted.
- 4.11 However, the emergence of competition in the fixed line market would effectively create the same incentive for firms to increase their efficiency. In this regards Optus consider that the emergence of competition removes the existing justification for retail level price controls. This issue will be discussed in more detail below.

### **Problems with the RPCs**

- 4.12 When RPCs were initially introduced they provided retail prices with a degree of certainty and stability. Given the wholesale market was immature and suffered from bottleneck characteristics RPCs were required to prevent Telstra from charging monopoly prices. It is appropriate the RPC regime is reviewed at this time as continuation of the current controls will no longer promote economic efficiency in the market. In summary Optus considers that the present RPC regime should be reformed because:

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<sup>20</sup> Commonwealth of Australia, *Telstra Carrier Charges - Price Control Arrangements, Regulation Impact Statement*, page 4

<sup>21</sup> This loss is often termed the 'dead-weight loss'.

- (a) RPCs have not resulted in the economic benefits which they were originally designed to achieve;
- (b) Price controls do not allow firms to price services efficiently, harming allocative efficiency and discouraging investment;
- (c) Price controls can lead to regulatory ‘price-squeeze’ between the wholesale and retail markets; and
- (d) Regulation should be targeted in the wholesale markets.

*RPCs have not resulted in the economic benefits which they were originally designed*

- 4.13 Unfortunately, instead of producing greater productivity efficiency from Telstra price caps have largely acted as a mechanism to distribute benefits between Telstra and consumers. International experience shows that this is not an uncommon result as RPCs have been found to be similarly ineffective in other jurisdictions. In the USA the FCC considered that price-capped markets were characterised by similar pricing, less dynamic vigour and less significant price falls over time.<sup>22</sup> Further international experience is detailed in Appendix B.
- 4.14 As noted earlier in this submission, price controls cap placed little downward pressure on retail prices as actual prices have fallen below the regulated cap. As the cap is meant to represent a lower bound, the fact that prices have fallen below this limit evidences that other forces have been more influential. Optus contends that competitive forces (e.g. market forces detailed in Section 3), as opposed to regulation, have been the main driver of lower retail service prices.

*Price controls do not allow firms to price services efficiently*

- 4.15 Whilst Telstra currently retains its dominant position in fixed line services, investment in new infrastructure and entry of competing wholesale and retail providers has meant that there are in roads being made into Telstra’s market share. Given these conditions, the application of a restrictive price control regime will simply stifle and distort investment decisions to the detriment of competition and the long-term interest of consumers
- 4.16 However, putting aside the prevailing market conditions for one moment, Optus considers that the promotion of long-term competitive market structures is far preferable to retail-level regulation. At best retail-level regulation is a second-best policy measure to address a market failure and, in terms of regulatory ‘tools’, retail price caps represent a relatively inflexible and stringent form of regulation.
- 4.17 Price caps change the focus from the enhancement of competition to a tug-of-war over the size of the x factor and in this regard Australia’s RPC regulation has suffered from the Aversch-Johnson effect which means that RPC

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<sup>22</sup> Refer to *Optus’ 2004 RPC submission*, page 8.

regulation has simply acted as rate of return regulation upon Telstra.<sup>23</sup> Price controls use an ‘X factor’ to stimulate firms to improve the efficiency of their production. However this factor can actually undermine the efficiency incentives because in a competitive market, or for that matter an unregulated monopoly market, a firm would otherwise retain efficiency improvements via increased profits. In a competitive (or unregulated) market the prospect of higher profits acts as a ‘carrot’, or motivation, for the firm to seek further efficiency gains. On the other hand under a price control scheme the X factor acts as a ‘stick’ as it forces the same efficiency improvement. However a firm will receive a lower profit payoff under the price control regime as, by definition, the service price is regulated. In this way the price controls essentially apply a form of rate of return regulation.

4.18 It has been previously recognised by the Commission and wider industry, that it may be difficult to achieve the stated objectives of price controls as the outcomes are not instinctively harmonious. As noted above, on one hand there is a desire to improve allocative efficiency by limiting the extent to which services can be priced above cost<sup>24</sup> yet on the other-hand the incorrect setting of price controls (i.e. prices too low) will harm dynamic efficiency by reducing returns on investment<sup>25</sup>.

