



RESPONSE TO COMMENTS REPORT

Public consultation on draft Service Specific Pricing Principles pursuant to Subsection 135 (3) of the National ICT Act 2009

18thSeptember 2013

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1 INTRODUCTION

In July 2013, NICTA published draft Service Specific Pricing Principles in relation to the international submarine cable transmission capacity service and the international submarine cable gateway access service following the declaration of those wholesale services by the Minister for Information and Communications on 21st March 2013.

Written comments on those draft pricing principles were received from

- Digicel;
- Telikom PNG;
- Independent Consumer and Competition Commission; and
- PNG National Research Institute.

This report provides a summary of the key comments and issues that were raised through that public consultation process and NICTA staff's response to them. In general the comments received in the consultation process have confirmed the proposed text of the exposure draft.

2 OVERVIEW OF THE COMMENTS RECEIVED AND NICTA STAFF'S RESPONSE

The table below provides a summary of NICTA staff's response to some of the more significant comments made by respondents to the discussion paper. It is a summary and is not an exhaustive and detailed description of the issues raised or considered by NICTA staff. NICTA staff have considered all submissions and the factual and legal points made by all respondents. The omission from the table below of one or more of the many matters raised by any of the respondents does not mean that NICTA staff failed to consider or take account of such matters.

No.	Submission	Reference or subject	Summary of comment	NICTA staff's response
1	Digicel	Para. 3	Digicel agrees that the use of TSLRIC+ or FAC, or a hybrid of both, would be the appropriate cost standard to use in the context.	Noted.
2	Digicel	Para 4.	If NICTA intends to use FAC it should consider including recognition in the service specific pricing principles that any pricing decisions will nonetheless be based on efficient costs.	This is unnecessary given s.134(1)(a) of the Act.
3	Digicel	Para.9	The service specific pricing principles should recognize that different access prices may be made available to access seekers based on the volume of capacity and/or the duration of the access agreement that the access seeker is willing to commit to.	NICTA staff agree and have amended the draft service specific pricing principles according. However, the point has been added that these factors are only relevant to price to the extent that they result in cost differences.
4	Telikom	p.1, para.2	'Telikom PNG undertook these major investments at its own risk and at great cost for its own business interests. It is unfortunate that this is now being coveted by other operators who could have done the same if they considered such investments of value. The inability to recover costs and gain an economic return from investments will impact considerations of future investments (sic).'	It is not in the public interest to require the duplication of investments when that might lead to uneconomic outcomes all round and where the capacity of existing infrastructure is sufficient to meet all current needs. Access to infrastructure on an efficient basis better serves the overall interest of customers and will increase total welfare. Increasing utilisation will reduce Telikom's risk exposure. Prices will be set on the basis of costs which will include a risk-adjusted return on the capital employed, so Telikom's interests will be protected in the process.
5	Telikom	p.1, para.3	'The pricing principle[s] developed should not	Noted and agreed. That is the intended effect of the proposed pricing

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			attempt to cannibalise the cost incurred by Telikom PNG in maintaining the submarine cable over the years. Telikom PNG would be supportive of any pricing principle that would improve the efficiency of the submarine cable while allowing access seekers to share the cost of maintaining the submarine cable and ensuring a fair economic return to itself for undertaking this risky venture.'	principles and the proposed costing methodologies in particular.
6	Telikom	p.1-2	'Telikom PNG considers the imposition of such regulation [of access to the submarine cables] is akin to the application of regulatory contracts, hence Telikom PNG strongly requests that any decision on principles and methodologies to be applied to determine prices and costs must first be presented in detail to Telikom PNG for its further consideration before it is approved. In particular, the presentation should demonstrate that such proposed principles and methodologies will actually assist with achieving an acceptable return on investment.'	This comment misunderstands the process that will apply to the setting of wholesale prices for submarine cable and landing station capacity. Having determined that services in question warrant being declared and such declarations satisfy all of the declaration criteria, NICTA must develop specific pricing principles. They are the principles now being subject to public consultation. Telikom may be challenged by NICTA or other interested parties on whether prices that are being charged are consistent with these specific pricing principles. In addition NICTA will require Telikom to demonstrate in the event of an access pricing dispute that any price changes proposed in future are consistent with the principles outlined. The onus in that situation will therefore fall upon Telikom, not NICTA, to provide the demonstration required.
7		Commencement and expiry of the service specific pricing principles	Telikom requests to be informed in advance before NICTA makes any determinations [which presumably means determinations that apply to the service-specific pricing principles].	Noted. If the pricing principles are to be amended, there will be a public consultation which will provide substantial notice to Telikom. However, if this comment refers to determinations in which the pricing principles are applied, then Telikom will have been fully engaged in and informed of the process either in the course of arbitration or in the course of considering an application from Telikom for the approval of a tariff or tariff change. The commencement of the determination that establishes the actual pricing principles though is as stated in the determination itself (i.e. upon Gazettal).
8	Telikom	Section 6 of the pricing principles p.3	'Telikom agrees that costs associated with any defaults [sic] that reduce the capacity available for the period should be borne propositionally [sic] by	The draft pricing principles do not state that the costs of a fault should be borne by all access seekers. The draft pricing principles state that any capacity constraints caused by a fault or other condition should be borne

