Australian
Competition &
Consumer
Commission

Inquiry to make final access determinations for the declared fixed line services

Final Report

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Public version

Contents

List of abbreviations and acronyms

ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
AD	access determination
AER	Australian Energy Regulator
BBM	building block model
CACS Act	Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Act 2010
CAN	customer access network
CCA	Competition and Consumer Act 2010
CPI	consumer price index
CSP	carriage service provider
c-i-c	commercial-in-confidence
DAC	depreciated actual cost
DORC	depreciated optimised replacement cost
DRP	debt risk premium
DSLAM	digital subscriber line access multiplexer
ESAs	exchange service areas
FAD	final access determination
FD	final arbitration determination
FLSM	Fixed Line Services Model
IAD	interim access determination
IHC	indexed historic cost
LCS	local carriage service
LSS	line sharing service

LTIE	long-term interests of end-users
MRP	market risk premium
NBN	National Broadband Network
ORC	optimised replacement cost
POI	point of interconnection
PSTN OA	public switched telephone network originating access service
PSTN TA	public switched telephone network terminating access service
RAB	regulatory asset base
RAF	regulatory accounting framework
RKR	record keeping rule
RMRC	retail minus retail cost
SAOs	standard access obligations
SIOs	services in operation
TPA	Trade Practices Act 1974
Tribunal	Australian Competition Tribunal
TSLRIC	total service long-run incremental cost
ULLS	unconditioned local loop service
VoDSL	voice over digital subscriber line
WACC	weighted average cost of capital
WLR	wholesale line rental service

Executive summary

The Australian Competition and Consumer Commission (ACCC) has completed its inquiry into the price terms included in final access determinations (FADs) for the six declared fixed line telecommunications services.[1]

The report sets out the final prices determined by the ACCC and explains how the ACCC reached its decision. It also describes the framework the ACCC will use to determine prices in future regulatory periods and explains the ACCC's approach to a number of non-price issues related to access to the declared fixed line services.

The ACCC has set wholesale access prices for three years.

The ACCC has determined wholesale access prices for a three year regulatory period ending on 30 June 2014. These prices will apply where there is no commercial agreement between an access seeker and the infrastructure operator, Telstra. They create a benchmark that the parties can fall back on when they have not negotiated alternative access terms.

To provide certainty and price stability for industry, the prices set in interim access determinations (IADs), made in March 2011, will continue to apply from 1 January 2011 until 30 June 2011.

The prices for the declared fixed line services, and the previous indicative prices, are shown below. The draft and final prices differ for five main reasons:

- a fall in the weighted average cost of capital (from 9.04 per cent to 8.54 per cent) as a result of changes in financial market conditions
- moving from a five-year regulatory period to a three-year period, which changes the average price calculated over the period for the ULLS, WLR and LCS
- revisions to the initial regulatory asset base (RAB) and tax asset values, which are largely offsetting except for the LCS
- adopting a total-SIO weighting method for calculating the nationally averaged WLR price increases the price by 84 cents, and
- higher forecast growth in data traffic, which reduces the estimated price for the PSTN OTA service.

Further detail on revisions to the model inputs is provided in Part A of this report and their impact on prices is summarised in chapter 13.

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[1] The declared fixed line services are the: line sharing service (LSS); local carriage service (LCS); public switched telephone network originating access service (PSTN OA); public switched telephone network terminating access service (PSTN TA); unconditioned local loop service (ULLS) and wholesale line rental (WLR).

Comparison of previous indicative prices, interim prices for 1 January–30 June 2011, draft FAD prices and final FAD prices for 1 July 2011–30 June 2014

	Previous indicative prices	Interim (IAD) prices, 1 January to 30 June 2011	Draft FAD prices, 1 July 2011 to 30 June 2016[a]	Final FAD prices, 1 July 2011 to 30 June 2014[a]
ULLS Band 1	$6.60	)	)	)
ULLS Band 2	$16.00	) $16.00	) $16.75	) $16.21
ULLS Band 3	$31.30	)	)	)
ULLS Band 4 (per line per month)		$48.00	$50.11	$48.19
WLR (per line per month)	$25.57 (HomeLine) $26.93 (BusinessLine)	$22.10 (nationally averaged)	$22.47 (nationally averaged)	$22.84 (nationally averaged)
LSS (per line per month)	$2.50	$1.80	$1.80	$1.80
PSTN OA and TA (per minute)	1.0c (headline rate)	1.0c (headline rate)	1.0c (national average rate)	0.95c (national average rate)
LCS (per call)	17.36c	9.1c	8.7c	8.9c

[a] The draft FAD prices averaged nominal prices over a five-year regulatory period while the final FAD prices are averaged over a three-year regulatory period.

The competitive environment for the telecommunications industry is undergoing substantial change.

The ACCC recognises that the prices set in the FADs will apply during a time of major industry change.

The transition to the National Broadband Network (NBN) has significant implications for industry structure and the way telecommunications service providers do business. The ACCC is aware that uncertainty remains about the details of the transition process.[2] It understands that this uncertainty has, in turn, created some uncertainty for the current service providers. The ACCC is committed to promoting competition and providing an appropriate level of price stability during the NBN roll-out and

[2] NBN Co, *Corporate Plan 2011-13*, 17 December 2010; Telstra, 'Telstra signs NBN Definitive Agreements', Media release and attached additional information, 23 June 2011, available at www.telstra.com.au/abouttelstra/download/document/2011-definitive-agreements-telstra-nbnco.pdf.

subsequent migration of services from the copper network to the NBN. This will benefit both industry and telecommunications end-users.

Significant changes to the telecommunications regulatory regime came into effect on 1 January 2011. The new regime replaced the previous negotiate/arbitrate framework with new access mechanisms designed to reduce disputes and provide greater certainty over access terms and conditions. These new mechanisms give the ACCC the power to make up-front price determinations.

In conjunction with the change in the regulatory regime, the ACCC has moved from its previous hypothetical pricing approach (total service long-run incremental cost, TSLRIC+) to now setting prices based on the assessed costs of providing services. To do this, the ACCC has adopted a 'building block' approach. Building block, or RAB, pricing approaches are commonly used in estimating prices for regulated utilities. The ACCC's adoption of this approach responds to industry demands for greater certainty over time in the ACCC's pricing framework and, in particular, in the value of the assets used to provide the declared fixed line services.

Regulatory certainty and predictability will support industry development within an evolving competitive environment.

The ACCC recognises the desirability of price certainty at a time of significant industry change. While the ACCC's preference was to set prices for a five-year regulatory period, it has heeded industry submissions in support of a shorter period. In addition, the ACCC recognises the difficulties of developing sufficiently reliable forecasts for a five-year period. Setting access prices for three years will still give industry participants sufficient certainty and stability to facilitate their business and investment planning during the initial transition to the NBN.

The ACCC has included fixed principles provisions in the FADs. These provisions lock in the value of Telstra's assets and the framework for setting prices beyond the expiry of the FADs.

These measures will promote certainty and predictability in the move to a new regulatory regime and new pricing approach. The ACCC considers the measures will avoid the potential for regulatory 'shock' in implementing the new regulatory framework.

In this regard, an important consideration for the ACCC has been promoting price stability to the extent that it supports past investments and promotes competitive outcomes. This objective has guided the ACCC's approach to setting prices for the FADs, including determining the initial RAB value, settling on forecasts for some inputs to the pricing model (such as the weighted average cost of capital), and determining appropriate price structures.

In setting an opening RAB value of $15.516 billion as at 1 July 2011, the ACCC has used the approach it proposed in the April 2011 Discussion Paper. Taking into account the inherent limitations of Telstra's historical records, especially for very long-lived assets like ducts and pipes, the ACCC has considered a range of valuations produced by different valuation methods (including depreciated actual cost, depreciated optimised replacement cost and current cost accounting). The ACCC considered a number of other relevant factors to assist it in reaching a decision on a

value from within the suitable range of potential values. The ACCC also considered submissions as well as additional information recently provided by Telstra on its written-down tax asset values. A full explanation of the ACCC's method for determining the initial RAB value is provided in chapter 5 of this report.

The ACCC has confirmed its decision to set an averaged Band 1–3 ULLS price and a separate Band 4 ULLS price. The ACCC maintains its view that the aggregation of these bands is appropriate and will support investment and competition. Further, the ACCC considers that averaging the price in these bands is likely to result in benefits to the industry, including from simplifying the price structure and easing the transition to nationally averaged wholesale pricing for the NBN (see chapter 11 of this report).

The ACCC has consulted extensively on moving to a more stable and predictable pricing framework.

Consultation on moving to a building block approach to setting prices commenced in December 2009. Since then, the ACCC has consulted extensively on price issues, its pricing model and the inputs to the model.

In September 2010, the ACCC released a Draft Report (under the previous regulatory regime) setting out its proposed pricing approach and draft indicative prices. At the same time, the ACCC released its Fixed Line Services Model (FLSM)—a new pricing model developed to estimate prices for the declared fixed line services—for industry review and comment.

In March 2011, the ACCC issued interim access determinations (IADs) for each of the declared fixed line services, accompanied by a brief Statement of Reasons. The ACCC considered that specifying interim price (and non-price) terms would provide certainty for industry until the ACCC made FADs for each of the services. In April 2011, the ACCC released a Discussion Paper setting out the ACCC's detailed reasoning for the IADs, its draft FAD prices and a full explanation of the methodology and information used to estimate the draft prices. At the same time, an updated version of the FLSM was released, which incorporated revisions made in response to submissions and updated information received by the ACCC.

The ACCC has had regard to all submissions received during the extensive consultation process, dating back to December 2009, in finalising prices for the FADs.

The ACCC will work with industry to improve clarity and certainty in other parts of the regulatory framework.

While consultation on pricing has been ongoing for over 18 months, non-price terms and exemptions have only been the subject of public consultation since April 2011. The April 2011 Discussion Paper noted that the ACCC would need to take a flexible approach in response to any submissions that raised significant issues.

The submissions received in response to the Discussion Paper and draft FADs on both non-price terms and exemptions were extensive and raised a number of matters. In the ACCC's view, these issues require further consultation and, in the case of exemptions, further information on certain aspects of the market for WLR, LCS, and PSTN OA.

In relation to non-price terms, the transition of the terms from guidance (as the ACCC's *Model Non-Price Terms and Conditions Determination 2008*) to carrier

licence conditions has given rise to a number of issues around practicality, proportionality, and whether the terms are appropriate for the current technical and commercial telecommunications environment.

The issue of exemptions has a long and contentious history. After examining the submissions received to date, the ACCC has decided that it needs further information to be in a position to properly assess the issue of coverage against the legislative criteria at subsection 152BCA(1) of the *Competition and Consumer Act 2010* (CCA).

The ACCC will commence a further inquiry and seek further information regarding whether the exemptions should continue in the future. The further inquiry and consideration is expected to conclude prior to 30 December 2011 before further exchange service areas are due to become exempt.

However, given the advanced state of consultation on pricing and the need for industry certainty after such a prolonged period of consultation, the ACCC considers that prices for the declared fixed line services should be finalised now. As noted above, this will enable industry to proceed with planning and investment decisions in the lead-up to the NBN.

The ACCC considers that an FAD must deal with non-price terms and the issue of coverage (which includes exemptions) (see parts B–D of this report). The finalisation of price terms means that the issues of non-price terms and exemptions will be maintained in their current form until further consideration is completed. By maintaining the non-price terms and exemptions as they currently stand in the IADs (with some minor amendment to non-price terms), the ACCC is preserving stability and certainty in the industry while it undertakes the further and more detailed consideration required on these key issues.

This approach balances the need for pricing certainty in the transition to NBN while ensuring that the ACCC has adequate time to consider thoroughly significant non-price and coverage matters.

1 Introduction

This report sets out the ACCC's views on making final access determinations (FADs) for the six declared fixed line services under section 152BC of the *Competition and Consumer Act 2010* (CCA). This report is made pursuant to section 505 of the *Telecommunications Act 1997* (Cth) for the public inquiry conducted by the ACCC under Part 25 of the Act.

The public inquiry commenced on 21 April 2011 when the ACCC released the *Public inquiry to make final access determinations for the declared fixed line services: Discussion paper* (April 2011 Discussion Paper). Submissions on the issues raised in the April 2011 Discussion Paper were sought from interested parties.

The April 2011 Discussion Paper set out the ACCC's views on the content of the FADs for the declared fixed line services. It included draft FADs for the services. The Discussion Paper included the ACCC's proposed approach to:

- pricing for the declared fixed line services
- non-price terms for access to the declared fixed line services
- exemptions from the standard access obligations (SAOs) in relation to certain services or in particular exchange service areas (ESAs), and
- fixed principles provisions.

Submissions to the April 2011 Discussion Paper were received from:

- AAPT
- Frontier Economics (on behalf of the Competitive Carriers' Coalition)
- Herbert Geer (on behalf of Adam Internet, Aussie Broadband, iiNet and Internode)
- Macquarie Telecom (with additional submissions on the exemptions issues prepared on Macquarie Telecom's behalf by Maddocks Lawyers and Frontier Economics)
- Optus, and
- Telstra.

A list of all submissions received by the ACCC during its consultation processes, including additional material provided with submissions or in separate correspondence, is set out in Appendix B to this report. All public versions of the submissions are available on the ACCC website. The ACCC thanks all submitters for their contributions to the consultation process.

This final report sets out the reasons in support of the FADs for each of the declared fixed line services.

The ACCC has formed the view that further consultation is required on the issues of non-price terms (for the declared fixed line services as well as other declared services) and coverage (which includes exemptions). However, given the advanced state of consultation on pricing and the need for industry certainty and stability after a prolonged period of consultation, the ACCC is now proceeding to finalise price terms

for the declared fixed line services and fixed principles provisions that give form to the pricing framework. This will enable industry participants to proceed with planning and investment decisions in the lead up to the National Broadband Network (NBN).

However, the ACCC is of the view that an FAD should deal with non-price terms, and the issue of coverage. The finalisation of price terms means that non-price and coverage terms will be maintained in their current form until further consideration is completed. By maintaining the non-price terms and exemptions as they currently stand in the interim access determinations (IADs) (with some minor amendment to non-price terms), the ACCC is preserving stability and certainty in the industry while it undertakes further and more detailed consideration on these key issues.

1.1 Background

The declared fixed line services are the:

- line sharing service (LSS)
- local carriage service (LCS)
- public switched telephone network originating access service (PSTN OA)
- public switched telephone network terminating access service (PSTN TA)[3]
- unconditioned local loop service (ULLS), and
- wholesale line rental (WLR).[4]

The current declarations for these services expire on 31 July 2014.

The telecommunications access regime contained in Part XIC of the CCA was amended with effect from 1 January 2011 by the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Act 2010* (CACS Act). The amendments replaced the previous negotiate/arbitrate framework with a range of different access mechanisms, including access determinations (ADs).

An AD (including an FAD) provides a base set of terms and conditions that access seekers can rely on if they are unable to reach agreement with an access provider on the terms and conditions of access to a declared service. If parties do come to an agreement on terms and conditions of access, their access agreement will prevail over the AD to the extent of any inconsistency.[5]

The amended regime requires the ACCC to make FADs for all declared services. On 2 March 2011, the ACCC made IADs for each of the declared fixed line services, which were backdated to take effect from 1 January 2011.

The ACCC made the IADs in order to provide industry with some certainty until the FADs for the declared fixed line services were made. The IADs are automatically revoked upon the commencement of the FADs relating to the same service.[6]

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3 PSTN OA and PSTN TA are together referred to as 'PSTN OTA'.

4 See ACCC, *Fixed Services Review Declaration Inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR: Final Decision*, July 2009. Appendix A to this discussion paper contains a short description of each of the declared fixed line services.

5 Section 152BCC of the CCA.

6 Subsection 152BCF(9A) of the CCA.

Where ADs specify terms and conditions of access they must include terms and conditions relating to price (or a method of ascertaining a price).[7] The ACCC has also included non-price terms in the FADs for the declared fixed line services.

Prior to commencing the public inquiry, the ACCC had consulted extensively on an appropriate pricing methodology for the declared fixed line services as part of its earlier pricing principles review.[8] The ACCC had proposed a shift from its previous pricing methodologies (total service long run incremental cost (TSLRIC+) and retail minus retail cost (RMRC)) to a building block model (BBM) pricing methodology. The ACCC developed the Fixed Line Services Model (FLSM) to estimate access prices based on a BBM pricing methodology. That consultation process was suspended in December 2010 because amendments to the CCA meant that the ACCC was no longer required to make pricing principles for declared services.[9]

The ACCC has taken into account the information collected during the pricing principles consultation, as well as responses to the April 2011 Discussion Paper, to inform its considerations on pricing for the declared fixed line services in the FADs. Accordingly, the ACCC has set the prices in the FADs based on a BBM pricing methodology with regard to the price estimates produced by the FLSM.

The CCA requires the ACCC to consider certain factors when making an FAD, including the long-term interests of end-users (LTIE), the legitimate business interests of carriers and carriage service providers and the direct costs of providing access to the declared services.[10] The ACCC may also take into account any other matters that it thinks are relevant when making an FAD.[11]

Once an FAD is made for a declared service, it is no longer possible to notify access disputes to the ACCC in relation to that service. However, for disputes that were previously notified, the ACCC may continue to arbitrate and make arbitration determinations.[12]

Compliance with an FAD is both a carrier licence condition and a service provider rule.[13] A breach of either a carrier licence condition or a service provider rule may lead to a pecuniary penalty of up to $10 million for each contravention.[14] Private enforcement of an FAD is available in the Federal Court.[15]

1.2 Structure of this report

This report is structured as follows:

Chapter 2 sets out the consultation process for the FADs for fixed line services.

Chapter 3 sets out the legislative criteria relevant to making an FAD.

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7 See section 152BC(8) of the CCA.
8 The pricing principles review is outlined in further detail at sections 4.2 of the ACCC's April 2011 Discussion Paper.
9 Following the repeal of sections 152AQA and 152AQB of the CCA.
10 Subsection 152BCA(1) of the CCA.
11 Subsection 152BCA(3) of the CCA.
12 Items 207(2) and (3) of the CACS Act.
13 Sections 152BCO and 152BCP of the CCA.
14 Section 570 of the Telecommunications Act 1997.
15 Section 152BCQ of the CCA.

Part A (Chapters 4 to 16) sets out ACCC's decision to include certain price terms and fixed principles provisions in the FADs.

Part B sets out the ACCC's decision to include certain non-price terms in the FADs.

Part C sets out the ACCC's decision to include exemptions in the FADs.

Part D sets out the ACCC's decision in not including NBN-based aggregated services in the FADs.

Appendix A contains a summary of the service descriptions for the six declared fixed line services for which the ACCC has made FADs.

Appendix B lists the submissions made to the April 2011 Discussion Paper, the December 2009 Discussion Paper and the September 2010 Draft Report.

Appendix C contains the FAD instruments for the six declared fixed line services.

2 Consultation process for final access determinations

The ACCC is required to commence a public inquiry into making a final access determination (FAD) for each currently declared service. Once a public inquiry has started, the ACCC must make an FAD within six months. However, this period may be extended by a further six months if the ACCC explains the reasons for the extension.[16]

With the April 2011 Discussion Paper, the ACCC published draft FADs which contained price and non-price terms. The draft FADs also contained fixed principles provisions regarding the mechanism for determining prices for the declared fixed line services beyond the expiry of the FADs.

The ACCC has consulted extensively on a pricing approach to the declared fixed line services. It published preliminary views in its December 2009 Discussion Paper and its September 2010 Draft Report. It has also published its BBM for the fixed line services. The ACCC has received extensive feedback and information in submissions to its previous consultation on the pricing approach. Feedback has been received on the ACCC's proposed pricing methodology for implementing a building block pricing approach, the design of its model, the inputs to the model, and draft FAD prices.

In developing its pricing framework and estimating draft prices for the April 2011 Discussion Paper, the ACCC built upon its previous work. It had taken into account all submissions to its previous consultation process (see Appendix B to this report).

The ACCC received submissions by or on behalf of nine industry participants in response to the April 2011 Discussion Paper.

The ACCC has decided to make FADs for fixed line services that include price terms, 'exemption' provisions, fixed principles provisions and non-price terms. The ACCC recognises that prior to the public inquiry for the FADs, it had not consulted extensively on non-price issues or on the issue of coverage of the FADs.

The ACCC has formed a view that further consultation is required in relation to non-price terms and coverage. The finalisation of price terms means that the issues of non-price terms and coverage will be maintained in their current form until further consideration is completed.

Non-price terms and conditions will be examined further in the context of the domestic transmission capacity services (DTCS) and mobile terminating access service (MTAS) FAD public inquiries. The results of those processes will inform whether variations are required to the non-price terms and conditions in the fixed line FADs. If so, the ACCC will consider holding a separate public inquiry to subsequently vary the FADs.[17]

The ACCC also believes that further consultation on the coverage of the FADs is appropriate. Such an approach balances the need for certainty in relation to the pricing issues on which the ACCC has already extensively consulted with the opportunity to conduct further consultation on new or contentious issues.

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16 Section 152BCK of the CCA.

17 See section 152BCN of the CCA for information of the variation process.

3 Relevant legislative framework for final access determinations

This section sets out the relevant legislative framework in relation to FADs.

3.1 Content of an FAD

Section 152BC of the CCA specifies what an FAD may contain. It includes, among other things, terms and conditions on which a carrier or carriage service provider (CSP) is to comply with the SAOs and terms and conditions of access to a declared service.

An FAD may make different provisions with respect to different access providers or access seekers.[18]

3.2 Fixed principles provisions

An FAD may contain a fixed principles provision, which allows a provision in an FAD to have an expiry date after the expiry date of the FAD.[19] Such a provision allows the ACCC to 'lock-in' a term so that it would be consistent across consecutive FADs.

3.3 Varying an FAD

Section 152BCN allows the ACCC to vary or revoke an FAD, provided that certain procedures are followed.

A fixed principles provision cannot be varied or removed unless the FAD sets out the circumstances in which the provision can be varied or removed, and those circumstances are present.[20]

3.4 Commencement and expiry provisions

Section 152BCF of the CCA sets out the commencement and expiry rules for FADs.

The initial FAD for a declared service may be backdated up to 1 January 2011.[21]

An FAD must have an expiry date, which should align with the expiry of the declaration for that service unless there are circumstances that warrant a different expiry date.[22]

3.5 Criteria to consider when making an FAD

The ACCC must have regard to the criteria specified in subsection 152BCA(1) of the CCA when making an FAD. These criteria are:

(a) whether the determination will promote the LTIE of carriage services or services supplied by means of carriage services

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18 Subsection 152BC(5) of the CCA.
19 Section 152BCD of the CCA.
20 Subsection 152BCN(4) of the CCA.
21 Subsections 152BCF(2) and (2A) of the CCA.
22 Subsection 152BCF(6) of the CCA.

(b) the legitimate business interests of a carrier or CSP who supplies, or is capable of supplying, the declared service, and the carrier's or provider's investment in facilities used to supply the declared service

(c) the interests of all persons who have rights to use the declared service

(d) the direct costs of providing access to the declared service

(e) the value to a person of extensions, or enhancement of capability, whose cost is borne by someone else

(f) the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility, and

(g) the economically efficient operation of a carriage service, a telecommunications network or a facility.

The subsection 152BCA(1) criteria mirror the repealed subsection 152CR(1) criteria that the ACCC was required to take into account in making a final determination (FD) in an access dispute. The ACCC interprets the subsection 152BCA(1) criteria in a similar manner to the approach taken in access disputes.

Subsection 152BCA(2) sets out other matters that the ACCC may take into account in making FADs in certain circumstances.

Subsection 152BCA(3) allows the ACCC to take into account any other matters that it thinks are relevant.

The ACCC's views on how the legislative criteria in section 152BCA should be interpreted for the FAD process are set out below.

3.5.1 Paragraph 152BCA(1)(a)

The first criterion for the ACCC to consider when making an FAD is 'whether the determination will promote the long-term interests of end-users of carriage services or of services supplied by means of carriage services'.

The ACCC has published a guideline explaining what it understands by the phrase 'long-term interests of end-users' in the context of its declaration responsibilities.[23] This approach to the LTIE was also used by the ACCC in making determinations in access disputes. The ACCC considers that the same interpretation is appropriate for making FADs for the declared fixed line services.

In the ACCC's view, particular terms and conditions promote the interests of end-users if they are likely to contribute towards the provision of:

- goods and services at lower prices
- goods and services of a high quality, and/or
- a greater diversity of goods and services.[24]

The ACCC also notes that the Australian Competition Tribunal (Tribunal) has offered guidance in its interpretation of the phrase 'long-term interests of end-users' (in the context of access to subscription television services):

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[23] ACCC, Telecommunications services – declaration provisions: a guide to the declaration provisions of Part XIC of the Trade Practices Act, July 1999, in particular pp. 31–38.

[24] ibid., p. 33.

> Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary to take the following matters into account when applying the touchstone – the long-term interests of end-users:
>
> * End-users: "end-users" include actual and potential [users of the service]…
>
> * Interests: the interests of the end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings. …[T]his would include access to innovations … in a quicker timeframe than would otherwise be the case …
>
> * Long-term: the long-term will be the period over which the full effects of the … decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the … industry) to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit – strategies.[25]

To consider the likely impact of particular terms and conditions on the LTIE, the CCA requires the ACCC to have regard to whether the terms and conditions are likely to result in:

- promoting competition in markets for carriage services and services supplied by means of carriage services
- achieving any-to-any connectivity, and
- encouraging the economically efficient use of, and economically efficient investment in:
  - the infrastructure by which listed carriage services are supplied, and
  - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.[26]

Promoting competition

In assessing whether particular terms and conditions will promote competition, the ACCC analyses the relevant markets in which the declared services are supplied (retail and wholesale) and considers whether the terms set in those markets remove obstacles to end-users gaining access to telephony and broadband services.[27]

Obstacles to accessing these services include the price, quality and availability of the services and the ability of competing providers to provide telephony and broadband services.

The ACCC is not required to precisely define the scope of the relevant markets in which the declared services are supplied. The ACCC considers that it is sufficient to broadly identify the scope of the relevant markets likely to be affected by the ACCC's regulatory decisions.

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25 *Seven Network Limited (No 4)* [2004] ACompT 11 at [120].

26 Subsection 152AB(2) of the CCA.

27 Subsection 152AB(4) of the CCA. This approach is consistent with the approach adopted by the Tribunal in *Telstra Corporations Limited (No 3)* [2007] A CompT 3 at [92]; *Telstra Corporation Limited* [2006] A CompT at [97], [149].

The ACCC's view is that the relevant markets for the purpose of making FADs for the declared fixed line services are:

- the market for the retail and wholesale supply of voice services (excluding Voice over Internet Protocol (VoIP) and mobile originated calls)
- the market for the retail and wholesale supply of broadband, and
- the market for the retail supply of a bundle of voice and broadband services.

Any-to-any connectivity

The CCA gives guidance on how the objective of any-to-any connectivity is achieved. It is achieved only if each end-user who is supplied with a carriage service that involves communication between end-users is able to communicate, by means of that service, with each other end-user who is supplied with the same service or a similar service. This must be the case whether or not the end-users are connected to the same telecommunications network.[28]

The ACCC considers that this criterion is relevant to ensuring that the terms and conditions contained in FADs do not create obstacles for the achievement of any-to-any connectivity.

Efficient use of and investment in infrastructure

In determining the extent to which terms and conditions are likely to encourage the economically efficient use of and investment in infrastructure, the ACCC must have regard to:

- whether it is, or is likely to become, technically feasible for the services to be supplied and charged for, having regard to:
  - — the technology that is in use, available or likely to become available
  - — whether the costs involved in supplying and charging for, the services are reasonable or likely to become reasonable, and
  - — the effects or likely effects that supplying and charging for the services would have on the operation or performance of telecommunications networks
- the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope
- incentives for investment in the infrastructure by which services are supplied; and any other infrastructure (for example, the NBN) by which services are, or are likely to become, capable of being supplied, and
- the risks involved in making the investment.[29]

The objective of encouraging the 'economically efficient use of, and economically efficient investment in ... infrastructure' requires an understanding of the concept of economic efficiency. Economic efficiency consists of three components:

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[28] Subsection 152AB(8) of the CCA.
[29] Subsections 152AB(6) and (7A) of the CCA.

- productive efficiency – this is achieved where individual firms produce the goods and services that they offer at least cost
- allocative efficiency – this is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e., those that provide the greatest benefit relative to costs), and
- dynamic efficiency – this reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.

On the issue of efficient investment, the Tribunal has stated that:

> An access charge should be one that just allows an access provider to recover the costs of efficient investment in the infrastructure necessary to provide the declared service.[30]
>
> …efficient investment by both access providers and access seekers would be expected to be encouraged in circumstances where access charges were set to ensure recovery of the efficient costs of investment (inclusive of a normal return on investment) by the access provider in the infrastructure necessary to provide the declared service.[31]
>
> …access charges can create an incentive for access providers to seek productive and dynamic efficiencies if access charges are set having regard to the efficient costs of providing access to a declared service.[32]

3.5.2 Paragraph 152BCA(1)(b)

The second criterion requires the ACCC to consider 'the legitimate business interests' of the carrier or CSP when making an FAD.

In the context of access disputes, the ACCC considered that it was in the access provider's legitimate business interests to earn a normal commercial return on its investment.[33] The ACCC is of the view that the concept of 'legitimate business interests' in relation to FADs should be interpreted in a similar manner, consistent with the phrase 'legitimate commercial interests' used elsewhere in Part XIC of the CCA.

For completeness, the ACCC notes that it would be in the access provider's legitimate business interests to seek to recover its costs as well as a normal commercial return on investment having regard to the relevant risk involved. However, an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.[34]

The Tribunal has taken a similar view of the expression 'legitimate business interests'.[35]

3.5.3 Paragraph 152BCA(1)(c)

The third criterion requires the ACCC to consider 'the interests of all persons who have the right to use the service' when making an FAD.

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30 Telstra Corporation Ltd (No. 3) [2007] ACompT 3 at [159].
31 ibid. at [164].
32 ibid.
33 ACCC, *Resolution of telecommunications access disputes – a guide*, March 2004 (revised) (Access Dispute Guidelines), p. 56.
34 ACCC, *Access pricing principles—telecommunications*, July 1997 (1997 Access Pricing Principles), p. 9.
35 Telstra Corporation Limited [2006] ACompT 4 at [89].

