**Australian
Competition &
Consumer
Commission**

18 December 2008

Dr Tony Warren
Executive Director Regulatory Affairs
Unit 11, Level 2
11 National Circuit
Barton ACT 2600

**By facsimile: 02 9261 8390**

Dear Dr Warren

**Telstra's Band 2 ULLS undertaking**

I refer to your letter dated 2 December 2008 requesting clarification on aspects of
the ACCC's draft decision to reject Telstra's Band 2 ULLS undertaking (the Draft
Decision).

The ACCC acknowledges the letter as a submission in response to the Draft
Decision.

Your letter indicates that Telstra considers aspects of the Draft Decision require
further clarification for Telstra to adequately respond. In addition, a list of issues
and questions relating to the Draft Decision is attached to the letter.

The ACCC has considered all the issues raised in Telstra's letter, in particular
whether:

- the issues should be addressed in the final decision and therefore do not
  require clarification prior to release of the final decision;

- provision of further material will better inform parties to assist them in
  responding to the Draft Decision; and

- responding to the issues raised by Telstra requires the ACCC to gain
  further information in the form of a section 152BT request. As sent to
  Telstra on 16 December 2008.

The ACCC considers that most of the issues raised in your letter will, where
necessary, be addressed in the final decision. With regard to these issues, the
ACCC considers that it has been transparent in setting out the reasoning for its
views and the information it has relied upon. Accordingly, the ACCC does not

consider that any further explanation/clarification of these issues would significantly assist Telstra in responding to the Draft Decision.

As you would be aware, the ACCC is required under section 152BV of the *Trade Practices Act 1974* to:

- engage in a public consultation process; and
- consider submissions received from interested parties.

It should also be noted that the draft decision is not a final articulation of the ACCC's decision. It is a draft document reflecting the ACCC's preliminary views on a particular issue, and requires further comments from interested parties. These comments, such as the ones raised in your letter, can then be addressed in the final decision.

Of the list of issues raised by Telstra, the ACCC has identified a number of issues which could benefit from further information being made available to interested parties to allow them to more fully respond to the ACCC's Draft Decision. This material is detailed in **Attachment A**.

The ACCC intends to place a copy of this letter and your letter of 2 December 2008, including the attachments for each, on its website.

Should you have any questions regarding this letter, please contact Kim Huynh on (03) 9290 1960.


Yours sincerely

Robert Wright
General Manager
Compliance and Regulatory Operations
Communications Group

**Attachment A: Answers to select questions raised in Telstra's letter to the ACCC dated 2 December 2008.**

1. Direct costs

*Could the ACCC explain/provide the workings and analysis underlying the information in Table 6.1 of the draft decision?*

See table below.

2. Variable inputs

*Could the ACCC provide the excel spreadsheets or other computer model runs which were performed by the ACCC in running its scenarios with "other parameter values", which led the ACCC to conclude that there is "significant doubt as to whether the Proposed Monthly Charge of $30 is reasonable"?*

*In any case, could the ACCC provide a complete set of values for inputs into the TEA model that it used in arriving at its draft decision to reject the Undertaking?*

See table below.

3. International Benchmarking

*Referring to page 42 of the draft decision, can the ACCC please provide all the documents used by the ACCC in its international benchmarking including the adjustments made to the Ovum report referenced in footnote 70 to convert the prices into Australian dollars?*

The overall aim of the exercise was to enable a direct comparison between Australian and international ULLS prices using both Purchasing Power Parity (PPP) and no PPP measures.

Original ULLS prices were obtained from Stefano Nicoletti, Matthew Howett, Charice Wang, Ovum, *Europe & Americas additional benchmarks tables and charts – benchmarking period Q2 2008*, July 2008 (thereafter referred to as the Ovum benchmarking report).

The method used to convert international ULLS charges, which were originally quoted in euros and US dollars, into Australian dollar equivalents is explained in the following text.

The method for converting a euro-denominated ULLS price to its Australian dollar equivalent is best illustrated by a set of examples described below.

It is relevant to note that the ACCC will update this methodology in its final decision on Telstra's ULLS Undertaking.

**A.  Conversion of euro ULLS prices to $AUD (assumes no PPP ie. nominal exchange rates)**

*Step one: converting euro based ULLS price to US dollars (common benchmark)*

This conversion used the USDEURO exchange rate of 0.64, an exchange rate quoted in the Ovum benchmarking report.

$EURO_{Q2\ 2008}$  *  1 USD/ 0.64 EURO  =  $USD_{Q2\ 2008}$
(1)

*Step two: converting US dollars into Australian dollar equivalents*

In the Draft Decision, the 31/12/2007 AUDUSD exchange rate of 0.8776 was used.

