



Australian
Competition &
Consumer
Commission

Telstra's compliance with the price control arrangements 1 January 2006 to 30 June 2007



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Report to the Minister for Broadband,
Communications and the Digital Economy

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1 Background and executive summary

Under paragraph 151CM(1)(b) of the *Trade Practices Act 1974*, the Australian Competition and Consumer Commission (ACCC) must report to the Minister for Communications, Information Technology and the Arts on the adequacy of Telstra's compliance with the price control arrangements that apply to it.

These price control arrangements are set by the minister. The current arrangements are contained in *Telstra Carrier Charge—Price Control Arrangements, Notification and Disallowance Determination No. 1 of 2005* (the determination).

This report relates to the initial reporting period under the current arrangements—an 18-month period from 1 January 2006 to 30 June 2007.

The ACCC considers Telstra has adequately complied with these price control arrangements. This view is based on the ACCC's review of an independently audited compliance report that Telstra provided.

1.1 Summary of the price control arrangements

The central framework of Telstra's retail price control arrangements consists of a series of price caps that apply to specified 'baskets of services'.

The first basket of services consists of local calls, trunk (national long-distance and fixed-to-mobile) calls, international calls and line rentals. This basket is subject to a price cap of CPI–CPI per cent. This means that Telstra is entitled to change the individual prices of the services within the basket as it wishes, but the aggregate price of all services in the basket must not increase in nominal terms.

The second basket consists of Telstra's most basic line rental product offered to residential customers. In the current reporting period, this basket was also subject to a price cap of CPI–CPI per cent.

The third basket consists of Telstra's most basic line rental product supplied to business customers and charity customers. This basket is subject to an annual price cap of CPI–0 per cent. As the initial reporting period was for 18 months, the price cap in the initial period was set at 1.5 times the annual CPI. For example, if the annual consumer price index (CPI) increased by 3 per cent, the nominal price of this basket must not increase by more than 4.5 per cent.

The fourth basket consists of connection services, and is subject to an annual price cap of CPI–0 per cent. In the initial 18-month reporting period, the aggregate price for these services must not increase by more than 1.5 times the increase in CPI.

All PSTN services, except those supplied to large business customers on individual contracts, are subject to the price caps.

Each price cap is an independent price cap and is not subject to any overall price cap. That is, price movements for each basket will be reported separately and are not required to be averaged to an overall price movement for all services.

Telstra is able to claim credits for investing to improve the quality of the services within the baskets, which are offset against actual price movements. Also, if Telstra prices below the maximum level permissible, the difference may be carried forward as a credit into the next price cap period.

The determination also provides for a number of other price controls.

- The price for untimed local calls is not to increase above 22 cents for each call (other than a local call made from a public payphone, or a local call made using a calling card), except in the case of discount plans when a customer may be required to pay more than 22 cents per local call.
- Local calls, and Telstra's most basic line rental product, supplied in non-metropolitan areas, must be offered at the same or a lower price and on the same price-related terms than in metropolitan areas.
- Telstra must offer a line rental to schools at a price at or below the standard line rental offered to residential customers.
- Increases in line rentals charged at residential rates must be notified to the ACCC, and are subject to the ACCC being satisfied that Telstra has in place a low-income package, and that Telstra consulted with a Low-Income Measures Assessment Committee before making any changes to that package.
- The price of each call to an internet service provider using a data network access service number starting with the numerals 0198 is not to exceed 22 cents.
- Telstra must notify the minister in advance if it intends to alter charges for directory assistance services, with the minister able to disallow the proposed changes if they are considered not to be in the public interest.

Telstra is required to report to the ACCC on its compliance with the price control arrangements, within three months of the end of a price cap period.

2 Methodology for determining revenue-weighted price movements

Under subclause 13(5) of the determination, the value of a price movement for a basket of services may be determined in accordance with a methodology developed by the ACCC in writing.

Following consultations with Telstra, the *Methodology for administration of the Telstra carrier charges price control arrangements* (the methodology) was established for the period from January 2006 to June 2009.