The ACCC considers that this criterion requires it to have regard to the interests of access seekers. The Tribunal has also taken this approach.[36] The access seekers' interests would not be served by higher access prices to declared services, as it would inhibit their ability to compete with the access provider in the provision of retail services.[37]

People who have rights to currently use a declared service will generally use that service as an input to supply carriage services, or a service supplied by means of carriage service, to end-users.

The ACCC considers that this class of persons has an interest in being able to compete for the custom of end-users on the basis of their relative merits. This could be prevented from occurring if terms and conditions of access favour one or more service providers over others, thereby distorting the competitive process.[38]

However, the ACCC does not consider that this criterion calls for consideration to be given to the interests of the users of these 'downstream' services. The interests of end-users will already be considered under other criteria.

3.5.4 Paragraph 152BCA(1)(d)

The fourth criterion requires the ACCC to consider 'the direct costs of providing access to the declared service' when making an FAD.

The ACCC considers that the direct costs of providing access to a declared service are those incurred (or caused) by the provision of access.

The ACCC interprets this criterion, and the use of the term 'direct costs', as allowing consideration to be given to a contribution to indirect costs. This is consistent with the Tribunal's approach in an undertaking decision.[39] A contribution to indirect costs can also be supported by other criteria.

However, the criterion does not extend to compensation for loss of any 'monopoly profit' that occurs as a result of increased competition.[40]

The ACCC also notes that the Tribunal (in another undertaking decision) considered the direct costs criterion 'is concerned with ensuring that the costs of providing the service are recovered.'[41] The Tribunal has also noted that the direct costs could conceivably be allocated (and hence recovered) in a number of ways and that adopting any of those approaches would be consistent with this criterion.[42]

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36 Telstra Corporation Limited [2006] ACompT 4 at [91].

37 ibid.

38 ibid.

39 Application by Optus Mobile Pty Limited and Optus Networks Pty Limited [2006] ACompT 8 at [137].

40 See Explanatory Memorandum for the *Trade Practices Amendment (Telecommunications) Bill 1996*, p. 44: [T]he 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.

41 Telstra Corporation Limited [2006] ACompT 4 at [92].

42 ibid. at [139].

3.5.5 Paragraph 152BCA(1)(e)

The fifth criterion requires that the ACCC consider 'the value to a party of extensions, or enhancements of capability, whose cost is borne by someone else' when making an FAD.

In the 1997 Access Pricing Principles, the ACCC stated:

> This criterion requires that if an access seeker enhances the facility to provide the required services, the access provider should not attempt to recover for themselves any costs related to this enhancement. Equally, if the access provider must enhance the facility to provide the service, it is legitimate for the access provider to incorporate some proportion of the cost of doing so in the access price.[43]

The ACCC considers that this application of paragraph 152BCA(1)(e) is relevant to making FADs.

3.5.6 Paragraph 152BCA(1)(f)

The sixth criterion requires the ACCC to consider 'the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility' when making an FAD.

The ACCC considers that this criterion requires that terms of access should not compromise the safety or reliability of carriage services and associated networks or facilities, and that this has direct relevance when specifying technical requirements or standards to be followed.

The ACCC has previously stated in the context of model non-price terms and conditions, it is of the view that:

> …this consideration supports the view that model terms and conditions should reflect the safe and reliable operation of a carriage service, telecommunications network or facility. For instance, the model non-price terms and conditions should not require work practices that would be likely to compromise safety or reliability.[44]

The ACCC considers that these views will apply in relation to the paragraph 152BCA(1)(f) criterion for the making of FADs.

3.5.7 Paragraph 152BCA(1)(g)

The final criterion of subsection 152BCA(1) requires the ACCC to consider 'the economically efficient operation of a carriage service, a telecommunications network facility or a facility' when making an FAD.

The ACCC noted in the Access Dispute Guidelines (in the context of arbitrations) that the phrase 'economically efficient operation' embodies the concept of economic efficiency as discussed earlier under the LTIE. That is, it calls for a consideration of productive, allocative and dynamic efficiency. The Access Dispute Guidelines also note that in the context of a determination, the ACCC may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated efficiently.[45]

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43 ACCC, 1997 Access Pricing Principles, p. 11.
44 ACCC, Final Determination – Model Non-price Terms and Conditions, November 2008, p. 8.
45 ACCC, Access Dispute Guidelines, p. 57.

Consistent with the approach adopted by the Tribunal, the ACCC considers that in applying this criterion, it is relevant to consider the economically efficient operation of:

- retail services provided by access seekers using the access provider's services or by the access provider in competition with those access seekers, and
- the telecommunications networks and infrastructure used to supply these services.[46]

3.5.8 Subsection 152BCA(2)

Subsection 152BCA(2) provides that, in making an AD that applies to a carrier or CSP who supplies, or is capable of supplying, the declared services, the ACCC may, if the carrier or provider supplies one or more eligible services,[47] take into account:

- the characteristics of those other eligible services
- the costs associated with those other eligible services
- the revenues associated with those other eligible services, and
- the demand for those other eligible services.

The Explanatory Memorandum states that this provision is intended to ensure that the ACCC, in making an AD, does not consider the declared service in isolation, but also considers other relevant services.[48] As an example, the Explanatory Memorandum states:

> …when specifying the access price for a declared service which is supplied by an access provider over a particular network or facility, the ACCC can take into account not only the access provider's costs and revenues associated with the declared service, but also the costs and revenues associated with other services supplied over that network or facility.[49]

The ACCC proposes to consider the costs and revenues associated with other services—whether declared or not declared—that are provided over Telstra's network when making FADs for the declared fixed line services.

3.5.9 Subsection 152BCA(3)

This subsection states the ACCC may take into account any other matters that it thinks are relevant when making an FAD.

The ACCC is of the view that considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs.

The ACCC also considers that it should have regard to:

- decisions of the ACCC in previous arbitration determinations made under the repealed Division 8 of the *Trade Practices Act 1974* (TPA) (now renamed the CCA)

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46 *Telstra Corporation Limited* [2006] ACompT at [94]–[95].

47 'Eligible service' has the same meaning as in section 152AL of the CCA.

48 Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 178.

49 ibid.

- information provided by parties to access disputes under the repealed Division 8 of the TPA
- submissions in response to the ACCC's Review of 1997 Guide to Telecommunications Access Pricing Principles for Fixed Line Services, Discussion Paper, December 2009 (December 2009 Discussion Paper)
- the ACCC's Review of the 1997 telecommunications access pricing principles for fixed line services: Draft Report, September 2010 (September 2010 Draft Report)
- submissions in response to the September 2010 Draft Report
- additional information requested and received from Telstra and other industry participants in order to address some of the issues identified in the submissions in relation to the FLSM
- information that Telstra provides to the ACCC under record keeping rules (RKRs), including:
  - the telecommunications regulatory accounting framework RKR (RAF RKR) and
  - the customer access network RKR (CAN RKR) (a summary of which are published at www.accc.gov.au)
- previous pricing principle determinations in relation to the declared fixed line services made by the ACCC under the repealed section 152AQA of the TPA
- previous model term determinations made by the ACCC under the repealed section 152AQB of the TPA
- exemption determinations made under the repealed sections 152AS and 152AT of the TPA, and
- submissions received in response to the April 2011 Discussion Paper.

These considerations and documents do not limit the matters that the ACCC may have regard to when making the FADs for the declared fixed line services.

Part A: Pricing approach

Part A of this report (which includes chapters 4–16) sets out the ACCC's final decision on the prices included in FADs for the declared fixed line services and its reasoning in reaching its decision.

As noted earlier in this report, the ACCC must have regard to the criteria specified in subsection 152BCA(1) of the CCA when making an FAD. The ACCC has assessed its decision on the final prices and pricing approach for the FADs against the criteria in this subsection. The analysis can be found in chapter 16. The ACCC may also consider any other matters that it thinks are relevant, such as regulatory certainty and consistency.

The price terms included in the FADs are based on prices estimated using the ACCC's Fixed Line Services Model (FLSM). Chapter 4 describes the FLSM and explains how it works. The remaining chapters in Part A provide a detailed explanation of the methodology, assumptions and model inputs used to estimate the final FAD prices.

In reaching its final decision on prices and the pricing approach, the ACCC has had regard to submissions from interested parties. A full list of submissions and other material provided to the ACCC during it consultation processes for this inquiry is set out at Appendix B to this report. The ACCC has consulted extensively in making its decision on prices and the pricing approach.

The ACCC has backdated the FAD prices to 1 July 2011. The FAD prices will apply for a three-year regulatory period, expiring on 30 June 2014. The FADs include a schedule that incorporates the prices in the IADs for a six month transitional regulatory period, to apply from 1 January 2011 to 30 June 2011. The ACCC considers that this approach will provide price certainty and stability for industry.

As noted in the April 2011 Discussion Paper, the ACCC is aware that, in addition to access and connection and disconnection charges, access seekers also incur a range of access-related charges relating to the supply of the declared fixed line services. The ACCC considers that information on the full range of access-related charges incurred by access seekers is important for transparency about the total costs involved in obtaining access and for ensuring that costs are only charged for once.

No submissions on this issue were received during the consultation process for this inquiry. However, the ACCC has separately collected information on access-related charges from Telstra and access seekers and it is currently analysing this information.

4 Adoption of a 'building block' pricing approach

Key points

- The ACCC confirms its adoption of a BBM pricing methodology to estimate prices for the six declared fixed line services. This approach has been adopted in estimating prices for the FADs.
- The ACCC has increased the transparency of the FLSM by adding two new worksheets.
- The ACCC will consult with industry on making a BBM RKR to obtain data required by the FLSM to calculate prices for future regulatory periods.
- The ACCC has determined prices for a three-year regulatory period from 1 July 2011 to 30 June 2014. The FADs provide that the IAD prices will continue to apply for a six month transitional period from 1 January to 30 June 2011.

In the April 2011 Discussion Paper, the ACCC confirmed its intention to adopt a BBM pricing methodology to estimate prices for the declared fixed line services. There has been broad industry support for moving to a BBM approach.

The ACCC adopted a BBM pricing approach in estimating prices for the draft FADs.

4.1 The Fixed Line Services Model

A BBM approach was first applied for the declared fixed line services in the September 2010 Draft Report. Draft indicative prices were estimated using the Ovum BBM, a model specifically developed for the fixed line services. The ACCC significantly revised the Ovum BBM in response to submissions and further information. The revised model is known as the Fixed Line Services Model (FLSM). The FLSM was used to estimate draft FAD prices in the April 2011 Discussion Paper.

The ACCC released the Ovum BBM for consultation with the September 2010 Draft Report and the FLSM with the April 2011 Discussion Paper.

4.1.1 Design of the FLSM

The FLSM is a Microsoft Excel-based spreadsheet model designed to implement a BBM approach for the declared fixed line services. The major features of the FLSM, and the model revisions made in estimating draft FAD prices, were described in chapter 4 of the April 2011 Discussion Paper.

As noted in the April 2011 Discussion Paper, the ACCC engaged Marsden Jacob Associates Pty Ltd (MJA) to check the FLSM and update the user manual prior to the release of the April 2011 Discussion Paper.

4.1.2 Submissions

In the consultation processes conducted since December 2009, there has been broad support for moving to a BBM framework for setting regulated prices for the declared fixed line services. In its submission to the April 2011 Discussion Paper, AAPT stated

that it continued to support the BBM approach because it will promote the LTIE.[50] Optus submitted that it supported the use of the BBM approach but stated that its effectiveness depends greatly on the implementation.[51]

Optus and Frontier Economics submitted that they had concerns about how the ACCC would account for the agreement between Telstra and NBN Co for the use of Telstra's assets.[52] Both submissions suggested that these payments should be factored into any wholesale pricing arrangements. Optus submitted that these payments should be viewed as a 'return of capital' to Telstra and as such Telstra should not receive any further return on or of capital associated with the assets for which the payment was made.[53]

Frontier Economics submitted that it supported the inclusion of the LSS in the FLSM because it would increase the consistency of the treatment of the LSS and other fixed line services.[54]

Telstra submitted that the actual residual tax asset values from Telstra's tax accounts should be used in setting the initial tax RAB instead of setting the tax RAB equal to the regulatory RAB.[55] Telstra also submitted that the FLSM indexes asset values from 1 July 2009 through the roll-forward of the RAB[56]—as noted in section 4.1.3 below, it appears to reflect a misunderstanding of how the FLSM operates in relation to asset values.

No other submissions were received on the design of the FLSM.

4.1.3 ACCC final view

The ACCC confirms its use of the FLSM to implement its BBM framework and to estimate prices for the ULLS, WLR, PSTN OTA, LCS and LSS services. The ACCC has made the following revisions to the version of the FLSM released with the April 2011 Discussion Paper. The FLSM user manual has been updated for these revisions (see table 4.1, below, for a summary of the revisions).

First, the ACCC has accepted Telstra's submission on setting the tax asset value. The initial tax asset value included in the FLSM is no longer set equal to the initial (regulatory) RAB value. Chapter 5 explains the calculation of the initial tax asset value.

Second, to improve the transparency of the FLSM, the ACCC has added a new worksheet 'G. Revenue Disaggregate' that shows the calculation method for allocating the revenue requirement to services. The revenue requirements for each service are set out in tables 9.1 and 9.2 of this report.

Third, the ACCC has included a new RAB roll-forward worksheet 'H. Nominal RAB Roll-Forward' that reports the rolled-forward RAB value in nominal terms. This worksheet has been added to address an apparent misunderstanding of the way the RAB is calculated in the FLSM. For example, as noted in section 4.1.2, Telstra's

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50 AAPT, Submission, June 2011, p.2.
51 Optus, Submission, June 2011, p. 6
52 Optus, Submission, June 2011, p. 21; Frontier Economics, Submission, June 2011, p. 19.
53 Optus, Submission, June 2011, p. 21.
54 Frontier Economics, Submission, June 2011, p. 34.
55 Telstra, Submission – Part A, 3 June 2011, p. 63.
56 ibid., p. 76.

submission states that the FLSM indexes asset values. As explained in the April 2011 Discussion Paper,[57] the FLSM undertakes all calculations (except the tax calculations) in real terms, that is, in the base year dollars used in the FLSM (1 July 2009). This methodology does not alter any of the underlying nominal values of any inputs, including the nominal value of the RAB. The RAB value is not indexed in the FLSM. (The only exception is land asset values, which are indexed as a proxy for the appreciation of land values over time; see chapter 5.)

The ACCC considers that the new worksheet will remove the potential for misunderstanding of how the nominal RAB value is rolled-forward. It will also provide greater transparency and certainty about the opening RAB value for the next regulatory period. The opening RAB value for the next (and subsequent) regulatory periods will be equal to the closing RAB value expressed in nominal terms, at the end of the preceding regulatory period.

The ACCC confirms its view that the LSS should be included in FLSM using the approach outlined in chapter 5 of this report.

In the next regulatory period, the ACCC will take into account the impacts of the NBN roll-out in determining the inputs to the FLSM. If any modifications to the design of the FLSM are required, the ACCC will consult on any such modifications at an appropriate time prior to finalising prices for the next regulatory period.

4.2 Proposed BBM record keeping rule

Using a BBM to estimate prices over a regulatory period requires the input of forecasts for operating and capital expenditures, demand and a number of economic variables. In other industries regulated by the ACCC and Australian Energy Regulator (AER), the regulated businesses submit forecasts of these inputs.

4.2.1 April 2011 Discussion Paper view

The ACCC proposed a formal record keeping rule (RKR) to obtain expenditure and demand forecasts for future regulatory periods.[58] A BBM RKR would clearly specify the information required, the nature of the supporting information required, the format for presenting the information, and timeframes for providing it.

The ACCC stated that it would consult broadly on the proposed BBM RKR in due course after issuing the FADs for the declared fixed line services. The ACCC considered that conducting the consultation concurrently with the FAD inquiry would place too high a regulatory burden on industry participants.

4.2.2 Submissions

Optus submitted that robust engagement with industry is vital to ensuring accurate forecasts for operating and capital expenditure. Without sufficient time and a clear framework, the ability for the ACCC to gather accurate forecasts is compromised.[59]

Optus proposed that the ACCC should consult on the parameters of an efficiency mechanism in conjunction with the BBM RKR consultation.[60] Optus also noted that the proposed RKR would not come into effect until the next regulatory period.[61]

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57 ACCC, Discussion Paper, April 2011, pp. 28–32.
58 ACCC, Discussion paper, April 2011, p. 34.
59 Optus, Submission, June 2011, p. 59.

Telstra submitted that there is no basis to the ACCC's claim that a BBM RKR would increase regulatory certainty or transparency.[62] It also submitted that the ACCC has not demonstrated that an informal process would not achieve the same outcomes as a BBM RKR.

Telstra submitted that an RKR process could prejudice Telstra's legitimate business interests and inflict potential harm on Telstra by disclosing confidential information.[63] Telstra submitted that, if the ACCC proceeds with an RKR, it must be targeted on the data that is required and provide sufficient protection of Telstra's confidential information.

4.2.3 ACCC final view

The ACCC confirms that it will consult with industry on making a BBM RKR to obtain expenditure and demand forecasts in due course.

4.3 Length of regulatory period

An FAD must have an expiry date. Unless there are circumstances that warrant a different expiry date, the date should align with the expiry of the declaration for that service.[64] The declarations for the six declared fixed line services all expire on 31 July 2014.

4.3.1 April 2011 Discussion Paper view

The ACCC proposed a five-year regulatory period that would start on 1 July 2011 and extend to 30 June 2016.[65] The ACCC proposed to incorporate the prices in the IADs for a transitional regulatory period for the six months from 1 January 2011 to 30 June 2011.

The primary reason for proposing a five-year regulatory period (and hence extending the expiry date beyond the declarations) was to provide certainty during the initial transition to the NBN. The ACCC considered that price certainty would facilitate access seekers' planning for their own transitions to the NBN. A five-year regulatory period would also reduce the regulatory burden from more frequent price reviews and would be consistent with regulatory periods in other industries.

The ACCC considered that these circumstances warranted a different expiry date for the FADs to the declarations for the declared fixed lines services.

4.3.2 Submissions

All submissions to the April 2011 Discussion Paper, with the exception of Telstra, stated that a five-year regulatory period was too long and that the regulatory period should be no longer than three years.

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60 ibid., p. 49.
61 ibid., p. 53.
62 Telstra, Submission – Part A, 3 June 2011, p. 83.
63 ibid., p. 83.
64 Subsection 152BCF(6) of the CCA.
65 ACCC, Discussion Paper, April 2011, p. 35.

Telstra did not submit on the length of the regulatory period. In its previous submission to the September 2010 Draft Report, Telstra proposed a two-year regulatory period.[66]

AAPT submitted that a three-year regulatory period would provide an 'optimal balance' between certainty and competitiveness.[67] AAPT also submitted that the formal agreement between NBN Co and Telstra would be finalised during the five-year regulatory period.[68]

Herbert Geer submitted that the regulatory period should be no longer than three years. It submitted that a five-year regulatory period could potentially lock in inaccurate forecasts for an extended period of time. Herbert Geer suggested that the ACCC would not be able to respond to changing circumstances in the telecommunications industry during a five-year period.[69]

Frontier Economics submitted that the regulatory period should be no longer than three years. It submitted that a shorter regulatory period would dull incentives for improved efficiency but would mitigate the impact of inaccurate forecasting.[70] It stated that a five-year regulatory period could not promote certainty because its expiry extended beyond the declaration term of the services and re-declaration of the services was not certain.

Macquarie Telecom submitted that the regulatory period should be no more than three years due to concerns over the accuracy of Telstra's forecasts.[71]

Optus submitted that the regulatory period should be no longer than three years. In regard to five-year regulatory periods in other industries (such as water and electricity), Optus submitted that these regulatory regimes are more stable and settled than the regulatory regime for telecommunications. It also stated that these industries are subject to less technological change and that demand in these industries is not significantly affected by the introduction of substitutes.[72] It submitted that a shorter regulatory period would have several benefits, including: increased accuracy of forecasts; prices being tied more closely to actual costs; and the development of increased experience and expertise by the ACCC in conducting price reviews due to the increased frequency of reviews.[73]

There were no submissions on the ACCC's proposal for a six month transition period.

4.3.3 ACCC final view

While the ACCC's preference was to set prices for a five-year regulatory period, it has had regard to submissions that a five-year regulatory period is too long and that a regulatory period of no more than three years is preferred. In addition, the ACCC recognises the difficulties of developing sufficiently reliable forecasts for a five-year period. Importantly, the ACCC notes that Telstra has advised that it cannot provide

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66 Telstra, Pricing principles for fixed line services – response to the ACCC's draft report, October 2010, p. 4.
67 AAPT, Submission, June 2011, p. 3.
68 ibid.
69 Herbert Geer, Submission, 3 June 2011, p. 2.
70 Frontier Economics, Submission, June 2011, p. 19.
71 Macquarie Telecom, Submission, 3 June 2011, p. 3.
72 Optus, Submission, June 2011, p. 52.
73 ibid., p. 52.

the ACCC with operating and capital expenditure and demand forecasts beyond 2012–13.

After taking these considerations into account, the ACCC has decided to set final prices in FADs for a three-year regulatory period from 1 July 2011 to 30 June 2014. The regulatory period has been set on a financial year basis to align with the financial year basis of the FLSM.

The ACCC confirms that it will incorporate into the FADs the prices in the IADs for a transitional regulatory period for the six months from 1 January 2011 to 30 June 2011.

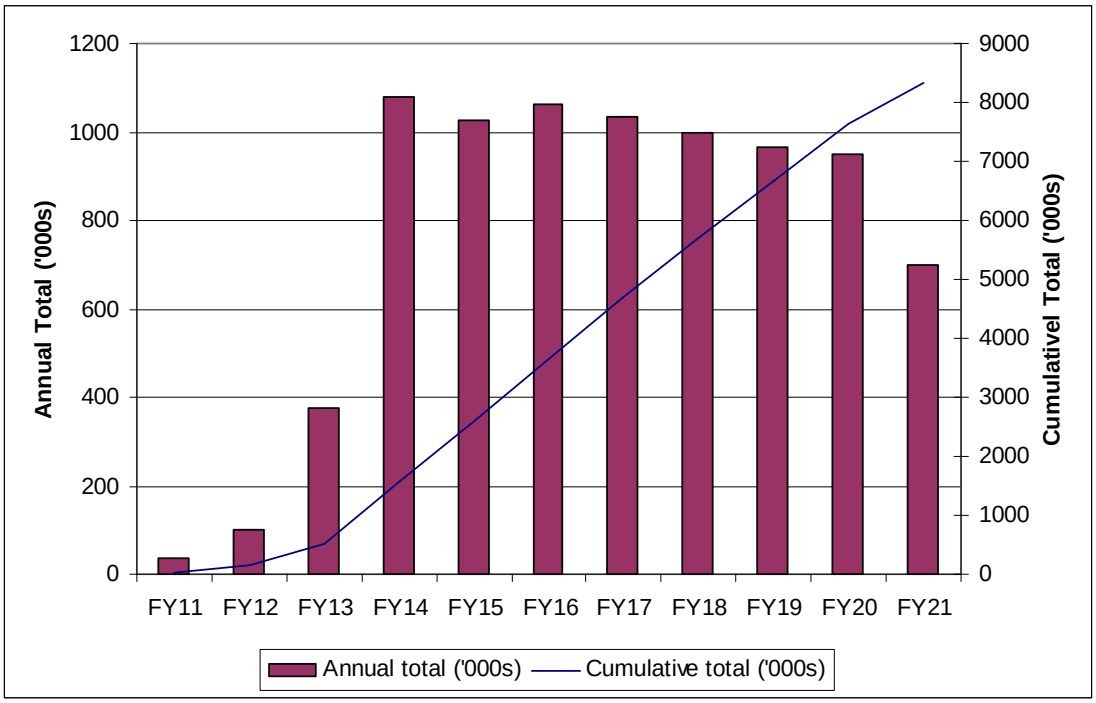
4.4 Impacts of the NBN on fixed line service cost and demand forecasts

The ACCC has not made specific adjustments to the design of the FLSM, or the inputs to the FLSM, to take into account the impacts of the NBN roll-out.

The ACCC considers that the impact from the roll-out of the NBN on Telstra's forecast expenditures and demand for the declared fixed services will be limited during the three-year regulatory period.

NBN Co's forecasts of fibre premises connected, included in its Corporate Plan (released in December 2010), indicated that NBN Co expected that the annual number of premises connected would be low in 2011-12 and 2012-13 and become significant during 2013-14.[74] Figure 4.1 shows NBN Co's forecasts of the annual number of fibre premises connected, and the cumulative total, from 2010-11 to 2020-21.

Figure 4.1: Expected number of fibre premises connected, annual and cumulative, 2010-11 to 2020-21



Source: NBNCo, *Corporate Plan 2011-13*, 17 December 2010, p. 77.

[74] NBNCo, *Corporate Plan 2011-13*, 17 December 2010, p. 77.

These forecasts were made on a range of assumptions, including that Telstra and NBN Co would finalise negotiations over their Definitive Agreements in early 2011, so that they could be implemented by around 30 June 2011.[75] The negotiations did not however finalise until 23 June 2011,[76] and are yet to be implemented. Hence it is likely that the actual number of premises connected will tend to lag behind these forecasts.

Furthermore, there is potential for a number of commercial matters (such as the awarding of additional construction contracts[77]) or regulatory matters to affect timing around the NBN during the current regulatory period.[78] Any delays would further reduce the potential effect on Telstra's demand and expenditures on fixed line services during the current regulatory period. This is because Telstra will generally have 18 months to disconnect standard copper-based customers after 90 per cent of premises in the region have been passed by NBN Co fibre.[79]

On the basis of this information, the ACCC considers that there is likely to be a relatively small number of premises migrated from Telstra's copper network to the NBN fibre network during the current regulatory period. The ACCC notes further that Telstra will have to continue to provide services over its copper network until all customers in the fibre roll-out region have been disconnected.

Similarly, the ACCC considers that there is insufficient certainty about the timing and quantum of NBN Co's demand for Telstra infrastructure to take that demand into account in the FLSM for the current regulatory period. Resolving this particular uncertainty will also be dependent upon operational projects to be undertaken by Telstra and NBN Co that are only now commencing.[80]

The ACCC expects that the uncertainties currently hindering the ACCC's assessment of the impacts of the NBN will be resolved well before the next regulatory period. If any modifications to the design of the FLSM are required to take into account these impacts, the ACCC will consult on any such modifications at an appropriate time prior to finalising prices for the next regulatory period.

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75 NBNCo, *Corporate Plan 2011-13*, 17 December 2010, p. 20.

76 Telstra, 'Telstra signs NBN Definitive Agreements', Media release, 23 June 2011. Available at www.telstra.com.au/abouttelstra/download/ document/2011-definitive-agreements-telstra-nbnco.pdf.

77 NBN Co, 'NBN & Silcar reach agreement to deliver value-for-money fibre rollout', Media release, 1 June 2011

78 Telstra, 'Telstra signs NBN Definitive Agreements', Media release and attached additional information, 23 June 2011, p. 5, available at www.telstra.com.au/abouttelstra/download/ document/2011-definitive-agreements-telstra-nbnco.pdf.

79 ibid., p. 8.

80 Bingemann, M and Lee, T, 'NBN probes Telstra's pits, pipes and ducts', *The Australian*, 6 July 2011, p. 37.

Table 4.1 Revisions to the FLSM and ACCC forecasts since the April 2011 Discussion Paper

Revision	Submission reference*	Comment
RAB roll-forward		
Addition of worksheet to FLSM reporting nominal rolled-forward RAB values	Telstra submission (part A, pp. 75–76)	Worksheet added for transparency. See section 4.1.3.
Regulatory period		
Regulatory period of three years, from 1 July 2011 to 30 June 2014	AAPT submission (p. 3), Macquarie Telecom submission (p. 3), Frontier Economics submission (p. 27), Herbert Geer submission (p. 9), Optus submission (p. 5)	To take into account views expressed in submissions. See section 4.3.3.
RAB		
Revision of initial RAB value for 'ducts and pipes' asset class		See section 5.1.3.
Capital expenditure		
Correction of error in deflator for 2011–12 capital expenditure forecast		Consistent with deflator used in subsequent years. Capital expenditure forecasts are deflated by CPI where no actual data are available for the relevant indices. See section 6.2.3.
WACC parameters		
Updated risk-free rate		Decreased to 5.16 per cent (from 5.61 per cent in the April 2011 Discussion Paper), based on 20 day average for 3–30 June 2011. See section 6.3.2.
Updated expected inflation		Reflects the updated inflation forecasts issued by the Reserve Bank of Australia (RBA) and the change to 10 year period to match 10 year period used for other WACC parameters. The updated expected inflation rate is 2.55 per cent; compared to 2.63 per cent in the April 2011 Discussion Paper. See section 6.3.2.

Revision	Submission reference*	Comment
Updated debt risk premium		The nominal debt risk premium has been updated to 2.06 per cent, based on the 20 day average for 3–30 June 2011 using a Telstra domestic bond. See section 6.3.3.
Operating expenditure		
Revision to LSS operating expenditure forecasts		Revised due to changes to LSS demand. Holds unit cost constant in real terms. See section 7.3.4.
Tax asset value		
Initial written-down tax assets value revised	Telstra confidential letter on 26 May 2011, Telstra submission (Schedule A.9)	Initial tax asset value set equal to actual written-down tax asset values in Telstra's tax accounts. See section 8.1.3.
Tax losses		
Formula for carryover of tax losses corrected		Previously, tax losses were carried forward for only 1 year before dropping out of the model: tax losses from more than 1 year ago were not recognised. Tax losses are now carried forward for every year in the regulatory period. This error had no effect on revenue or estimated prices as there are no tax losses in the model. See worksheet '10. Tax Liabilities' in the FLSM.
Revenue requirement		
Addition of worksheet showing individual cost blocks for each service		Worksheet added to show the calculations for the tables 9.1 and 9.2.
Cost allocation factors		
PSTN OTA transmission allocation factors	Optus submission (Appendices A to H, p. 26)	Forecast growth rate of data traffic revised to 40 per cent (from the 20 per cent figure used in the April 2011 Discussion Paper). This has the effect of reducing the 'transmission equipment' allocation factor for PSTN OTA. See section 10.3.3.

Revision	Submission reference*	Comment
Pricing		
Adoption of a total-SIO weighting for WLR	Telstra submission, (Part A, p. 72)	See section 11.3.3
Forecast demand		
Updated LSS demand forecasts	Telstra confidential letter on 18 May 2011	Based on more recent actual demand data and consideration of information provided in submissions. See section 12.4.2.

