

## Telstra must supply unbundled access to ISPs for \$3.20 per month. Surely a typo!?

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Hard to believe? Well, it's true where Telstra continues to sell the standard phone line.

It's annoyed Telstra enough for it to head off to the High Court of Australia, effectively alleging that the ACCC has breached the constitution and pinched Telstra's property rights without proper payment.

On 19 January, the Australian Competition and Consumer Commission (ACCC) released its reasons for this decision.<sup>1</sup>

We'll overview what's happening generally in Australia, deal with this decision in particular, and then turn to implications for New Zealand.

We include comment on Telstra's strange constitutional challenge, and the strange split between its media releases and the ACCC case itself.

### What's happening in Australia

Some long-standing issues are coming to a head around access that Telstra must supply to other providers. In October, the ACCC came up with interim determinations confirming LLU (aka ULLS) charges at A\$7.20 for CBD, A\$17.70 for metro and A\$34.20 for regional access.<sup>2</sup> Like New Zealand, this is a cost-based calculation. Press reports suggest that the final price for the main service (metro at \$17.70) might drop as low as \$14.

In relation to wholesale of standard voice telephony (that is, analogue phone lines) the ACCC has come up with suggested (non-binding) prices of A\$23.12 per month for residential customers and A\$25.84 per month for business customers. This is the Wholesale Line Rental or WLR service.

Next up was the interim decision by which Telstra must sell the service known as LSS (Line Sharing Service) at A\$3.20 per month. Telstra have climbed into the ACCC on this decision and upped its very strong attack on

the regulator, and taken the ACCC to court alleging breach of Australian constitutional requirements.

### What's LSS?

LSS is a variation on the LLU/ULLS theme. An access seeker (such as an ISP) gets access only to the higher frequencies over the local loop, leaving Telstra with the lower frequencies. DSL services (that is, broadband) utilise the high frequencies, centring around a piece of equipment installed at an exchange or cabinet box called a DSLAM.

Under LLU/ULLS, an access seeker such as an ISP typically installs a DSLAM and related equipment at the incumbent's premises.

For LSS, the ISP does the same, but Telstra still supplies an analogue phone line service over the lower frequencies, (either direct to its retail customers or to other providers via wholesale channels (ie the WLR service))

The price the access seeker must pay for LSS is cost-based.

The LSS price history is striking. It moved from an initial price proposition from Telstra of around \$15 per month. This was rejected by the ACCC. The ACCC responded a couple of years ago with suggested pricing of \$7-\$9. Then, under Australia's undertaking process, Telstra proposed a price of \$9. By this stage, the ACCC wouldn't run with a figure at the top end of its suggested range. So it rejected Telstra's proposed undertaking to sell at \$9. Telstra unsuccessfully appealed against that rejection.

At that stage Telstra maintained that its costs were \$11.75 (that is, an LSS price of \$11.75 could be justified) but they were prepared to

<sup>1</sup> <http://www.accc.gov.au/content/index.phtml/itemId/778519>

<sup>2</sup> <http://www.accc.gov.au/content/index.phtml/itemId/768632>

compromise at \$9. Late last year, the ACCC has decided, in an interim determination, that the price should only be \$3.20.

A fifth of where Telstra started!

### How did the ACCC get to A\$3.20?

The ACCC decided that Telstra was recovering all its line costs from the analogue phone line service and ADSL services. Requiring ISPs to contribute to line costs, as part of LSS charges, would amount to double dipping.

So the \$3.20 is the ACCC's interim assessment based on the direct cost of providing the LSS service.

The ACCC rejected a Telstra proposal that it reduce the analogue phone line price and correspondingly increase the LSS price to rejig allocation of line costs. A main reason was that this would still leave excessive charges.

However, this is an interim determination with a final decision to be made by the end of March. The ACCC has left open the ability for Telstra to reasonably rebalance the pricing as between the two services, so that line costs are allocated differently.

### Telstra's High Court Challenge

Reading Telstra-produced comments<sup>3</sup> leaves the impression that it is talking about an ACCC decision that is quite different from the actual decision, when it justifies its constitutional challenge to Australia's highest tribunal, the High Court.

The argument is that the wholesale broadband access arrangements amount to acquisition of property rights on other than "just terms" (ie: the price is too low).