The methodology defines the price movement for a component service within a basket of services as a percentage change between the following:

- yield calculated from post-discounted revenue and usage (demand) for the price cap period
- yield calculated from post-discounted revenue and demand for the financial year immediately preceding the price cap period.

The methodology provides a robust and transparent method for measuring price movements for a single service, which can be aggregated with price movements of other services in the basket using revenue weights for each of the component services. The price movement for each component service in a basket is weighted based on revenues in the previous and current reporting periods.

Telstra has commenced proceedings in the Federal Court challenging the validity of the methodology. The price movements that Telstra has reported to the ACCC, and which are set out in this report, have however been calculated in accordance with the ACCC methodology.

3 Auditing of Telstra's price control report

3.1 Audit process and requirements

The methodology requires Telstra to provide a final, independently audited report to the ACCC, providing full details of its compliance with the price cap requirements, within three months after the end of the price cap period.

The aim of the audit is to determine whether:

- Telstra has complied with the price cap requirements as specified in the determination and the methodology
- Telstra has complied with the procedural requirements that are specified in the determination and methodology
- Telstra has exercised consistency in applying the methodology specifications to its data capture systems
- Telstra has in place internal procedures and information management systems to efficiently monitor and report on its compliance with its obligations under the determination and the methodology, including any change to these procedures or systems that may have a material effect on its monitoring and reporting.

The methodology states that the independent auditor will be appointed by the ACCC, so that it may be directly involved in the plan and approach to the audit as well as having direct access to the auditor's independent advice. In consultation with Telstra, Ernst & Young was appointed as auditor for the 1 January 2006 to 30 June 2007 price control compliance report.

3.2 Audit opinion

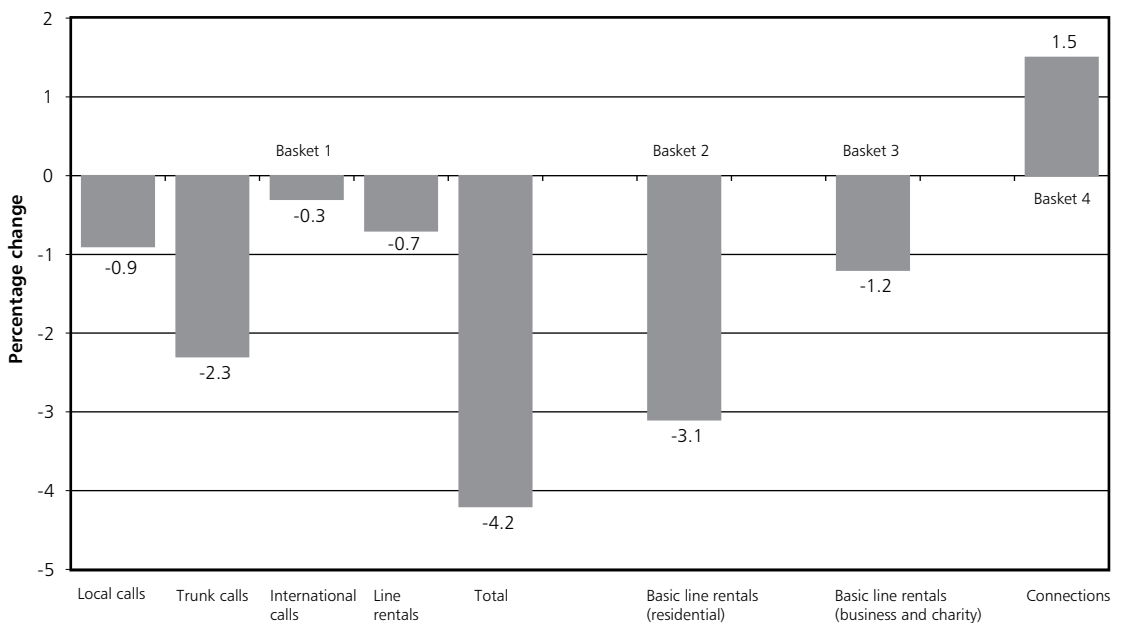
The auditor has expressed the opinion that Telstra has in all material respects fairly presented its compliance report to the ACCC in complying with the determination and methodology as it relates to the aims of the audit as described above.