4.19 Tardiff and Taylor quote the FCC’s chief economist Joseph Farrell to demonstrate that whilst competition can be promoted by an effective wholesale access regime, retaining price controls under these circumstances can be detrimental and so it is a fine balance of the two:

*“Smoothly functioning wholesale regulation...permits and indeed almost demands retail deregulation. If multiple providers can compete for a customer’s business and promptly supply it at reasonable overall cost, even if they do so by leasing the incumbent’s facilities, then it would seem that prompt deregulation of all charges to the provider’s end-users will be appropriate...Indeed if regulators continue to regulate the incumbent’s retail prices, and don’t happen to replicate the solution that the incumbent and the customer find jointly most beneficial, it puts the incumbent at an artificial competitive disadvantage.*

*Thus, while economic theory has evolved, especially in its application to telecommunications markets, the pattern is clear: the opening of local exchange markets to competition (facilities-based or that made available by the provision of wholesale services) makes continued regulation of retail markets increasingly problematic. By implication, any retrogression towards traditional regulation would be especially counterproductive. And ...practice is advancing with theory: regulators in other states have recently revised incentive regulation plans consistently with these advancements in economic theory.”<sup>26</sup>*

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<sup>23</sup> This means that Telstra does not have economic incentives to make cost reducing investments. For further details on the theory refer to Aversch, H. and Johnson, L. “*Behaviour of the firm under regulatory constraint*”, American Economic Review, vol 52, pages 1052–69.

<sup>24</sup> ACCC, *Review of Telstra’s price control arrangements*, Final report, February 2005, page 13

<sup>25</sup> ACCC, *Review of Telstra’s price control arrangements*, Final report, February 2005, page 14

<sup>26</sup> Tardiff T. J and Taylor W. E, “*Aligning Price Regulation with Telecommunications Competition*”, in Review of Network Economics Vol. 2, Issue 4 – December 2003, page 347-348

- 4.20 Experience in the UK shows that the removal of RPCs has benefited consumers and the industry by improving overall economic welfare. Between 2002 and 2006, three of the UK's regulators (Ofcom, Ofgem and Postcomm) removed retail price controls from their respective industries (fixed line telephony, gas and electricity supply respectively).
- 4.21 Ofcom, Ofgem and Postcomm removed the controls because they considered that competition had developed sufficiently to rely on the market, and on the restrictions imposed by competition law and consumer protection rules to protect consumers, without the need for price regulation
- 4.22 A report by the National Audit Office (NAO) evaluated the outcomes from removing RPC in these jurisdictions.

*“The available data shows that competition has developed to varying degrees in all three areas where price controls have been removed. The former incumbents in energy have all lost market share to competitors, although they still retain a large share (46 per cent in gas, and just under 50 per cent in electricity). In the energy sector prices have risen since the price control was removed by around 60 per cent, but Ofgem consider that this reflects increases in the underlying costs. Prices in fixed line telephony have continued to fall after removal of the price control, for example the average cost of residential fixed line calls in 2006 was some 25 per month, down from 30 per month in 2002. BT, the former incumbent, still retains 37 per cent of the telecoms market, but this has been declining recently. In the postal sector, Special Delivery (Next Day business account users) accounts for some 4 per cent of the guaranteed next day express market.*

*Where price controls have been removed all three regulators monitor the markets to assess whether competition is working effectively and consumers are protected, but have to focus on areas where data is readily available. Ofcom and Postcomm, which removed retail price controls very recently in 2006, publish regular monitoring reports, as well as ad-hoc reports if they feel that there is a particular need. Ofgem has a longer experience, having removed retail price controls six years ago in 2002. In the years following removal it used to publish annual reports, but now publishes full retail reports (such as the recently announced review of the domestic energy market) 5 and ad-hoc reports (such as on switching rates) only when it considers that there is an issue of interest, as it believes that competition is now effective and there is no need for routine reporting..”<sup>27</sup>*

- 4.23 The UK experience highlights that the decision to remove price controls in telecommunications resulted in lower prices for consumers. The NAO determined that most important criteria for removing RPCs was that the market conditions and regulatory regime were sufficient to allow competition to develop. In this regard Optus considers that the emergence of genuine competition in the Australian fixed line market and the existence of a

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<sup>27</sup> National Audit Office, Protecting consumers? Removing retail price controls, HC 342 Session 2007-2008, 28 March 2008, page

regulated wholesale market effectively removes the justification for retaining retail level price controls.