*****Where relevant, the submissions taken into account by the ACCC in deciding on revisions are listed. In some cases, the ACCC has made revisions based on its own analysis since releasing the April 2011 Discussion Paper.

5 Initial value of the regulatory asset base

Key points

- The ACCC confirms its view that a suitable range of RAB values is set by the depreciated historic value of Telstra's investment in network assets (that is, depreciated actual cost) and by depreciated optimised replacement cost.
- The opening RAB for estimating access prices is $15.516 billion as at 1 July 2011.
- The opening tax asset value is $10.144 billion as at 1 July 2011.
- As a result of revising the initial tax asset value, the ACCC has reduced the 'ducts and pipes' increment (as at 1 July 2009) from $1.44 billion to $911 million to maintain the $16 'tie point' for the ULLS price in moving to the building block approach.
- The ACCC confirms its approach to land asset values adopted in the April 2011 Discussion Paper. This approach effectively treats the return on capital allowed for land assets as a proxy for the cost of rent on the use of those assets.
- The ACCC maintains its view that, on balance, Telstra is unlikely to have significantly under- or over-recovered depreciation on its network assets under the previous TSLRIC+ approach.
- The ACCC confirms the asset classes and asset lives set out in the April 2011 Discussion Paper.

In implementing a BBM approach, an initial value for the access provider's RAB must be established. In estimating the initial RAB value, the ACCC identifies the asset classes used to provide the declared fixed line services and determines its approach to valuing those assets.

5.1 The initial RAB value

5.1.1 April 2011 Discussion Paper view

The ACCC proposed to set an opening RAB value as at 1 July 2011 of $15.9 billion. This value was calculated by rolling-forward the initial opening RAB value as at 1 July 2009 of $17.75 billion. The opening RAB value as at 1 July 2011 was lower because depreciation exceeded the combined value of asset additions and land value inflation over the two years from 1 July 2009.

The ACCC noted that there is no uniquely 'correct' value for the initial RAB. An element of judgement is therefore required to determine a suitable range of potential values for Telstra's sunk investment in network assets and then to settle on a value within this range that forms a sound basis for estimating prices.

In setting the initial opening RAB value, the ACCC considered a suitable range of RAB values was set by the depreciated actual cost (DAC) value of Telstra's investments in network assets and by the depreciated optimised replacement cost (DORC) value. In calculating the proposed initial RAB value within this range, the ACCC used the DAC value that forms the lower bound of the suitable range as a

starting point. Due to the more substantial limitations associated with estimating a DORC value, it was not considered an appropriate starting point.[81]

The ACCC made two adjustments to the starting point DAC value. First, it accepted that the value of land assets should be indexed by the consumer price index (CPI) to reflect the appreciation of land values over time. Second, it increased the value assigned to the 'ducts and pipes' asset class by $1.44 billion above its value in Telstra's Regulatory Accounting Framework (RAF) accounts. In making this adjustment, the ACCC was guided by its view that pricing stability is desirable to the extent that it supports past investments and promotes industry confidence in making future investment decisions. These two adjustments resulted in an initial opening RAB value as at 1 July 2009 of $17.75 billion.

In determining this value, the ACCC also took into account Telstra's past recovery of its investment costs. The ACCC considered that it was impossible to reach a definitive conclusion about the exact amount of Telstra's past cost recovery on the basis of the available data. However the ACCC considered that, on the basis of the available evidence and its detailed analysis,[82] Telstra is unlikely, on average, to have under-recovered depreciation under the previous TSLRIC+ approach.

The RAB comprises the assets used to provide the declared fixed line services. The ACCC revised the asset classes included in the RAB on the basis of Telstra's advice on the asset classes it uses to provide the declared fixed line services.[83]

5.1.2 Submissions

Initial RAB value

AAPT submitted that the initial RAB value appeared to be inflated and endorsed the analysis in Frontier Economics' submission.[84]

Frontier Economics submitted that, while a net present value (NPV) approach is a valid methodology for determining an initial RAB value, it should not be adopted to set the initial RAB for the fixed line services.[85] Frontier Economics submitted that an NPV approach would not promote the LTIE or be in the legitimate business interests of access seekers or Telstra.

Frontier Economics submitted that it supports the use of a DAC valuation and stated that the ACCC's criticisms of DAC are unfounded. It stated further that the ACCC did not provide an indication of the materiality of the problems associated with incomplete asset records.[86]

Frontier Economics submitted that the ACCC's rationale for allocating more value to ducts and pipes 'is not convincing'.[87] It submitted that there is no argument to suggest that these duct and pipes assets have any higher 'economic value' than any other asset.[88] Frontier Economics submitted that the ACCC's approach would result in end

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81 ACCC, Discussion paper, April 2011, pp. 54–55.
82 ibid., p. 58.
83 ACCC, Discussion paper, April 2011, p. 48. Other revisions to the RAB are listed in table 5.1 in the Discussion paper.
84 AAPT, Submission, 3 June 2011, p. 2.
85 Frontier Economics, Submission, June 2011, p. 7
86 ibid., p. 11.
87 ibid., p. 13.
88 ibid.

users paying more than once for these assets.[89] It stated that ducts and pipes are probably the most sunk of all of Telstra's assets and their scrap values are likely to be close to zero.[90]

Herbert Geer submitted (on behalf of Adam Internet, Aussie Broadband, iiNet and Internode) that the ACCC's approach to setting the initial RAB value by deciding the final ULLS price and working backwards is inappropriate.[91] It stated that the initial RAB value should be set at a level that allows Telstra to recover an appropriate return on those investments to the extent that Telstra has not already recovered those investments.[92] In addition, it submitted that the LTIE requires the RAB value to be set at a level that results in the best possible services at the lowest possible prices.[93]

Optus submitted that the most appropriate methodology for valuing Telstra's assets is DAC. It submitted that the value of Telstra's CAN in 2010 is between $2 billion and $6 billion.[94]

Optus submitted that the ACCC's justification for the ducts and pipes adjustment, that is, price stability, is not a relevant criterion in the *Competition and Consumer Act 2010* (CCA). It submitted that, while access seekers have invested in DSLAM infrastructure in reliance on the Band 2 ULLS price, a lower ULLS price would not impact adversely on these investments.[95] Optus stated that:

> The ACCC's proposed inflation of the RAB denies consumers the opportunity to benefit from the lower retail prices which would flow from the more competitive environment brought about through lower access prices.[96]

Telstra submitted that an appropriate initial RAB value is $32 billion (based on DORC) or alternatively $28 billion (based on an indexed DAC value). It submitted that the ACCC's method for establishing the RAB value on the basis of the $16 ULLS price is 'not reasonable'.[97] Telstra stated that DSLAM investments were made before the $16 ULLS price was established.[98]

Telstra submitted that the ACCC gave insufficient consideration to setting an appropriate value for Telstra's asset base and to maintaining the expected price path. Telstra stated that the ACCC decided to maintain a 2008-09 ULLS Band 2 price instead of the upward price trend consistent with the tilted annuity depreciation method adopted under the previous TSLRIC+ pricing approach. Telstra stated that the ACCC's decision would prevent Telstra from recovering deferred depreciation and 'strand' a proportion of the remaining value of the fixed line network.[99]

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89 ibid., p. 7.
90 ibid., p. 14.
91 Herbert Geer, Submission, 3 June 2011, p. 4.
92 ibid., p. 7.
93 ibid., p. 4.
94 Optus, Submission, June 2011, p. 7.
95 Optus, Submission, June 2011, p. 10.
96 ibid., p. 11.
97 Telstra, Submission – Part A, 3 June 2011, p. 29.
98 ibid.
99 ibid., p. 30.

Telstra stated that the net benefits of a fibre network over a copper network 'may be very small' and therefore a DORC valuation based on fibre would incorporate a correspondingly small discount off a copper network valuation.[100]

Telstra stated that a DORC valuation would be consistent with the 'economic value' of its assets. It submitted that the economic value has been established through previous pricing decisions and that an asset's economic value is not necessarily affected by the amount that has been recovered for use of the asset in the past. Telstra stated that the ACCC does not claim that DAC will reflect economic value and has, in fact, acknowledged that DAC may understate economic value. Telstra submitted that its written down book asset values are not relevant to the assets' remaining economic value.[101] It stated that setting an initial RAB value that is lower than the economic value of the assets would not be in its legitimate business interests.

Telstra submitted that the ACCC failed to properly consider indexed historic cost values proposed by Telstra and had failed to have sufficient regard to Professor Yarrow's opinion (submitted on behalf of Telstra) on valuation methods. Telstra submitted that indexing its DAC values would not involve double counting of the inflation adjustment because Telstra has not been compensated on the basis of a nominal weighted average cost of capital (WACC) applied to a nominal, historic cost-based asset value.[102] Telstra also submitted that the FLSM indexes the RAB value—as explained in chapter 4, Telstra appears to have misunderstood this aspect of the FLSM, as the FLSM does not index the RAB (except in respect of land values).

Telstra further submitted that the ACCC had not had sufficient regard to Professor Yarrow's view that there is no inherent reason why a change in regulatory approach should lead to significant price changes.[103]

Professor Sappington submitted (on behalf of Telstra) that the ACCC's proposed RAB value resulted in lower prices for LSS, WLR and LCS.[104] Professor Sappington submitted that the initial value of Telstra's RAB should be the 'ACCC's most recent valuation of Telstra's RAB, modified to reflect any major relevant industry changes since this valuation was set'.[105] He did not state what modifications should be made or propose a specific value.

Macquarie Telecom submitted that the ACCC's method of setting the initial RAB value has set a 'dangerous precedent'. [106] It stated that the ACCC has adopted a 'subjective and contrived approach which irresponsibly increases the cost of declared fixed services to the disadvantage of access seekers'.[107] Macquarie Telecom submitted that the ACCC should adopt a DAC valuation based on RAF data adjusted downwards for past over-recovery and adjusted upwards for the indexation of land values.[108]

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100 ibid., p. 8.
101 ibid., p. 9.
102 ibid., p. 25.
103 ibid., p. 31.
104 Telstra, Submission – Part A , Schedule A.1, 3 June 2011, p. 8.
105 ibid., p. 17.
106 Macquarie Telecom, Submission, 3 June 2011, p. 2.
107 ibid.
108 ibid., p. 2.

Past recovery of depreciation

Macquarie Telecom submitted that the ACCC should make a downwards adjustment to its DAC valuation for over-recovery of 'past compensation'.[109]

Frontier Economics submitted that it accepts that calculating past compensation is difficult. It submitted that the ACCC should consider Telstra's retail returns from its CAN and Core networks as these returns indicate that Telstra has been able to recover more than straight line depreciation.[110]

Herbert Geer submitted that the ACCC should conduct a study to assess whether Telstra's rate of return from 1997 to 2011 exceeds the WACC. Herbert Geer submitted that such a study would be likely to show that Telstra has recovered all, or at least a large part of, its past investment and the ACCC should make an appropriate adjustment to the initial RAB value to account for past over-recovery.[111]

Optus submitted that past compensation must be taken into account in setting an opening RAB.[112] It stated that the ACCC's proposed approach violates this principle by valuing Telstra's assets higher than its residual costs, resulting in a windfall gain to Telstra.[113]

Telstra submitted that a large proportion of its asset base has been deployed since the introduction of TSLRIC+. It stated that the RAF accounts overstate the extent to which asset values have been recovered through prices and therefore understate the remaining value of Telstra's asset base.[114]

It submitted that its analysis of its real economic returns on fixed line services since 2007–08 shows that there has been no over-recovery over this period. Telstra submitted that the ACCC's analysis of past recovery is incorrect and the ACCC cannot be reasonably satisfied that its shift in valuation methodologies will not result in under-recovery by Telstra of its actual investment costs.[115]

Telstra stated that under the TSLRIC+ approach, some assets were 'optimised out' and Telstra obtained no return on those assets during the TSLRIC+ regime. Telstra submitted that the ACCC should not assume that fully depreciated assets still in use were valued under the TSLRIC+ regime since older assets are likely to be optimised out in a TSLRIC+ pricing model.[116]

Professor Sappington submitted (on behalf of Telstra) that concerns about potential over-recovery of depreciation should be assessed in the context of the threat of substantial under-recovery of investment that a TSLRIC+ regime imposes.[117]

Indexation of land asset values

Macquarie Telecom submitted that it accepted the ACCC's indexation of land asset values.[118]

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109 ibid.
110 Frontier Economics, Submission, June 2011, p. 12.
111 Herbert Geer, Submission, 3 June 2011, pp. 7–8.
112 Optus, Submission, June 2011, p. 7.
113 ibid., p. 8.
114 Telstra, Submission – Part A, 3 June 2011, p. 16.
115 ibid., p.17.
116 ibid., p. 23.
117 Telstra, Submission – Part A , Schedule A.1, 3 June 2011, p. 15.

Frontier Economics submitted that revaluations of land asset values should be treated as income to ensure the NPV = 0 requirement of the BBM is met for those assets.[119] It stated that capital gains reflect an expectation of higher cash flows in the future, through higher revenues from supplying services and/or through the (future) sale of assets.[120]

Optus submitted that Telstra's argument for the appreciation of land asset values is flawed. Optus stated that land assets should be treated in the same way as other assets. It submitted that land asset values should be reduced to reflect the assumed proportion of its land purchase costs that Telstra has recovered.[121] It also submitted that Telstra will be able to realise the gain in the value of its land assets when the assets are sold.

Telstra submitted that the ACCC has partly acknowledged Telstra's concern over assets not being indexed by indexing land values but it is not clear why the ACCC has not similarly indexed other asset values in determining the initial RAB value.

Treatment of NBN Co payments to Telstra

AAPT submitted that the ACCC's pricing approach 'does not appear to have factored in the significant payment pending from NBN Co to Telstra for access to its ducts and pits'.[122]

Frontier Economics submitted that it is not clear that the ACCC has taken sufficient account of how any prospective deal with NBN Co might alter the value ascribed to 'ducts and pipes' assets. It stated that allowing Telstra to keep any revenue it is able to extract for renting ducts and pipes to NBN Co will lead to over-recovery.[123]

Optus submitted that:

> ... migration payments should be viewed as a 'return of capital' to Telstra shareholders for capital invested in the CAN. Accordingly, once received Telstra should no longer earn either a return on capital or a return of capital associated with the asset for which the payment was made.[124]

Telstra submitted that it agrees with the ACCC's approach of not explicitly taking the NBN deal into account. Telstra submitted that there is too much uncertainty surrounding the deal to account for it. It stated that, if the NBN roll out were to be taken into account, then other areas of the FLSM would also have to be modified for the impacts of the NBN.[125]

5.1.3 ACCC final view

Initial RAB value

The ACCC has determined that the opening RAB value at the commencement of the regulatory period (that is, as at 1 July 2011) is $15.516 billion (in nominal terms).

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118 Macquarie Telecom, Submission, 3 June 2011, p. 2.
119 Frontier Economics, Submission, June 2011, p. 16.
120 ibid., pp. 15–16.
121 Optus, Submission, June 2011, p. 9.
122 AAPT, Submission, 3 June 2011, p. 2.
123 Frontier Economics, Submission, June 2011, p. 14.
124 Optus, Submission, June 2011, p. 21.
125 Telstra, Submission – Part A, 3 June 2011, p. 13.

This value has been calculated by rolling-forward the initial (nominal) RAB value set by the ACCC as at 1 July 2009.[126]

In determining the initial RAB value as at 1 July 2009, the ACCC has applied the same methodology as it adopted in the April 2011 Discussion Paper. The ACCC confirms its view that there is no uniquely 'correct' value for the RAB. Consequently, the ACCC considered a number of alternative valuation methodologies including DAC, DORC and current cost accounting in settling on an appropriate initial RAB value. The ACCC also considered the views and information submitted during the consultation process, the limitations of the historical records (particularly for long-lived assets), and price stability to the extent that it supports past investments and promotes industry confidence in making future investment decisions.

The ACCC has calculated a value within the suitable range of RAB values set by the DAC and DORC values for Telstra's network assets. In calculating an appropriate value within this range, the ACCC used the DAC value as a starting point because the more substantial limitations associated with estimating a DORC value meant that it was not considered an appropriate starting point.

The ACCC confirms its decision to make two adjustments to the starting point DAC value. First, it has accepted that the value of land assets should be indexed by the CPI to reflect the appreciation of land values over time. Second, the ACCC has increased the value assigned to the 'ducts and pipes' asset class above its value in Telstra's RAF accounts. The ACCC confirms its view that this second adjustment is warranted to provide sufficient pricing stability to support past investments and promote industry confidence in making future investment decisions. The ACCC has, however, reduced the increment to the value of the 'ducts and pipes' asset class.

As explained in chapter 8, the ACCC has accepted Telstra's submission that the initial tax asset value should reflect the actual written-down tax asset value recorded in its tax accounts as at 1 July 2009. The actual written-down tax asset value in Telstra's tax accounts determines Telstra's actual tax liabilities. For the purposes of estimating prices in the April 2011 Discussion Paper, the initial tax asset value (also known as the tax RAB) was assumed to be equal to the initial (non-tax) RAB value of Telstra's assets. The initial tax asset value is now $10.673 billion as at 1 July 2009 (rolled forward to $10.144 billion as at 1 July 2011).

The depreciated tax and accounting values of Telstra's assets differ because of previous accelerated tax depreciation (see chapter 8). The tax laws allowed Telstra to claim depreciation for tax purposes on its eligible assets faster than depreciation could be under accounting rules. As a result, the initial RAB for regulatory purposes and for tax purposes are different. This approach ensures that estimated tax liabilities will reflect Telstra's actual tax liabilities.

The revision to the initial tax asset value increases the tax liabilities estimated by the FLSM (see chapter 8). This occurs because tax depreciation is a deduction in

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[126] The ACCC has corrected an error in the (nominal) rolled forward RAB value of $15.9 billion as at 1 July 2011 proposed in the April 2011 Discussion Paper. The roll-forward did not account for the indexation of real capital expenditure in the two years 2009–10 and 2010–11. This adjustment added $61 million to the RAB value as at 1 July 2011. As discussed in section 6.1.3 of this report, the ACCC has added a new worksheet to the FLSM to report the roll-forward the nominal RAB value.

calculating estimated tax liabilities. Estimated tax depreciation is lower on a lower tax asset value.

It is important to note that, had Telstra provided the written-down tax value of the assets included in the RAB prior to the release of the April 2011 Discussion Paper, the ACCC would have taken this information into account in determining the proposed increment to the 'ducts and pipes' asset value used in settling on its proposed initial RAB value. Although Telstra raised the issue of its tax asset value in its submission to the September 2010 Draft Report, it stated that it was still considering the materiality of the issue and did not propose a tax asset value.[127]

The ACCC considers that it is appropriate to adjust the initial RAB value because the written-down tax asset value is directly related to the value of the assets included in the RAB. Other revisions that were not directly related to these assets' value at the time of determining the initial RAB value would not warrant any revision to the initial RAB value determined by the ACCC. Further, the ACCC has decided that once the initial RAB value has been determined, and 'locked in', no further revisions will be considered (see chapter 15).

After revising the initial tax asset value, the ACCC made a consequential revision to the initial RAB value. An initial RAB value of $17.75 billion (as proposed in the April 2011 Discussion Paper) would no longer provide the degree of price stability considered desirable by the ACCC in the transition to the BBM pricing approach. The ACCC has therefore reduced the 'ducts and pipes' increment from $1.44 billion to $911 million, as at 1 July 2009. The lower increment maintains a $16.00 'tie-point' ULLS price between the old and new pricing approaches (TSLRIC+ and BBM).

The revised initial RAB value as at 1 July 2009 is $17.22 billion. This value is rolled forward to obtain the opening RAB value of $15.516 billion as at 1 July 2011.

The ACCC considers that the pricing stability obtained by its decision on the initial RAB value meets the legitimate business interests of both access seekers and Telstra by supporting past investments and promoting industry confidence in making future investment decisions. As stated in the April 2011 Discussion Paper, this consideration led the ACCC to conclude that a clear justification is required for any significant change in the Band 2 ULLS price in implementing its new pricing approach.

The ACCC has had regard to Professor Yarrow's view (submitted on behalf of Telstra) that unexpected changes in prices could indicate regulatory opportunism.[128] The ACCC notes that the ULLS and PSTN OTA prices are broadly stable. In respect of WLR and LCS prices, the ACCC has previously indicated to industry participants that it would stop using the retail minus retail cost (RMRC) pricing approach once a suitable cost-based model was developed and that prices were expected to fall.[129] The

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127 Telstra, Submission to September 2010 Draft Report, p. 63.

128 Professor George Yarrow, *RAB valuation for reformed pricing principles in telecoms*, October 2010, p. 13.

129 ACCC, *Final determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003; ACCC, *Local services review – Final decision*, July 2006; ACCC, *LCS and WLR – Final pricing principles and indicative prices for 2008–2009*, August 2008; ACCC, *Pricing principles and indicative prices – 1 August 2009–31 December 2010*, December 2009.

ACCC has also previously indicated that the LSS price was expected to fall when the information technology (IT) assets used to provide the LSS was fully depreciated.[130]

The ACCC has also considered the submissions by Telstra and Professor Sappington (on behalf of Telstra) that Telstra's prices were expected to increase over time under the TSLRIC+ pricing approach and that the ACCC should maintain the price path expected by Telstra. The ACCC considers that as assets were revalued at each price review, based on updated modern equivalent asset (MEA) values, the price path associated with any TSLRIC+ asset valuation was only indicative until the next revaluation occurred.

In regard to Telstra's submission that the initial RAB value be set on the basis of an indexed DAC value, the ACCC maintains its view that indexing a DAC value would compensate Telstra twice for inflation over time. The ACCC notes that a nominal WACC was applied to the (nominal) optimised replacement cost asset value used in estimating prices under the TSLRIC+ pricing approach.

Past recovery of depreciation

The ACCC confirms its view that Telstra is, on average, unlikely to have under-recovered depreciation on its network assets under the previous TSLRIC+ approach. The ACCC maintains its view that it is not possible to obtain sufficient detailed and reliable information to reach a definitive finding on the amount of past recovery by Telstra. The ACCC considers that any empirical study into past recovery, as proposed by Herbert Geer, would be limited by the shortcomings of the available data.[131]

The ACCC notes that estimates of past rates of return earned by Telstra are similarly limited by the shortcomings of the historical records. In addition, developing such estimates for the declared fixed line services, as distinct from Telstra's broader operations, rests on assumptions made about the allocation of joint and common costs (including network costs and business overheads) to those services.

In reaching its findings on past recovery, the ACCC has had regard to:

- the information available in the historical records, including Telstra's regulatory accounts and asset register
- further information and analysis provided in submissions, and
- the ACCC's own analysis, including its detailed technical analysis set out in section 5.7 of the April 2011 Discussion Paper.

The ACCC confirms its view that, on balance, Telstra is unlikely to have significantly under- or over-recovered depreciation on its network assets under the previous TSLRIC+ approach.

Indexation of land asset values

The ACCC confirms its approach of indexing land asset values by the CPI to recognise the typical appreciation of land over time. The ACCC also confirms that land assets are not depreciated in the FLSM since these assets do not suffer 'wear and tear' as other assets do.

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130 ACCC, Discussion Paper, April 2011, p. 156.
131 ibid., pp. 61–69.

In adopting this approach, the ACCC accepted Telstra's submission to the September 2010 Draft Report that land assets differ from other assets and should be treated differently to other assets in the FLSM. Telstra previously submitted that:

> Unlike other types of assets, land does not depreciate and, in fact, generally appreciates over time.[132]
>
> Given land values typically appreciate and land does not suffer from deterioration in the same way as other assets, it should not be depreciated in the Ovum BBM.[133]

The ACCC's approach effectively treats the return on capital allowed for land assets as a proxy for the cost of rent for the use of those assets. Rents are typically based on a return on current asset values. The return on capital is not intended to reflect actual rental yields (which vary over time reflecting the balance of supply and demand in the economy and local conditions).

The ACCC considers that, contrary to Frontier Economics' submission, the NPV = 0 property holds for land assets. When land assets are sold, their disposal value will be deducted from the RAB value. In the FLSM, the disposal value will be equal to the indexed value of the land assets since no depreciation is allowed on these assets. Frontier Economics incorrectly included an allowance for depreciation in its formula and consequently obtained an outcome that did not satisfy the NPV = 0 requirement.

The correct formula is:

$$land\ purchase\ price + \sum revaluations = land\ disposal\ price$$

Treatment of NBN Co payments to Telstra

The ACCC recognises that the FLSM currently does not account for the impacts of the NBN (see section 4.4 of this report).

The ACCC notes that further information was recently released on some of the expenditures and payments likely to be made under the proposed agreement between Telstra and NBN Co.[134] However, the ACCC considers that there is insufficient certainty about the timing and quantum of NBN Co's demand for Telstra infrastructure to take that demand, and related payments made for use or acquisition of Telstra's infrastructure, into account in the FLSM for the current regulatory period.

5.2 Asset classes in the RAB

The asset classes included in the RAB are the CAN and Core network assets used in providing the declared fixed line services.

The ACCC requires estimated actual and remaining asset lives for these assets to determine depreciation schedules for the assets. Most of the assets in the RAB are partly depreciated.

5.2.1 April 2011 Discussion Paper view

The ACCC accepted Telstra's advice on the network assets used to supply the declared fixed line services and adjusted the list of asset classes included in the RAB

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132 Telstra, Submission to the September 2010 Draft Report, October 2010, p. 12.

133 ibid., p. 59. The revised version of the Ovum BBM is now known as the FLSM.

134 Telstra, 'Telstra signs NBN Definitive Agreements', Media release and attached additional information, 23 June 2011, available at www.telstra.com.au/abouttelstra/download/document/2011-definitive-agreements-telstra-nbnco.pdf.

accordingly. The ACCC removed 'international network cables' and 'satellite equipment' from the FLSM and added four additional asset classes: 'other communications plant and equipment', 'network land', 'network buildings and support assets' and 'indirect capital assets'. The ACCC also created a new asset class 'LSS equipment' to allow it to estimate LSS prices through the FLSM.

The ACCC maintained the approach adopted in the September 2010 Draft Report to calculate remaining asset lives for each asset class. To estimate asset lives for CAN and Core assets, the ACCC took into account information provided by Telstra and estimates from the TEA model and the Analysys cost model. The remaining lives for asset classes were calculated by taking the undepreciated percentage of the asset value multiplied by the total asset life. The remaining asset lives for newly added asset classes were calculated using the same undepreciated percentage methodology applied to Telstra's data from Telstra's asset register.

Each asset class contains a mixture of assets put in place at different times. For the purposes of the FLSM, the ACCC has calculated average total and remaining asset lives as a simplifying assumption since developing a full investment and depreciation profile for all existing assets from the date when they were put in place is not feasible.

Land assets were given a 10,000 year asset life in the FLSM to ensure that they received negligible depreciation. In the absence of information about the different assets within the 'indirect capital assets' asset class, the ACCC adopted a conservative average asset life of 10 years and a remaining average asset life of five years.

5.2.2 Submissions

There were no submissions on asset lives or the asset classes used in the RAB.

5.2.3 ACCC final view

The ACCC confirms the asset classes included in the RAB. The asset classes are listed in table 5.4 of the April 2011 Discussion Paper[135] and shown in table 5.1 below. The ACCC also confirms its estimates of total and remaining asset lives, shown in table 5.2 below.[136]

[135] ACCC, Discussion paper, April 2011, p. 51
[136] ibid., p. 60.

Table 5.1: Asset classes included in the RAB—ACCC revised view

CAN Asset Class	Core Asset Class
▪ Ducts and pipes ▪ Copper cables ▪ Other cables ▪ Pair gain systems ▪ CAN radio bearer equipment ▪ Other CAN assets ▪ Other communications plant and equipment ▪ Network land ▪ Network buildings and support assets ▪ Indirect capital assets	▪ Switching equipment – Local ▪ Switching equipment – Trunk ▪ Switching equipment – Other ▪ Inter-exchange cables ▪ Transmission equipment ▪ Core radio bearer equipment ▪ Other communications plant and equipment ▪ Network land ▪ Network buildings and support assets ▪ Indirect capital assets ▪ LSS equipment

Table 5.2: Estimated average and remaining asset lives by asset class

Asset class	Average asset life	Remaining asset life
Ducts and pipes	35	**[c-i-c]**
Copper cables	20	
Other cables	20	
Pair gain systems	12	
CAN radio bearer equipment	12	
Other CAN assets	12	
Other communications plant & equipment (CAN)	**[c-i-c] [c-i-c]**	
Switching equipment – Local	27	
Switching equipment – Trunk	25	
Switching equipment – Other	20	
Inter-exchange cables	38	
Transmission equipment	**[c-i-c]**	
Core radio bearer equipment		
Other communications plant & equipment (Core)	**[c-i-c]**	**[c-i-c]**
Network land	10 000	10 000
Network buildings & support	**[c-i-c] [c-i-c]**	**[c-i-c] [c-i-c]**
Indirect capital assets	10	5

6 Capital costs

Key points

- The ACCC confirms the RAB roll forward and the tax asset value roll forward mechanisms proposed in the April 2011 Discussion Paper.
- The RAB roll forward process is conducted in real terms. To improve transparency and clarity, a new spreadsheet has been added to the FLSM to report the rolled forward nominal RAB.
- The ACCC confirms its capital expenditure forecasts and allocations to asset classes. The ACCC will consult on developing a BBM RKR to obtain capital expenditure forecasts for future regulatory periods in due course.
- No adjustments will be made for 'unders or overs' in actual, compared to forecast, capital expenditures over the regulatory period.
- The ACCC has used a nominal vanilla WACC of 8.54 per cent (5.84 per cent in real terms), based on the following parameters:

Input	ACCC approach
Risk-free rate	Based on the 10 year Commonwealth Government Securities bond yield, using an averaging period of 20 business days. The nominal risk-free rate used to estimate FAD prices is 5.16 per cent.
Expected inflation	Based on a geometric average of ten years of forecast inflation. Expected inflation used in estimating FAD prices is 2.55 per cent.
Market risk premium	Within the range of long-term historic average MRP estimates. Set at 6 per cent.
Equity beta	Set at 0.7, based on benchmarking information and AER findings on an appropriate range for the equity betas of regulated utilities.
Debt risk premium	Based on the difference in yield between a Telstra bond yield with 10 years to maturity and the 10 year CGS yield, using an averaging period of 20 business days. The DRP used to estimate FAD prices is 2.06 per cent.
Gearing ratio	Set at 40 per cent debt and 60 per cent equity.
Debt issuance cost	Updated using the methodology developed by Allen Consulting Group (ACG). The debt issuance cost used to estimate FAD prices is 0.081 per cent.
Gamma (imputation factor)	Set at 0.45, taking into account considerations of regulatory certainty and predictability, submissions, a range of empirical and theoretical evidence, and the Australian Competition Tribunal's May 2011 decision.