$USD_{Q2\ 2008}$  *  1 AUD/ 0.8776  =  AUD
(2)

Using Austria as a numerical example to illustrate this methodology:

$9.33\,euro \div 0.64 = \$US\,14.58$
$\$US14.58 \div 0.88 = \$AUD\,16.61$

**B.  Conversion of euro ULLS prices to $AUD (assumes PPP ie Ovum composite exchange rate)**

*Step one: converting euro based ULLS price to US dollars, applying the composite exchange rate*

The ACCC adopted the use of the composite rate but may revise this methodology in the Final Decision on Telstra's ULLS Undertaking.

The Ovum benchmarking report quotes a USDEURO composite exchange rate of 0.77 calculated by:

exchange rate$_{composite}$  =  0.6 (PPP)  +  0.4 (exch. rate)
(3)

Euro based ULLS prices were converted to US dollars using this composite exchange rate:

$EURO_{Q2\ 2008}$  *  1 USD/ 0.77 EURO  =  $USD_{Q2\ 2008,\ composite\ ex. rate}$
(4)

*Step 2: converting $USD_{Q2\ 2008,\ composite\ ex.\ rate}$ from (4) to $AUD*

In the Draft Decision, a nominal AUDUSD exchange rate of 0.8776 was used.

$$USD_{Q2\ 2008,\ composite\ ex.\ rate} \quad * \quad 1\ AUD/\ 0.8776\ USD = \quad AUD \quad (5)$$

Using Austria as a numerical example:

$$9.33\ euro \div 0.77\ (PPP\ composite\ AUDUSD\ ) = \$USD\ 12.12 \quad (6)$$

*Step 3: converting USD from (5) to \$AUD PPP using an \$AUDUSD*<sub>composite</sub>

$$\$USD12.12 \div 0.797 = \$AUD15.20_{PPP}$$

<u>4. Trench sharing</u>

*What is the precise basis for the ACCC's estimate that "a trench sharing value of between 13-17 per cent approximates cumulative trench sharing potential in new estates" and please clarify/explain how the calculation of the percentages was performed?*

The 13 per cent figure referred to above is based on the ACCC's 2006 Final Decision on Telstra's previous ULLS undertaking.[1] For the purposes of the 2008 Draft Decision, this figure was updated using the methodology described below.

The ACCC's reference to a trench sharing figure of 17 per cent in the Draft Decision, was calculated using Australian Bureau of Statistics data[2] on the number of new dwellings constructed since 1992. This year was selected as the practice of sharing trenches by utility providers was well established for new housing estates.

It should be noted that the ABS Building Activity Survey does not disaggregate data for new dwelling constructions occurring in new estates and those occurring in already populated areas. As such, it is necessary to apply a factor to estimate the percentage of dwellings (since 1992) with shared trenches in Telstra's customer access network. The ACCC viewed that a factor of 2/3 could be used as a following consideration of claimed assumptions made in a submission made by Telstra in a previous regulatory process.[3] Applying the 2/3 factor to the total number of new dwelling constructions completed since 1992 in each year provides an estimate of the number of non-infill new estate dwellings per period. The resulting figure can then be compared to the total number of new dwellings since 1992, to indicate a percentage level of trench sharing in new estates.

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[1] At page 55 (public version)
[2] Building Activity Survey – catalogue No. 8752
[3] Telstra, *Annexure J to Telstra's detailed submission in support of its undertakings dated 9 January 2003 – Trench Lengths* (confidential version).

**Issue 1: Direct Costs**

**Note: Cell references in this sheet refer to cell reference in file: CCA_fin2008_ACCC.xls which was provided to the ACCC by Telstra**