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			all the customers'.	<p>proportionally by all access seekers (except those who have paid a premium for service continuity under such circumstances).</p> <p>Efficient operating costs will be included in the calculation of access prices.</p>
9	Telikom	p.4	Telikom should be allowed to 'provide its costs [sic] model [to NICTA] and NICTA should use this as a basis at this initial stage'	If Telikom has a suitable cost model then it may offer that model to NICTA during the course of arbitration. However NICTA will not be constrained to use a model prepared by Telikom or to base its decisions on such a model. The reasons why such a commitment is inappropriate include: (1) NICTA would need to examine the relevant model at the time of any dispute or price approval to determine if it was fit for NICTA's purposes; (2) NICTA may have its own cost model(s) and may prefer to rely on them; and (3) Telikom's model may include costs that are inefficient and need adjustment. There may be a range of additional considerations that are matters for judgment and which are unlikely to be adequately reflected in Telikom's cost model.
10	Telikom	p.3, 7	NICTA should decide now on what cost model(s) it intends to rely on to determine the price of the transmission capacity service rather than proposing to rely on TSLRIC+, FAC, or a hybrid of the two.	Most TSLRIC models do not calculate certain non-network operating and overhead costs, but use data derived from the accounts adjusted for efficiency. For that reason the use of both FAC and TSLRIC+ approaches needs to be left open and discussed with Telikom when the issues arise. Telikom need have no concerns about recovering efficient, relevant and risk-adjusted costs that it has incurred as such is expressly provided for in Part VI of the Act.
11	Telikom	p.4, 7	'Most telecommunications operators around the world have now moved away from TSLRIC because... [its use does not allow] operators to fully recover their common cost and [because it is unable] to include historical cost data for cost recovery.'	It is true that <i>some</i> regulators are moving away from TSLRIC in the case of <i>some</i> fixed network services because of the risks of both under and over recovery over a long period in which the data in the model may have been reloaded a number of times. Some regulators, such as the ACCC in Australia, have adopted a building block approach, which involves establishing an efficient rate base in the first place (possibly using a LRIC model) and then adding cost increments when the model is reviewed. It is important to note however that the primary focus of such models is for subscriber access lines rather than for submarine cable capacity pricing or