4 Telstra’s compliance with the price control arrangements for the period 1 January 2006 to 30 June 2007

4.1 An overview of the revenue-weighted price movements for Telstra’s services

Figure 1 shows the size of the revenue-weighted price movements, inclusive of any credit for improvement in service quality, for each of the Telstra services subject to the price control arrangements during the period 1 January 2006 to 30 June 2007.

Figure 1. Telstra’s revenue-weighted price movements for 1 January 2006 to 30 June 2007



4.2 Deemed price reduction for quality improvement

To calculate Telstra’s compliance with the price control arrangements, the determination states that the ACCC may take it that the price of a service have decreased if the value of the service increases because Telstra altered the quality of service or the provision of the service.

During the current reporting period, Telstra submitted a value claim to the ACCC advising that it had undertaken capital investments of \$4.203 million that led to improvements to the quality of its line rental and connections services, and invested a further \$2.108 million that led to improvements to the quality of its connections service.

On the basis of the information provided by Telstra in support of the value claim, the ACCC accepted that Telstra's prices for line rentals and connections should be taken to have decreased slightly. In the case of Telstra's line rental service, and basic rental products, the approved credit was \$0.64 per line per annum. A credit of \$0.32 per connection was also approved.

The price movements reported below are inclusive of these credits.

4.3 Telstra's compliance with the price cap for the first basket

4.3.1 Cap on price movement

The first basket of services consists of local calls, trunk calls, international calls and line rentals. Trunk calls consist of national long-distance calls and fixed-to-mobile calls.

The determination provides that the revenue-weighted price movement of the first basket must not exceed CPI–CPI per cent.

4.3.2 Reported price movement

As indicated in table 1 below, the weighted average price decreased by 4.2 per cent. Accordingly, Telstra could have charged a weighted average price for the first basket that was 4.2 per cent greater than it actually charged and met this price cap.

This would suggest that, in this period, the aggregate price for the first basket was influenced by other factors, and the price cap did not provide a strong constraint on the aggregate price. The extent to which these factors will continue to influence Telstra's prices is unclear.

These price movements are possibly influenced by productivity improvements, and/or growing competition in PSTN and/or other services. As Telstra has publicly reported, its operating performance is indicative of strong productivity gains and reduced unit costs. In these circumstances, yield reductions can be made without reducing margins, and can lead to higher profitability. PSTN price reductions are possibly also being used to attract or retain customers for PSTN services and/or bundled mobile, data or pay TV services. Competition may have constrained Telstra in resetting prices for other customer segments to the extent necessary to maintain historical yields across all PSTN services.

Table 1 Telstra's compliance with the price cap for the first basket

Service	Price movements (%)	Revenue weights	Weighted price movement (%)
Local calls	–6.5	0.134	–0.9
Trunk calls	–6.2	0.374	–2.3
International calls	–8.3	0.037	–0.3
Line rentals*	–1.5	0.456	–0.7
Overall		1.000	–4.2
CPI			+2.7
(CPI–CPI)			+0.0
Carry-in from 2005–06			+0.0
Surplus (%)			+4.2

* Includes the deemed price reduction for quality improvements.

4.4 Telstra’s compliance with the price cap for the second basket

4.4.1 Cap on price movement

The second basket comprises basic line rental services supplied to residential customers. For the period 1 January 2006 to 30 June 2007, the price movement for basic residential line rentals must not exceed CPI–CPI per cent, although this can be adjusted to reflect deemed price reductions as a consequence of an improvement in quality. Further, the permitted price in the base period for this service from which price movements were to be calculated was set at \$31.95 (GST exclusive), which is higher than the actual average price charged for the service.