- The ACCC confirms its decision to adopt the straight line depreciation method.

Capital investments are recouped through the two capital cost blocks in the building block approach—the return of capital (regulatory depreciation) and a commercial return on capital.

6.1 Rolling-forward the regulatory asset base

The RAB value is rolled-forward each year to account for forecast capital expenditure, forecast regulatory depreciation and any forecast asset disposals in that year. The FLSM rolls forward the RAB at the end of each year. The closing value for that year determines the opening value of the RAB for the next year, that is, the closing RAB value equals the next year's opening RAB value.

6.1.1 April 2011 Discussion Paper view

The ACCC proposed in the April 2011 Discussion Paper to implement a RAB roll-forward approach using the following equation:

$$RAB_{t+1} = RAB_t + capex_t - depreciation_t - asset\ disposals_t$$

where RAB_{t+1} = opening RAB for the next regulatory year

RAB_t = opening RAB for the current year

$capex_t$ = forecast capital expenditure during the current year (after the half-WACC adjustment)

$depreciation_t$ = depreciation during the current year

$asset\ disposals_t$ = asset disposals during the current year

The ACCC's proposed roll-forward mechanism incorporates a half-WACC adjustment. Capital expenditures are assumed to be incurred evenly during each year—this is equivalent to investments being undertaken (on average) half-way through the year. Using this assumption, the half-WACC adjustment provides a return on the capital expenditure undertaken during the year prior to rolling it into the RAB at the end of the year. The half WACC adjustment is given by the following equation:

$$capex_t = capex_{t,u} * (1+\text{WACC})^{\frac{1}{2}}$$

where $capex_t$ = forecast capital expenditure during the current year after the half-WACC adjustment

$capex_{t,u}$ = unadjusted forecast capital expenditure during the current year before the half-WACC adjustment

Similarly, a half-WACC adjustment is applied to asset disposals based on the assumption that asset disposals occur (on average) half-way through the financial year. No asset disposals are forecast to occur during the current regulatory period.

The ACCC revised its treatment of land asset values in the FLSM so that they are indexed by the CPI in the RAB roll-forward process. This reflected the fact that land assets generally appreciate in value over time.

All tax liability calculations, including the tax asset value roll-forward, were undertaken in nominal terms. The tax asset value roll-forward mechanism incorporated a half-WACC adjustment for consistency within the FLSM in the assumed timing of capital expenditures.

6.1.2 Submissions

Telstra submitted that the method for calculating the opening RAB for the second and subsequent regulatory periods should be specified in fixed principles provisions.[137] Telstra submitted that the ACCC should allow the closing value of the RAB as at the conclusion of the immediately preceding regulatory period to be increased by an amount necessary to maintain the real value of RAB by adding an adjustment for compound inflation. Telstra stated that the FLSM indexed asset values from 1 July 2009[138]—as noted in chapter 4 and in section 6.1.3 below, Telstra appears to have misunderstood how the FLSM operates in relation to the roll-forward mechanism.

There were no other submissions on the roll-forward mechanism.

6.1.3 ACCC final view

The ACCC confirms the RAB roll-forward mechanism set out in the April 2011 Discussion Paper.

The ACCC considers that Telstra's statement that the FLSM indexes the RAB value represents a misunderstanding of the roll-forward mechanism. As explained in the April 2011 Discussion Paper, the RAB value is not indexed. The ACCC accepts Telstra's view that greater transparency and clarity around the calculation of the opening RAB for the next regulatory period is desirable.

To provide this transparency, the ACCC has created a new spreadsheet in the FLSM titled 'H. Nominal RAB Roll-Forward'. The worksheet reports the roll-forward of the RAB value in nominal terms. In rolling-forward the RAB value in nominal terms, the only difference compared with the real roll-forward mechanism is that the real value of forecast capital expenditure is converted into nominal terms.[139] This ensures that the opening RAB value is not indexed.

The new worksheet calculates the nominal RAB for each year of the regulatory period. The closing value as at 30 June 2014 would be the opening RAB for the next regulatory period.

The ACCC also confirms its approach to rolling-forward the tax value of assets in the FLSM. The tax asset value roll-forward is conducted with an explicit inflation adjustment applied to forecast capital expenditure for each year of the regulatory period. The ACCC has retained the use of straight line depreciation to estimate tax depreciation for existing and new assets in the tax RAB roll-forward mechanism. The tax RAB roll-forward uses Telstra's actual depreciated tax asset values[140] at 30 June 2009 as the initial tax asset value. The use of straight line depreciation and the method for setting the initial tax asset value are discussed in further detail in chapter 8.

6.2 Capital expenditure forecasts

Capital expenditure forecasts are an input into calculating prices for the declared fixed line services. Forecast annual capital expenditure is rolled into the RAB each year

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137 Telstra Submission – Part A, 3 June 2011, p. 75.

138 ibid., p. 76.

139 For consistency the conversion from real to nominal dollars uses the geometric average inflation forecast used in the FLSM.

140 Telstra, Fixed line services review – request for further information, Letter to the ACCC (confidential), 26 May 2011.

(see section 6.1) and forms a component of the revenue requirement through the return on and of capital.

6.2.1 April 2011 Discussion Paper view

Capital expenditure forecasts

In estimating draft prices for the FADs, the ACCC largely adopted Telstra's updated forecasts provided in March 2011.

In its updated forecasts, Telstra revised its 2010–11 capital expenditure upwards by **[c-i-c]** **[c-i-c]** to reflect actual capital expenditure in the first six months of 2010–11.[141] Telstra advised the ACCC that it was still updating its capital expenditure forecasts for future years but stated that for the purpose of forecasting capital expenditure over the regulatory period, it would be reasonable to assume a nominal **[c-i-c]** **[c-i-c]** annual increase from Telstra's revised 2010–11 expenditure forecast.

The ACCC considered that Telstra's forecast of a real decline in capital expenditure over the regulatory period was reasonable. The ACCC expected that Telstra's investments were likely to focus on 'baseline' projects needed to maintain its current network and cater for population growth. The ACCC considered that Telstra was unlikely to undertake significant discretionary investments in the fixed line network, due to the planned roll-out of the NBN. Consequently, the ACCC adopted Telstra's updated capital expenditure forecasts (converted to the 1 July 2009 base year dollars used in the FLSM) to estimate the draft FAD prices.

Telstra's forecasts did not include capital expenditure for 'indirect capital assets'. The ACCC proposed to forecast capital expenditure for 'indirect capital assets' by setting capital investment equal to estimated annual depreciation on those assets as estimated in the FLSM.

Allocation of forecast capital expenditure to asset classes

Telstra provided actual capital expenditures by asset category in its November 2010 response to the ACCC's information request.[142] As these asset categories were more disaggregated than the asset classes listed in the RAF and used in the FLSM, the ACCC reconciled these asset categories against the asset classes in the FLSM. In estimating draft FAD prices, the ACCC applied its forecast capital expenditure growth rate to actual capital expenditure in each asset class.

Telstra's capital expenditure on the 'other communications plant and equipment', 'network land', 'network buildings/support assets' and 'indirect capital assets' asset classes were not separately identified for the CAN and Core network. Since these expenditures must be allocated between the two networks in the FLSM, the ACCC allocated the forecast expenditures for these assets to the corresponding CAN and Core asset classes based on the share of each asset's total depreciated value in the CAN and Core respectively.

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141 Telstra, Pricing Principles for Fixed Line Services – Updated capital expenditure information, Letter to the ACCC (confidential), 2 March 2011.

142 Telstra, Pricing Principles for Fixed Line Services – Response to the ACCC's request for further information, Letter to the ACCC (confidential), 22 November 2010.

Efficiency mechanisms for capital expenditure

The ACCC considered that introducing efficiency incentives would promote efficient capital expenditure by Telstra. Under the ACCC's proposed efficiency benefit sharing scheme, no adjustments would be made for 'unders or overs' in actual expenditure, compared to forecast expenditure during the regulatory period. Differences between actual and forecast expenditure would be taken into account in developing forecasts for the next regulatory period. The ACCC considered that this scheme would provide Telstra with incentives to improve its efficiency and would share the benefits from efficiency improvements with access seekers and end-users in the next regulatory period.

The ACCC recognised that Telstra has incentives to overstate its forecast capital expenditures. Consequently, the ACCC proposed, for the next regulatory period, to require Telstra to provide a detailed explanation of its forecasts. In subsequent regulatory periods, Telstra would be required to explain any significant differences between its actual and forecast expenditures. The ACCC proposed to analyse Telstra's supporting information and consult publicly to assess the prudency and efficiency of Telstra's proposed capital expenditure. The ACCC noted that it did not intend to review capital projects on an individual basis.

6.2.2 Submissions

Capital expenditure forecasts

Herbert Geer submitted that the ACCC should demonstrate that the forecasts provided by Telstra were subject to rigorous scrutiny and prudency checking.[143]

Frontier Economics submitted that it agreed with the ACCC's proposed processes for assessing Telstra's capital expenditure forecasts for future regulatory periods, but stated that: 'It is concerning that many of these requirements … do not seem to apply to the first (current) regulatory process'.[144] Frontier Economics submitted that there was a lack of detail on how the ACCC would undertake its proposed prudency checks, monitor actual capital investment or implement cost pass-throughs in certain circumstances. Frontier Economics further submitted that large variations in the capital expenditure forecasts between the September 2010 Draft Report and the April 2011 Discussion Paper do not promote confidence in the forecasts.[145]

Optus submitted that the ACCC should amend the capital expenditure forecasts by assuming zero nominal growth. It stated that this was a conservative approach and reflected industry views.[146] Optus submitted that the ACCC has compromised transparency by not subjecting Telstra's capital expenditure forecasts to the assessment criteria proposed in the April 2011 Discussion Paper for future regulatory periods, that is, obtaining Telstra's forecasts and detailed explanation through a BBM RKR and subjecting those forecasts and explanatory material to industry consultation.

Telstra submitted that it maintained its previous position that record keeping rules (RKRs) are neither necessary nor appropriate for obtaining capital expenditure

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143 Herbert Geer, Submission, 3 June 2011, p. 9.
144 Frontier Economics, Submission, June 2011, p. 20.
145 ibid.
146 Optus, Submission, June 2011, p. 55.

forecasts.[147] Telstra stated that the ACCC had not provided evidence demonstrating that an informal process would not achieve regulatory certainty or transparency. In addition, Telstra submitted that an RKR process would risk disclosing its confidential information and causing it significant and ongoing commercial harm. Telstra stated that if an RKR was to be implemented, it must be targeted exclusively to the data that is required and protect its confidential information appropriately.

Allocation of forecast capital expenditure to asset classes

Optus submitted that the approach detailed in the April 2011 Discussion Paper was an improvement over the approach in the September 2010 Draft Report.[148]

Frontier Economics noted that no explanation was provided on how Telstra allocated its forecast capital expenditures to asset classes.[149]

Telstra did not provide further information on the allocation of forecast capital expenditure to asset classes in its June 2011 submission.

Efficiency mechanisms for capital expenditure

Frontier Economics reiterated its previous view that the proposed incentive scheme was 'too high-powered' and inappropriate for a new approach when there is significant uncertainty around key forecasts.[150] It submitted that the ACCC should consider less high-powered schemes, such as rolling-forward actual (instead of forecast) capital costs and depreciation or adopting 'sliding scale regulation'.[151]

Optus submitted that Telstra already faces significant and high-powered incentives to minimise costs due to competitive pressures in retail markets.[152] It considered that Telstra's past expenditures had been efficient and further efficiency gains were unlikely. In addition, Optus submitted that an efficiency carry-over mechanism would create an incentive for Telstra to game the system by inflating forecasts to achieve efficiencies that are not real.[153] Optus stated that the ACCC was unlikely to gain the knowledge required to assess the efficiency of Telstra's forecasts due to imminent industry change, information asymmetry and difficulty in obtaining information. Optus submitted that Telstra should only be allowed to recover its actual costs, as this approach would ensure that access prices align with actual costs. It submitted that the ACCC should consult on its proposed efficiency mechanism when it consults on a BBM RKR.

6.2.3 ACCC final view

Capital expenditure forecasts

The ACCC considers that the capital expenditure forecasts proposed in the April 2011 Discussion Paper are reasonable for the reasons set out below.

The revisions to the ACCC's forecasts between the September 2010 Draft Report and the April 2011 Discussion Paper reflected the receipt of more accurate information from Telstra on its previous investments in assets used to provide the declared fixed

147 Telstra, Submission – Part A, 3 June 2011, p. 83.
148 Optus Submission, June 2011, p. 57.
149 Frontier Economics, Submission, June 2011, p. 20.
150 ibid., June 2011, p. 25.
151 ibid., pp. 25–26.
152 Optus, Submission, June 2011, pp. 46–47.
153 ibid., Submission, June 2011, p. 48.

line services.[154] The ACCC has accepted that Telstra's annual report figures relate to broader asset categories than used in the RAF and their use would overstate Telstra's investments in the assets included in the FLSM. The ACCC notes that Telstra's more accurate information resulted in a significant reduction in past capital expenditures and, consequently, the ACCC's forecasts of future capital expenditures on the assets included in the FLSM.

The ACCC confirms its view that forecasts provided by Telstra are likely to be the most accurate measure of capital expenditures available.

The ACCC has noted comments in some submissions that it has not sufficiently assessed, or consulted on, Telstra's capital expenditure forecasts. The ACCC explained the basis for the forecasts in its April 2011 Discussion Paper and released Telstra's 2 March 2011 letter for consultation.[155] In reviewing its capital expenditure forecasts, the ACCC has had regard to all submissions received on those forecasts.

The ACCC recognises that Telstra's forecasts were provided prior to the release of the Definitive Agreements recently made between Telstra and NBN Co. Telstra has indicated that any capital works required in relation to the Agreements would be met from within its existing capital expenditure target.[156]

The ACCC considers that there is insufficient certainty about the timing, quantum and nature of any such capital works to take any related expenditures into account in the FLSM for the current regulatory period. The ACCC has therefore concluded that no adjustments are required to the capital expenditure forecasts used in estimating prices in the FLSM.

The ACCC has considered the alternative capital expenditure forecast proposed in Optus' submission. Optus did not provide firm supporting evidence for the proposed forecast. Its submission appears based largely on its view that without 'further information or substantiation from Telstra, it is unreasonable to impose increasing nominal costs on access seekers'.[157] The ACCC assessed the sensitivity of the price estimates to the lower capital expenditure forecasts proposed by Optus. The impact on prices is minor, decreasing the WLR price, for example, by less than 1 cent. The ACCC has concluded that there are insufficient grounds to adopt Optus' proposed capital expenditure forecasts.

The ACCC has made a correction to the capital expenditure forecasts set out in the April 2011 Discussion Paper. The ACCC incorrectly deflated Telstra's 2010–11 capital expenditure estimate (to the FLSM base year dollars) in the April 2011 Discussion Paper. It used the simple average of the RBA's CPI forecast for the year ended June 2011 (2.75 per cent),[158] and the 2009–10 value for the ABS producer price index for communications equipment manufacturing (–2.51 per cent) as the proxy for capital equipment inflation that year. The ACCC's revised approach is to use the ten year geometric average of CPI (2.55 per cent) as the proxy for 2010–11 capital

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154 ACCC, Discussion Paper, April 2011, pp. 76–79.

155 Telstra, Pricing Principles for fixed Line Services – Updated capital expenditure forecasts, Letter to the ACCC (confidential), 2 March 2011.

156 Telstra, 'Telstra signs NBN Definitive Agreements', Media release and attached additional information, available at www.telstra.com.au/abouttelstra/download/document/2011-definitive-agreements-telstra-nbnco.pdf.

157 Optus, Submission, April 2011, p. 55.

158 RBA, *Statement on monetary policy*, 4 November 2010, p. 62.

equipment inflation. This approach is consistent with the methodology applied in subsequent years.

Table 6.1 sets out the final capital expenditure forecasts used in estimating FAD prices.

Table 6.1: 2009–10 capital expenditure and final capital expenditure forecasts for 2010–11 to 2013–14 ($m at 1 July 2009)

	2009–10	2010–11	2011–12	2012–13	2013–14
CAN	[c-i-c] [redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Core	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	[redacted]	[redacted]	[redacted]	[redacted]	[redacted] [c-i-c]

Allocation of forecast capital expenditure to asset classes

The ACCC confirms its view that adopting Telstra's allocations of forecast capital expenditures to asset classes is reasonable. No submissions proposed alternative allocations to asset classes or included information that demonstrated that the allocations are not reasonable.

The ACCC has not received any submissions on the appropriateness of its methodology for allocating forecast capital expenditures on the 'other communications plant and equipment', 'network land', 'network buildings/support assets' and 'indirect capital assets' asset classes between the CAN and Core network and the ACCC has maintained its approach to these allocations.

The final capital expenditure forecasts by asset class used in estimating the FAD prices are set out in tables 6.2 and 6.3. Telstra did not forecast any capital expenditures on 'network land' assets. The ACCC has not allocated any capital expenditure to the 'LSS equipment' asset class because the assets used to provide the LSS have been fully depreciated and Telstra has not made further capital investments in these assets. Telstra has not indicated that it intends to make any further investments in those assets.

Table 6.2: Allocation of forecast capital expenditure by CAN asset class ($m at 1 July 2009)

CAN asset class	2011–12	2012–13	2013–14
Ducts and pipes	[c-i-c]		
Copper cables			
Other cables			
Pair gain systems			
Radio bearer equipment			
Other CAN assets			
Other communications plant and equipment			
Network land			
Network buildings/support			
Indirect capital assets			[c-i-c]

Table 6.3: Allocation of forecast capital expenditure by Core asset class ($m at 1 July 2009)

Core asset class	2011–12	2012–13	2013–14
Switching equipment – Local	[c-i-c]		
Switching equipment – Trunk			
Switching equipment – Other			
Inter-exchange cables			
Transmission equipment			
Radio bearer equipment			
Other communications plant and equipment			
Network land			
Network buildings/support			
Indirect capital assets			
LSS equipment			[c-i-c]

Efficiency mechanisms for capital expenditure

The ACCC confirms its view that no adjustments should be made for 'unders or overs' in actual expenditure compared to forecast expenditure. Any differences between actual and forecast expenditure would be taken into account in developing forecasts for the next regulatory period.

In regard to the proposed BBM RKR for obtaining forecasts and detailed explanatory material for future regulatory periods, the ACCC has previously stated its view that

consultation is essential before an RKR can be finalised and implemented.[159] As noted in chapter 4, the ACCC will consult on the proposed BBM RKR in due course.

6.3 Weighted average cost of capital

A firm's WACC is the risk-adjusted rate of return on capital required by debt and equity capital providers to the firm. It reflects the return investors could expect to earn by investing in the next best investment with equivalent risk; that is, it represents the firm's opportunity cost of capital. The WACC is multiplied by the regulatory asset base to calculate the firm's return on capital.

The WACC ensures that a regulated firm receives an appropriate commercial return on efficient investments in regulated assets, including an allowance for risk. This provides an incentive for the firm to invest in the assets used to provide regulated services. The regulated firm also receives an allowance for regulatory depreciation (see section 6.4), which enables it to recover its investment costs. The return on the firm's investments provided by the WACC, and the return of investment costs provided by regulatory depreciation, meet the legitimate commercial interests of the supplier of declared services. By encouraging the economically efficient use of, and investment in, infrastructure used to provide declared services, an appropriate WACC is in the LTIE.

The ACCC has used a real vanilla WACC in the FLSM to calculate the return on capital. The vanilla WACC is calculated as follows:

$$WACC_{Vanilla} = \frac{D}{V} \times E[Kd] + \frac{E}{V} \times E[Ke]$$

where D = the value of debt

E = the market value of equity

V = the market value of equity and debt

$E[Kd]$ =the required/expected return on debt

$E[Ke]$ =the required/expected return on equity

The vanilla WACC is a post-tax WACC. For consistency with the vanilla WACC, the cash flows modelled in the FLSM are post-tax and include the benefits from imputation as well as the interest tax shield (that is, the tax deduction of interest payments).

6.3.1 WACC estimate

For the purpose of making IADs in March 2011, and publishing draft FADs in April 2011, the ACCC's real vanilla WACC estimate was 6.25 per cent, which equated to a nominal vanilla WACC of 9.04 per cent. The parameters underlying this estimate were explained in detail in the April 2011 Discussion Paper and are summarised in the rest of this section.

In updating its WACC estimate for the FADs, the ACCC took into account submissions on the WACC and more up-to-date information on the WACC

[159] ACCC, Discussion Paper, April 2011, pp. 82–83.

parameters. The parameter values used to estimate the WACC for the April 2011 Discussion Paper, and the updated parameter values used in determining the WACC used to estimate prices for the FADs, are set out in table 6.4 below.

Table 6.4: Estimates of the vanilla WACC and WACC parameters—April 2011 Discussion Paper and July 2011 Final Report

WACC parameter	Discussion Paper	Final Report
Nominal risk-free rate	5.61%	5.16%
Expected inflation	2.63%	2.55%
Real risk-free rate	2.91%	2.55%
Nominal debt risk premium	2.19%	2.06%
Debt issuance cost	0.083%	0.081%
Nominal market risk premium	6%	6%
Equity beta	0.7	0.7
Debt gearing	40%	40%
Gamma	0.45	0.45
Equity issuance costs	0%	0%
Nominal vanilla WACC	***9.04%***	***8.54%***
Real vanilla WACC	*6.25%*	*5.84%*

Submissions

Optus' submission was broadly supportive of the ACCC's approach to setting the WACC.[160] It submitted alternative values should be used for two parameters (equity beta and gamma, which are each discussed below).

Telstra supported the use of a real vanilla WACC to estimate prices.[161] However, it submitted that the overall WACC value was too low and would not adequately compensate Telstra for the risks associated with providing PSTN-based services.[162] It stated that higher demand risks warrant a higher risk premium in the WACC and that the ACCC has not sufficiently taken into account these higher risks.[163] It submitted a report by its consultant Professor Sappington that made a similar argument.[164]

In the context of fixed principles provisions, both Telstra and Macquarie Telecom supported the use of a real vanilla WACC.[165]

Submissions by other parties did not comment on the WACC.

ACCC final view

The ACCC confirms its view that a real vanilla WACC is consistent with the FLSM and will provide an appropriate risk-adjusted rate of return to Telstra.

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160 Optus, Submission, 3 June 2011, p. 59.
161 Telstra, Submission – Part A, 3 June 2011, p. 78.
162 ibid., p. 55.
163 ibid., pp. 45–47.
164 ibid., Schedule A.1: D Sappington, 'The ACCC's new approach to setting access prices', p. 12.
165 Telstra, Submission – Part A, 3 June 2011, p. 78; Macquarie Telecom, Submission, 3 June 2011, p. 14.

The methodology and data used to derive the parameter estimates in the April 2011 Discussion Paper, the submissions on those parameters, and the ACCC's updated parameter estimates are discussed below.

While the ACCC makes use of individual WACC parameters in estimating the WACC value, its key objective is to obtain an overall value that is reasonable in terms of the access provider's legitimate commercial interests and incentives for efficient investment. Therefore, while the ACCC has carefully considered the appropriateness of each WACC parameter estimate, the reasonableness of the resulting WACC value is the prime consideration.

In this regard, the ACCC notes that the values estimated for certain WACC parameters will be influenced by values assigned to other parameters. The value of theta, for example, influences historical estimates of the market risk premium (MRP) because the value of imputation credits must be added to the stock accumulation indices used to calculate the historical equity risk premium.[166] The estimated equity beta is influenced by the value of gamma and the gearing ratio used in the Monkhouse formula.[167] The gearing ratio also influences the debt risk premium (DRP) because of its impact on the business' default risk.

Consequently, the ACCC has considered the values of the WACC parameters in the context of their interactions with other parameters and the reasonableness of the overall WACC estimate. The ACCC is of the view that changing individual WACC parameters without considering potential parameter interactions or the overall reasonableness of the WACC risks setting a WACC value that is not in the LTIE.

Further, the ACCC considers that the regulatory return provided through the WACC is likely to influence Telstra's incentives to undertake economically efficient investments in the infrastructure used to provide the fixed line services. The ACCC considers that Telstra's investment incentives will be supported by a degree of certainty and predictability over time in the methodologies used in estimating the WACC. Such certainty and predictability is likely to promote confidence that a reasonable real rate of return will be received over the lives of the fixed line assets, many of which are long-lived. These considerations support the ACCC's view that certainty and predictability over time in the way the WACC is determined is in the LTIE and in Telstra's legitimate business interests.

In estimating the WACC value, the ACCC has adopted a 'conservative' approach. The ACCC has applied a conservative approach by having regard to the uncertainties surrounding the parameter estimates and the interactions between the parameters. This approach means that, where the available evidence produces a range of potential

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166 This adjustment is necessary because '[e]xisting stock accumulation indices in Australia take into account returns from (cash) dividends and capital gains only and, therefore, post-July 1987, these indices implicitly attribute no value to imputation credits distributed to investors.' T Brailsford, JC Handley and K Maheswaran, 'Re-examination of the historical equity risk premium in Australia', *Accounting and Finance*, vol. 48, 2008, p. 84.

167 P Monkhouse, 'Adapting the APV Valuation methodology and the Beta Gearing Formula to the Dividend Imputation Tax System', *Accounting and Finance*, vol. 37, no. 1, 1997, pp. 69–88. The Monkhouse formula is expressed as: $\beta_e = \beta_a + (\beta_a - \beta_d) * \{1 - \left[\frac{E[K_d]}{1 + E[K_d]}\right] * [(1-\gamma) * t]\} * \frac{D}{E}$

The ACCC's benchmarking approach requires the equity beta estimates sourced from Bloomberg to be de-levered and re-levered using the Monkhouse formula in order to compute comparable estimates of the equity beta.

parameter values, the ACCC has used values that result in a higher estimate of the WACC.

The ACCC considers that adopting this conservative approach will ensure that Telstra is able to recoup at least the cost of its efficient investments. Ensuring that Telstra can recoup its efficient investment costs will underpin Telstra's incentives to undertake efficient investments in network assets.

Based on its consideration of a wide range of evidence and other available information, and its conservative approach to setting the WACC parameters, the ACCC considers that the WACC value of 5.84 per cent provides a reasonable risk-adjusted commercial rate of return on Telstra's fixed line network investments.

6.3.2 Cost of equity

The cost of equity is a direct input into the WACC formula. It reflects the opportunity cost of not investing in another investment of equivalent risk. As noted in the April 2011 Discussion Paper, the ACCC estimates the cost of equity using the capital asset pricing model (CAPM). The CAPM specifies a relationship between the expected return on an individual risky asset or business and the level of systematic (or non-diversifiable) risk.[168] The formula is:

$$E[Ke] = rf + \beta_e \times (E[Rm] - rf)$$

where $E[Ke]$ = the required/expected return on equity

rf = the risk-free rate

β_e = the firm's equity beta

$E[Rm]$ = the required/expected return on the market portfolio

$(E[Rm] - rf)$ = the market risk premium (MRP)

Risk-free rate

As noted in the April 2011 Discussion Paper, Australian Commonwealth Government bonds are typically used as a proxy for the risk-free asset. The ACCC generally uses 10 year Commonwealth Government Securities (CGS) bonds.

The ACCC considers regulated firms should use an averaging period when estimating the risk-free rate to reduce the impact of day-to-day market volatility.

In the FLSM, the ACCC uses a real risk-free rate, which is calculated by deflating the nominal risk-free rate by expected inflation using the Fisher equation.[169]

April 2011 Discussion Paper view

In estimating draft FAD prices, the ACCC used the same 20 day averaging period from 6 December 2010 to 31 December 2010 as used in estimating IAD prices. The

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[168] Systematic risk refers to risk that is inherent in the asset that cannot be diversified away. Systematic risk includes market-wide factors which affect all companies: for example, changes in interest rates and inflation. Hence, systematic risks faced by investors are those risks that are common to the market as a whole.

[169] $\frac{1+i}{1+\pi} = 1 + r$, where i = nominal interest rate; π = expected inflation; and r = real interest rate.

average ten year yield to maturity of 10 year CGS bonds for the period was 5.61 per cent.

In the April 2011 Discussion Paper, the ACCC used a geometric average of forecast inflation rates over a ten year period from 2009–10 to 2018–19 to calculate expected inflation. The data included 2009–10 actual inflation, the RBA's short-term inflation forecasts for 2010–11, 2011–12 and 2012–13, and the midpoint of the RBA's inflation target range (2.5 per cent) for the remaining years.

Expected inflation was calculated to be 2.63 per cent. This resulted in a real risk-free rate of 2.91 per cent.

The ACCC noted in the April 2011 Discussion Paper that it proposed to update these parameters in estimating prices for the FADs.

Submissions

Optus supported the ACCC's move to a 20 day averaging period as it would mitigate the effects of daily volatility on the average risk-free rate.[170] It submitted that this length is consistent with the averaging periods used by other regulators.

In relation to fixed principles provisions, Telstra submitted that the risk-free rate for future regulatory periods should be determined 'on a moving average basis from the annualised yield on Commonwealth Government bonds with a maturity of 10 years using the indicative mid rates published by the Reserve Bank of Australia'.[171] Additionally, Telstra proposed a fixed principles provision that would permit it to propose the length of the averaging period.

There were no other submissions on the risk-free rate.

ACCC final view

The ACCC considers that its methodology for calculating the risk-free rate remains appropriate.

In updating its estimate of the risk-free rate for the FADs, the ACCC has used the same CGS bonds to calculate the risk-free rate as in the April 2011 Discussion Paper.[172] The ACCC has updated its estimate of the risk-free rate by taking the 20 day average from 3 to 30 June 2011 which gives a nominal risk-free rate of 5.16 per cent.

Expected inflation has also been updated for the RBA's latest short-term inflation forecasts.[173] In calculating expected inflation, the ACCC has used the ten year period from 2011–12 to 2020–21. This period aligns the ten year inflation period with the ten year horizon used to calculate other WACC parameters such as the risk-free rate and DRP. The expected inflation forecast uses the RBA's short-term inflation forecasts for 2011–12 and 2012–13, and the midpoint of the RBA's inflation target range (2.5 per cent) for the remaining years. The updated inflation forecast is 2.55 per cent. Using the estimated nominal risk-free rate and expected inflation, the real risk-free rate is 2.55 per cent.