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				co-location at network nodes. It is because the situation is changing that the pricing principles have retained a degree of flexibility to better reflect the overall needs of both access seekers and of Telikom as access provider.
12	Telikom	p.4,7-8	If NICTA applied TSLRIC then Telikom would make 'a loss equal to its common costs, because TSLRIC only considers product specific costs but makes no allowance for common costs associated with multiple services'.	Telikom misunderstands the draft service specific pricing principles. The pricing principles clearly state (at 7(3) and again at 10(3)) that 'The cost standard that shall be applied shall be: (a) total service long run average incremental cost (TSLRIC), to which shall be added an equi-proportionate mark-up to reflect a reasonable contribution to common costs that are accepted by NICTA as reasonably needed and appropriate for the provision of the transmission capacity service'. NICTA staff have made a minor editorial change in the revised draft to make this point clearer.
13	Telikom	p.4, 8	If NICTA applies TSLRIC+ it should not be based solely on forward-looking costs solely but instead on actual or historical costs.	Telikom has already noted that some regulators are moving away from TSLRIC+ cost standards in their models. That does not mean that such regulators are accepting that the rate base (or basic building blocks) is the same as the historical accounting costs in the books of the access provider. In fact with alternative methods there is always consideration given to the efficiency of expenditures. If costs are forecast to decline in future that cost would have been born by the access provider through write offs or write down of assets in any case, whether the asset was subject to facility sharing or not. The regulator seeks to obtain price outcomes that reasonably reflect the outcomes that would have occurred in a competitive market. In effectively competitive markets there are constraints on the ability of providers to pass inefficiencies onto their customers. Nevertheless, in the case of specific assets and facilities, Telikom can be assured that NICTA will give very serious consideration to any argument about specific cost that Telikom wishes to make in the course of any access dispute.
14	Telikom	p.5, 8	Telikom is concerned about the potential use of FAC because it is 'based on accounting practices rather than on economic ones [and] normally historical cost data is used to allocate costs and	Noted. The way in which costs are allocated is one requiring considerable care, whether the model is FAC, TSLRIC+ or hybrid. The general principle is that costs should be allocated on the basis of cost causation. Allocation of shared network costs amongst services should be on the

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			such information does not bear much resemblance to the actual or prospective cost situation'.	basis of the relative extent to which each service caused the costs to be incurred. The allocations should be adjusted to reflect volume and other changes in the mix for prospective years, but, as Telkom's comments suggest, there may be insufficient data for the allocation to be robust. It is for these reasons that reliance on cost models, of any kind, needs to be leavened with common sense judgment.
15	Telikom	p.5	Prices based on FAC tend to encourage inefficient operation and investment and provide incentives an operator to increase its costs. Therefore Telkom would like to know how NICTA would apply FAC.	Some regulators have developed both FAC and TSLRIC+ models, as well as both top down (accounting based) and bottom up models to examine the way costs evolve under various modelling assumptions. This option is open to NICTA. A hybrid approach is also an option that many regulators have adopted and which NICTA wishes to keep open. With hybrid cost models some costs may be calculated using FAC standards. The costs involved tend to be those that are not traffic-sensitive and which are typically derived from the efficiency-adjusted accounts of the access provider. It is usually the case that these costs, once established are applied as mark-ups on the traffic-related unit or total costs associated with network services or, depending on the nature of the model, network elements. At this stage, this is probably the best indication of how NICTA might apply FAC.
16	Telikom	p. 5–6, 8–9	Telikom suggests that NICTA should use the building block methodology to calculate access prices because, among other things, it allows the access provide to recover its efficient actual costs as well as a reasonable rate of return on its investment in sunk assets.	The building block method is a form of FAC model, but with initial adjustment of the blocks to reflect efficient costs. The efficiency process may have been undertaken using benchmarks or using TSLRIC+ costing standards where appropriate. Sunk costs are not necessarily efficient costs, and they need only be imposed on wholesale customers if they are efficient. However NICTA recognises that when investments are made there are risk factors and that the efficiency that appears to have been achievable with perfect hindsight is not the level of efficiency that can be reasonably expected at the time investments are made. Some judgment needs to be applied in such cases and NICTA is obliged under the Act to articulate its reasons and exercises of judgment when it prepares and consults on draft decisions. This will be done in specific cases at the appropriate time.