*Price controls can result in regulatory 'price-squeeze'*

- 4.24 As far as incentive regulation goes, price-controls are a very blunt instrument and run the risk of causing more harm than good. By their very nature price controls restricts the market's ability to determine the price of services which means that the incorrect setting of price controls will harm dynamic efficiency by reducing the ability of firms to recover the cost of their investment. Moreover, the retail level regime is capable of undermining the wholesale access regime by imposing a 'regulatory price squeeze' on retailers.
- 4.25 Regulatory price-squeeze arises when price regulation at different points of the market moves in opposing directions. For example, consider the scenario of wholesale ULLS charges being allowed to increase but the retail line rental price remaining capped. Telstra's most recent ULLS Undertaking that is presently being reviewed by the Australian Competition Tribunal seeks Band 2 wholesale ULLS price of \$30 per month. If this Undertaking were to be accepted, and the present RPC regime also retained, many retailers would have to increase their retail prices or face a negative margin.
- 4.26 These opposing price movements therefore distort competition. Retail firms are not able to earn sufficient revenue to be able to compete in the market. At the same time, given that Telstra is vertically integrated and a supplier of both retail and wholesale service, a price squeeze would provide it with an unfair competitive advantage and discourage ULLS-based access seekers to invest in infrastructure.

*Regulation should be targeted in the wholesale markets*

- 4.27 Previously the merit of mandating retail price controls was that it provided certainty and stability at the retail level at a time when the underlying market (i.e. the wholesale market) was immature and poorly regulated. In the last review one of the key reasons for continuing to apply price controls was that the Commission considered there to be insufficient competition in retail service markets. However, this competition issue stemmed largely from the bottleneck in the wholesale market where Telstra had unrivalled market power. In 2004 the ACCC provided the following explanation:

*"The ACCC considers that many retail telecommunications markets in Australia are not effectively competitive. This generally stems from a lack of competition in the wholesale markets where Telstra has ownership of the ubiquitous fixed-line local access network, which connects virtually every household in Australia, and from which it derives market power.*

*In these circumstances, retail price controls can assist in delivering the benefits of competition to consumers. Retail price controls aim to limit the extent to which a service can be priced above cost (including a normal return*

*on investment), thereby promoting the long-term interests of end-users (LTIE)”,<sup>28</sup>*

- 4.28 Furthermore, as noted in Section 3, there have also been a number of developments in the market including:
- An increase in the number of retail and wholesale service providers;
  - FTM substitution in the consumer voice telephony market;
  - Growth in wireless technologies;
  - Significant reduction in service prices; and
  - Competition in metropolitan areas.
- 4.29 Although the wholesale market is still far from competitive new legislative reforms will address the wholesale access regime and streamline the dispute resolution process, whilst there is still a long way to go before the impediments to competition in the wholesale access layer are ironed-out, the impending reforms will greatly assist in creating a much more level playing field.
- 4.30 In this regard Optus considers that the emergence of genuine competition in the Australian fixed line market and the existence of an effectively regulated wholesale market will remove the justifications for retail level price controls.

### **The ACCC should fix the wholesale regime**

- 4.31 The present wholesale market and the regulatory framework are still subject to a number of serious deficiencies. These are well known and have been well documented in a number of Optus’ past regulatory submissions so need not be repeated in detail.<sup>29</sup>
- 4.32 Specific problems that require reform include Telstra’s vertical integration (which causing issues such as margin squeeze and discriminatory access) and components of the present regulatory regime (particularly the negotiate/arbitrate framework and appeals processes).

### *Structural reform*

- 4.33 Many of the problems identified with the current market structure and the regulatory arrangements have their root cause in the vertically integrated structure of Telstra and the corresponding misalignment of incentives this creates. As a dominant retail and wholesale supplier Telstra has strong incentives to act in a manner that discriminates against its competitors. Coupled with a weak regulatory system it has the opportunity to act on these incentives to exploit its market power to the fullest possible extent.

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<sup>28</sup> ACCC, *Review of Telstra’s price control arrangements*, Final report, February 2005, page 13

<sup>29</sup> Optus, *Regulating the National Broadband Network*, June 2008; Optus, *Submission to the Senate Select Committee on the National Broadband Network*, September 2008; Optus, *Submission on Fixed Service Review 2009*.