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170 Optus, Submission, 3 June 2011, p. 59.
171 Telstra, Submission – Part A, 3 June 2011, p. 78.
172 Bloomberg ticker: C12710Y Index.
173 RBA, Statement on monetary policy, 5 May 2011, p. 63.

Market risk premium

The MRP is the expected risk premium investors require over the risk-free return to be willing to invest in a well-diversified risky 'market' portfolio. The MRP is normally quoted as an annual figure and the ACCC has adopted that convention. The MRP is not directly observable as it is an expected premium.

April 2011 Discussion Paper view

In determining the MRP for the April 2011 Discussion Paper, the ACCC had regard to historical estimates, current studies of Australian market practitioners and regulatory precedent. The ACCC also took into account a broad range of evidence and expert commentary demonstrating that economic and financial conditions have returned to relatively normal levels following the global financial crisis. The ACCC considered that the appropriate value for the MRP was six per cent.

Submissions

Optus supported an MRP value of six per cent as an appropriate long-term, economy wide measure, noting that 'the effect of the global financial crisis in Australia has been very limited'.[174]

There were no other submissions on the MRP.

ACCC final view

The MRP represents investors' expectations about future returns. Realised excess stock market returns are likely to inform investors' expectations of future returns. However, investors' expectations and their required MRP are unlikely to be solely informed by past excess returns. Investors' expectations are likely to be informed by a range of factors including current market conditions and the economic and financial market outlook. In estimating the MRP, the ACCC has had regard to available information about investors' expectations of what the MRP will be in the future.

The ACCC notes that estimates of historical excess returns produce a range of relevant values for the MRP. Professor John Handley's latest estimates of historical excess returns fall within a range of 4.0 to 6.6 per cent.[175] This range assumes a conservative theta value of 0.65.

The ACCC maintains its view—based on analysis by the International Monetary Fund, Organisation for Economic Co-operation and Development (OECD) and RBA—that the outlook for economic and financial markets is robust.[176] The ACCC considers that the favourable outlook is likely to be factored into investors' expectations of future equity market returns and therefore the MRP required by

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174 Optus, Submission, 3 June 2011, p. 59.

175 JC Handley, *Historical Equity Risk Premium for the period 1883 to 2010*, 25 January 2011, p. 8. The estimated range depends on the time period considered, the calculation method (such as, use of a geometric or arithmetic mean), and the assumed value of theta. The estimated MRP increases for higher assumed values for theta.

176 Yan Sun, 'Potential Growth of Australia and New Zealand in the Aftermath of the Global Crisis', IMF Working Paper, WP/10/27, May 2010, pp. 9–10; p. 19; IMF, *Mining Boom Bodes Bright Future for Australia*, IMF, 28 October 2010, available at www.imf.org/ external/pubs/ft/survey /so/2010/car102810a.htm; OECD, *Australia – Economic Outlook 87 Country Summary*, OECD, 2010, available at www.oecd.org/document/ 15/0,3343,en_2649_34573_45268687_1_1_1_ 1,00.html; RBA, *Statement by Glenn Stevens, Governor: Monetary Policy Decision*, 2 November 2010, at www.rba.gov.au/media-releases/2010/mr-10-26.html.

investors. Recent surveys suggest that the MRP adopted by firms and market practitioners is six per cent or lower.[177]

The ACCC confirms its view that the best estimate of the MRP is six per cent. The ACCC considers that this MRP value is conservative as it is near the top of the most recent range of MRP estimates (calculated using a conservative assumption about the value of theta) and at the top of the range of values adopted by firms and market practitioners.

Equity beta

The equity beta represents a measure of the systematic risk of an equity investment in a company relative to an equity investment in the equity market as a whole. The equity beta includes both the fundamental systematic business risk of the firm and any financial risk due to leverage.

Regulators adopt a value for the equity beta that is expected to best represent the systematic risk profile of an efficient business. This provides the regulated business with the necessary incentives to undertake only those capital investments that are expected to earn a reasonable return.

April 2011 Discussion Paper view

Regulators typically determine the equity beta by reference to the historical equity betas of a selection of businesses deemed to be close comparators to the regulated business. The ACCC considered five years of monthly and weekly benchmarking data for comparable telecommunications firms from selected OECD countries.[178]

In considering the benchmarking data, the ACCC noted that the asset and equity betas related to the entire range of services provided by the surveyed telecommunications firms, not just their fixed line services. The ACCC recognised that the systematic risk associated with business lines like mobile communications is likely to be significantly higher than the systematic risk associated with fixed line services. Since firms in the benchmark sample provide services using both fixed and mobile networks, the benchmark asset beta is likely to be higher than the asset beta of Telstra's CAN alone.

The ACCC also had regard to empirical evidence that an appropriate range for the equity beta of a regulated utility is between 0.41 and 0.68.[179]

After considering these factors and information and comments provided in submissions, the ACCC proposed to use a conservative equity beta of 0.7. This value is slightly above the appropriate range for the equity beta of a regulated utility.

Submissions

Optus submitted that an equity beta of 0.7 was likely to overstate the level of systematic risk for Telstra's fixed line services.[180] However, it recognised the difficulty in estimating an equity beta specifically for Telstra's fixed line business.

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177 Pablo Fernandez and Javier del Campo, 'Market Risk Premium used in 2010 by Analysts and Companies: a survey with 2,400 answers', *IESE Business School*, 21 May 2010, pp. 1–15; AMP Capital Investors, 'Are shares good value & what about bank deposits?', *Oliver's insights*, 16 September 2010.

178 ACCC, Discussion paper, April 2011, p. 95.

179 AER, *Electricity transmission and distribution network service providers—Review of the weighted average cost of capital (WACC) parameters: Final decision*, May 2009, p. iv.

Telstra submitted that the equity beta should be higher than the value of 0.83 used in previous ACCC decisions based on its view that the systematic risks associated with the PSTN have increased.[181] Telstra submitted that a number of factors, including advances in wireless technologies, changes in consumer tastes and the rollout of the NBN, have increased the demand risks in providing fixed line services. Further, Telstra challenged the relevance of equity beta estimates for other regulated utilities, on the basis that systematic risks vary significantly in other industries.[182]

There were no other submissions on the equity beta.

ACCC final view

The ACCC confirms its view that an equity beta of 0.7 is appropriate and conservative.

In reaching this decision, the ACCC has had regard to the views expressed in submissions and the updated benchmark estimates of equity and asset betas across OECD countries, shown in table 6.5 below. The ACCC considers that a value of 0.7 is consistent with the updated benchmark values.

In regard to Telstra's submission about demand risks, the ACCC considers that the benchmark values incorporate investors' assessments of the demand and other risks involved in providing telecommunications services, including the fixed line services. The ACCC has noted that its previous estimates of the equity beta were conservative.[183] The ACCC notes that an equity beta of 0.7 is substantially higher than Telstra's estimated equity beta of 0.301.

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180 Optus, Submission, 3 June 2011, p. 59.
181 Telstra, Submission – Part A, 3 June 2011, p. 56.
182 ibid.
183 ACCC, Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking – Final decision, April 2009, p. 228.

Table 6.5: Updated benchmark estimates of equity and asset betas across OECD countries

Firm	5 year monthly equity beta	5 year weekly equity beta	5 year monthly asset beta	5 year weekly asset beta	Debt/ Equity Ratio	Country of Origin
AT&T Inc.	0.659	0.764	0.486	0.563	0.36	US
Qwest Communications Intl	0.793	1.285	0.330	0.535	1.42	US
Verizon Communications Inc.	0.666	0.717	0.458	0.493	0.46	US
Cincinnati Bell Inc.	1.53	1.26	0.378	0.311	3.082	US
BCE Inc.	0.43	0.16	0.291	0.108	0.482	Canada
BT Group PLC	1.051	0.826	0.523	0.411	1.022	Britain
Telekom Austria AG	0.554	0.725	0.331	0.434	0.68	Austria
Telecom Italia SpA	0.492	0.842	0.186	0.319	1.662	Italy
Hellenic Telecommunications Organisation SA	0.518	0.584	0.268	0.302	0.946	Greece
TDC A/S	0.149	0.224	0.077	0.116	0.946	Denmark
Portugal Telecom SGPS SA-REG	0.626	0.872	0.334	0.466	0.882	Portugal
TeliaSonera AB	0.648	0.699	0.521	0.562	0.246	Sweden/ Finland
Telefonica SA	0.718	0.767	0.427	0.456	0.69	Spain
Deutsche Telekom AG-REG	0.334	0.667	0.172	0.344	0.952	Germany
France Telecom SA	0.435	0.545	0.246	0.308	0.776	France
Koninklijke KPN NV	0.253	0.448	0.157	0.279	0.614	Netherlands
Swisscom AG-REG	0.277	0.552	0.187	0.372	0.49	Switzerland
Nippon Telegraph & Telephone Corporation	0.494	0.601	0.272	0.331	0.826	Japan
Singapore Telecom Ltd	0.791	0.77	0.692	0.674	0.144	Singapore
PCCW Ltd	0.111	0.062	0.046	0.026	1.44	Hong Kong
Bezeq The Israeli Telecom Corp Ltd	0.542	0.447	0.415	0.342	0.31	Israel
Telecom Corp of New Zealand	1.164	1.14	0.796	0.779	0.468	New Zealand
Telstra Corp Ltd	0.301	0.425	0.228	0.322	0.322	Australia
Average	**0.589**	**0.669**	**0.340**	**0.385**	**0.836**	

Source: Bloomberg Data Services, data as at June 2011.

Equity issuance costs

Equity issuance costs are the fees associated with issuing new equity capital. Since equity issuance costs are only incurred when a business raises equity capital, the ACCC's view in the April 2011 Discussion Paper was that Telstra should not be compensated for costs it has not incurred. The ACCC considered that equity issuance costs should be recovered as a cash flow (operating expenditure) allowance when a business raises equity capital and should not be included in the WACC.

Submissions

Optus supported the ACCC's view in the April 2011 Discussion Paper that equity issuance costs should be recovered as an operating cost rather than through an allowance in the WACC.[184]

There were no other submissions on equity issuance costs.

ACCC final view

The ACCC confirms its view that equity issuance costs should be recovered as a cash flow (operating cost) allowance when Telstra raises equity capital. It has not therefore included equity issuance costs in the WACC.

6.3.3 Cost of debt

The cost of debt is given as the sum of the risk-free rate and a margin for debt, including the costs of raising debt:

$$E[Kd] = rf + \text{debt risk premium} + \text{debt issuance costs}$$

where $E[Kd]$ = the required/expected return on debt

rf = the risk-free rate

To maintain consistency within the WACC formula, the risk-free rate used to estimate the cost of debt is the same as the risk-free rate used to calculate the return on equity.

Debt risk premium (DRP)

The DRP accounts for debt-specific risk compensation over and above the risk-free rate. The DRP is dependent on the firm's gearing level, its credit rating and the term of the debt.

The DRP is derived as the difference between the yield to maturity (YTM) on the chosen debt proxy (for example, 10 year A-rated bond yields) and the yield to maturity on the chosen risk-free proxy (for example, 10 year CGS bond yields). In the past, the value for the YTM on the chosen debt proxy was usually derived from a benchmark bond index obtained from a reputable financial market data source.

April 2011 Discussion Paper view

In estimating draft FAD prices, the ACCC proposed using a benchmark A-rated bond to estimate the efficient cost of debt of an A-rated telecommunications business. In the absence of a benchmark A-rated bond, the ACCC decided to use a long-term Telstra bond as a proxy for a benchmark bond in calculating the DRP. Therefore, the ACCC took the average yield on the Telstra bond maturing on 15 July 2020[185] (average yield of 7.81 per cent) and subtracted the corresponding average yield on the Bloomberg 10 year CGS[186] (average yield of 5.61 per cent), to estimate a DRP of 2.19 per cent.

The ACCC noted that it intended to update the DRP in estimating FAD prices.

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184 Optus, Submission, 3 June 2011, p. 59.
185 Bloomberg ticker: EI291758 Corp.
186 Bloomberg ticker: C12710Y Index.

Submissions

Telstra submitted that the ACCC should not have relied on a single bond to estimate the DRP in the April 2011 Discussion Paper, and that the resulting estimate of 2.19 per cent was too low. It noted that the AER had given a weighting of 25 per cent to the Australian Pipeline Trust bond and 75 per cent to the extrapolated Bloomberg fair value curve in its decision on Victorian electricity distribution businesses. Telstra submitted that the ACCC should 'be similarly cautious in relying too heavily on a single bond observation' to estimate the DRP.[187]

Telstra stated that 'the best estimate of Telstra's actual cost of debt is the Telstra-wide DRP',[188] which it considered should be estimated using a methodology proposed in its November 2010 response to the ACCC's information request.[189] Telstra's proposed methodology is discussed below. Alternatively, Telstra suggested that the ACCC should continue to extrapolate the Bloomberg A-rated fair yield curve.

There were no other submissions on the DRP.

ACCC final view

The ACCC remains of the view that the difficulties in extrapolating the Bloomberg A-rated fair yield curve warrant the use of a more reliable methodology.

The ACCC considered the appropriateness of Telstra's proposed methodology using information on Telstra's corporate bond rate, as set out in its November 2010 response to the ACCC's information request. In its response, Telstra stated that the bond rates used in its methodology are 'quotes' obtained from 'eight independent bank estimates' for bonds with a yield to maturity of three, five, seven and ten years.[190] Telstra's response described a number of adjustments it made to the information obtained from these 'quotes' to obtain its estimated range.

The ACCC has concerns about the appropriateness of Telstra's proposed methodology:

- The ACCC is unable to assess the suitability and reliability of the data used, the appropriateness of Telstra's adjustments to that data, or the accuracy of Telstra's calculations. Telstra has not provided any details of the data used or the calculations it made to obtain its range of values.
- Telstra has provided no information about the 'eight independent bank estimates' used, such as the identity of the banks providing the estimates.
- The ACCC considers that 'quotes' are unlikely to be as reliable as actual bond yields. Telstra has not provided an explanation for its use of a range of 'quotes' rather than publicly available Bloomberg information on Telstra bond yields.
- Telstra's use of the 10-year CGS rate with bonds of varying terms is unlikely to produce reliable DRP estimates. The term of the risk-free rate should match the term of the bond.

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187 Telstra, Submission – Part A, 3 June 2011, p. 57.
188 ibid.
189 Telstra, Pricing principles for fixed line services: Response to the ACCC's request for further information, November 2010, pp. 25–28.
190 ibid., p. 25.

- Telstra has not updated its estimated DRP range. The figures provided in its November 2010 response appear to relate to the June quarter 2010.[191] The yield on the 7-year A-rated fair yield curve is now lower than it was in mid-2010.[192]

The ACCC has had regard to Telstra's comments on the ACCC's use of a single long-term Telstra bond. Information about the bond used by the ACCC is publicly available,[193] which allows interested parties to assess its suitability and reliability. The bond contains no non-standard features, which might, in Telstra's view, have affected its yield.[194]

In regard to the AER's use of Bloomberg, the ACCC notes that the AER is required to estimate a DRP with respect to a benchmark corporate bond with a credit rating of BBB+ and a term to maturity of 10 years. Under current market conditions it is more difficult to find a single bond that provides a good proxy for such a benchmark. Bloomberg's fair value curves have also been relied upon by the AER and other regulators in the past. In the ACCC's view, these considerations are relevant to the AER's continued use of extrapolated Bloomberg data. They are not a relevant consideration in determining an appropriate DRP for Telstra as a suitable Australian A-rated bond with a term to maturity of close to 10 years is available.

The ACCC has concluded that its methodology for calculating the DRP remains appropriate. The DRP estimate has been updated by taking the 20 day average of the Telstra bond maturing on 15 July 2020[195] from 3 to 30 June 2011 (average yield of 7.22 per cent) and subtracting the corresponding average yield on the Bloomberg 10 year CGS[196] (average yield of 5.16 per cent), to estimate a DRP of 2.06 per cent. The averaging period used is the same 20 day period as used for estimating the risk-free rate.

Gearing ratio

The gearing level of a firm refers to the ratio of debt to equity that a firm uses to finance its capital. The gearing level is used to weight the return on equity and cost of debt in the WACC formula. Where the firm's capital structure is highly geared (that is, the firm has a high level of debt), this implies greater financial risk for the firm and therefore a greater required rate of return for both equity and debt holders.

April 2011 Discussion Paper view

The ACCC considered that the appropriate gearing ratio was 40:60, consistent with the gearing ratio used in previous fixed line services pricing decisions.

Submissions

Optus supported the gearing ratio of 40:60 used in the April 2011 Discussion Paper.[197] There were no other submissions on the gearing ratio.

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191 ibid., Figure 1: Telstra wide DRP, p. 27.
192 Bloomberg ticker: C3597Y Index.
193 Bloomberg ticker: EI291758 Corp.
194 Telstra, Submission – Part A, 3 June 2011, p. 57, footnote 174.
195 Bloomberg ticker: EI291758 Corp.
196 Bloomberg ticker: C12710Y Index.
197 Optus, Submission, 3 June 2011, p. 59.

ACCC final view

The ACCC confirms its view that a debt/equity ratio of 40:60 is appropriate.

Debt issuance costs

Debt issuance costs are the costs associated with raising debt. They can be recovered through a direct cash flow allowance or an adjustment to the WACC. In the past, the ACCC has accepted the inclusion of debt issuance costs in the return on debt.[198]

April 2011 Discussion Paper view

Using the Allen Consulting Group's methodology,[199] the ACCC proposed that debt issuance costs should be set at 8.3 basis points.

Submissions

Optus supported the methodology and assumptions used to calculate debt issuance costs and considered a value of 8.3 basis points to be reasonable.[200] There were no other submissions on debt issuance costs.

ACCC final view

The ACCC has updated its calculation of debt issuance costs, shown in table 6.6. Consistent with its reasoning in the April 2011 Discussion Paper, the ACCC maintains its view that debt issuance costs should be set assuming six debt issues of $500 million, which results in an updated estimate of debt issuance costs of 8.1 basis points.

198 ACCC, Final decision: Assessment of Telstra's Unconditional Local Loop Service Band 2 monthly charge undertaking, April 2009, p. 206.

199 The Allen Consulting Group, Debt and Equity Raising Transaction Costs – Final Report, December 2004.

200 Optus, Submission, 3 June 2011, p. 59.

Table 6.6: Indicative direct debt raising costs based on a nominal vanilla WACC of 8.54 per cent

	Estimated costs	1 issue	2 issues	4 issues	6 issues	10 issues	12 issues
Total amount raised	Multiples of median MTN* ($500m)	$500m	$1000m	$2000m	$3000m	$5000m	$6000m
1. Gross underwriting fee	Bloomberg spread, upfront per issue, amortised	6.87	6.87	6.87	6.87	6.87	6.87
2. Legal and roadshow	$115k upfront per issue, amortised	0.35	0.35	0.35	0.35	0.35	0.35
3. Company credit rating fee	$50k per annum	1.00	0.50	0.25	0.17	0.10	0.08
4. Issue credit rating	4 basis points upfront per issue, amortised	0.61	0.61	0.61	0.61	0.61	0.61
5. Registry fees	$3.5k per issue, per annum	0.07	0.07	0.07	0.07	0.07	0.07
6. Paying fees	$4/$1million, per annum	0.04	0.04	0.04	0.04	0.04	0.04
Total	**Basis points per annum**	**8.9**	**8.4**	**8.2**	**8.1**	**8.0**	**8.0**

* Medium term note

Source: ACG, Bloomberg.

Imputation factor (gamma)

The gamma parameter represents the value of tax credits, otherwise referred to as imputation credits, generated by the regulated business that could be distributed in the form of franked dividends to shareholders.

In its recent decision on gamma in relation to the AER's electricity distribution determinations for South Australia and Queensland, the Australian Competition Tribunal stated that:

> … an explanation is needed of the basis for adjusting the costs of a DNSP [Distribution Network Service Provider] to take account of the tax liabilities of its shareholders. Such an explanation should be the starting point for considering how best to estimate gamma.[201]

Under the imputation system introduced in 1987, shareholders who receive franked dividends are credited for the corporate tax paid by the regulated business on the profits from which dividends are distributed. These corporate tax payments generate the imputation credits attached to franked dividends. Shareholders can redeem these imputation credits against their personal (income) tax liabilities to reduce the amount

[201] Australian Competition Tribunal, Application by Energex Limited (Gamma) (No 5) [2011] ACompT 9, 12 May 2011, [44].

of personal tax payable. Since 1 July 2000, cash refunds of excess imputation credits have been allowed.

Shareholders' ability to redeem imputation credits to reduce their personal tax liabilities means that part of the business' corporate tax payments represents pre-payment of personal tax on behalf of its shareholders. It is this pre-payment of personal tax that reduces the shareholders' personal tax liabilities or generates a tax refund.

The personal tax benefits obtained from imputation credits effectively increase the rate of return received by shareholders from holding shares in the regulated business. The total return to the shareholder will be the dividend plus the personal tax benefits from imputation credits.[202] Shareholders will therefore be willing to accept a lower rate of return received in the form of dividends when they receive imputation credits with those dividends, compared to the rate of return required on shares that do not pay franked dividends.

Consequently, in determining the WACC, the regulated business' capacity to pay imputation credits with dividends must be taken into account to avoid over-compensating the business for its cost of equity. Gamma measures the amount by which the rate of return required by shareholders is reduced due to the tax benefits obtained from imputation credits.

There are two alternative methods of taking into account the reduction in the cost of equity to the regulated business that results from shareholders' receipt of imputation credits.[203]

In the first method, the WACC provided to the regulated business is reduced to reflect the lower rate of return required by shareholders in the form of dividends. To adopt this method, the formula for estimating the WACC includes terms for gamma and the corporate tax rate. These terms make allowance for the benefits shareholders obtain from imputation credits (that is, the pre-payment of personal tax). The resulting WACC estimate is known as the effective classical WACC.[204]

The second method takes into account the benefits to shareholders from the pre-payment of personal tax by adjusting the regulated business' estimated corporate tax liabilities, rather than through its WACC. The business' estimated tax liabilities are reduced by the proportion of its tax liabilities that represents pre-payment of personal tax on behalf of its shareholders (the imputation credits). This adjustment is made through the business' estimated cash flows. When using this method, the formula for estimating the WACC does not include terms for the gamma or the corporate tax rate as these terms are already included in the cash flow calculations. This formula is the formula for the vanilla WACC. Hathaway states that:

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202 Shareholders may also receive capital gains on their equity holdings.

203 See RR Officer, 'The cost of capital of a company under an imputation tax system', *Accounting and Finance*, vol. 34, no. 1, May 1994, pp. 1–17. Officer demonstrates that the two methods are conceptually equivalent.

204 N Hathaway, *Imputation WACCs: Descriptions and numerical valuation calculations*, Capital Research Pty Ltd, November 2004, available at www.capitalresearch.com.au/downloads/WACC_descript.pdf.

> Only the Vanilla WACC accurately reflects all the tax effects in the cash flow, both classical tax and imputation credits, so only the Vanilla WACC has no tax terms … [205]

The ACCC has adopted a vanilla WACC and the FLSM captures all tax effects including imputation benefits in the cash flows. This is consistent with standard regulatory practice in Australia.

Gamma has generally been defined for regulatory purposes as the utilisation rate multiplied by the imputation payout ratio:[206]

$$\gamma = \theta * F$$

where γ = gamma

θ = (theta) the utilisation rate of imputation credits is the value of distributed imputation credits to investors as a proportion of their face value

F = the imputation payout ratio is the face value of imputation credits distributed by the firm as a proportion of the face value of imputation credits generated by the firm, that is, the tax paid by the business

However, this formula only applies where retained imputation credits have no value and/or the imputation payout ratio, F, is equal to 1. If neither of these assumptions holds, the gamma formula is:

$$\gamma = F*\theta + (1–F)*\psi$$

where parameters are defined as above, and ψ (psi) is the per dollar value of a retained imputation credit ($\psi > 0$), which is a function of the appropriate discount rate and the expected retention period.

Empirical estimation of the value of gamma has proven difficult due to inherent problems in separating returns due to imputation credits from returns obtained from dividends and changes in share prices (capital gains or losses). In addition, since foreign investors cannot generally make use of imputation credits, the balance between foreign and domestic shareholders can be a factor in determining the appropriate value of gamma. Furthermore, there has been recent debate on whether retained imputation credits have value and, if so, how to assign an appropriate value to retained credits.

Expert studies have produced a wide range of estimates of gamma and its components, theta and F. Consequently, the ACCC, other regulators and expert analysts have generally qualified the use of these studies' estimates of gamma.

The method most commonly used to produce empirical estimates of theta is economy-wide dividend drop-off studies, which measure the extent to which an average company's share price drops once it goes ex-dividend. These studies exhibit wide divergences in their results, reflecting the widely recognised problem of

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[205] ibid., p. 4.

[206] See AER, Electricity transmission and distribution network service providers – Review of the weighted average cost of capital (WACC) parameters – Final decision, May 2009, p. 414; J C Handley, Further Comments on the Valuation of Imputation Credits – Final, 15 April 2009.

disaggregating the ex-dividend price drop between the value of the cash dividend and the value of the attached imputation credits.[207]

Tax statistics provide an alternative method of estimating the amount of pre-payment of personal tax represented by imputation credits.

April 2011 Discussion Paper view

In the April 2011 Discussion Paper, the ACCC adopted a benchmark economy-wide gamma. A benchmark approach was considered to provide stronger incentives for the regulated business to operate efficiently. In determining an appropriate benchmark value, the ACCC had regard to the most up-to-date economy-wide empirical evidence available at the time.[208] While recognising that there was uncertainty around the value of gamma, the ACCC proposed to adopt an economy-wide value for gamma of 0.45.

Submissions

Optus did not support the ACCC's decision to adopt a value for gamma of 0.45.[209] It submitted that a benchmark approach was not appropriate for the telecommunications sector as the legislative criteria, specifically the LTIE, differ from those in other sectors such as energy. According to Optus' submission, a benchmark gamma would not provide incentives for Telstra to operate efficiently and would instead allow Telstra to over-recover costs which would not be in the LTIE.[210]

Optus submitted that in changing the value for gamma to 0.45, the ACCC had not had regard to Optus' submission, which supported a value of 0.65. While recognising the uncertainty around the value for gamma, it submitted that the ACCC's previous approach and the value of 0.65 proposed in the ACCC's September 2010 Draft Report remained appropriate.

Telstra supported the ACCC's proposal to adopt an economy-wide value for gamma.[211] However, it submitted that the ACCC should adopt a gamma value of 0.25, based on the Tribunal's recent decision in its review of the AER's South Australia and Queensland electricity distribution determinations. In relation to fixed principles provisions, Telstra submitted that a gamma value of 0.25 should be adopted for future regulatory periods.[212]

In the context of fixed principles provisions, Macquarie Telecom submitted that there should be no provision specifying the value for gamma 'until such time as a widely accepted practice for setting gamma emerges'.[213]

There were no other submissions on gamma.

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[207] See, for example, M Dempsey and G Partington, 'The cost of capital equations under the Australian imputation tax system', *Accounting and Finance*, vol. 48, no. 3, Sept 2008, pp. 439–460; M McKenzie and G Partington, *Report to AER – Evidence and submissions on gamma*, 25 March 2010, pp. 33–50; and SFG Consulting, *The impact of franking credits on the corporate cost of capital: Empirical evidence*, Report prepared for Envestra, March 2007.

[208] AER, Draft Decision: Envestra Ltd – Access arrangement proposal for the SA gas network: 1 July 2011– 30 June 2016, February 2011.

[209] Optus, Submission, 3 June 2011, p. 60.

[210] ibid., p. 60.

[211] Telstra, Submission – Part A, 3 June 2011, p. 58.

[212] ibid., p. 79.

[213] Telstra, Submission – Part A, 3 June 2011, p. 78; Macquarie Telecom, Submission, 3 June 2011, p. 14.

ACCC final view

For the purpose of estimating FAD prices for the declared fixed line services, the ACCC has adopted a value for gamma of 0.45. In reaching this decision, the ACCC has had regard to a range of available evidence, the views expressed in submissions, the Tribunal's recent decision on gamma in the context of the electricity industry,[214] and considerations of regulatory certainty and predictability.

In its recent decision on gamma in relation to the AER's electricity distribution determinations for South Australia and Queensland, the Tribunal determined a value for gamma of 0.25, based on an estimate of 0.7 for F and a recent SFG estimate for theta of 0.35.[215] In its Reasons for Decision, the Tribunal recognised the 'unavoidable' difficulties in estimating theta[216] and noted that the SFG study provided the best estimate 'currently available'.[217] It added that:

> … the Tribunal notes that estimation of a parameter such as gamma is necessarily, and desirably, an ongoing intellectual and empirical endeavour. Its decision in these proceedings is based on the material before it.[218] (emphasis added)

The ACCC considers that the Tribunal's comments indicate that it is open to considering new empirical evidence on the value of gamma in the future. Further, the ACCC considers an implication of the Tribunal's comments is that it may settle on a different value for gamma in the future, if warranted by new evidence presented to it.

In these circumstances, the ACCC has decided that it should have regard to additional evidence available to it in deciding on the value of gamma to adopt in estimating prices for a three year regulatory period. The ACCC's decision to adopt this approach has been guided by the principle that, in respect of the WACC parameters, regulatory certainty and predictability are desirable to the extent that they support economically efficient investment in the infrastructure used to provide the declared fixed line services. A reasonable degree of certainty and predictability in the value of gamma will, in the ACCC's view, support past investments and promote industry confidence in making future investment decisions.

The ACCC considers that estimating a value for gamma by taking into account a range of evidence is more likely to promote certainty and predictability in both the value of gamma and the basis for its calculation, than reliance on a single, albeit most recent, study. Consequently, the ACCC has also had regard to Telstra-specific considerations, estimates of gamma from other dividend drop-off studies, and tax statistics studies. The ACCC's specific considerations are set out as follows.

First, in the September 2010 Draft Report, the ACCC considered constraints on foreign ownership in Telstra in reaching a view on an appropriate gamma for the industry. The ACCC took into account the shareholder limitations in section 8BG(a) of *Telstra Corporation Act 1991* that restrict aggregate foreign ownership of Telstra to

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214 Australian Competition Tribunal, Application by Energex Limited (Gamma) (No 5) [2011] ACompT 9, 12 May 2011.
215 ibid., [12], [42]; SFG Consulting, *Dividend drop-off estimate of theta*, 21 March 2011.
216 ibid., [21].
217 ibid., [29].
218 ibid., [45].