4.4.2 Reported price movement

Telstra’s compliance with the second basket is summarised in table 2. The table shows that the weighted average price has decreased by 3.1 per cent. Telstra’s list price for this line rental product did not change during the reporting period. The reported ‘decline’ in price therefore reflects the determination setting a higher base period price for the service, and also the credit for quality improvement, rather than a product-wide price decline. As a result, Telstra could have charged a weighted average price for the second basket that was 3.1 per cent greater than it actually charged and met this price cap.

Table 2 Telstra’s compliance with the price cap for the second basket

Service	Price movements (%)	Revenue weights	Weighted price movement (%)
Basic residential line rentals*	–3.1	1.000	–3.1
Overall		1.000	–3.1
CPI			+2.7
(CPI–CPI)			+0.0
Carry-in from 2005–06			+0.0
Surplus (%)			+3.1

* Includes the deemed price reduction for quality improvements.

4.5 Telstra's compliance with the price cap for the third basket

4.5.1 Cap on price movement

The third basket comprises basic line rental services supplied to business customers and charity customers.

The overall revenue-weighted price movement for this service must not, on an annual basis, exceed $(\text{CPI}-0) * 1.5$ per cent.

The specified CPI measure represents the aggregate price movement in the 'all groups' basket for the weighted average of the eight Australian capital cities, as published by the Australian Bureau of Statistics, for the 12-month period immediately preceding the first price cap period (January to December 2005). From January to December 2005 the CPI increase was 2.7 per cent.

Consequently, Telstra could have increased the weighted average price for the third basket during the price cap period by 4.1 per cent¹ without breaching the applicable price control arrangement.

4.5.2 Reported price movement

Table 3 illustrates that the revenue-weighted price for connections decreased by 1.2 per cent. This result was driven by the credit for quality improvement and customer specific discounts. As a result, Telstra could have charged 5.3 per cent more for products within this basket and met this price cap.

Table 3 Telstra's compliance with the price cap for the third basket

Service	Price movements (%)	Revenue weights	Weighted price movement (%)
Basic business and charity line rental*	-1.2	1.000	-1.2
Overall		1.000	-1.2
CPI			+2.7
$(\text{CPI}-0)*1.5$			+4.1
Carry-in from 2005-06			+0.0
Maximum permitted			+5.3

* Includes the deemed price reduction for quality improvements.

¹ That is, $(2.7-0) * 1.5 = 4.1$ (rounded).

4.6 Telstra’s compliance with the price cap for the fourth basket

4.6.1 Cap on price movement

The fourth basket comprises connections. Telstra supplies connections that require new cabling and in-place connections.

The overall revenue-weighted price movement for this service (comprising new and in-place connections) must not exceed $(CPI-0)*1.5$ per cent in the period 1 January 2006 to 30 June 2007.

The CPI applicable to the reporting period was 2.7 per cent. Consequently, Telstra could have increased the weighted average price for the third basket during the price cap period by 4.1 per cent² without breaching the applicable price control arrangement.

4.6.2 Reported price movement

Table 4 illustrates that the revenue-weighted price for connections increased by 1.5 per cent. Accordingly, Telstra could have charged a weighted average price for the fourth basket that was 2.6 per cent greater than it actually charged and met this price cap.

Table 4 Telstra’s compliance with the price cap for the fourth basket

Service	Price movements (%)	Revenue weights	Weighted price movement (%)
New connections*	+4.7	0.48	+2.2
In-place connections*	-1.5	0.52	-0.8
Overall		1.000	+1.5
CPI			+2.7
$(CPI-0)*1.5$			+4.1
Carry-in from 2005–06			+0.0
Maximum permitted			+2.6

* Includes the deemed price reduction for quality improvements. Price movements reflect rounding.

2 That is, $(2.7-0) * 1.5 = 4.1$ (rounded).

4.7 Telstra's compliance with maximum prices for untimed local calls and calls for extended zones

The determination requires that Telstra charge a price of not more than 22 cents for each untimed local call (other than a local call made from a public payphone) and not more than 50 cents for each untimed local call made from a public payphone.