- 4.34 The current regulatory regime was established in order to control the market power of Telstra and encourage competition. The opening of Telstra’s local copper loop to competition through the regulation of ULL access has represented a stand out policy initiative by the ACCC in recent years. This policy has been aimed at deepening the level of infrastructure based competition in the fixed line market and reducing the industry’s reliance on resale based access
- 4.35 The policy has stimulated significant investment in fixed line voice and broadband services by several carriers, particularly in metropolitan areas (e.g. Band1 and 2 ESAs). At the same time there has been a corresponding reduction in the level of pure resale-based access services as service providers have moved up the ladder of investment.
- 4.36 Consumers see the fruits of this policy with increased competition in the market and real choice across large parts of metropolitan Australia. Competitors are using their own infrastructure to deliver innovative services of their own (e.g. bundled products, VoIP services) which brings important benefits to consumers in the form of lower prices, improved quality of service and greater innovation.
- 4.37 However the current framework has been ineffective in preventing Telstra from exercising its market power and has failed to make the fixed-line market truly competitive.
- 4.38 An important consequence of Telstra’s vertical integration is that it lacks the incentive to reach agreement on reasonable access terms, or to conclude negotiations speedily. This means Telstra has strong incentives to act in a manner that discriminates against its competitors, for example raising their costs and reducing the quality of its rivals’ offerings to the extent it is capable of doing so. In consequence access seekers have been unable to obtain access to services on equivalent terms to Telstra.
- 4.39 The changes set out in the draft reform legislation provide the ACCC with the tools it needs to make pro-competitive decisions unimpeded by the risk of Telstra challenging each and every decision. Once the new legislation is in force the ACCC will have the opportunity afforded by the new legislation to introduce a new, more pro-competitive pricing regime for all fixed line services.
- “... the ACCC is of the view that the market has evolved to the point that the ULLS provides the most effective form of regulation, rather than pure re-sale regulation.”<sup>30</sup>*
- 4.40 Continuation of the price control regime will result in significant market distortions to the detriment of competition and the long-term interests of consumers. If the cap is too restrictive, which Optus argues it is, service providers will be unable to recover the cost of investments and further efficient investments in network infrastructure will be discouraged.<sup>31</sup> Further,

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<sup>30</sup> ACCC, *Telstra’s local carriage service and wholesale line rental exemption applications, Final Decision and Class Exemption*, August 2008, page 5

<sup>31</sup> Tardiff T. J and Taylor W. E, “*Aligning Price Regulation with Telecommunications Competition*”, in *Review of Network Economics* Vol. 2, Issue 4 – December 2003, page 348.

a regulatory imposed upper limit will have no impact on competitive outcomes if it is set higher than the prices that competition would produce.

- 4.41 In summary, the achievement of an effective wholesale access regime would completely negate the need for retail price controls altogether as both the retail and wholesale markets would be operating efficiently. It is therefore the wholesale market is where regulation, both access-based regulation and price regulation, needs to be focused.

#### *Pricing reform*

- 4.42 Optus also notes that the reform agenda also needs to include certainty around the prices that the industry will pay Telstra for access to regulated services. This is important because the entry and investment decisions of competitors are based on the premise that they will be able to compete with Telstra on a level playing field.
- 4.43 For example, when Optus made its original commitment to invest in ULL based access in September 2005 it did so in part because it had confidence that the ACCC would deliver access prices that would render the investment case for ULLS sustainable. The ACCC duly delivered when it set Band 2 access prices from \$12.30 to \$14.30 per month for the period 2005 through to 2008.
- 4.44 The policy intent from the ACCC has been quite clear in these related decisions – reasonable access prices and conditions will foster the development of competition in the market.
- 4.45 It is therefore important that in reforming the wholesale regime that price terms and conditions are given equal attention.



## **5. The current RPC regime needs to be reformed**

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- 5.1 The RPC regime has provided the industry with certainty and stability at the retail level during a period in which underlying markets were immature and poorly regulated. However, as has been evidenced earlier, the retail market is now more competitive and the wholesale access market is subject to better regulation. Although wholesale market is still far from competitive, the proposed regulatory reforms should result in significant improvements in the price and non-price terms and conditions offered to access seekers.
- 5.2 Given these circumstances, Government and the ACCC should set policy that continues to encourage investment in these markets. The application of a restrictive price control regime will only serve to stifle the industry's future progress by distorting investment decisions at the detriment of competition and the long-term interest of consumers.
- 5.3 Optus considers that the Commission should remove RPCs on all fixed line services as this will provide firms with the pricing flexibility that they need to make efficient investments and compete in the market. In a similar vein Optus also considers that no new price caps are necessary for mobile or data services as these markets are clearly already competitive. As noted previously, this is in-line with experiences in the UK showing that the timely removal of RPCs will foster competition and improve overall economic welfare.
- 5.4 However in the event that the Commission believes that the RPC regime is necessary on the basis of social or equity grounds, targeted programs are a far more efficient economic tool to achieve this aim.<sup>32</sup>
- 5.5 Whilst Optus does not believe there is a case for price controls to be retained, to the extent that the Ministerial Direction deems them to be necessary then the controls should be significantly relaxed. Potential reform options include the following:
- (a) Changing the cap from CPI – CPI per cent to CPI – 0 per cent,
  - (b) Retain controls only in rural and regional areas where competition is less intense and removal of retail price controls on all fixed line services in urban areas,
  - (c) Retain price cap on the basket of Telstra's most basic line rental product offered to consumers but remove the cap for business customers