35 per cent.[219] Since imputation credits cannot be utilised by foreigners, but are redeemable to Australian shareholders regardless of tax status, the ACCC considered that this legislative restriction was relevant to estimating an appropriate theta. These restrictions are likely to mean the theta for Telstra's shareholders is higher than the market-wide estimate.

Second, in regard to the value of F, Telstra submitted in October 2010 that its average dividend payout ratio was approximately 0.9.[220] Subsequent analysis by the ACCC indicated that Telstra's payout ratio was approximately 0.99. In combination with the legislative constraints on foreign ownership of Telstra, this evidence supports a conclusion that an appropriate gamma for Telstra is likely to be significantly higher than 0.25.

Third, the ACCC had regard to the Tribunal's decision on the value of F, for the market as a whole, of 0.7 in its review of the AER's electricity distribution determinations for South Australia and Queensland.[221]

Fourth, the ACCC notes that the debate over use of tax statistics versus dividend drop-off studies when estimating theta relates to estimation of the face value of imputation credits (in tax statistics) or their market value (in dividend drop-off studies). While a dividend drop-off study, and therefore a market value, formed the basis of the recent Tribunal decision, it is not certain whether the sole reliance on market value has implications for the estimation of other WACC parameters. For example, the ACCC currently uses the face value of dividends in estimating the MRP. It may be necessary to consider the consistency of estimation methodologies across the range of WACC parameters.

Fifth, in regard to market-based studies, the ACCC is not convinced that a single dividend drop-off study can provide, without any doubt, the most accurate and appropriate estimate of theta. The ACCC is, therefore, not persuaded that no weight should be given to other studies and has taken the view that conclusions should be drawn from consideration of a range of studies.

Given the above uncertainties, without further long-term in-depth analysis of all factors affecting the gamma estimate, the ACCC is unable to determine a single point estimate. Consequently, the ACCC considers that a reasonable approach is to choose a point within the possible range of gamma estimates. Having regard to the range of possible estimates, the ACCC's previous draft views, and the principles of regulatory certainty and predictability, the ACCC has settled on a value for gamma of 0.45.

The ACCC considers that the uncertainties discussed above weigh against specifying the value of gamma in fixed principles provisions, as proposed in Telstra's submission. The ACCC notes further that 'locking in' a gamma value could prevent the ACCC from having regard to potential future changes in the tax system.

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219 Telstra has estimated that as at 3 June 2011, the number of Telstra shares recorded as foreign on the Telstra register was 23.61 percent of the total number of issued Telstra shares. See Telstra's website www.telstra.com.au/abouttelstra/investor/my-shareholding/faqs.

220 Telstra, Pricing Principles for Fixed Line Services – Response to the ACCC's Draft Report, October 2010, p. 88.

221 Australian Competition Tribunal, Application by Energex Limited (Distribution Ratio (Gamma)) (No 3) [2010] ACompT 9, 23 December 2010.

6.4 Regulatory depreciation

Regulatory depreciation is the return of capital, that is, the allowance included in the revenue requirement to allow Telstra to recover its investments in the assets used to supply the fixed line services over the lives of those assets.

6.4.1 April 2011 Discussion Paper view

The ACCC adopted straight line depreciation in estimating draft prices for the FADs. In addition, the ACCC adjusted the profile of depreciation for the last two years of the regulatory period (2014–15 and 2015–16). The adjustment was made to remove a distortion in the depreciation profile, which was a mathematical consequence of commencing the FLSM part-way through the lives of Telstra's assets. The ACCC considered that the unadjusted depreciation profile would significantly understate the expected path of regulatory depreciation.

To make the adjustment, the ACCC extrapolated the inputs to the FLSM for the full 11 year model estimation period (2010–11 to 2020–21) to identify the underlying trend level of regulatory depreciation. It then substituted trend values of regulatory depreciation for the three asset classes affected by the distortion. The affected asset classes were 'pair gain systems', 'local switching equipment' and 'indirect capital assets', all of which had relatively short asset lives.[222]

6.4.2 Submissions

There were no submissions on regulatory depreciation.

6.4.3 ACCC final view

The ACCC confirms its adoption of the straight line depreciation method and the use of a trend level of regulatory depreciation for 'pair gain systems' and 'local switching equipment' over 2012–13 and 2013–14.

[222] ACCC, Discussion paper, April 2011, p. 105.

Table 6.7: Estimated regulatory depreciation, 2009–10 to 2013–14

Asset Class	2009–10	2010–11	2011–12	2012–13	2013–14
CAN asset class					
Ducts and pipes	[c-i-c]				
Copper cables					
Other cables					
Pair gain systems					
CAN radio bearer equipment					
Other CAN assets					
Other communications plant and equipment					
Network land					
Network buildings/support					
Indirect capital assets					
Total					
Core asset class					
Switching equipment – Local					
Switching equipment – Trunk					
Switching equipment – Other					
Inter-exchange cables					
Transmission equipment					
Core radio bearer equipment					
Other communications plant and equipment					
Network land					
Network buildings/support					
Indirect capital assets					
LSS equipment					
Total					[c-i-c]

Notes: Figures shown in italics denote values that have been adjusted by the ACCC to reflect the underlying trend value for the years shown. Estimated depreciation for years beyond the regulatory period has been calculated by extrapolating forecast operating and capital expenditures in the regulatory period.

7 Operating expenditure

Key points

- Forecast operating expenditure forms a cost block in the building block approach and therefore contributes directly to Telstra's total revenue requirement.
- The ACCC confirms its forecasts for direct and indirect operating expenditure:
  - Direct CAN operating expenditure is assumed to remain constant in real terms at its most recent actual level (for 2009–10) to reflect recent reductions in CAN operating costs.
  - Direct Core operating expenditure is forecast to remain constant in real terms at the average real level of Telstra's actual operating expenditures over the five years to 2009–10.
  - The mark-up for indirect operating expenditure (that is, corporate overheads) remains at 80 per cent.
- Forecast LSS operating expenditure has been revised downwards to reflect lower forecast LSS demand. The real unit costs of providing the LSS have been held constant over the regulatory period.
- No adjustments will be made for 'unders or overs' in actual, compared to forecast, operating expenditures over the regulatory period.
- Total operating expenditure has been allocated to each asset class according to its share of the total undepreciated asset value in 2008–09.

Operating expenditure is one of the cost blocks in the FLSM. Forecast operating expenditure contributes directly to the estimated revenue requirement over the regulatory period.

7.1 April 2011 Discussion Paper view

In the April 2011 Discussion Paper, the ACCC considered that direct operating expenditure on the CAN was likely to remain constant in real terms over the regulatory period, at the same level as in the most recent year of available data (that is, 2009–10).[223] In adopting this approach, the ACCC placed greater weight on the recent declining trend in CAN operating expenditure than it had in its earlier forecasts for the September 2010 Draft Report.

For the Core network, the ACCC forecast real operating expenditure to remain stable over the regulatory period at its average real level for the five years to 2009–10.[224] Direct operating expenditure on the Core network was broadly stable in real terms over this period.

To convert nominal operating expenditure to real dollars (that is, in the FLSM's base year dollars as at 1 July 2009), the ACCC indexed operating expenditure prior to July 2009 using a simple average of the Australian Bureau of Statistics (ABS) producer

[223] ACCC, Discussion Paper, April 2011, p. 111.
[224] ibid., p. 112.

price index for communication equipment manufacturing and the ABS labour price index for communications. Since the labour price index for communications is no longer published after July 2009, operating expenditure in 2009–10 was indexed back to the base year dollars using a simple average of the ABS producer price index for communication equipment manufacturing and the ABS labour price index for information media and telecommunications.[225]

To calculate indirect operating expenditure for the CAN and Core network, the ACCC applied an 80 per cent mark-up on direct operating expenditure. This value is the mid-point of the 60 per cent mark-up estimated by the Analysys (optimised) model and the 100 per cent mark-up estimated from Telstra's RAF data.

In April 2011, Telstra submitted a forecast growth rate for operating expenditure in 2010–11.[226] This growth rate applied to total operating expenditure (excluding depreciation) on providing all services (excluding Sensis and international entities). The ACCC considered that operating expenditure on Telstra's non-fixed line services, such as mobile services, would increase significantly faster than expenditure on providing the fixed line services. Without disaggregated forecasts for the fixed line services, the ACCC considered that it did not have sufficient evidence to justify revising its operating expenditure forecasts.[227]

Since the ACCC does not have forecasts for operating expenditure by asset class, the ACCC calculated allocation factors to allocate operating expenditure to each asset class in the CAN and Core networks. Operating expenditure was allocated to each asset class according to its share of the total undepreciated asset value in 2008–09.

The ACCC estimated LSS operating costs as the sum of the indirect costs allocated to LSS and the LSS specific cost estimates provided by Telstra. The ACCC excluded network costs as these costs are recovered through the WLR price and prices charged for Telstra's retail line services. Since the costs allocated to LSS in the FLSM are a component of total indirect operating expenditure, total LSS costs are deducted from total indirect operating expenditure in the FLSM before the remaining indirect operating expenditure is allocated to the other fixed line services. This avoids allocating the same costs to more than one service.

The ACCC proposed to implement an efficiency benefit sharing scheme.[228] Under this scheme, no adjustments would be made for 'unders or overs' in actual operating expenditure, compared to forecast expenditure, during the regulatory period.

7.2 Submissions

7.2.1 Direct operating expenditure

Telstra stated that the ACCC's direct operating expenditure forecasts in the April 2011 Discussion Paper were reasonable.[229] After conducting its own analysis, Telstra submitted that the main drivers of operating expenditure on the CAN and Core network were labour costs, productivity and the number of reported faults. Telstra

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225 ibid., pp. 112–113.

226 Telstra, Fixed Line Services – Request for information and response to Telstra queries on Interim Access Determinations – Letter from Telstra to the ACCC (confidential), 18 April 2011.

227 ACCC, Discussion Paper, April 2011, p. 111.

228 ibid., pp. 82, 114.

229 Telstra, Submission – Part A, 3 June 2011, p. 63.

submitted that operating expenditure may grow at a faster rate than CPI in nominal terms. However, it acknowledged the difficulty in estimating the relationship between changes in the drivers of operating expenditure and changes in operating expenditure.

Optus supported the ACCC's proposed approach to selecting a base year for direct operating expenditure on the CAN.[230] However, Optus submitted that the ACCC should use the same methodology to calculate the base year for the Core—that is, to use direct operating expenditure on the Core in 2009–10, rather than the five year average.

Optus submitted that the ACCC should apply a zero per cent nominal growth rate (to 'base year' expenditure) to generate operating expenditure forecasts. Optus stated that no nominal growth was justified on the basis of cost reductions due to declining use of the fixed line network.[231] It submitted that, although maintenance costs for Telstra's network assets were likely to increase as the assets aged, this would be more than offset by Telstra forgoing some types of maintenance and shutting down parts of its network as services were migrated to the NBN.

Frontier Economics submitted that Telstra had not justified its forecast growth rate for operating expenditure, and noted that Telstra's forecast did not apply to the fixed line network alone.[232] Frontier Economics stated that the ACCC had not provided sufficiently detailed information on the relative importance of different categories of operating expenditure or its assumption that Telstra's 'Project New' was more likely to influence indirect operating expenditure. Frontier Economics stated that Telstra would need to have 'a very sharp focus on reducing operating costs to avoid future price rises', given that total fixed line revenues are declining.[233]

7.2.2 Indexation of past operating expenditure

Frontier Economics submitted that past operating expenditure should be indexed by the ABS telecommunications equipment import price index instead of the ABS producer price index for communications equipment manufacturing.[234] Frontier Economics' analysis suggested that using its preferred measure would reduce forecast direct operating expenditure on the Core network by $50 million and forecast indirect operating expenditure by $40 million (in real terms).

Frontier Economics submitted that the ACCC's criticism of the import price index—that it is too broad—also applies to the producer price index used in the April 2011 Discussion Paper.[235] It stated that the import price index is likely to be a good proxy for relevant telecommunications equipment, and that the share of irrelevant goods accounts for a relatively small share of the index. In addition, it submitted that operating expenditure for 2009–10 should not be indexed back to 1 July 2009.

7.2.3 Mark-up for indirect operating expenditure

Optus submitted that the ACCC should use a mark-up for indirect operating expenditure of 60 per cent.[236] It disagreed with the ACCC's rationale for viewing the

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230 Optus, Submission, June 2011, Confidential Version p. 54.
231 ibid., p. 55.
232 Frontier Economics, Submission, June 2011, p. 21.
233 ibid.
234 Frontier Economics, Submission, June 2011, p. 23.
235 ibid., p. 24.
236 Optus, Submission, June 2011, p. 57.

60 per cent mark-up in the Analysys model as a lower limit. Optus submitted that the ACCC had not described the methodology it used to calculate the mark-up of 100 per cent using RAF data.

Optus submitted that indirect costs have not been optimised in the Analysys model.[237] Optus submitted that the mark-up in the Analysys model was calculated using RAF data, and therefore was not subject to the same optimisation that had occurred in modelling direct network costs. In addition, Optus submitted that maintenance costs were not included in indirect costs, and therefore disagreed with the ACCC's statement that indirect operating expenditure was likely to be higher for Telstra's existing network than in the optimised Analysys model.

Herbert Geer submitted that expenditure data provided by Telstra, including the mark-up for indirect operating expenditure, should be subject to rigorous scrutiny and prudency checks by the ACCC.[238]

Frontier Economics submitted that the ACCC's 80 per cent mark-up for indirect operating expenditure was 'extraordinarily high' and was not transparent.[239] It submitted that the ACCC and the Analysys model had both used RAF data to calculate the mark-up, and questioned the reason for the difference between the two estimates given that they had used the same data source.

Frontier Economics submitted that the 60 per cent mark-up applied in the Analysys model should not be viewed as a lower bound as, in its view, indirect costs in the Analysys model were actual costs and were not optimised.[240] In addition, Frontier Economics submitted that applying the Analysys model's 60 per cent mark-up to actual direct costs (instead of to optimised direct costs as in the Analysys model) could overstate actual indirect costs.

Frontier Economics submitted that it was concerned by the revisions to the ACCC's forecasts of indirect operating expenditure and indirect capital expenditure since the September 2010 Draft Report, stating that the changes in forecasts did not 'inspire confidence' in the accuracy of the ACCC's forecasts.[241] Frontier Economics also submitted that access seekers were given very little information on which to make submissions.

7.2.4 LSS operating expenditure

Herbert Geer submitted that the ACCC should demonstrate that the LSS specific cost information provided by Telstra has been subjected to rigorous scrutiny and prudency checking. It stated that the ACCC should not accept Telstra's advice on the costs of providing the LSS 'at face value'.[242]

Frontier Economics submitted that the ACCC should not use Telstra's LSS specific costs to set prices if it is unable to assess the reasonableness of the costs.[243]

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237 ibid., p. 57.
238 Herbert Geer, Submission, 3 June 2011, p. 21.
239 Frontier Economics, Submission, June 2011, p. 21.
240 ibid.
241 ibid., p. 22.
242 Herbert Geer, Submission, 3 June 2011, p. 9.
243 Frontier Economics, Submission, June 2011, p. 34.

Optus submitted that the ACCC's approach of not allocating network costs to the LSS is inappropriate and inconsistent with the legislative criteria.[244] Optus stated that the ACCC's approach does not promote competition and is likely to distort the demand for LSS and other services. Optus submitted that the ACCC has previously agreed that not allocating line costs to LSS does not promote competition.

7.2.5 Efficiency mechanisms

Optus submitted that an efficiency mechanism for operating expenditure is unnecessary.[245] It submitted that Telstra receives only a small proportion of its revenue from regulated sources—in contrast to regulated utilities in other industries—and therefore that it is only compensated for a small proportion of its costs through regulated tariffs. Optus stated that Telstra faced strong external pressure and had commercial incentives to minimise its costs and considered that the scope for further efficiency gains by Telstra was limited.[246]

Optus submitted that Telstra has a financial incentive to overstate its forecasts under the proposed efficiency mechanism and that the ACCC's proposed measures to mitigate this incentive would be insufficient.[247] Optus submitted that material deviations between actual and forecast expenditure—that is, deviations outside a 'deadband' around the forecast—should enter an 'under/over' account. It submitted that this approach would ensure Telstra was compensated for its actual operating expenditure.

Frontier Economics submitted that the proposed five year regulatory period and uncertainty over the accuracy of forecasts meant the incentive regime proposed by the ACCC was 'too high-powered'. [248] It submitted that the ACCC should either set a shorter regulatory period or use an alternative incentive mechanism, such as an 'unders and overs' account.

7.2.6 Allocation of operating expenditure to asset classes

Optus submitted that it supported the ACCC's methodology for allocating operating expenditure to asset classes in the April 2011 Discussion Paper.[249]

No other submissions were received on the allocation of operating expenditure to asset classes.

7.3 ACCC final view

Table 7.1 compares forecast operating expenditure in the April 2011 Discussion Paper and the ACCC's operating expenditure forecasts for the final decision.

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244 Optus, Submission, June 2011, p. 63.
245 ibid., p. 44.
246 ibid., p. 47.
247 ibid., p. 48.
248 Frontier Economics, Submission, June 2011, p. 26.
249 ibid., p. 57.

Table 7.1 Comparison of April 2011 forecast operating expenditure and July 2011 forecasts of operating expenditure ($m as at 1 July 2009)

	2011–12		2012–13		2013–14	
	April 2011	**July 2011**	**April 2011**	**July 2011**	**April 2011**	**July 2011**
CAN ($m)	**[c-i-c]** [redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Core ($m)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
LSS ($m)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total ($m)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted] **[c-i-c]**

7.3.1 Direct operating expenditure

The ACCC confirms its view that the operating expenditure forecasts proposed in the April 2011 Discussion Paper are reasonable. In reaching its final view, the ACCC has taken into account comments in submissions and undertaken further analysis of the drivers of operating expenditure.

The ACCC considers that Telstra's network is likely to require a certain unavoidable, or baseline, level of operating expenditure each year. This expenditure will largely reflect maintenance expenditure to repair faults and maintain the quality of service provided by the network, as well as the direct costs of running the network. Much of the variability in annual direct operating expenditure is likely to reflect variability in the number of faults occurring on Telstra's network. The number of faults is heavily influenced by adverse weather conditions (such as floods), which are difficult to predict, particularly over longer time periods.

In addition, the ACCC considers that Telstra will require a certain number of employees or contractors each year for managing network performance, marketing and staffing call centres.

While the total demand for fixed line services has been declining over time, annual declines have been relatively small (see chapter 12). Further, as noted in chapter 10, the ACCC's cost allocation methodology accounts for declining total fixed line demand. In relation to the impact of the NBN roll-out, the ACCC maintains its reasons, as set out in the April 2011 Discussion Paper, for not adjusting its operating expenditure forecasts for migrations to the NBN at this stage.[250] Having regard to these factors, the ACCC considers that a forecast of no nominal growth (that is, a 2.5 per cent real reduction) in operating expenditure cannot be justified on the information available to it.

The ACCC notes that, under the Definitive Agreements recently made between Telstra and NBN Co, Telstra expects to incur approximately $0.6 billion (in post-tax NPV terms) for 'necessary work on infrastructure and maintenance activities' and approximately $0.5 billion (in post-tax NPV terms) 'incremental operational expenses, spread over 10 years, for those customer migration costs and the necessary

[250] ACCC, Discussion Paper, April 2011, p. 112.

work on infrastructure which have been brought forward as a consequence of the NBN rollout'.[251]

Telstra has stated publicly that the costs of 'necessary work on infrastructure and maintenance activities' are 'covered within existing operational expenses, as Telstra routinely projects such costs on an ongoing basis' while the 'incremental' costs will be absorbed within existing expenditure plans.[252]

The ACCC has concluded, on the basis of this information, that no adjustments are required to the operating expenditure forecasts used in estimating prices in the FLSM.

7.3.2 Indexation of past operating expenditure

The ACCC contacted the ABS to determine the weights of different components of the ABS' import price index for telecommunications equipment and the ABS' producer price index for communications equipment manufacturing. The ABS was unable to provide the weights of different 'primary activities' in the producer price index series due to confidentiality of the information. However, the ACCC notes that the producer price index includes relevant primary activities including 'telecommunication equipment manufacturing', 'telephone switching equipment manufacturing' and 'data transmission equipment manufacturing'.[253]

In contrast, the import price index is dominated by components that are largely irrelevant to providing the fixed line services.[254] The ACCC has concluded that using the import price index is not appropriate. Therefore, the ACCC confirms its view that the producer price index for communication equipment manufacturing remains appropriate for converting past operating expenditure into the base year dollars used in the FLSM.

The ACCC has assumed, for the purpose of converting operating expenditures into the base year dollars, that operating expenditure is incurred at the end of the financial year. This assumption is consistent with the timing assumption used in the FLSM. Operating expenditure in 2008–09 has not been indexed because it is assumed to incurred on 30 June 2009 and is therefore effectively in 1 July 2009 dollars. Operating expenditure in 2009–10 must be converted to 1 July 2009 dollars for consistency with this assumption.

7.3.3 Mark-up for indirect operating expenditure

The ACCC confirms its view that an 80 per cent mark-up for indirect operating expenditure is appropriate.

In response to submissions from Optus and Frontier Economics, the ACCC re-examined the methodologies used to calculate the mark-up for indirect operating

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251 Telstra, 'Telstra signs NBN Definitive Agreements', Media release and attached additional information, available at www.telstra.com.au/abouttelstra/download/document/2011-definitive-agreements-telstra-nbnco.pdf.

252 ibid.

253 ABS, 'Catalogue 6427.0 - Producer Price Indexes, Australia, Mar 2011' at www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6427.0Main+Features1Mar%202011?OpenDocument.

254 These include: 'Transmission apparatus for radio telephony, radio telegraphy, radio broadcasting or television, incorporating reception apparatus'; 'Telephone sets (including telephones) for cellular networks or for other wireless networks'; and 'Radar apparatus, radio navigational aid apparatus and radio remote control apparatus'.

expenditure in the April 2011 Discussion Paper, in the Analysys model and in Telstra's October 2010 submission.[255]

The ACCC accepts that Analysys Mason calculated its mark-up on the basis of Telstra's RAF accounts, rather than on an optimised basis as assumed by the ACCC in the April 2011 Discussion Paper. However, the ACCC has two major concerns about the methodology adopted in the Analysys model.

First, the Analysys model calculated the mark-up on the basis of only one year (2006-07) of RAF data. The RAF accounts show that direct (network) operating expenditures and indirect expenditures vary significantly from year to year. Consequently, the ACCC considers an average mark-up should be calculated over a longer period of time in order to smooth out the annual variability and estimate an underlying mark-up.

In the April 2011 Discussion Paper, the ACCC calculated an average mark-up over a five year period to 2009–10.[256] This mark-up was close to 100 per cent.

Using the Analysys model methodology for calculating the mark-up, the ACCC has estimated an average mark-up of 72 per cent over the five years to 2009–10. This estimate is significantly higher than the Analysys estimate of 60 per cent. The ACCC notes that over the five year period, the mark-up ranges from 58.2 per cent (in 2006–07) to 80.2 per cent (in 2007–08).

Second, the ACCC is concerned about applicability within a BBM of an assumption made by Analysys Mason when allocating indirect operating costs to calculate its mark-up. The ACCC considers that the categorisation of line items in the RAF by Analysys Mason—into 'business overheads', 'network costs' and 'non-network costs'—is appropriate. However, the ACCC considers there is no strong evidence or analysis to support Analysys' assumption of an equi-proportionate allocation of business overheads (that is, indirect operating expenditure) between network and non-network costs. The assumption reduces the mark-up estimated by Analysys Mason.

On the basis of its further consideration of the Analysys model approach, the ACCC has reached the conclusion that there is no strong evidence to suggest that the ACCC's 80 per cent mark-up is not appropriate. The ACCC notes that estimates of the mark-up range from Analysys' 60 per cent to 104 per cent in Telstra's TEA model. Considering all the evidence and alternative estimates, the ACCC considers that an 80 per cent mark-up represents a reasonable allowance for an efficient level of indirect operating expenditure.

7.3.4 LSS operating expenditure

As noted in the April 2011 Discussion Paper, the ACCC modified the expenditure figures provided by Telstra to ensure that the costs allocated to the LSS reflects the direct costs Telstra incurs in providing the service.[257]

The revisions to forecast LSS demand over the regulatory period have led the ACCC to review its operating expenditure forecast for the LSS. The ACCC considers that reductions in LSS demand should not lead to increases in the estimated unit costs of

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255 Telstra, Submission, October 2010, p. 13.
256 The April 2011 Discussion Paper incorrectly recorded the period as the six years to 2008–09.
257 ACCC, Discussion Paper, April 2011, p. 156.

providing the service since the costs incurred mainly relate to the labour costs associated with provisioning and billing. As noted in chapter 6, the equipment used to provide the LSS specific service are fully depreciated so all costs are now transaction-related.

As noted in the April 2011 Discussion Paper, the ACCC was unable to assess Telstra's LSS operating expenditures in 2008–09 and 2009–10 because Telstra did not provide a detailed explanation of the basis for their calculation or the demand levels underlying the figures. The ACCC did not therefore have confidence in calculating the unit cost of providing LSS from Telstra's expenditure figures.

The ACCC sought an alternative source of unit cost information for the LSS. The only alternative information on LSS costs was the TSLRIC-based LSS specific costs model. The ACCC calculated the direct unit cost for LSS and ULLS specific costs from the model for 2007–08 and applied the 80 per cent indirect cost mark-up to obtain a total unit cost estimate for 2007–08. The ACCC then inflated this estimate by the CPI to obtain a unit cost estimate for 2009–10 (the base year of the FLSM).

The 2009–10 unit cost was input to the FLSM and multiplied by forecast LSS demand to estimate a lower bound for LSS operating expenditure. This method produced an averaged LSS price for the regulatory period of $1.16 (in nominal terms).

The ACCC considers this price estimate forms a lower bound for the LSS price. Adopting Telstra's operating expenditure and maintaining it in real terms over the regulatory period gives an upper bound for the LSS price of $2.26. Since the draft price of $1.80 falls within this bound, the ACCC considers it is reasonable.

In regard to Optus' submission that a share of network costs should be allocated to the LSS, the ACCC notes that LSS can only be provided on a line that is already carrying a voice service (for example, through a WLR service or a retail line rental service provided by Telstra). The end-user currently pays the network costs associated with the line through the voice service charges. Since the end-user is already paying the full costs associated with receiving services on the line, the ACCC sees no compelling reason for re-allocating the recovery of costs between voice and data services.

7.3.5 Efficiency mechanisms

The ACCC confirms its view that efficiency incentives will promote efficient expenditure by Telstra. The ACCC further confirms that no adjustments will be made for 'unders or overs' in actual expenditure, compared to forecast expenditure, during the regulatory period. In developing its operating expenditure forecasts for future regulatory periods, the ACCC will take into account actual operating expenditure in previous years.

7.3.6 Allocation of operating expenditure to asset classes

The ACCC confirms its approach to allocating operating expenditure to asset classes. LSS operating expenditure is fully allocated to the 'LSS equipment' asset class. Tables 7.2 and 7.3 set out the operating costs allocated to each asset class in estimating prices for the FADs.

Table 7.2: Allocation of operating expenditure by CAN asset class ($m at 1 July 2009)

CAN	2010–11	2011–12	2012–13	2013–14
Ducts and pipes	[c-i-c]			
Copper cables				
Other cables				
Pair gain systems				
Radio CAN				
Other CAN assets				
Other communications plant & equipment				
Network land				
Network buildings/support				
Total CAN assets				[c-i-c]

Table 7.3: Allocation of operating expenditure by Core asset class ($m at 1 July 2009)

Core	2010–11	2011–12	2012–13	2013–14
Switching equipment – Local	[c-i-c]			
Switching equipment – Trunk				
Switching equipment – Other				
Inter-exchange cables				
Transmission equipment				
Radio bearer equipment				
Other communications plant & equipment				
Network land				
Network buildings/support				
LSS equipment				
Total Core assets				[c-i-c]

8 Tax liabilities

Key points

- The ACCC has adopted a revised initial tax value for the assets included in the RAB based on the written-down tax value of these assets in Telstra's tax accounts. This value is lower than the tax asset value previously included in the FLSM due to past accelerated tax depreciation.
- For simplicity, the straight line depreciation method is used as a good proxy for the actual profile of Telstra's tax depreciation.
- The prices and charges in the FADs are exclusive of the Australian Capital Territory Utilities Tax and the Goods and Services Tax (GST).

The ACCC has adopted a post-tax BBM framework where corporate tax liabilities form a separate building block component of the revenue requirement. This is because the access provider requires sufficient tax revenue to meet its corporate tax expenses as well as its operating costs and the costs associated with its return on and of capital. Corporate tax liabilities are calculated in nominal terms in the FLSM.

Prices may also be subject to other applicable taxes, such as the Goods and Services Tax (GST), that are not modelled in the FLSM.

8.1 Corporate tax liabilities

8.1.1 April 2011 Discussion Paper view

The ACCC proposed to adopt the standard regulatory approach of setting the initial tax asset value equal to the regulatory asset value. Tax depreciation was calculated using the straight line method and the ACCC applied the corporate tax rate to determine the tax payable.

8.1.2 Submissions

Telstra submitted that the ACCC should calculate tax liabilities by referencing Telstra's actual tax asset values determined using methods outlined in Telstra's letter of 26 May 2011.[258] Telstra stated that the ACCC's approach of setting the initial tax asset value equal to the initial value of the RAB would significantly underestimate its actual tax expenses and harm its legitimate business interests.[259]

Telstra submitted that the AER does not set the initial tax asset value equal to the RAB value. Telstra stated that it was common practice for the AER to adopt different values for the RAB and the tax asset base by determining or accepting tax asset values using additions and depreciations according to the prevailing tax law at the time.[260]

In addition, Telstra submitted that the Australian Energy Market Commission (AEMC) does not set the initial tax asset value equal to the regulatory asset value. Telstra stated that the AEMC's decision and arguments related to using actual or

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[258] Telstra, Submission – Part A, 3 June 2011, p. 59.
[259] ibid, p. 63.
[260] ibid., p. 60.

benchmark initial tax asset values to estimate tax depreciation. Telstra also noted that the Essential Services Commission of Victoria (previously the Office of the Regulator General) used benchmark tax values to set the tax asset value.[261]

Telstra submitted that, except for network land and some network buildings, assets purchased on or prior to 30 June 2010 should be depreciated using the diminishing value method. Land is not depreciable for tax purposes and the ability to claim tax depreciation for network buildings applies only to buildings constructed after 19 July 1982.[262] Telstra generally proposed straight line depreciation for assets purchased after 30 June 2010.[263]

8.1.3 ACCC final view

The ACCC confirms its method of calculating tax liabilities in the FLSM. The methodology adopted in the FLSM is consistent with the conventional accounting treatment of tax and with the fact that tax liabilities are based on nominal values.