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17	Telikom	p.6	Telikom requests that NICTA inform licensees of the basis of any cost adjustments and the efficiency gains it intends to achieve as a result of the cost adjustments.	Telikom misunderstands the pricing principles. This section applies if the price of the gateway access service is to be specified by NICTA in an interim determination or a final determination
18	Telikom	p.6	'In considering the economic life of the transmission capacity asset, NICTA should rely entirely on Telikom PNG's costs incurred in maintaining the assets. For any benchmarking Telikom must be given the opportunity to access [sic] the cost details and its operating jurisdiction	Economic life determines the period during which operating and maintenance costs will be incurred, not the other way around. NICTA will have regard to all useful sources of information on depreciation and asset lives, including the views of the access seeker (Telikom in this case). Benchmarking may be relevant and useful in some cases. NICTA is obliged to operate on the basis of general administrative law principles. An important principle is that it must take into account all relevant considerations. For that reason it is inappropriate to limit itself only to the data or information or practices of Telikom in advance. However, NICTA will fully take into account relevant information provided by Telikom during the course of any access dispute – which it must do under the same principle.
19	Telikom	p.6	In determining the reasonable return on investment NICTA should not underestimate the entire investment Telikom PNG has undertaken over the years and should give considerable attention to the whole transmission capacity service. Telikom PNG will dispute any piecemeal assessment of the transmission capacity services.	Noted. In looking at the investments that have occurred NICTA will require that they be both relevant and reasonably efficient. Not all of Telikom's investments are relevant to the assets associated with the submarine cable capacity and with backhaul to the first network node. Naturally they will not be considered unless relevance to the declared services can be demonstrated.
20	Telikom	p.6	Telikom 'considers that the choice between actual collocation and virtual collocation as part of the international submarine cable gateway access service should be mutually agreed by access provider and access seeker.'	Mutual agreement is clearly the best way of proceeding. The parties will need to understand the circumstances at the relevant locations in order to make a decision. However if agreement cannot be reached NICTA will be required to arbitrate. If both forms of interconnection are technically feasible and there are no other factors that act as barriers to one or other form of interconnection, the choice will be with the access seeker. In these circumstances arbitration often becomes an examination of the validity of the access provider's objections to the access seeker's preference. If the objections are valid, they will be upheld.

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21	ICCC	p.2 Investment	<p>Given the high risks of service failure associated with the current submarine cable systems, ICCC considers that there is a need for further investment in submarine and backhaul systems and that the 'Service Specific Pricing Principles must support the following requirements:</p> <ul style="list-style-type: none"> • Capacity to increase bandwidth requirements in line with market demand ... • Diversity – PNG needs at least two geographically diverse and reliable fiber optic cables landing in PNG. • National backhaul ...' 	<p>Noted and agreed. NICTA staff consider that the draft principles are supportive of further investment in the submarine cable sector. Application of the principles needs to be undertaken bearing in mind the need to encourage such further investment. Note also that these requirements are expressed in the Act and in the General Pricing Principles.</p>
22	ICCC	p 4, principles	<p>The ICCC notes that 'pricing must support further investment – not just the maintenance of existing infrastructure. Pricing which is only designed to cover current costs will not succeed in driving the further investment that PNG needs.'</p>	<p>Noted and, subject to the comments that follow, agreed. Cost based pricing is concerned to match prices that will apply during future periods with costs that are forecast for that period. These include annualised capital costs that are recovered in full over longer period. If future demand levels are forecast to rise the costs associated with investments and operating costs to address those higher volumes of demand will reflect that. NICTA does not have an approach to pricing that covers any lesser definition of costs.</p>
23	ICCC	p.4 replacement costs	<p>ICCC considers that prices should be based on the replacement costs of 'modern equivalent assets' reflecting the best-in-use technology available to the network operator'.</p>	<p>Noted – this is the general approach taken to cost-based pricing. It might also be mentioned that regulated pricing will also cover operating costs of an efficient operator together with a risk adjusted return on the capital employed. These are not pricing principles specific to the services in question however. They are of a more general nature.</p>
24	ICCC	P 4, annual reviews	<p>ICCC recommends that pricing reviews should be done at least once every two years, if not annually, because telecommunications equipment and connectivity prices are falling on a per unit basis.</p>	<p>Noted. If there are unanticipated changes in the evolution of equipment and connectivity prices then review may well be justified. However, NICTA staff consider that reliable forecasting should be undertaken to enable input cost evolution to be determined for the future years in cost models and other calculations. This means that a period of up to 3 years should typically be able to be determined for unit prices, in the ordinary course of</p>