| Cost of Capital | | A-CES-Internal sheet | | O&M plus depreciation | A-CAP-Internal sheet |
|---|---|---|---|---|---|
| **Internal** | | | | **Internal** | |
| 2-1-01 | | CU11 | | 4-3-01 | CU31 |
| 2-1-02 | | | | | |
| 2-1-05 | | CU13 | | 4-3-05 | CU35 |
| 2-1-06 | | | | | |
| 2-1-10 | | | | 4-3-10 | CU39 |
| 2-1-11 | | | | | |
| 2-1-15 | | CU17 | | 4-3-15 | CU43 |
| 2-1-16 | | | | | |
| 2-1-25 | | CU21 | | 4-3-25 | CU51 |
| 2-1-26 | | | | | |
| | | | | | |
| | | | | | |
| **External** | | A-CES-external sheet | | | A-CAP-External sheet |
| 2-1-01 | | BK11 | | 4-3-01 | BK50 |
| 2-1-02 | | | | | |
| 2-1-05 | | BK13 | | 4-3-05 | BK54 |
| 2-1-06 | | | | | |
| 2-1-10 | | BK15 | | 4-3-10 | BK58 |
| 2-1-11 | | | | | |
| 2-1-15 | | BK17 | | 4-3-15 | BK62 |
| 2-1-16 | | | | | |
| 2-1-25 | | BK21 | | 4-3-25 | BK70 |
| 2-1-26 | | | | | |
| | | | | | |
| | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| TOTAL | | Sum cells (A-CES-Internal: CU11+CU13+CU17+CU21) + (A-CES-External: BK11+BK13+BK15+BK17+BK21) | | | Sum cells (A-CAP-internal: CU31+CU35+CU39+CU43+CU55)+ (A-CAP-external: BK50+BK54+BK58+BK62+BK70) |
| | | | | | |
| **Applying ovum WACC of 9.22%** | **0.0922** | Sum cells [(A-CES-Internal: CU11+CU13+CU17+CU21) + (A-CES-External: BK11+BK13+BK15+BK17+BK21)]*9.22% | | | |

**Note: Cell references in this sheet refer to cell reference in file: HCA_fin2008_ACCC.xls which was provided to the ACCC by Telstra**

| Cost of Capital | | A-FAS-Internal sheet | | |
|---|---|---|---|---|
| **Internal** | | Book | Depreciation | Net |
| 2-1-01-1 | | CU12 | | |
| 2-1-01-2 | | | CU13 | |
| | | | | CU12 minus CU13 |
| 2-1-02-1 | | | | |
| 2-1-02-2 | | | | |
| | | | | |
| 2-1-05-1 | | CU18 | | |
| 2-1-05-2 | | | CU19 | |
| | | | | CU18 minus CU19 |
| 2-1-06-1 | | | | |
| 2-1-06-2 | | | | |
| | | | | |
| 2-1-10-1 | | CU24 | | |
| 2-1-10-2 | | | CU25 | |
| | | | | CU24 minus CU25 |
| 2-1-11-1 | | | | |
| 2-1-11-2 | | | | |
| | | | | |
| 2-1-15-1 | | CU30 | | |
| 2-1-15-2 | | | CU31 | |
| | | | | CU30 minus CU31 |
| 2-1-16-1 | | | | |
| 2-1-16-2 | | | | |
| | | | | |
| 2-1-25-1 | | CU43 | | |
| 2-1-25-2 | | | CU43 | |
| | | | | CU42 minus CU43 |
| 2-1-26-1 | | | | |
| 2-1-26-2 | | | | |
| | | | | |

| | | A-FAS-External sheet | | |
|---|---|---|---|---|
| | | | | |
| **External** | | Book | Depreciation | Net |
| 2-1-01-1 | | BK12 | | |
| 2-1-01-2 | | | BK13 | |
| | | | | BK12 minus BK13 |
| 2-1-02-1 | | | | |
| 2-1-02-2 | | | | |
| | | | | |
| 2-1-05-1 | | BK18 | | |
| 2-1-05-2 | | | BK19 | |
| | | | | BK18 minus BK19 |
| 2-1-06-1 | | | | |
| 2-1-06-2 | | | | |
| | | | | |
| 2-1-10-1 | | BK24 | | |
| 2-1-10-2 | | | BK25 | |
| | | | | BK24 minus BK25 |
| 2-1-11-1 | | | | |
| 2-1-11-2 | | | | |
| | | | | |
| 2-1-15-1 | | BK30 | | |
| 2-1-15-2 | | | BK31 | |
| | | | | BK30 minus BK31 |
| 2-1-16-1 | | | | |
| 2-1-16-2 | | | | |
| | | | | |
| 2-1-25-1 | | BK42 | | |
| 2-1-25-2 | | | BK43 | |
| | | | | BK42 minus BK43 |
| 2-1-26-1 | | | | |
| 2-1-26-2 | | | | |
| | | | | |

| | | | | |
|---|---|---|---|---|
| TOTAL | | Sum cells (A-FAS-internal: CU12+CU18+CU24+CU30+CU43) +(A-FAS-external: BK12+BK18+BK24+BK30+BK42) | Sum cells (A-FAS-internal: CU13+CU19+CU25+CU31+CU44) + (A-FAS-external: BK13+BK19+BK25+BK31+BK43) | Sum cells (A-FAS-internal: CU12+CU18+CU24+CU30+CU43) +(A-FAS-external: BK12+BK18+BK24+BK30+BK42) minus Sum cells (A-FAS-internal: CU13+CU19+CU25+CU31+CU44) + (A-FAS-external: BK13+BK19+BK25+BK31+BK43) |
| | | | | |
| **Applying ovum WACC of 9.22%** | **0.0922** | | | [Sum cells (A-FAS-internal: CU12+CU18+CU24+CU30+CU43) +(A-FAS-external: BK12+BK18+BK24+BK30+BK42) minus Sum cells (A-FAS-internal: CU13+CU19+CU25+CU31+CU44) + (A-FAS-external: BK13+BK19+BK25+BK31+BK43)]*9.22% |