### **Discontinuation of the RPC regime**

- 5.6 The first-best policy response is for the Commission to remove RPCs on all fixed line services immediately as there are no efficiency gains to be made by continuing the regime.

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<sup>32</sup> For example, the granting of concession cards for specific disadvantaged groups and socio-economic circumstances (e.g. low income).

- 5.7 The continuation of RPC will be at the detriment of competition as it:
- (a) encourages prices that are too low from an efficiency perspective in competitive markets,
  - (b) undermines otherwise efficient entry, investment and competition in these markets; and
  - (c) motivates firms to set higher prices in other (unregulated) markets.<sup>33</sup>

### **Other options for reform**

- 5.8 Whilst Optus does not believe there is a case for price controls to be retained, to the extent that the Ministerial Direction requires its retention then the controls should instead be significantly relaxed.
- 5.9 In this section Optus presents a number of options for rolling back the RPC regime.

#### *Lift the cap to CPI-0 per cent*

- 5.10 The first available option is for the price cap on the basket of local calls, trunk (which includes national long distance and fixed-to-mobile) calls, international calls and line rentals to be softened. Specifically, Optus considers that the cap should be changed from CPI – CPI per cent to CPI – 0 per cent. That is, it is recommended that Telstra be entitled to change the individual prices of services in the basket as long as the aggregate revenue-weighted price of all the services in the basket does not increase faster than the general rate of consumer price inflation in any given year. Such a cap would provide firms with greater pricing flexibility and improve their ability to return a legitimate return on their investments.
- 5.11 However, the Commission should not be concerned that relaxing the cap will increase consumer prices as competitive forces will keep their own ‘cap’ on retail prices. Optus considers that competition will come from a number of different sources including in both the wholesale and retail markets (refer to Section 3 above). Of these influence it is important to note that the price of substitute services (e.g. mobile and VoIP) will exert an increasing level of pressure on the price of fixed-line voice telephony services.

#### *Remove price caps from certain markets*

- 5.12 If price controls are to be retained, the Commission should consider altering their scope with a mind to excluding certain markets from regulation.
- 5.13 As noted in Section 3, there have been significant market developments including the following:
- An increase in the number of retail and wholesale service providers;
  - FTM substitution in the consumer voice telephony market;

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<sup>33</sup> For further discussion of these issues refer to Chapter 3.

- Growth in wireless technologies;
  - Significant reduction in service prices; and
  - Strong competition in metropolitan areas.
- 5.14 In this regard Optus considers that in markets that exhibit signs of genuine competition, retail level price controls can be removed. Recent decisions by the Commission and Tribunal accept that competition is well developed in certain regions, particularly urban areas. For example, in its review of Telstra’s 2009 PSTN OA Exemption the Tribunal considered that competition was well developed in the CBDs:
- “The Tribunal is of opinion that the widespread existence of competing supply options to serve large business and government end-users in the CBD ESAs means that exemption is not likely to result in any serious long-term damage either to a supplier’s ability to compete, or to the efficient working of the competitive process in areas where many rivals exist and where alternative supply options are available to meet the needs of government agencies and large firms”*<sup>34</sup>
- 5.15 Optus proposes that the Commission should review the degree of competition in each Band and only retain price controls where competition is less intense. In practise this would likely to initiate the removal of retail price controls in Bands 1 and 2 areas.

