3 November 2005

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ELECTRONIC LODGEMENT

Dear Sir or Madam

Telstra letter to ACCC

For your information, attached is a copy of a letter sent to the ACCC from Telstra's Chief Financial Officer John Stanhope.

Yours sincerely

Douglas Gration
Company Secretary

John V Stanhope
Chief Financial Officer &
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Finance and Administration

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3 November 2005

Mr Graeme Samuel
Chairman
ACCC
Level 35
360 Elizabeth Street
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Dear Graeme

We were surprised to say the least to see you reported in today's media to the effect that the Commission has no idea of the source of Telstra's estimate of an $800m annual loss if the ACCC's de-averaged pricing model for ULL is adopted. We were equally surprised to see you seek in effect to discredit our use of an OECD report which highlights the need for averaged ULL prices if geographically averaged prices are going to be maintained at the retail level.

The $800m figure is derived directly from detailed analysis of the ACCC's draft ULL determination.

On the basis of this analysis of the ACCC's draft ULL determination, Telstra would need to charge $144 per month for ULL in Band 4 (rural and remote areas) to permit cost recovery. As the Commission knows, Telstra is unable in practice to charge these figures, as ULL rollout would be uneconomic in these areas - competitors would rely instead on straight re-sale of Telstra's existing network, which is priced at $40 per month on average for telephony customers and $70 per month on average for combined telephony and DSL customers.

With 715,000 Telstra customers in Band 4, the average gap between the position adopted by the ACCC as to the price needed to allow cost recovery (estimated at $144 per month per customer), and the revenues that will actually be received by Telstra (average about $45 per month per customer), would be over $70m per month, or in excess of $800m p.a.

This loss is covered today by the cross subsidy inherent in an averaged wholesale and retail pricing structure - which the ACCC wants to strip away on "economic efficiency" grounds, but without any regard to the resultant negative consequences for rural Australia.

We note the comment in the recent OECD report entitled "Access Pricing in Telecommunications" (2004) which stated:

> *"If the regulator wishes to preserve the geographically averaged structure of end-user prices, it is essential to geographically average ULL prices".*

As the Government has recently adopted a retail parity pricing position for telephone services, the above-mentioned OECD report clearly demonstrates that the Government's policy position is only sustainable if ULL prices are averaged.

I particularly note in this context that this OECD Report, adopted by the OECD's Competition Committee, stated "The report was drafted by Darryl Biggar, consulting economist to the ACCC, previously a member of the OECD Competition Division."

Additionally I would note that this **OECD report highlights a major conflict between the de-averaged wholesale pricing approach the ACCC is taking on ULL, and the averaging approach it has adopted in relation to local call resale** in response to the Government's policy on setting local call rates. In relation to this averaging approach, known as "retail-minus", the OECD reports states:

"Australia........................which has per-call charges for local calls, resolves the trade-off by introducing a special set of charges for local calls. Specifically, rather than use (cost-plus) per minute charges for call origination and termination, **in the case of local calls, Australia relies on a retail-minus approach which** sets access prices on a per call basis. This retail-minus approach **maintains a close relationship between final prices and access prices.** Since local calls in Australia are not geographically differentiated, are not differentiated according to peak/off-peak but do depend on the identity of the customer (business/residential), **the retail-minus approach ensures that this same structure is reflected in the access prices.**" (page 114); emphasis added.

Finally I wish to correct an error you made when you advised the relevant Senate Estimates Committee yesterday that, in referring to OECD material when presenting its position on ULL pricing, Telstra was referring to an OECD staff paper (with the strong inference that this staff paper had no official status). There are in fact 2 documents: the staff paper you referred to, as well as the official OECD document noted above. We are only referring to the major report released by the OECD in January 2004. You may therefore wish to consider correcting your error as to Telstra's use of OECD material with the relevant Senate Estimates Committee.

Yours sincerely

John V Stanhope
Chief Financial Officer &
Group Managing Director
Finance and Administration