It also requires that Telstra charge for calls between customers within an extended zone and between a customer in an extended zone and a customer in an adjacent extended zone at an untimed local call rate. Moreover, Telstra must not charge for preferential calls at a rate of more than 27.5 cents per 12-minute block of time (or part thereof).

The maximum prices charged for each of these calls as reported by Telstra are set out in table 5.

Table 5 Maximum prices for untimed local calls and calls for extended zones

Call type	Maximum charged (\$ including GST)
Extended zone call	\$0.22
Preferential call	Untimed local rate introduced
Call to Telstra's Big Pond internet service	\$0.22
Local call from payphone	\$0.50
Local call	\$0.22
Dial-up internet call	\$0.22

4.8 Telstra's compliance with the metropolitan/non-metropolitan 'pricing parity'

The determination requires that Telstra offer untimed local calls, extended zone calls and dial-up internet calls in metropolitan areas at the same or lower price per call and on the same price-related terms as those charged to its customers in non-metropolitan areas.

The rationale for this price control arrangement is to ensure that price reductions in areas where competition has developed also become available to customers in areas where competition may not yet have developed.

Similarly, Telstra is obliged to offer its most basic line rental products³ on the same price terms, or better, in non-metropolitan areas. Only a small proportion of customers are acquiring this particular line rental. Should other more popular line rentals increase significantly in price, however, the basic line rental product could act as a safety net, and the 'parity arrangement' will ensure that the safety net is equally available in metropolitan and non-metropolitan areas.

Telstra certified that there were no instances where it did not comply with the 'pricing parity' requirements during the period 1 January 2006 to 30 June 2007.

Telstra reported that it offers a range of standard products to residential customers as well as to charity customers even though there sometimes might not be a difference in the price and price-related terms of each product within those ranges as between customers in metropolitan areas and non-metropolitan areas.

However, Telstra reported that it may negotiate non-standard contracts with charity customers, and that its preparedness to negotiate non-standard contracts does not vary between metropolitan and non-metropolitan areas.

4.9 Telstra's compliance with requirements to offer standard line rental for residential/charity customers and schools

Under clauses 18 and 19 of the determination, Telstra is required to offer a standard line rental for residential/charity customers.

The standard line rental is the most popular line rental charged at residential rates. During the price cap period, the standard line rental was HomeLine Plus and the price was \$29.95 (GST included) per month.

The applicable line rental products reported by Telstra for each month are identified in table 6.

³ During the reporting period, Telstra's most basic line rental products were HomeLine Part and BusinessLine Part.

Table 6 Line rental prices for standard residential/charity, school and bundled products from 1 January 2006 to 30 June 2007

Month	Standard product	School product	Higher local call bundled product
January 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget, HomeLine Low Income Health Care Card ('LIHCC')
February 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget, HomeLine LIHCC
March 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget, HomeLine LIHCC
April 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget, HomeLine LIHCC
May 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget, HomeLine LIHCC
June 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget, HomeLine LIHCC
July 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget, HomeLine LIHCC
August 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
September 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
October 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
November 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
December 06	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
January 07	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
February 07	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
March 07	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
April 07	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
May 07	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget
June 07	HomeLine Plus	BusinessLine Complete (Non-profit organisation)	HomeLine Budget

Should Telstra supply a residential/charity customer with line rental at a price below that charged for a standard line rental, Telstra is allowed to charge that customer for untimed local calls in excess of the maximum untimed local call price set out in the determination, i.e. greater than \$0.22 per call.

Telstra offered two such arrangements to residential customers during the reporting period:

- HomeLine Budget—on which Telstra charged a line rental of \$16.82 GST excluded) (1 January to 31 July 2006) and \$18.14 (GST excluded) per month (1 August 2006 to 30 June 2007) and a charge of \$0.30 per local call.
- HomeLine Low Income Health Care Card—on which Telstra charged a line rental of \$18.64 (GST excluded) and a charge of \$0.24 per local call—this product offering was withdrawn on 1 August 2006.

Telstra is required to offer to schools a line rental that is at, or below, the standard line rental it offers to residential and charity customers.

