RG 111104
18 November 2011

Price Control Review Team
Department of Broadband, Communications and the Digital Economy

By email

pricecontrols@dbcde.gov.au

Retail Price Controls Review

Macquarie Telecom Pty Limited ("**Macquarie**") appreciates the opportunity to make this submission to the Department of Broadband, Communications and the Digital Economy ("**DBCDE**") in relation to the discussion paper concerning the above.[1] This submission sets out some general comments on retail price controls and then responds to each of the questions raised in the Discussion Paper.

General Comments

Macquarie is a strong advocate of competition in retail communications markets to drive better quality and lower prices for end-users. Where markets fail or have the potential to fail, Macquarie believes that competition should be promoted via appropriate policy and regulatory intervention particularly in upstream (wholesale) markets. Ensuring that competitors have access to wholesale services on fair terms and conditions will allow competitive retail service providers ("**RSPs**") to compete more effectively with the dominant market player (Telstra). This in turn will enable market forces to set efficient retail prices, i.e., prices which recover costs including a cost of capital.

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

Retail price controls as they apply to Telstra are designed to protect consumer interests by ensuring that retail prices are not excessive given Telstra's market power. While this is an important policy objective, retail price controls do not promote competition *per se*. That is, while retail price controls may simulate competitive pressure, they do not create the conditions for sustainable competition to emerge.

Macquarie submits that the evident failure of effective competition to emerge in fixed telecommunications services is primarily a result of a sub-optimal sector structure. Telstra is an integrated retail / wholesale operator and, as such, has no incentive to act as a willing wholesale service provider. The deep-seated problem with sector structure is currently being addressed by the Australian Government's NBN policy. Under this policy NBN Co will be a

[1] DBCDE, Retail Price Controls Review, Discussion Paper, October 2011, ("**Discussion Paper**")

"wholesale-only" operator and Telstra is anticipated to decommission its copper access network and to migrate its customers to the NBN.

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

<u>Responses to Discussion Paper Questions</u>

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

1. To what extent are retail price controls beneficial to consumers? In what circumstances are they needed as a substitute for competitive market pressures? To what extent do they limit competition?

In Macquarie's view retail price controls are beneficial to end-users when they are used to compensate for actual or anticipated market failure. Essentially this means putting a ceiling on the price of services provided by the dominant market supplier (Telstra) to ensure that end-users are not charged excessive prices. It also means setting prices for socially important services (such as connection) at levels which are affordable for end-users, particularly those users with low incomes.

Retail price controls may be used as a substitute for competitive market pressure to safeguard against a dominant market supplier setting excessive prices for services. That is, prices which exceed costs including a cost of capital. However, the need for retail price controls in this circumstance is a second best solution given that the fundamental problem is one of market structure. That is, the first best solution is a competitive retail market reflecting an efficient wholesale market or an effectively regulated wholesale market.

2. Once a more effective competitive market emerges via the NBN, will retail price controls still be necessary?

Prima facie Macquarie believes that once an effective <u>wholesale</u> market emerges via the NBN retail price controls should not be necessary. With the NBN being a wholesale-only provider all RSPs (including Telstra) will buy the same wholesale services at common prices. As such, competition will be on the basis of service, i.e., service performance, responsiveness and reliability. Thus in the absence of an integrated wholesale / retail operator, there should be no need for retail price controls to safeguard against excessive prices. However, this does not rule out the need for retail price controls to pursue social policy objectives. For example, ensuring that connection services are affordable.

3. Should price controls remain in place for services over the copper network during the NBN deployment?

Prima facie Macquarie believes that retail price controls should remain in place for services provided over the copper network during the NBN deployment. This is because the NBN will not be complete for at least nine years, and Telstra remains an integrated operator and a dominant market supplier. However, the case for retail price controls weakens as the market continues to develop and structural concerns are addressed. Key anticipated developments include:

- Telstra committing to a robust structural separation undertaking;
- the execution of the definitive agreements between Telstra and NBN Co; and
- the effective regulation of wholesale prices for fixed access services including the removal of exemption provisions and adopting cost-based prices across all wholesale services.

4. If price controls are retained, which key services should be regulated?

The key retail services supplied by Telstra that should be subject to price controls are in principle those services that in the course of supplying Telstra has market dominance in addition to those services which are considered to have social importance. Such services comprise those which are already subject to retail price controls, that is:

- local calls;
- trunk (national long-distance, and fixed to mobile) calls;
- international calls;
- basic line rental for residential customers;
- basic line rental for business customers and charity customers; and
- connection services.