**NOTE: Cell references in this sheet refer to other cells in this workbook**

|  | CCA | HCA |
|---|---|---|
|  |  |  |
| O+M+depn | =Calculations!G30 | =Calculations!G30 |
| Return on capital | =Calculations!C32 | ='200708-HCA'!E70 |
|  |  |  |
| Total | =B3+B4 | =C3+C4 |
| SIOs | Sept 2008 total SIOs (From Telstra RKR data) | Sept 2008 total SIOs (From Telstra RKR data) |
| **Monthly cost** | **=(B6/B7)/12** | **=(C6/C7)/12** |

## Issue 2: Variable inputs

| Section heading | Sheet reference | Cell reference | New value |
|---|---|---|---|
| Breakout and reinstatement costs | Inputs Costs and Rules | E139 | $ 13.50 |
| | | E140 | $ 13.50 |
| | | E141 | $ 13.50 |
| | | E142 | $ 13.50 |
| | | E143 | $ 13.50 |
| | | E144 | $ 13.50 |
| | | E145 | $ 13.50 |
| | | E146 | $ 13.50 |
| | | E147 | $ 13.50 |
| | | E148 | $ 13.50 |
| | | E149 | $ 13.50 |
| Cost Per Metre for Placing Conduit Runs | Inputs Costs and Rules | D171 | $ 23.76 |
| | | D172 | $ 79.79 |
| | | D173 | $ 23.76 |
| | | D174 | $ 79.79 |
| | | D175 | $ 23.76 |
| | | D176 | $ 79.79 |
| | | D177 | $ 23.76 |
| | | D178 | $ 79.79 |
| | | D179 | $ 8.57 |
| | | E171 | $ 28.50 |
| | | E172 | $ 95.01 |
| | | E173 | $ 28.50 |
| | | E174 | $ 95.01 |
| | | E175 | $ 28.50 |
| | | E176 | $ 95.01 |
| | | E177 | $ 28.50 |
| | | E178 | $ 95.01 |
| | | E179 | $ 12.65 |
| | | F171 | $ 36.18 |
| | | F172 | $ 108.38 |
| | | F173 | $ 36.18 |
| | | F174 | $ 108.38 |
| | | F175 | $ 36.18 |
| | | F176 | $ 108.38 |
| | | F177 | $ 36.18 |
| | | F178 | $ 108.38 |
| | | F179 | $ 22.48 |
| | | G171 | $ 60.30 |
| | | G172 | $ 145.41 |
| | | G173 | $ 60.30 |
| | | G174 | $ 145.41 |
| | | H171 | $ 93.85 |
| | | H172 | $ 314.11 |
| | | H173 | $ 93.85 |
| | | H174 | $ 314.11 |
| | | D187 | $ 129.62 |
| | | D188 | $ 454.29 |
| | | D189 | $ 129.62 |
| | | D190 | $ 454.29 |

| | | E187 | $ 260.00 |
|---|---|---|---|
| | | E188 | $ 734.63 |
| | | E189 | $ 260.00 |
| | | E190 | $ 734.63 |
| | | F187 | $ 270.85 |
| | | F188 | $ 1,051.06 |
| | | F189 | $ 270.85 |
| | | F190 | $ 1,051.06 |
| | | G187 | $ 342.80 |
| | | G188 | $ 1,358.46 |
| | | G189 | $ 342.80 |
| | | G190 | $ 1,358.46 |
| | | H187 | $ 416.63 |
| | | H188 | $ 1,792.14 |
| | | H189 | $ 416.63 |
| | | H190 | $ 1,792.14 |
| 2 Pair Lead-ins | Inputs Costs and Rules | B259 | $ - |
| Cost of Capital Inputs | Inputs Capital Costs | C10 | 8.67% |
| | | C11 | 8.18% |
| | | C12 | 66.00% |
| | | C13 | 34.00% |
| | | C14 | 20.00% |
| Cost of Capital Calculation | Inputs Capital Costs | F59 | 9.22% |
| Capital Cost Factor Calculation (when applying a tilt) | Capital cost calculation | B11 | 3.50% |
| | | C11 | 3.50% |
| | | D11 | 3.50% |
| | | E11 | 3.50% |