Telstra reports that it has satisfied this obligation by noting within its standard customer terms that schools are eligible to receive the line rental prices that Telstra offers to non-profit organisations, namely:

- Business Complete (Non-profit organisation)—on which Telstra charge a line rental of \$17.73 (GST excluded) per month and a charge of \$0.20 per local call.

4.10 Telstra’s compliance with the requirement to notify the ACCC of increases in line rental charged at residential rates

Under the determination, line rentals charged at residential rates must not be increased unless the ACCC is satisfied that Telstra has complied with clause 22 of the Carrier Licence Conditions (Telstra Corporation Limited) Declaration 1997 (the declaration). The ACCC cannot refuse to consent to a proposed line rental increase on any other basis.

Clause 22 of the declaration requires Telstra to have measures in place to ensure that low-income customers have access to basic telephony services. Specifically, clause 22 of the declaration requires that Telstra must:

- have a low-income package in place that has been endorsed by low-income consumer advocacy groups and specified in writing to the Australian Communications Authority (ACA)
- have a marketing plan in place for the package, approved by the LIMAC
- obtain and consider the LIMAC’s views on proposed changes to the package.

The ACCC is satisfied that Telstra complied with these requirements in the period 1 January 2006 to 30 June 2007.

ACCC contacts

Infocentre: 1300 302 502

Website: www.accc.gov.au

Callers who are deaf or have a hearing or speech impairment can contact the ACCC through the National Relay Service, www.relayservice.com.au.

TTY or modem users—phone 1333 677 and ask for 1300 302 502.

Voice-only (speak and listen) users—phone 1300 555 727 and ask for 1300 302 502.

Addresses

National office

23 Marcus Clarke Street
Canberra ACT 2601

GPO Box 3131
Canberra ACT 2601

Tel: (02) 6243 1111
Fax: (02) 6243 1199

New South Wales

Level 7, Angel Place
123 Pitt Street
Sydney NSW 2000

GPO Box 3648
Sydney NSW 2001

Tel: (02) 9230 9133
Fax: (02) 9223 1092

Victoria

Level 35, The Tower
360 Elizabeth Street
Melbourne Central
Melbourne Vic 3000

GPO Box 520
Melbourne Vic 3001

Tel: (03) 9290 1800
Fax: (03) 9663 3699

Queensland

Brisbane

Level 3
500 Queen Street
Brisbane Qld 4000

PO Box 10048
Adelaide Street Post Office
Brisbane Qld 4000

Tel: (07) 3835 4666
Fax: (07) 3832 0372

Townsville

Level 6
370 Central Plaza
Building Flinders Mall
Townsville Qld 4810

PO Box 2016
Townsville Qld 4810

Tel: (07) 4729 2666
Fax: (07) 4721 1538

Western Australia

3rd floor, East Point Plaza
233 Adelaide Terrace
Perth WA 6000

PO Box 6381
East Perth WA 6892

Tel: (08) 9325 0600
Fax: (08) 9325 5976

South Australia

Level 14
13 Grenfell Street
Adelaide SA 5000

GPO Box 922
Adelaide SA 5001

Tel: (08) 8213 3444
Fax: (08) 8410 4155

Northern Territory

Level 8 National Mutual Centre
9–11 Cavenagh St
Darwin NT 0800

GPO Box 3056
Darwin NT 0801

Tel: (08) 8946 9666 (general)
Tel: (08) 8946 9610 (reception)
Fax: (08) 8946 9600

Tasmania

3rd floor, AMP Building
86 Collins Street
(Cnr Elizabeth and Collins streets)
Hobart Tas 7000

GPO Box 1210
Hobart Tas 7001

Tel: (03) 6215 9333
Fax: (03) 6234 7796

Australian Energy Regulator

Level 42, The Tower
360 Elizabeth Street
Melbourne Central
Melbourne Vic 3000

GPO Box 520,
Melbourne Vic 3001

Tel: (03) 9290 1444
Fax: (03) 9290 1457

Email: AERInquiry@aer.gov.au
Web: www.aer.gov.au