Macquarie notes that there some anomalies in the pricing of particular services such that the price of the service is greater if the call originates from a mobile service rather than originating from a fixed service. For example, calls to “1223” (Telstra Directory Assistance) are $0.50 from a mobile service and are free from a residential fixed line service. Price differences are also evident in the case of “1800” (Toll Free Numbers) and “13” (Local Call Numbers) services. This suggests that price controls might be applied to such services to ensure that mobile customers are not being charged excessive prices.

In addition, Macquarie considers that it may be appropriate for changes to be made to the structure of the service baskets under the existing retail price controls to ensure more focused control on the prices of specific services. In particular, a sub-cap on the price of fixed to mobile calls is desirable as a means of ensuring that a reduction in the mobile terminating access service charge would be passed on to end-users.

5. If retail price controls are retained on the copper network, should they be also be applied to services provided via the NBN fibre network? If not, why not?

Prima facie, Macquarie does not believe that retail price controls should be applied to services provided via the NBN fibre network. This is because NBN Co is a wholesale-only operator and is obliged to provide the same wholesale service to all RSPs at the same price. This means that the supply of retail services over the NBN is not via an integrated wholesale / retail operator with market dominance (Telstra). However, there remains a case for retail price controls to ensure that basic services provided via the NBN are available to low income end-users.

6. If price controls continue in future, should they apply to all service providers? Would this restrict competition by smaller service providers?

Macquarie believes that retail price controls should not apply to all RSPs generally rather they should apply only to Telstra. This is because Telstra is in a dominant market position. As the communications industry transitions to the NBN environment and existing structural concerns are ameliorated, more effective competition should emerge obviating the need for retail price controls on any operator let alone Telstra save for the pursuit of social policy objectives.

In addition, given the parlous state of effective competition in Australia's communications industry characterised by Telstra's market leadership across fixed, mobile, internet and pay TV service sectors, competing RSPs cannot afford to be hampered by any additional regulatory burden. In principle, Macquarie prefers less regulation to more and favours dominant carrier regulation. As such, Macquarie would be concerned if retail price controls were to apply to all RSPs.

7. How should low-income users be provided with equitable access to affordable basic telecommunications services and how should such access be delivered and funded?

Macquarie believes that existing arrangements to support access to affordable basic telecommunications services should continue to apply. That is, Telstra is required under its carrier licence to offer a service package for low-income users which is endorsed by consumer advocacy groups. Macquarie submits that this is an appropriate arrangement particularly while Telstra occupies a position of market dominance.

8. What is the ongoing role for LIMAC or should it be replaced, and if so, by whom?

Macquarie is not aware of any concerns with the operational effectiveness of LIMAC in its current role. As such, Macquarie does not advocate any changes to its current role or its replacement *per se*. Importantly, LIMAC includes representatives from a wide range of welfare groups, is independent of Telstra and reports annually to the Minister for Communications, Broadband and the Digital Economy ("**Minister**").

9. Is there a long-term need for a legislative obligation to have regulations or other arrangements in place to provide untimed calls within and between adjacent Extended Zones?

Macquarie submits that the requirement for Telstra to provided untimed calls within and between adjacent Extended Zones might be better placed within the existing framework of the Price Control Determination pursuant to the *Telecommunications (Consumer Protection and Service Standards) Act 1999.* This would ensure that all like requirements concerning the pricing of Telstra's retail service are set out in the one place. This would be consistent with basic principles of public policy including administrative ease and the promotion of transparency.

10. What is the best option for meeting this obligation?

Refer to Macquarie's response to question 9.

11. What regulatory oversight is required for the effective operation of the retail price controls? What role should the ACCC play in this?

Under the current legislative and regulatory framework, the ACCC has responsibility for wholesale price setting, while the Minister has responsibility for setting retail price controls. Macquarie has no concerns with this arrangement. This is because:

- the ACCC should be focussed on the detailed task of setting cost-based wholesale prices and this role should be independent of the task of retail price setting;
- the Minister should be concerned with achieving broad-based social policy outcomes through retail price controls.

Macquarie does not advocate for change in the legislative and regulatory framework for retail price controls except to note that it is the ordinary practice of the Minister to seek advice from the ACCC on retail price controls and the impact on competition and that this should continue. Moreover, any reports from the ACCC to the Minster or his Department ought to remain public documents.

12. What transitional arrangements might be required should price control arrangements be changed?

As per its response to question 11, Macquarie does not advocate for change in the legislative and regulatory framework for retail price controls.

Closing

Macquarie would welcome an opportunity to discuss the detail of this submission with you. Should you have any queries please do not hesitate to contact me.

Yours sincerely

Chris Zull
Senior Manager - Regulatory & Government

T 03 9206 6848
E czull@macquarietelecom.com