Initial tax asset value

The ACCC has revised the initial tax asset value used in the FLSM based on information provided by Telstra on 26 May 2011 on its actual written-down tax asset value.[264] Telstra had not previously provided information on its tax asset value. The initial tax asset value as at 1 July 2009 is $10.673 billion. The tax value of assets is lower than their accounting value because Telstra has taken the option provided by the tax laws of claiming accelerated tax depreciation on its assets.

Tax depreciation is a deduction in calculating tax liabilities. Adopting Telstra's proposed tax asset value increases the tax liabilities estimated by the FLSM because past accelerated tax depreciation means that some of the allowed deductions for tax depreciation have already been claimed. By taking account of past accelerated tax depreciation, estimated tax liabilities will more accurately approximate Telstra's actual tax liabilities.

The ACCC considers this approach is consistent with the AER's approach to setting the initial tax asset value based on the 'actual tax position of assets that constitute the RAB' where possible.[265] At the time of finalising the April 2011 Discussion Paper, Telstra had not provided the ACCC with information on its tax asset value.

As noted in chapter 5, the ACCC has taken into account the revision to the written-down tax value of Telstra's assets in setting the final value for the initial RAB.

The opening tax asset value as at 1 July 2011 (the commencement of the regulatory period) is $10.144 billion.

Tax depreciation method

The ACCC confirms the use of straight line depreciation for estimating tax depreciation. The straight line method apportions depreciation evenly over an asset's tax life and allows full tax deductibility of the allowable cost of the asset.

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261 ibid, p. 61.
262 Telstra, Letter to the ACCC, 6 June 2011, pp. 1–2.
263 Telstra, Letter to the ACCC (confidential), 26 May 2011.
264 ibid., Appendix A.
265 AER, Matters relevant to Distribution Determination for ACT and NSW DNSPs for 2009–2014: Preliminary Positions, November 2007, pp. 51–52.

In contrast, the diminishing value method proposed by Telstra for assets purchased on or prior to 30 June 2010 does not allow full depreciation of an asset's tax value. Under this method, an undepreciated residual amount always remains at the end of an asset's life. A BBM approach is based on the net present value (NPV) of a regulated asset being equal to zero over the life of that asset. The NPV = 0 objective is met when an asset can be fully depreciated.

The ACCC is aware that Telstra applied the diminishing value method prior to 30 June 2010 to accelerate the tax depreciation of assets (instead of the alternative method permitted under tax law of choosing a shorter effective asset life for tax purposes). The ACCC considers that applying the straight line method to those assets from the commencement of the FLSM will not have a material impact on the profile of tax depreciation over the remaining lives of those assets. Most of the relevant assets have already been substantially depreciated for tax purposes.

While the estimated and actual tax depreciation profiles will consequently differ to some extent, the ACCC notes that it is impossible to replicate reality exactly in a model (which is a simplified approximation of reality). The ACCC considers that the tax liabilities estimated in the FLSM are a good proxy for Telstra's actual tax depreciation. While the estimated profile of tax depreciation will not be completely accurate, it is important to note that the total amount of tax depreciation received over the life of the asset will reflect the full cost of that asset.

In estimating tax depreciation, the ACCC has set the tax lives of assets equal to their regulatory asset lives. Telstra has advised the ACCC that it is not feasible to attempt to estimate average remaining tax lives for its written-down assets.[266] Telstra stated that:

> So long as the tax WDV [written-down value] of assets is accurately reflected in the FLSM, then the overall amount of tax depreciation deductions that are made in the FLSM will be similar to the overall amount of tax depreciation deductions that Telstra can make in practice.[267]

8.2 Other tax liabilities

As well as corporate taxation, Telstra may also be liable to pay other taxes, such as GST. Only corporate tax liabilities are included in the tax building block in the FLSM.

In previous arbitral decisions, access seekers and Telstra submitted on the inclusion of the Australian Capital Territory (ACT) Utilities Tax[268] in access prices. Telstra also submitted on other applicable taxes and the Goods and Services Tax (GST).[269]

The ACT Utilities Tax is levied per kilometre of the utility network. For the year to 31 March 2010, the tax was $722 per kilometre. Telstra passes on the tax via a monthly utilities tax charge imposed on eligible services provided in the ACT and Jervis Bay areas.

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266 Telstra. Letter to the ACCC (confidential), 26 May 2011, p. 4.
267 ibid.
268 ACCC, ULLS Access Dispute – Chime/Telstra reason for final determination, April 2011, pp. 14-15.
269 ibid, pp. 15, 18.

8.2.1 April 2011 Discussion Paper view

The ACCC proposed that the ACT Utilities Tax should not be recovered through connection and disconnection charges. The ACCC sought submissions on how the ACT Utilities Tax should be recovered from Telstra's wholesale customers. The ACCC did not seek submissions from parties in relation to the GST or other applicable taxes.

8.2.2 Submissions

Telstra submitted that the FADs should explicitly state that the access prices and connection/disconnection charges are exclusive of current and future taxes and levies where no allowance has been made for these in estimating prices.[270] Telstra stated that it should be allowed to recover these costs from access seekers as an additional charge. Telstra submitted further that it should be allowed to recover taxes from eligible SIOs where these taxes are payable only in certain jurisdictions and that the ACCC has previously made similar provisions.[271]

Optus submitted that it would not be appropriate to include the ACT Utilities Tax in the revenue requirement in the FLSM, in access prices or in connection and disconnection charges.[272] Optus stated that payment of this tax should be addressed in a commercially acceptable manner in the service supply agreements between Telstra and access seekers.

Optus submitted that the structure of the ACT Utilities Tax in Telstra's customer terms differs from how the tax is levied on Telstra. Optus stated that Telstra should provide transparent information on how it passes on the ACT Utilities Tax to its customers to ensure that an appropriate share of the tax is allocated to Telstra's own services.[273]

8.2.3 ACCC final view

The ACCC notes that Telstra did not specify which taxes should or would apply to the declared fixed line services apart from the ACT Utilities Tax. After considering submissions, the ACCC's final view is that the FADs should specify that the prices and charges included in the FADs are exclusive of the ACT Utilities Tax and the GST.

The ACCC considers that any issues associated with incorrect pass-through of applicable taxes not included in the FADs can be resolved through binding rules of conduct (BROC).

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[270] Telstra Submission – Part A, 3 June 2011, pp. 81–82.
[271] ibid.
[272] Optus, Submission, June 2011, p. 61.
[273] ibid., p. 62.

9 Summary of the estimated revenue requirement

The FLSM calculates the aggregate revenue required by Telstra to recover its costs of supplying all services provided using the PSTN. As such, the aggregate revenue requirement calculated in the FLSM includes the estimated costs incurred in providing the declared fixed line services, other declared services that use the PSTN (such as the transmission and mobile services), and non-regulated services provided using the PSTN, such as Telstra's retail fixed line services, wholesale ADSL, and some transmission and mobile services. The allocation of appropriate shares of the aggregate revenue requirement to specific declared fixed line services is discussed in chapter 10.

The aggregate revenue requirement is calculated according to the following formula:

$$RR_t = E(OPEX_t) + (RAB_{t-1}*WACC) + E(DEP_t) + E(TAX_t)$$

where RR_t = the aggregate revenue requirement for the year

$E(OPEX_t)$ = the forecast operating expenditure for the year

RAB_{t-1} = the RAB at the beginning of the year, which equals the closing value of the RAB for the previous year

WACC = the regulatory WACC, which is multiplied by the RAB to calculate the required return on capital for the year

$E(DEP_t)$ = the forecast depreciation expensed for the period, which represents the return of capital for the year

$E(TAX_t)$ = the tax liabilities forecast to be incurred during the year

The methodology and assumptions used to estimate each cost block were discussed in chapters 4–8 of this final report. The table below summarises the resulting aggregate revenue requirement for each year (in real terms) and the individual cost blocks of the revenue requirement. It calculates each cost block for each declared fixed line service in the FLSM.

Table 9.1: Aggregate revenue requirement (in $m as at 1 July 2009)

	2010–11	2011–12	2012–13	2013–14
Operating expenditure ($m)	[c-i-c]			
Return on capital (RAB*WACC) ($m)				
Return of capital (regulatory depreciation) ($m)				
Tax payments ($m)				
Estimated revenue requirement ($m)				[c-i-c]

The aggregate revenue requirement shown in table 9.1 represents the estimated total revenue required to recoup the costs of providing all the services that use the CAN

and Core assets included in the RAB. To determine the revenue required to provide specific services, the aggregate revenue requirement must be allocated to the different services sharing the use of these network assets. The ACCC has applied the cost allocation factors discussed in chapter 10 to estimate the share of the total revenue requirement attributed to specific services. The revenue requirements allocated to each service are shown in table 9.2 below. The ACCC has added a new spreadsheet, Worksheet 'G. Revenue Disaggregate', to the FLSM showing the calculations.

Table 9.2: Revenue requirement allocated to services (in $m as at 1 July 2009) [numbers in table are c-i-c]

			2010–11	2011–12	2012–13	2013–14
Declared fixed line services	**ULLS**	Operating expenditure				
		Return on capital				
		Return of capital				
		Tax payments				
		Total				
	WLR	Operating expenditure				
		Return on capital				
		Return of capital				
		Tax payments				
		Total				
	PSTN OTA	Operating expenditure				
		Return on capital				
		Return of capital				
		Tax payments				
		Total				
	LCS	Operating expenditure				
		Return on capital				
		Return of capital				
		Tax payments				
		Total				
	LSS	Operating expenditure				
		Return on capital				
		Return of capital				
		Tax payments				
		Total				
	Total revenue requirement allocated to declared fixed line services					
		Operating expenditure				
Other regulated and unregulated services		Return on capital				
		Return of capital				
		Tax payments				
		Total				
Total						

10 Cost allocation factors

Key points

- The ACCC maintains its view that the cost allocation factors set out in the April 2011 Discussion Paper represent an appropriate allocation of the costs of supplying the fixed line services.
- The cost allocation factors are not adjusted to reflect declines in total demand for fixed line services that reflect Telstra's loss of market share or reductions in the size of the market.
- The cost allocation factors for PSTN transmission equipment have been revised to reflect updated forecasts for growth in data traffic.

Each service's share of the aggregate revenue requirement is calculated by applying cost allocation factors to the total operating, capital and tax costs associated with each of the asset classes in the FLSM. The cost allocation factors represent the share of costs incurred in supplying a particular service.

10.1 April 2011 Discussion Paper view

In the April 2011 Discussion Paper, the ACCC re-iterated its view that the Analysys model cost allocation factors are a good starting point for determining cost allocation factors in the FLSM, where they are available and appropriate.[274]

Industry submissions to the September 2010 Draft Report stated that the ACCC should provide greater transparency around its methodology for adjusting the Analysys model cost allocation factors and for calculating cost allocation factors for asset classes where Analysys model factors are either not available or not appropriate. The ACCC included an additional worksheet in the FLSM, which was released with the April 2011 Discussion Paper. This worksheet set out in detail the calculations underlying the cost allocation factors.

Since the LSS specific costs identified in the FLSM relate wholly to providing the LSS, 100 per cent of these costs are allocated to the service.

10.1.1 Initial cost allocation factors

Where appropriate and available, the Analysys model was used as a starting point to determine the initial cost allocation factors used in the FLSM. Where Analysys model factors were either not appropriate or not available, the ACCC used three alternative methodologies to develop cost allocations for particular asset classes.

All of the methods adopted by the ACCC, including use of the Analysys model factors, are based on relative usage of the assets included in the FLSM to provide each of the declared fixed line services. Where costs cannot be directly attributed to assets, such as common assets like network buildings and indirect capital assets, the method adopted by the ACCC calculates an appropriate allocation to specific services using a proxy that broadly reflects expected usage of the relevant assets.

[274] ACCC, Discussion Paper, April 2011, p. 126.

Table 10.1 sets out the method used to calculate each of the cost allocation factors used in the FLSM by asset class.

Table 10.1: Methods used to determine initial cost allocation factors

	ULLS	WLR	PSTN	LCS
CAN Asset Class				
Ducts and pipes	G	G		
Copper cables	G	G		
Other cables		A		
Pair gain systems		A		
CAN radio bearer equipment				
Other CAN assets	A	A		
Other communications plant and equipment	A	A		
Network land	A	A		
Network buildings and support	A	A		
Indirect capital assets	R	R		
Core Asset Class				
Switching equipment – local		A	D	A
Switching equipment – trunk			D	A
Switching equipment – other			D	A
Inter-exchange cables			A	A
Transmission equipment			A	A
Core radio bearer equipment			A	A
Other communications plant and equipment			R	R
Network land			R	R
Network buildings and support			R	R
Indirect capital assets		R	R	R
Legend[a]				
Analysys model basis	A			
Geographic cost basis	G			
De optimised Analysys model basis	D			
Revenue share basis	R			

[a] The methods used to calculate cost allocation factors are described below.

Analysys model-based cost allocation factors

The September 2010 Draft Report included a detailed explanation of how the Analysys cost allocation factors are derived.[275] Following the release of the September 2010 Draft Report, the ACCC made a version of the Analysys model, and associated documentation, available on its website.[276]

Analysys model cost allocation factors were derived from demand data for individual services combined with routing factors (from engineering and industry best practice). These factors reflect the share of particular assets used in providing the fixed line services. The ACCC updated the factors obtained from the Analysys model for actual service demands in 2008–09 to obtain the starting point factors for the FLSM.

[275] ACCC, Draft Report, September 2010, p. 44.
[276] See www.accc.gov.au/content/index.phtml/itemId/889101.

Geographic cost basis—'ducts and pipes' and 'copper cables' asset classes

In the April 2011 Discussion Paper, the ACCC set out a proposed methodology to adjust the allocation of costs to ULLS, WLR and other services (mainly Telstra's retail services) to reflect the differential costs of providing services in the different geographic bands.[277] The ACCC's final view on this methodology is set out in chapter 11 of this report.

After the costs of supplying services in each band are estimated, the cost allocation factors for the two asset classes 'ducts and pipes' and 'copper cables' are adjusted to reflect geographic cost differentials in supplying ULLS and WLR.

De-optimised Analysys model basis

In the April 2011 Discussion Paper, the ACCC re-iterated its view that switching equipment has been over-provisioned for current voice traffic levels.[278] The ACCC considered that Telstra's investment in switching capacity was a commercial decision based on past voice traffic and Telstra's forecasts of future demand. The ACCC stated that Telstra has received compensation for the business risks of a fall in demand through the commercial rate of return earned on assets.

Consequently, the ACCC concluded that Telstra should not be permitted to spread the total fixed costs of its switching equipment over its remaining customers, particularly since the switching equipment is, to a large extent, a natural monopoly.[279]

Since there cannot be any over-provisioning in the optimised Analysys model, the Analysys cost allocation factors reflect a smaller, cheaper amount of switching equipment than the equipment actually in place. The ACCC adjusted the Analysys cost allocation factors for the three classes of switching equipment (local, trunk and other) to ensure that unit costs per minute are not inflated by Telstra's loss of traffic on its switching equipment.

Revenue share basis

The Analysys model does not contain cost allocation factors for land or for building and support assets for the LCS or PSTN OTA service or for indirect capital assets for any of the declared fixed line services. In the April 2011 Discussion Paper, the ACCC proposed to use a revenue share approach to derive initial cost allocation factors for these asset classes.

The revenue share approach determines cost allocation factors for these assets based on the average allocation to the relevant service for assets where costs can be attributed more directly. A detailed description of the method is set out in the April 2011 Discussion Paper.[280]

10.1.2 Adjustments for changes in service demand

The ACCC proposed to adjust the cost allocation factors to reflect changes in the demand for the declared fixed line services. Demand changes will alter the share of CAN and Core assets used to provide specific services. The cost allocation factors are

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277 ACCC, Discussion Paper, April 2011, p. 151.

278 ibid., p. 129.

279 Access seekers, whose customers (end-users) call a number on the Telstra network, cannot avoid paying terminating access charges to Telstra for the use of its network.

280 ACCC, Discussion Paper, April 2011, p. 132.

adjusted to reflect changes in the expected usage of assets to provide the declared fixed line services.[281]

These adjustments to the cost allocation factor effectively hold fairly constant the share of costs allocated to each unit of service (that is, by SIO for ULLS and WLR, and by minute of traffic for LCS and PSTN OTA). Changes in demand will therefore be reflected in the total costs allocated to the service. That is, if demand increases, the total share of costs allocated to the service will increase to reflect its increased usage of the assets used to provide it.

The ACCC did not accept Telstra's view that the cost allocation factors for the declared fixed line services should be adjusted to reflect declining total demand for the fixed line services.[282] The ACCC noted that Telstra's proposed approach would mean that as total demand fell, the costs of the network would be recouped from a smaller number of remaining services. Adopting this approach would increase the unit costs of providing all remaining services.

The ACCC identified a number of reasons for the recent declining trend in traffic on Telstra's PSTN, including:

- reduced demand for wholesale services like WLR, LCS and PSTN OTA, due to growth in access seekers' own networks
- increased competition by access seekers, which has reduced Telstra's retail market share. Much of the fall in total demand for fixed line services reflects reduced demand for Telstra's retail services.
- continuing fixed to mobile substitution, which has decreased the total fixed line services market.

The ACCC considered that it was not appropriate to compensate Telstra for a loss of market share or for reductions in the size of the market. The ACCC considered that Telstra has been appropriately compensated for these business risks through the risk premium included in the commercial rate of return provided by the WACC.

10.2 Submissions

Optus and Frontier Economics supported the inclusion of an additional worksheet in the FLSM to increase the transparency of the calculation of cost allocation factors.[283]

10.2.1 Demand adjustments

Telstra submitted that the ACCC's approach to not adjusting the cost allocation factors to reflect declining total demand for fixed line services is incorrect. Telstra stated the ACCC's methodology 'has the effect of allocating costs to services that do not exist such that Telstra cannot recover the value of its investments as valued by the Commission and will not recover its actual forward-looking operating and capital expenditure costs.'[284] Telstra submitted that this outcome is not in its legitimate business interests.

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281 ACCC, Draft Report, September 2010, p. 94.
282 ACCC, Discussion Paper, April 2011, p. 127.
283 Optus, Submission, June 2011, p. 62. Frontier Economics, Submission, June 2011, p. 32.
284 Telstra, Submission – Part A, 3 June 2011, p. 36.

Telstra submitted further that the ACCC's approach to determining the cost allocation factors is inconsistent because it uses 2002–03 PSTN OTA traffic and 2009–10 SIO numbers as 'peak' demand.[285] It stated that the ACCC should base the cost allocation factors on actual demand levels, where available, and forecast future annual demands.

Telstra referred in its submission to a 'hotel analogy', which it stated is irrelevant and does not support the ACCC's approach to determining cost allocation factors.[286]

Telstra also stated that the ACCC's view that Telstra has been appropriately compensated for its business risks through the risk premium included in the commercial rate of return provided by the WACC is incorrect and inconsistent with the AER's approach and the ACCC's previous decisions.[287]

No other submissions were received on this issue.

10.2.2 PSTN switching equipment

Optus submitted that the ACCC should review whether it used the correct pool of minutes for PSTN OTA in determining the cost allocation factors for PSTN switching equipment.[288]

10.2.3 PSTN transmission equipment

Optus submitted that the ACCC should increase its forecasts for total data volume downloaded for the period 2010–11 onwards.[289]

Frontier Economics also submitted that the ACCC's forecast data growth rates, including the assumed fall in data downloaded over the second half of 2010–11, were too low.[290] It noted a recent industry forecast of annual growth of 41 per cent over the period 2010 to 2015.

10.2.4 PSTN OTA and LCS—'inter-exchange cables'

Frontier Economics submitted that cost allocation factors for 'inter-exchange cables' should be adjusted for past and future data traffic growth as undertaken for transmission equipment.[291]

10.2.5 Revenue share basis

Optus submitted that cost allocation factors calculated using the revenue share basis were dependent on the cost allocations of selected asset classes being correct. It stated that changes to these assumptions could result in significant changes to the calculated cost allocation factors. It submitted that it remained 'cautious' of the revenue share approach.[292]

There were no other submissions on the cost allocation factors.

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285 ibid., p 37.
286 ibid., p. 44.
287 ibid., pp. 45–54.
288 Optus, Submission – Appendix F, June 2011, p. 24.
289 ibid., p. 25.
290 Frontier Economics, Submission, June 2011, p. 32.
291 ibid., p. 33.
292 Optus, Submission – Appendix F, June 2011, p. 28.

10.3 ACCC final view

The ACCC maintains its view that the cost allocation factors set out in the April 2011 Discussion Paper represent an appropriate allocation of the costs of supplying the fixed line services. The ACCC has used these cost allocation factors in estimating final prices for the FADs.

10.3.1 Demand adjustments

The ACCC maintains its view that the cost allocation factors should not be adjusted to reflect declines in total demand for fixed line services that reflect Telstra's loss of market share or reductions in the size of the market.

The ACCC maintains its view that Telstra's investment in switching capacity was a commercial decision based on past voice traffic and Telstra's forecasts of future demand. Telstra has been appropriately compensated for these business risks through the risk premium included in the commercial rate of return provided by the WACC.

The ACCC notes that the BBM approach is based on allowing the access provider to recover its efficient costs and does not include monopoly profits in prices. In a competitive market, a business would not be able to spread the costs of inefficient or over-provisioned assets over its remaining customers as this would reduce its ability to compete with alternative suppliers. Only a monopolist could recover inefficient costs from its remaining customers by charging prices that include monopoly profits.

The ACCC has noted reported comments by Telstra's chief executive, in a recent media interview, that the proposed deal between Telstra and NBN Co will compensate Telstra for loss of market share.[293] The ACCC considers that Telstra would be compensated twice if any compensation for loss of market share were to be allowed in estimating prices for the declared fixed line services. Telstra's chief executive is also reported as stating, in the same interview, that: 'There ain't another telco in the world that would be compensated for decline in margin and market share in their PSTN [traditional fixed line] business.'[294]

The 'hotel analogy' referred to in Telstra's submission was not a relevant consideration in the ACCC's decision. The April 2011 Discussion Paper does not include reference to a 'hotel analogy'.[295]

As noted in section 4.4 of this report, the ACCC considers that there is likely to be a relatively small number of premises migrated from Telstra's copper network to the NBN fibre network during the current regulatory period. Further, the ACCC considers that there is insufficient certainty about the timing and quantum of NBN Co's demand for Telstra infrastructure to take that demand into account in the FLSM for the current regulatory period.

10.3.2 PSTN OTA—switching equipment

The ACCC has confirmed that the PSTN OTA traffic data used in determining the cost allocation factors for PSTN switching equipment is correct.

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293 D. White, 'Light hand demanded from ACCC', *Australian Financial Review*, 27 June 2011.

294 ibid.

295 The analogy was discussed verbally between ACCC and Telstra staff in the context of a request by Telstra staff for a simple explanation to assist them in understanding the ACCC's reasoning.

10.3.3 PSTN OTA—transmission equipment

In the April 2011 Discussion Paper, the ACCC indicated that its data traffic growth forecasts were conservative and that recent ABS data[296] (released in April 2011) suggested that the ACCC's 2010 forecast may be too low.[297]

The ACCC has analysed the most recent ABS internet activity statistics for data downloaded by dial-up and fixed line broadband users and had regard to submissions on appropriate data traffic forecasts. It is now forecasting annual 40 per cent data traffic growth in 2010–11 and over the regulatory period. While the revised forecast reduces the cost allocation factors for PSTN OTA, the impact on the estimated price is less than 0.1 cents.

10.3.4 PSTN OTA and LCS—'inter-exchange cables'

The ACCC maintains its view that an adjustment to the cost allocation factors for 'inter-exchange cables' is not warranted for the reasons set out in the April 2011 Discussion Paper. The ACCC notes that, apart from Frontier Economics, no other submissions were received on the cost allocation factors for 'inter-exchange cables'.

10.3.5 Revenue share basis

The ACCC confirms its view that the revenue share basis is an appropriate method for calculating cost allocation factors for asset classes where alternative methods of attributing costs to services are not available.

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296 Australian Bureau of Statistics, Cat. No. 8153.0 – *Internet Activity, Australia*, December 2010 quarter.

297 ACCC, Discussion Paper, April 2011, p. 131.

11 Pricing structures

Key points

- The ACCC confirms its methodology for calculating ULLS and WLR prices, taking into account geographic cost differentials in supplying these services.
- The ACCC has set an averaged Band 1–3 ULLS price and a separate Band 4 ULLS price. The ACCC considers that this pricing structure is appropriate and will support investment and competition. Averaging the Band 1–3 ULLS price will simplify the price structure and ease the transition to nationally averaged wholesale pricing for the NBN.
- The ACCC confirms the use of total-SIO weights for calculating the averaged Band 1–3 ULLS price. For consistency with the ULLS weighting method, the ACCC has calculated the nationally averaged WLR price using total-SIO weights.
- National average prices have been set for LSS, LCS and PSTN OTA. Access seekers and Telstra can negotiate disaggregated PSTN OTA prices should they choose to do so.

This chapter explains the ACCC's methodology for estimating the geographic costs of providing the ULLS and WLR services and the basis for the price structures adopted for each of the declared fixed line services.

11.1 April 2011 Discussion Paper view

The April 2011 Discussion Paper set out the ACCC's proposed methodology for setting ULLS and WLR prices on the basis of geographic cost estimates. It also proposed price structures for the declared fixed line services—for ULLS, an averaged Band 1–3 price and a separate Band 4 price; a nationally averaged WLR price; and single national average prices for the LSS, LCS and PSTN OTA services.

11.1.1 Methodology for calculating geographically adjusted costs

In the April 2011 Discussion Paper, the ACCC acknowledged that the lack of geographic cost adjustments to the cost allocation factors for the ULLS and WLR in the September 2010 Draft Report caused estimated ULLS costs to be overstated relative to WLR and Telstra's retail costs.

The ACCC considered three sources of information on geographic costs relativities—the Analysys model and Telstra's TEA and PIE II models. The ACCC identified major shortcomings with the TEA and PIE II models. It proposed to use the Analysys model cost relativities for determining costs in the four geographic bands.

The methodology used by the ACCC to estimate the geographic costs of providing the ULLS and WLR service is explained in detail in the April 2011 Discussion Paper.[298] Briefly, the ACCC identified that the basic network costs associated with the 'ducts and pipes' and 'copper cables' asset classes vary by geographic band. Using the Analysys model band relativities, these costs were estimated in the FLSM for each of the four geographic bands. These basic network costs are the same within each band

[298] ACCC, Discussion Paper, April 2011, pp. 140–142, 151–153.

for supplying the ULLS, WLR and Telstra's retail services. The additional costs of providing ULLS and WLR are added to the estimated basic network costs to calculate the total cost of providing ULLS and WLR in each band. These additional costs are assumed not to vary on a geographic basis.

11.1.2 ULLS price structure

In the April 2011 Discussion Paper, the ACCC proposed to set an averaged Band 1–3 ULLS price. In reaching this view, the ACCC had regard to the following considerations:

- Since Bands 1–3 share similar characteristics, the aggregation of these geographic regions is appropriate and will support investment and competition. Further, the ACCC's more robust methodology for estimating geographic costs indicates that the cost differential between Bands 2 and 3 is narrower than previously thought.
- Setting a separate Band 4 price ensures that the much higher cost of providing services in Band 4 is reflected in the price.
- A single price in Bands 1–3 will simplify the ULLS price structure and may reduce administrative costs.
- For most access seekers the proposed Band 1 price increase will be more than offset by lower prices for ULLS in Band 3 and for other declared fixed line services such as the WLR and LSS.
- The reduction in the ULLS price in Band 3 may promote further DSLAM investment in Band 3 ESAs.
- Setting an averaged Band 1–3 price may ease industry's transition to national wholesale pricing for the NBN and promote industry stability.

In setting an averaged Band 1–3 price, the ACCC weighted the band costs estimated by the FLSM by the share of total SIOs in each band. The ACCC considered the alternative approach of weighting the estimated band costs by the percentage of ULLS SIOs in each band. However, it considered that this approach could result in significant price changes over time if the pattern of demand across the bands were to change significantly. The ACCC concluded that using SIO weights was preferred as this approach would provide greater pricing stability over time.

11.1.3 Nationally averaged WLR price

The ACCC proposed to maintain its current approach of setting a nationally averaged WLR price. The ACCC considered that setting WLR prices on a nationally averaged basis is consistent with the Government's current arrangements for setting retail prices.[299]

The nationally averaged WLR price was calculated by averaging the band costs estimated by the FLSM using WLR SIO (not total SIO) weights.

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[299] The current arrangements are set by the Minister for Broadband, Communications and Digital Economy and are contained in *Telstra Carrier Charges – Price Control Arrangements, Notifications and Disallowance Determination No. 1 of 2005.*

11.1.4 LSS and LCS prices

The ACCC proposed to maintain its current approach of setting a national average price for the LCS and LSS. The ACCC considered that neither LCS supply costs nor LSS specific costs are expected to vary significantly by geographic area.

11.1.5 National average PSTN OTA price

In its April 2011 Discussion Paper, the ACCC considered two possible approaches to setting prices for the PSTN OTA service:

- updating the existing pricing structure by removing the access deficit contribution (ADC) and using the current geographic traffic pattern and average call duration (option 1), or
- set a national average rate and discontinue setting de-aggregated charges (option 2).

The ACCC noted that the price matrix calculated under option 1 was based on estimated call conveyance costs and cost relativities derived from the PIE II model. The ACCC did not have confidence that these estimates were an accurate reflection of current actual costs.

The ACCC therefore proposed to set a single national average price (option 2) and allow access seekers and Telstra to negotiate disaggregated prices. The ACCC sought submissions on whether it should provide any further information to assist parties to negotiate disaggregated prices.

11.2 Submissions

A number of submissions acknowledged that the inclusion of specific worksheets in the FLSM had improved the transparency of the methodology used by the ACCC to undertake geographic cost adjustments and to average prices.