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				events. Changes from year to year in these forecasts might be smoothed to provide increased certainty for the industry and to support the climate that may be best for investment. Annual changes to regulated prices should be avoided if possible because the predictability and certainty that is best for investment may be put at risk.
25	ICCC	P 4	ICCC 'supports the proposed principles outlined by NICTA in their document (principle 7).'	Noted.
26	ICCC	P 4	'A complicating factor occurs If prices are based upon replacement costs and costs are falling on a per unit bandwidth basis, then an investor may not fully recover their investment before the end of the equipment's economic life. A solution to this which [ICCC] recommends is the use of "tilted annuities".'	Noted and agreed in principle. Falling input costs is indeed a complicating factor as the ICCC observes. However, in competitive markets service providers also encounter this issue. They may be forced to write off equipment or write it down faster if new lower cost platforms and equipment are being deployed by their competitors. They may choose to keep using their current equipment. These are choices and risks that competitors face and resolve everyday in competitive markets. They have the same choices in regulated markets, when the return is based on the most efficient replacement technologies and their actual costs are higher. In practice they receive some regulatory relief from front end loaded returns – which is what they might seek in competitive markets as well.
27	ICCC	P 5 bottom up and top down models	ICCC recommends that NICTA use bottom up rather than top down models and notes that if the latter are used adjustments will be needed to reflect true replacement costs. ICCC notes that doing this can be difficult.	Noted and agreed. Any models developed by NICTA will almost certainly be bottom up models which include assumptions about efficient costs. However NICTA will consider any relevant factor put forward by an operator, including a top down model based on the operator's accounts. NICTA will however be mindful of the issues and challenges that are posed by top down models, of the kind listed by ICCC.
28	ICCC	P 5, contribution to common costs	'Prices should include a reasonable contribution toward the common costs of the network operator. NICTA have already proposed the principle in their draft and [ICCC] supports this approach.'	Support noted. The contribution to such costs is a requirement of Part VI of the Act.
29	ICCC	P 6 Spare capacity	'The access provider must be able to recover the cost of spare capacity, subject to NICTA's approval of the level of spare capacity delivered.'	Noted and agreed subject to more detailed specification in the circumstances of any case that arises, and subject to the capacity referred to being more accurately described as 'unused'. Typically a new network

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				has substantial unused capacity. Pricing is based on the capacity that is used rather than allocating an equi-proportionate share of unused capacity. If that were not the case the unit price of capacity would be excessive and artificially kill off demand. However in most models it is usual to include the advanced purchase of capacity that is necessary to meet unexpected demand surges. If the provisioning period for equipment is substantial then including forward capacity that is installed in advance of any need is appropriate. A further allowance might be made where the minimum capacity of available equipment or systems exceeds the capacity required by demand volumes. This latter concession might not apply however in the case of submarine cable capacity and related equipment. In any case, this response comment reflects general network costing and pricing principles and is not specific to the declared services.
30	National Research Institute (NRI)	P ii, Natural monopoly – also at p 4, section 4	'Theoretically, the market in which the International Submarine Cable falls under is a natural monopoly.'	NRI's view is noted. This is not the basis of NICTA's declaration in relation to the wholesale services, however. A natural monopoly is one where a single provider will be the most efficient arrangement. In the case of sub-sea cable systems, diversity of routes and ownership will contribute to a secure and competitive outcome.
31	NRI	P ii Ownership and vertical integration	'NRI strongly proposes that a separate commercial entity should be set up to provide wholesale telecommunication services through the International Submarine Cables to retail subscribers (businesses). In other words, the trunk infrastructure (International Submarine Cables) should be owned by ideally a PNG-owned enterprise.' 'NRI, therefore, strongly opposes a model where a telecommunication company which owns the wholesale telecommunication services of the International Submarine Cable services also engages in providing retail telecommunication services.'	Noted. The present consultation is about pricing rather than ownership. It is noted that Telikom is a PNG-owned enterprise. NRI's view about the need to address conflicts of interest when firms operate on a vertically integrated basis in both the wholesale and retail markets in a sub-sector is noted. The present review seeks to address the issue through regulation of wholesale prices and the establishment of appropriate pricing principles as required by the Act, rather than through market restructuring of the kind suggested by NRI. The latter approach involves broader policy issues for the Government that are not on the table in this review.