The Telstra press release, announcing the High Court case, gives the overall strong impression that Telstra isn't recouping its line costs because ACCC has set the broadband wholesale access as low, at \$3.20, when in fact what ACCC actually said and did was more comprehensive:

- Telstra is recouping that cost from line rentals and so the LSS charge is reduced
- To allow more than \$3.20 for LSS would have Telstra double-dipping (that is, Telstra would have been getting more than recovering its costs). To the opposite of Telstra not recovering its costs, it would be getting more than its entitlement.
- ACCC has overtly invited Telstra to rebalance charges so that the costs can be recovered by dropping line rentals and in turn increasing LSS charges

Telstra feels able to tell only part of a complex story, put a spin on it, and even describe an ACCC process as "arbitrarily" reducing wholesale prices. Its [www.nowweareretalking.com.au](http://www.nowweareretalking.com.au) site gives the appearance of talking about a different case, even saying, in a heading, that "ACCC admits its mistake". It hasn't.

Alan Kohler in *The Age*<sup>4</sup> mounts an articulate case for why he thinks Telstra's High Court challenge will fail (well fail, except, as he says, to keep a few lawyers in German cars).

Now if the actual complaint was that ACCC had wrongly decided the underlying cost price, rather than the LSS cost and the balancing between LSS a line rental, Telstra comments would start to make sense. But then that's a question of whether ACCC has got its assessment of Telstra's cost (via economic modeling) right or wrong. That sounds like territory for ACCC and the Australian Competition Tribunal, and not a constitutional issue. The Commission and the Tribunal would need to be out of left field before the constitution got a look in.

So anyone on for a bet (100 Telstra shares) on the side that the High Court challenge won't fail (er, the court case itself we mean, not the PR heat around the sides).

### Implications for New Zealand

Now New Zealand has new legislation, and Telecom has confirmed that the Commission must decide price, the next step is for the

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<sup>3</sup> Telstra Media Release of 24 January 2007 (<http://www.telstra.com.au/abouttelstra/media/release.cfm?ObjectID=39041>) and its Now We are Talking site (<http://www.nowweareretalking.com.au/Home/ByTheWay.aspx#intNav29>)

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<sup>4</sup> <http://www.stuff.co.nz/print/3947587a1864.html>

Commission to start standard terms determinations (or for an ISP to apply) in relation to LLU and UBS pricing. The LLU price is to be calculated on a basis similar to that used in Australia (cost-based (TSLRIC)). The Australian experience and information will be very useful.

New Zealand doesn't have a direct equivalent of LSS. The closest regulated service is the "clothed DSL" variation of UBS (this is the proposed enhanced UBS where Telecom still sells the PSTN line).

UBS differs from LLU/ULLS and LSS particularly around the fact that Telecom supplies the DSLAM and related kit and services for UBS, while LLU/ULLS and LSS have the access seeker (eg, an ISP) providing that kit and service.

With the "naked DSL" variation of UBS, the ISP takes UBS on the basis that Telecom does not also provide an analogue phone line. As Telecom loses the standard phone line revenue, the new legislation has the ISP paying the cost which would normally be recovered from the phone line customer. That is so unless the Commission considers that the naked DSL price already takes into account all those relevant costs.

"Clothed DSL" on the other hand assumes that Telecom continues to get the phone line revenue. So this is the service that is closest to the Australian LSS service, but with two key differences:

- As Telecom provides the DSLAM and associated kit and services, that is taken into account in the pricing of the service.

- LSS has cost-based pricing but both UBS variants (clothed and naked) have retail-minus pricing.

Retail-minus and cost-based pricing are very different models. We have overviewed some of the difficulties with retail-minus pricing in the article on our website, *Problems for NZ's UBS Pricing Apparent from UK Judgment*. NZ faces ongoing major problems with its retail-minus structure.

It is interesting to compare:

- The currently available NZ regulated service, which is clothed DSL restrained on the uplink at 128 kbps. The retail-minus price has been set at around NZ\$28.00 per month, although the Commission is currently reconsidering that price.
- The cost-based LSS pricing of A\$3.20.

The main service difference between the two is only the DSLAM and associated kit and service.

The LSS pricing may go up (as contribution to line cost is rebalanced) and the UBS charge may go down (although query whether in fact the price will go up with unrestrained UBS speeds). But even so, it is interesting to see what different pricing models produce: it is unlikely the DSLAM etc is more than a small part of the difference.

### Conclusion

Telstra, for the time being, has ended up in the remarkable situation where it provides LSS at only A\$3.20 per month. The Australian experience provides some useful pointers for New Zealand.

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