**A separate FTM price cap is not warranted**

- 5.16 Optus expects that the ACCC will continue to come under some pressure to recommend a specific sub-cap on Fixed to Mobile services (FTM) to ensure that any reductions in termination rates resulting from its recent decision on mobile termination prices are passed through in retail prices (known as the ‘pass-through’ mechanism).
- 5.17 Optus does not support the imposition of a separate sub-cap on FTM services as a pass through mechanism may create distortions by reducing fixed operators’ pricing flexibility in downstream retail fixed-to-mobile services. The application of a restrictive price control regime in the mobile market will simply stifle and distort investment decisions to the detriment of competition and consumers. As noted in Section 3, Optus considers that the promotion of long-term competitive market structures is far preferable to regulation.
- 5.18 A pass through mechanism would not only influence how retail FTM rates are structured but also how other prices that are sold within the preselect bundle are structured. Such changes may have distributional consequences in terms of which customer groups receive the greatest price reductions – this would necessarily raise equity issues that the ACCC and Government should avoid.

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<sup>34</sup> Application by AAPT Limited [2009], ACompT5 (24 August 2009) at [72].

## **Social measures**

- 5.19 In the event that there is concern over equity issues or the welfare of rural or low income users the Government should consider specific targeted measures to address these objectives. For example the use of specific (limited) price control measures or through targeted welfare schemes.
- 5.20 Examples of targeted measures may include the following:
- The availability of products suited to a variety of consumer groups (e.g. pre-paid products with not contracts);
  - Product discounts for persons in certain welfare categories (e.g. Pension discounts);
  - Financial hardship assistance (e.g. debt management for unpaid bills); and
  - Short-term credit support (e.g. Optus' \$3 mobile account IOU service).

## **Appendix: Answers to the ACCC's specific questions**

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

Yes. Refer to Sections 3 and 4.

***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 further price controls should be introduced. Refer to Sections 3 and 5.

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

The RPC regime has supported the development of competition in the retail market however the price controls should now be removed.

However, the wholesale market and its associated regulatory framework are still subject to a number of serious deficiencies and it is this area of the market where the Commission should focus its intervention.

Refer to Sections 3 and 4.

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

The RPC regime has supported the development of competition in the retail market however the price controls should now be removed.

However, the wholesale market and its associated regulatory framework are still subject to a number of serious deficiencies and it is this area of the market where the Commission should focus its intervention.

Refer to Sections 3 and 4.

***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?***

The RPC regime should be removed from all services, or failing that, significantly relaxed. Refer to Section 5.

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

The RPC regime provided the industry with certainty and stability at the retail level during a period in which underlying markets were immature and poorly regulated. However, the retail market is now more competitive and the wholesale access market is subject to better regulation.

Given these circumstances, Government and the ACCC should set policy that continues to encourage investment in these markets. The continued application of a price control regime will only serve to stifle the industry's future progress by distorting investment decisions at the detriment of competition and the long-term interest of consumers.

Refer to Sections 3, 4 and 5.

***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 RPC regime provided the industry with certainty and stability at the retail level during a period in which underlying markets were immature and poorly regulated. However, the retail market is now more competitive and the wholesale access market is subject to better regulation.

Given these circumstances, Government and the ACCC should set policy that continues to encourage investment in these markets. The continued application of a price control regime will only serve to stifle the industry's future progress by distorting investment decisions at the detriment of competition and the long-term interest of consumers.

Refer to Sections 3, 4 and 5.

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

When RPCs were initially introduced they provided retail prices with a degree of certainty and stability. Given the wholesale market was immature and suffered from bottleneck characteristics RPCs assisted the development of competition in the retail market. The continuation of the current price controls will no longer promote economic efficiency in the market. The present RPC regime should be reformed because:

- RPCs have not resulted in the economic benefits which they were originally designed to achieve;
- Price controls do not allow firms to price services efficiently, harming allocative efficiency and discouraging investment; and
- Price controls can lead to regulatory 'price-squeeze' between the wholesale and retail markets; and
- Regulation should be targeted in the wholesale markets.

The continued application of a price control regime will only serve to stifle the industry's future progress by distorting investment decisions at the detriment of competition and the long-term interest of consumers.

Refer to Sections 3, 4 and 5.

***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.***

The RPC regime should be completely removed from all services, or failing that, significantly relaxed. Refer to Section 5.

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

The RPC regime should be completely removed from all services, or failing that, significantly relaxed. Refer to Section 5.

***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?***

The RPC regime should be completely removed from all services, or failing that, significantly relaxed. Refer to Section 5.

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

The RPC regime should be completely removed from all services, or failing that, significantly relaxed. Refer to Section 5.