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32	NRI	P 1, actual prices	'NICTA should specify the price of the transmission capacity service both in the interim and in the final determination, in consultation with the Independent Consumer & Competition Commission (ICCC).'	<p>NICTA staff consider that the complexities of sub-sea cable capacity pricing are such that detailed price setting and price options that will meet the requirements of a range of access seekers should be left to the access provider (Telikom). The important point, recognised by the Act, is that such prices should comply with guidelines (pricing principles) determined by the regulator after consultation. It is not best practice for regulators to simply substitute their views on appropriate prices for those of the industry. The commercial aspects that should be reflected in prices and price terms are better understood by the commercial participants than by a regulator, for example.</p> <p>To avoid doubt, however, NICTA considers that it has the power to set prices or price ranges when establishing pricing principles, but, in this case, considers that such an approach is non-preferred for the reasons stated. It is not ruled out for other situations, however.</p>
33	NRI	P 2, Key issue on pricing	NRI lists as a key issue 'Whether NICTA should determine the price (both interim and in final determination) alone or should other national agencies such as the ICCC be consulted in specifying the prices?'	<p>Following from the comment at item 32 above, NICTA staff consider that the key issue is not whether to set prices for sub-sea cable capacity, but, rather, how best to establish pricing principles that will provide necessary commercial flexibility to the access provider, while addressing the issues associated with dominance and the protection of wholesale customer and, ultimately, consumer interests in efficient pricing. It is not an issue whether the ICCC would be or should be consulted on these matters. The answer is clear that consultation with the ICCC is important and must always occur. The ICCC has made a valuable contribution to the current public consultation and discussion.</p>
34	NRI	P 3, NICTA price determination	'Prices, as per the Determination, will be set by NICTA based largely on the cost of production, in this case, the cost of transmission prepared by NICTA, access providers and access seekers. However, could specification/setting of prices be incentivised to encourage efficiency and cost-reduction which will ultimately reduce prices and result in increased consumer welfare?'	<p>See items 32 and 33 above. It is for the access seeker to propose access prices that comply with the specific pricing principles that emerge from the present exercise and with general pricing principles already established. NICTA will only determine actual prices if required in the event of non-compliance. In the course of such proceedings NICTA will adopt the various tools that are referred to in the draft principles to examine efficiency. These tools include benchmarking and cost studies applying the standards referred to in the draft principles.</p>

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35	NRI	P 2 para (iii), 'incentive' regulation	'... could NICTA specific how efficiency be achieved and "incentivised" and for what type of costs incurred could result in efficiency and the International Submarine Cable Capacity Services' provider be rewarded for? For example, should NICTA "reward" the wholesale provider for costs incurred as a result of its operational costs, or capital expenditure which actually should lead to transmission efficiency and lower prices?'	NICTA staff believe that it is inappropriate to go beyond the clear indicators that are already in the draft principles about the way in which cost standards will be applied by NICTA to ensure best outcomes. In addition to the matters raised ny NRI, NICTA will need to ensure that the price outcomes that it may impose, if indeed it is required to impose any, should be commercially viable and encourage appropriate investment in the sector.
36	NRI	P 2 para (iv) costs of assets	'Should the costs of return of assets be entirely passed onto consumers which will lead to high prices, or should a mechanism be set up for the wholesaler to bear some of the costs, as well as other stakeholders such as the government, and retailers? Given the monopolistic market in which the wholesaler will operate, the return on asset should just be for the wholesaler to break-even.'	NICTA staff do not accept that such an approach is consistent with the requirements of the Act in relation to sector development and investment, already referred to. Telikom has a dominant position in that market, and at present has a monopoly position. If regulation is based on a break-even position or on non-recovery of capuital and other costs properly incurred, investment will suffer and new entrants will be discouraged from entry. These are outcomes to be avoided.
37	NRI	P 3 para (v) price monitoring	'Could the wholesale prices be also a declared item as per ICCC Act and be therefore monitored by ICCC in consultation with NICTA?'	The approach adopted to declaration of the services under the National ICT Act involvesd price monitoring by NICTA. Information available from such monitoring is routinely shared with ICCC at the latter's request. The most important process however tis that wholesale prices are carefully scrutinised by wholesale customers who will formally complain and seek review if, in their view, the pricing principles are infringed.
38	MRI	P 3 gateway access price setting	'(10.1) This section applies if the price of the gateway access service is to be specified by NICTA in an interim determination or a final determination. <i>NRI is of the view that ICCC could be consulted also to specify the price of the gateway access both in the interim and in the final determination.</i> '	Noted. The ICCC would always be consulted in such circumstances.
39	NRI	P 5	'NRI notes and supports in principle the pricing principles proposed by NICTA for both the international submarine cable transmission capacity	Noted. The involvement of the ICCC has been addressed through the operational arrangements in place for cooperation between the ICCC and

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			service and the international submarine cable gateway access service. However, NRI is also of the view that relevant agencies that deal with competition and consumer welfare be consulted as well for a better, informed outcome.'	NICTA.