11.2.1 Methodology for calculating geographically adjusted costs

Optus submitted that the ACCC's methodology for estimating the geographic costs of providing the ULLS and WLR is appropriate.[300]

11.2.2 ULLS price structure

Optus submitted that the ACCC's reasoning that an averaged Band 1–3 ULLS price will promote DSLAM investment in Band 3 ESAs as a result of a fall in the price charged in Band 3 is incorrect.[301]

Optus submitted further that using SIO weights in calculating the Band 1–3 price is incorrect and will lead to over-recovery of the costs of supplying the ULLS. Optus submitted that the ACCC should calculate the weighted average price using the share of ULLS SIOs in each band. It stated that the ACCC's view that this approach would lead to price instability is incorrect.

AAPT submitted that it did not support setting an averaged Band 1–3 ULLS price as it would cause prices to depart significantly from the underlying costs of supplying

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300 Optus, Submission – Appendix F, June 2011, p. 24.
301 ibid., p. 14.

ULLS in each of the bands.[302] AAPT submitted that ULLS prices should be differentiated across the four geographic bands.

There were no other submissions on the ULLS price structure.

11.2.3 Nationally averaged WLR price

Telstra submitted that the nationally averaged WLR price should not be calculated using the share of WLR SIOs in each band. Telstra proposed that the nationally averaged price be calculated using SIO weights for consistency with the calculation of ULLS prices.[303]

AAPT submitted that it supported a nationally averaged WLR price. It stated that retail line rental costs are priced by AAPT and its main competitors on a national basis.[304]

There were no other submissions on the WLR price structure.

11.2.4 LSS and LCS prices

AAPT submitted that it supported a nationally averaged LCS price. It stated that at the retail level, local calls are priced by AAPT and its main competitors on a national basis. It also submitted that no geographic break-down of LCS costs is available.[305]

There were no other submissions on the structure of LCS and LSS prices.

11.2.5 National average PSTN OTA price

AAPT submitted that a nationally averaged PSTN OTA price was not in the LTIE.[306] It stated that setting a national average PSTN OTA price would result in a significant price increase. AAPT submitted that the ACCC should update the existing geographically differentiated price matrix.

Macquarie Telecom submitted that the ACCC's updated price matrix should be adopted because it would provide certainty and stability. It stated that access seekers will not be able to negotiate disaggregated prices with Telstra.[307]

Frontier Economics submitted that a national average PSTN OTA price would not be in the LTIE.[308] It submitted that differentiated charges would promote efficient investment and use of infrastructure and competition by allowing access seekers to face the same cost structure as Telstra faces.[309] It stated that a national average charge could deter efficient competition in lower cost areas and encourage inefficient competition in higher cost areas. It submitted that the Australian Competition Tribunal found efficient use of infrastructure would not occur under an average price.

Frontier Economics submitted that the ACCC could estimate geographic cost differentials from an optimised model or from Telstra's actual cost and traffic data.[310]

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302 AAPT, Submission, 3 June 2011, p. 4.
303 Telstra, Submission – Part A, 3 June 2011, p. 72.
304 AAPT, Submission, 3 June 2011, p. 4.
305 ibid., p. 4.
306 AAPT, Submission, 3 June 2011, p. 5.
307 Macquarie Telecom, Submission, 3 June 2011, p. 3.
308 Frontier Economics, Submission, June 2011, p. 28.
309 ibid., p. 29.
310 ibid., p. 31.

It submitted that it is unrealistic to expect access seekers to negotiate geographically differentiated charges.

Telstra submitted that the ACCC has not given any clear justification for the proposed change in structure of PSTN OTA prices.[311] Telstra stated that the ACCC's updated PSTN OTA price matrix appropriately reflects cost relativities in the four geographic bands as the relativities are similar to the relativities in the Analysys model.[312] It submitted that the ACCC's updated matrix should be adopted.

Telstra stated that a national average price would not reflect the cost differentials in providing services in different geographic areas.[313] It submitted that the ACCC would be wrong to expect geographically disaggregated prices to be negotiated in the presence of a national average price. Telstra stated that the average price paid under the current de-averaged prices is around 1.3 cents per minute, based on its current traffic profile. It submitted that setting a national average price would lead to an immediate fall in OTA revenues and cause Telstra to under-recover its costs of providing the PSTN OTA service, which would not meet the LTIE or Telstra's legitimate business interests.[314]

Optus submitted that setting a national average PSTN OTA rate would: reflect current costs and enable cost recovery; simplify administration and reduce the regulatory burden; better reflect retail pricing (which is set as a single national rate); and 'be NBN-ready'.[315] It stated that updating the existing PSTN OTA matrix was not supported because the matrix is based on costs from the 'flawed' PIE II model.[316] It submitted that traffic profiles are dynamic and a pricing matrix would require frequent revision to remain relevant. It also stated that de-averaged prices will not be consistent with the NBN.

CEG submitted, on behalf of Optus, that a national average price would promote efficiency because:

- there was no evidence of cost differences in supplying PSTN OTA services in different geographic areas
- there was no reliable evidence of differences in the elasticities of demand for PSTN OTA services between geographic areas, and
- geographically differentiated PSTN OTA prices were not reflected in retail services.[317]

CEG stated that a national average PSTN OTA price would minimise 'cherry picking' by access seekers because it would align the PSTN OTA price structure with the structure of prices for the other access services.[318]

CEG submitted further that the Analysys model suggested that a flagfall charge may be inefficient and there is no empirical evidence supporting such a charge. CEG

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311 Telstra, Submission – Part A, 3 June 2011, p. 65.
312 ibid., p. 69.
313 ibid., p. 70.
314 ibid., p. 71.
315 ibid., pp. 28–32.
316 Optus, Submission, June 2011, pp. 24–28.
317 CEG, PSTN OTA rates structures – a report for Optus, June 2011, p. 22.
318 ibid., p. 27.

submitted that by not imposing a flagfall charge, the ACCC would provide the flexibility for operators to offer tariffs that best match the structure of retail demand.[319]

11.3 ACCC final view

11.3.1 Methodology for calculating geographically adjusted costs

The ACCC confirms its view that ULLS and WLR prices should be based on the costs estimated in the FLSM using the geographic cost-based pricing methodology developed by the ACCC and set out in the April 2011 Discussion Paper.

11.3.2 ULLS price structure

The ACCC confirms its proposed decision to set an averaged Band 1–3 ULLS price and a separate Band 4 ULLS price. The ACCC maintains its view that the aggregation of these bands is appropriate and will support investment and competition. Further, the ACCC considers that averaging the price in these bands is likely to result in benefits to the industry, including from simplifying the price structure and easing the transition to nationally averaged wholesale pricing for the NBN.

The ACCC maintains its view that using total-SIO weights to calculate the averaged Band 1–3 price is appropriate for promoting price stability. In addition, this averaging methodology is consistent with the method used to calculate the $16 'tie-point' price for the purposes of determining the initial RAB value.[320]

11.3.3 Nationally averaged WLR price

For consistency with the averaging method used in calculating the Band 1–3 ULLS price, the ACCC has decided to calculate the nationally averaged WLR price using total-SIO weights.

Similar to its reasoning in regard to the ULLS, the ACCC considers that using total-SIO weights will promote price stability over time in the WLR price. The demand weighting method will result in price changes over time if the pattern of WLR demand across the bands were to change significantly.

Adopting the total-SIO weighting method for the WLR service will also minimise any distortions that could potentially arise as a result of using different averaging methodologies for the ULLS and WLR service.

11.3.4 National average LSS and LCS prices

The ACCC confirms its approach of setting a national average price for LCS and LSS.

11.3.5 National average PSTN OTA price

After having regard to submissions, and the available cost evidence, the ACCC has decided to set a national average PSTN OTA price in the FADs.

The ACCC continues to lack confidence that the PIE II cost relativities provide an accurate measure of current geographic cost differences in providing PSTN OTA services. No submissions provided reliable information on the geographic costs of providing PSTN OTA services.

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[319] ibid., p. 24.
[320] ACCC, Discussion Paper, April 2011, p. 47, footnote 73.

The ACCC notes that Telstra submitted no information on its current actual costs of providing PSTN OTA services in different geographic areas. Instead, Telstra used the Analysys model to derive cost relativities. The Analysys model is an optimised model. Telstra has not submitted on the impact of the optimisation in the model on the appropriateness of using its estimated geographic cost relativities to determine actual cost relativities. Telstra has submitted only that the Analysys model cost relativities produce disaggregated rates that 'are almost identical to the Commission's calculations'.[321] However, the ACCC has previously noted, and remains of the view, that it is not confident that the PIE II cost relativities, which underpin the proposed matrix included in the April 2011 Discussion Paper, provide an accurate measure of current geographic cost differences.

Telstra has submitted a proposed price matrix that assumes the geographic cost relativities between the fixed costs and variable costs of providing PSTN OTA services are the same. It has therefore applied the same cost relativities to calculate a flagfall and effective minutes of use (EMOU) charge. Telstra has not provided any actual cost evidence to support this assumption.

Telstra's proposed price matrix also assumes that the per minute flagfall charge comprises 25 per cent of the headline rate and the EMOU comprises 75 per cent of the headline rate. Telstra has not provided any actual cost evidence to support this assumption. The ACCC considers that changes in traffic patterns and call duration since the existing price matrix was calculated in 2003 raise questions about the validity of continuing to assume that 25 per cent of costs should be recovered through a flagfall and 75 per cent through an EMOU charge.

The ACCC has concluded that Telstra's proposed approach does not represent a reliable basis for determining a de-averaged price matrix.

The ACCC notes that access seekers and Telstra can negotiate disaggregated prices should they choose to do so. The ACCC notes that, if concerns are subsequently raised due to parties being unable to agree on disaggregated prices, the ACCC may consider whether it is necessary and appropriate to utilise other regulatory mechanisms such as, for example, binding rules of conduct.

[321] Telstra, Submission – Part A, 3 June 2011 p. 69.

12 Demand forecasts

Key points

- The FLSM requires demand forecasts for each of the declared fixed line services in order to calculate unit prices for each service.
- Telstra provided revised demand forecasts to the ACCC in May 2011 for the period 2010–11 to 2012–13.
- Apart from the LSS (and to a smaller extent, the ULLS), Telstra's revised demand forecasts do not differ significantly from its earlier November 2010 forecasts.
- The ACCC does not consider that Telstra has provided sufficient new information or explanation to warrant an amendment to the ACCC's demand forecasts for the ULLS, WLR, PSTN OTA and LCS.
- The ACCC has revised its demand forecasts for the LSS downwards. This revision takes into account up-to-date information on trends in actual demand for the LSS and information provided in submissions.

The FLSM requires demand forecasts for each of the declared fixed line services in order to calculate a unit price for each service. The share of the revenue requirement allocated to each service is divided by forecast demand to determine the average price (or unit price) for that service.

12.1 ACCC's April 2011 demand forecasts

In the April 2011 Discussion Paper, the ACCC revised its September 2010 demand forecasts for the period 2010–11 to 2013–14. These revisions were made to take into account:

- more up-to-date actual demand figures
- demand forecasts for the fixed line services provided by Telstra in November 2010
- updated information on factors expected to influence demand for the fixed line services, and
- submissions received in response to the September 2010 Draft Report.

Demand forecasts for the financial years 2014–15 and 2015–16 were also developed, as the ACCC proposed to extend the regulatory period to June 2016. For these two years, the ACCC adopted a conservative approach by forecasting stable demand for each of the fixed line services. The ACCC considered that a conservative approach was appropriate, having regard to the uncertainty surrounding the migration schedule for the NBN and lack of forecasts supplied by Telstra.[322]

Furthermore, the ACCC noted that its methodology for adjusting the cost allocation factors to reflect changes in demand for particular services (see chapter 10) would generally limit the impact on unit costs (and therefore prices) due to changes in the

[322] ACCC, Discussion Paper, April 2011, pp. 160–161.

NBN migration schedule. It would also limit the impact on unit costs (and prices) of any other demand forecasting errors.

The ACCC recognised that total demand for fixed line services, including Telstra's retail services, had been declining over recent years. The ACCC did not consider it appropriate to compensate Telstra for any loss of market share, or reduced customer demand, by allocating total network costs across a declining number of services. The ACCC did not therefore adjust the FLSM cost allocation factors to reflect any further declines in the total demand for fixed line services (see chapter 10).

12.1.1 Demand forecasts for each fixed line service

This section summarises the demand forecasts for each of the declared fixed line services used in estimating the draft prices included in the ACCC's April 2011 Discussion Paper.[323]

- ULLS—The ACCC forecast strong positive growth in ULLS lines in 2010–11, followed by slower growth in the next two years. The ACCC considered that the declining rate of growth would reflect the expected impact of the roll-out of the NBN on access seekers' DSLAM investment decisions from the second half of 2012. The ACCC adopted conservative forecasts of stable ULLS demand in 2014–15 and 2015–16 as sufficiently reliable information on the planned NBN migration schedule was not available.
- LSS—Total LSS lines were forecast to grow significantly in 2010–11, followed by a declining rate of growth over the next two years. In developing these forecasts, the ACCC considered that demand for the LSS would increase in the second-half of 2010–11, due to the IAD price for LSS falling compared to the previous indicative price. For 2014–15 and 2015–16, the ACCC adopted a conservative approach by forecasting stable LSS demand.
- WLR—Total WLR lines were forecast to decrease over the first three years of the regulatory period. The ACCC forecast that the rate of decline in WLR SIOs would slow compared to its past trend, reflecting the lower WLR price in the IAD compared to the previous indicative price. The ACCC adopted a conservative approach by forecasting stable WLR demand in the last two years of the regulatory period.
- PSTN OTA—Total PSTN OTA minutes were forecast to decline over the first three years of the regulatory period, but at a slower rate than in recent years. The ACCC accepted that access seekers' substitution away from Telstra's resale services was likely to slow in the lead-up to the roll-out of the NBN. For 2014–15 and 2015–16, the ACCC adopted a conservative approach by forecasting stable demand for the PSTN OTA services.
- LCS—Total LCS minutes were forecast to decline over the first three years of the regulatory period, reflecting continuing fixed to mobile substitution. The ACCC adopted a conservative approach by forecasting stable demand for the LCS service in the last two years of the regulatory period.

[323] ibid., pp. 162–167.

12.2 Submissions

In May 2011, Telstra submitted revised demand forecasts to the ACCC. These demand forecasts are discussed in section 12.3 below.

AAPT submitted that a three minute call duration should be applied to the LCS. It stated that applying this call duration would significantly reduce the LCS price. AAPT noted that it had previously provided information to the ACCC regarding its actual average call duration and requested that the ACCC rely on this evidence.[324]

No other submissions were received on the ACCC's demand forecasts.

12.3 Telstra's revised demand forecasts

On 18 May 2011, Telstra submitted revised demand forecasts in respect of its CAN and Core network services for the period 2010–11 to 2012–13.[325]

Two sets of demand forecasts were submitted—one set that took into account the potential impact of the NBN roll-out and another that did not. Telstra stated that its estimate of the impact of the NBN roll-out was drawn from demand forecasts contained in NBN Co's business case study as this was the best information available to it.[326] Telstra's November 2010 demand forecasts did not include any allowance for customer migration due to the NBN.

12.3.1 ULLS, WLR, PSTN OTA and LCS demand forecasts

Apart from the LSS (and to a smaller extent, the ULLS), Telstra's revised demand forecasts for the fixed line services do not differ significantly from its earlier November 2010 forecasts.

Telstra submitted that the NBN roll-out is not expected to have a significant impact on demand for the fixed line services in 2011–12 and 2012–13.[327] Migration of services to the NBN is forecast by Telstra to cause demand for ULLS lines to increase at a slightly slower rate and demand for WLR lines to fall more slowly compared to its forecasts without the NBN. In regard to traffic volume demand for PSTN OTA and LCS minutes, Telstra advised that it **[c-i-c]** [redacted] **[c-i-c]**.

Compared to Telstra's November 2010 demand forecasts, the revised demand forecasts project:

- a sizable increase in the number of ULLS lines—Telstra's November 2010 forecasts were based on estimated 2009–10 demand while its updated forecasts take into account the strong growth in actual 2009–10 demand
- a smaller decrease in the WLR lines, particularly when the potential impact of the NBN is taken into account, and
- a slightly lower rate of decline in traffic minutes for PSTN OTA and LCS.

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[324] AAPT, Submission, 3 June 2011, p. 6.
[325] Telstra, Demand Forecasts for Customer Access Network and Inter Exchange Network services, Letter to the ACCC, 18 May 2011.
[326] ibid., p. 5.
[327] Telstra, Demand Forecasts for Customer Access Network and Inter Exchange Network services, Letter to the ACCC, 18 May 2011.

12.3.2 LSS demand forecasts

Telstra's revised LSS demand forecasts (not taking the NBN roll-out into account) show a steep annual decline from 2010–11 to 2012–13, reversing the positive growth trend Telstra had forecast in November 2010. Telstra has forecast a further small decline in the LSS lines due to migration to the NBN.

Telstra's revision to its November 2010 forecast reflects a decline in LSS SIOs by approximately **[c-i-c]** [redacted] **[c-i-c]** between August 2010 and March 2011. Telstra is now forecasting that the decline in LSS demand will continue, due to the following factors:

- access seekers' change of strategy, that is, refocussing on ULLS and moving away from LSS in order to protect their market share in anticipation of the NBN
- 'Telstra Retail's effective strategy in winning new businesses and in retaining its existing customers', and
- Telstra's expectation that the rate of fixed to mobile substitution will be higher than previously forecast.[328]

12.4 ACCC final view

12.4.1 ULLS, WLR, PSTN OTA and LCS demand forecasts

The ACCC considers that Telstra has not provided sufficient new information or explanation to warrant an amendment to the ACCC's demand forecasts for the ULLS, WLR, PSTN OTA and LCS. Telstra's submission does not identify any new factors that might be expected to result in a change in the market outlook or its demand projections during the three-year regulatory period.

While the ACCC broadly accepted Telstra's November 2010 demand forecasts, the ACCC also made a number of adjustments in order to take into account other factors relevant to demand, including issues raised by access seekers in submissions. These factors included:

- the impacts on demand for the fixed line services resulting from price changes (that is, between the IAD prices and the previous indicative prices)
- ongoing fixed to mobile substitution, and
- a slowing in access seekers' substitution away from Telstra's resale services to their own infrastructure in the lead up to the NBN roll-out.

Telstra's November 2010 demand forecasts did not take into account the potential impact of the NBN roll-out. The ACCC took limited account of the NBN roll-out in its demand forecasts for fixed line services.[329]

Apart from AAPT's views on the appropriate average call duration for the LCS, submissions to the ACCC's April 2011 Discussion Paper did not comment on the ACCC's demand forecasting methodology or its demand forecasts.[330]

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328 Telstra, Letter to the ACCC (confidential), 26 May 2011, p. 2.

329 In relation to the ULLS, the ACCC forecast a strong positive growth (20 per cent in 2010–11), followed by a lower growth rate 10 per cent in 2011–12 and 5 per cent in 2012–13). The ACCC considered that the declining rate of ULLS growth would reflect the expected impact of the NBN roll-out from the second half of 2012.

The ACCC confirms it will apply the same percentage rate of growth in 2013–14 as forecast for 2012–13 for each of the services. The ACCC considers this is an appropriate approach considering Telstra's failure to provide forecasts for 2013–14 and the uncertainty surrounding the NBN migration schedule.

LCS average call duration

Because the LCS price is set on a per call basis, the ACCC requires forecasts for average call duration for the LCS. These forecasts are used in conjunction with the forecasts for total demand (measured in minutes) to calculate the price per call.

The ACCC adopted an average call duration of four minutes in the April 2011 Discussion Paper. The ACCC notes that Telstra submitted that analysis of its 2009–10 RAF data confirmed that its average call duration was four minutes.[331] In contrast, AAPT submitted that the industry standard would be much closer to three minutes than to four.[332] However, it did not provide evidence to support this statement. No other submissions provided information on LCS call duration.

Without further information from other access seekers, the ACCC has maintained its estimate of an average call duration of four minutes.

12.4.2 LSS demand forecasts

The ACCC has analysed recent LSS uptake using the latest available CAN record keeping rule (RKR) data. This analysis has confirmed that demand for the LSS peaked during the September 2010 quarter and declined in the two subsequent quarters, as shown in table 12.1 below.

Table 12.1: LSS SIO quarterly growth rates, 2010–11

Measurement period	SIO growth
June to September 2010	2.18%
September to December 2010	–1.45%
December 2010 to March 2011	–1.49%
June 2010 to March 2011 (nine months)	*–0.80%*

Source: Telstra CAN RKR data, June 2010, September 2010, December 2010 and March 2011.

The ACCC agrees with Telstra that LSS SIOs are likely to decline over coming years. Access seekers are expected to focus on growing their customer bases and consolidating their positions prior to the move to the NBN. This focus is expected to lead some access seekers to develop their own voice service capabilities rather than using a third party service. With a small number of centralised voice application servers, these access seekers can provide voice over digital subscriber line (VoDSL) to their DSL customers. Those same voice application servers can then provide their

330 Optus submitted that if the ACCC considers the NBN migration in its demand forecasting, it should also have regard to the migration payments from NBN Co to Telstra. Optus, Submission, April 2011, p. 64.

331 Telstra, Submission – Part A, October 2010, p. 129.

332 AAPT Limited, Submission, October 2010, p. 22.

voice services when the access network changes from copper pairs to the NBN. These considerations are likely to underpin ongoing LSS to ULLS migration.[333]

Taking into account these considerations, the most recent LSS demand figures and the information provided in Telstra's letter of 18 May 2011, the ACCC considers that a downward revision to its LSS demand forecasts is justified. However, the ACCC considers that Telstra's large forecast declines in LSS demand for 2011–12 of **[c-i-c]** [redacted] **[c-i-c]** per cent and 2012–13 of **[c-i-c]** [redacted] **[c-i-c]** per cent are not supported by the currently available evidence. In addition, the ACCC considers that the fall in the LSS price in the IADs compared to the previous indicative price will limit the decline in LSS demand.

A number of access seekers purchase the LSS in a bundle with WLR and other resale services, particularly when they do not have comprehensive voice service capabilities in place across their coverage footprint. The ACCC has therefore decided to forecast the same rate of decline for LSS as forecast for WLR, that is, 1.5 per cent for each year of the regulatory period.

12.4.3 Final demand forecasts for the declared fixed line services

The ACCC's final demand forecasts for each of the declared fixed line services are shown in table 12.2.

Table 12.2: Actual/estimated demands in 2009–10 and forecast demands in 2010-11 to 2013–14

Services	2009–10	2010–11	2011–12	2012–13	2013–14
ULLS (lines)	827,333	992,800	1,092,080	1,146,684	1,204,018
Growth rate		*20.00%*	*10.00%*	*5.00%*	*5.00%*
LSS (lines)	734,155	723,143	712,296	701,611	691,087
Growth rate		*–1.50%*	*–1.50%*	*–1.50%*	*–1.50%*
WLR (lines)	1,252,784	1,233,992	1,215,482	1,197,250	1,179,291
Growth rate		*–1.50%*	*–1.50%*	*–1.50%*	*–1.50%*
PSTN OTA (million minutes)	**[c-i-c]** [redacted]	[redacted]	[redacted]	[redacted]	[redacted] **[c-i-c]**
Growth rate		*–5.00%*	*–5.00%*	*–5.00%*	*–5.00%*
LCS (million calls)	**[c-i-c]** [redacted]	[redacted]	[redacted]	[redacted]	[redacted] **[c-i-c]**
Growth rate		*–20.00%*	*–18.00%*	*–15.00%*	*–15.00%*

Sources: For 2009–2010: actual ULLS and LSS data obtained from Telstra's CAN RKR; WLR data obtained from Telstra's 2009–10 Annual Report; and PSTN OTA data obtained from Telstra RAF report for 2009–10. For LCS, demand data was obtained from Telstra's November 2010 submission using 9 months of actual data and 3 months of forecast data.

[333] According to CAN RKR data, for the first nine months of 2010–11, ULLS SIOs grew by 15.8 per cent. This is consistent with the ACCC's view in the April 2011 Discussion Paper that ULLS SIOs would grow by 20 per cent in 2010–11.

13 Overview of prices for fixed line services

Key points

- The ACCC has estimated FAD prices using its Fixed Line Services Model (FLSM). The prices apply for a three-year regulatory period commencing on 1 July 2011 and expiring on 30 June 2014.
- Prices have been averaged over the three-year period so that a single price applies over the regulatory period.
- Since releasing the April 2011 Discussion Paper, the ACCC has made a number of minor revisions to the FLSM and updated some of the forecasts used in estimating the FAD prices. These changes have resulted in the final prices being different from the draft prices included in the April 2011 Discussion Paper.

Final prices for the declared fixed line services have been estimated by the FLSM based on the assumptions and forecasts described in chapters 4–12 of this report.

The table below compares the FAD prices with the IAD and draft FAD prices. It also includes, for comparison, the previous indicative prices that expired on 31 December 2010 and the draft prices released in the September 2010 Draft Report.

Table 13.1: Comparison of previous indicative prices, September 2010 draft prices, IAD prices applying from 1 January 2011, April 2011 draft prices and final FAD prices

	Previous indicative prices	September 2010 draft prices	IAD prices 1 January to 30 June 2011	Draft FAD prices from 1 July 2011 to 30 June 2016[a]	FAD prices from 1 July 2011 to 30 June 2014[a]
ULLS Band 1	$6.60	$6.50	)	)	)
ULLS Band 2	$16.00	$16.00	) $16.00	) $16.75	) $16.21
ULLS Band 3	$31.30	$31.00	)	)	)
ULLS Band 4 (per line per month)		$100 (notional)	$48.00	$50.11	$48.19
WLR (per line per month)	$25.57 (HomeLine) $26.93 (BusinessLine)	$20.00 (nationally averaged)	$22.10 (nationally averaged)	$22.47 (nationally averaged)	$22.84 (nationally averaged)
LSS (per line per month)	$2.50	$2.50	$1.80	$1.80	$1.80
PSTN OA and TA (per minute)	1.0c (headline rate)	1.1c (headline rate)	1.0c (headline rate)	1.0c (national average rate)	0.95c (national average rate)
LCS (per call)	17.36c	7.0c	9.1c	8.7c	8.9c

Note: All prices are in nominal terms. [a] The draft FAD prices averaged nominal prices over a five-year regulatory period while the final FAD prices are averaged over a three-year regulatory period.

As shown in table 13.1, prices estimated by the FLSM are generally lower than the previous indicative prices set using the TSLRIC+ pricing approach.[334] Final prices differ from previous prices estimates reflecting information and comments received during the consultation process. As explained in chapters 4–12 of this report, the ACCC has updated its forecasts for operating expenditure, capital expenditure and demand and its estimate of the weighted average cost of capital (WACC). It has also made revisions to the FLSM (see chapter 4).

13.1 Submissions

This section summarises issues raised in submissions that have not been addressed in other chapters in this report.

AAPT stated that the draft prices for WLR and ULLS in the April 2011 Discussion Paper were expensive by international standards. It submitted that all prices except LSS were 'based on an initial RAB value which is set too high'.[335]

Frontier Economics submitted that, in deciding whether or not to smooth prices over the regulatory period, some consideration should be given to the expected price for the first year of the next regulatory period.[336] Frontier Economics supported the ACCC's decision not to round up prices in the April 2011 Discussion Paper.

13.2 Method of calculating FAD prices

The ACCC has estimated prices from the FLSM for a three-year regulatory period expiring on 30 June 2014 (see section 4.3.3). The ACCC has determined a single price for each service over the regulatory period by calculating a simple average of the prices estimated by the FLSM for the years 2011–12 to 2013–14. The annual prices estimated by the FLSM are shown in table 13.2 below.

Table 13.2: Estimated annual prices for each service from the FLSM and FAD prices

	FAD prices			Average 3-year FAD price*
	2011–12	2012–13	2013–14	
ULLS Band 1 to 3 ($/month)	$15.87	$16.21	$16.56	$16.21
ULLS Band 4 ($/month)	$47.45	$48.18	$48.95	$48.19
WLR ($/month)	$22.94	$22.69	$22.88	$22.84
PSTN (cents/minute)	0.99c	0.93c	0.92c	0.95c
LCS (cents/call)	8.8c	8.8c	9.1c	8.9c
LSS ($/month)	$1.75	$1.80	$1.85	$1.80

Note: * Smoothed three-year price obtained by averaging annual prices for 2011–12 to 2013–14.

The ACCC considers that smoothing prices to obtain a single price for each service over the regulatory period will promote certainty and stability. As shown in table 13.2, estimated prices vary on a year to year basis but these variations are not significant. The ACCC considers that some of the annual price movement reflects

334 LSS was not estimated within the Ovum BBM framework in the September 2010 Draft Report.
335 ibid., p. 5.
336 ibid., p. 34.

'lumpiness' in the FLSM inputs (for example, in assets reaching the end of their asset lives) rather than trends in the underlying costs of supplying the services.

For the ULLS, PSTN OTA and LSS, the trend movement in estimated prices is small and does not, in the ACCC's view, warrant setting annual prices. In reaching this view, the ACCC has taken into account the uncertainty around demand forecasts and operating and capital expenditure forecasts—and therefore future estimated prices—after the end of the regulatory period (that is, after 30 June 2014). The ACCC considers this uncertainty prevents it from identifying clear trends in underlying costs at this time.

For these reasons, the ACCC considers that it is not possible, on the information currently available, to adopt Frontier Economics' view that the ACCC should take into account the expected price for the first year of the next regulatory period. The ACCC considers there is too much uncertainty about the future path of expenditures and demand for the fixed line services to develop reliable expectations about expected prices in the next regulatory period. The ACCC notes that there is still significant uncertainty about the magnitude and timing of the impacts of the NBN roll-out on future expenditures and demand for the fixed line services.

13.3 Differences between the draft FAD prices and FAD prices

The FAD prices for ULLS, WLR, PSTN OTA and LCS differ from the draft prices set out in the April 2011 Discussion Paper. The main reasons for the shift in prices for these services are:

- The major single factor behind the reduction in the ULLS, WLR and LCS prices is the reduction in the WACC. The nominal vanilla WACC has fallen to 8.54 per cent, for the 20 day trading period to 30 June 2011, down from the 9.04 per cent used in the April 2011 Discussion Paper (based on the 20 day trading period to 31 December 2010). The WACC used in the April 2011 Discussion Paper was the same WACC value used in estimating the IAD prices. The April 2011 Discussion Paper indicated that the WACC value would be updated in estimating final prices (see chapter 6). The lower WACC has little impact on the other prices; the LSS has no capital costs allocated to it.
- Moving to a three-year regulatory period, from the five-year period used in the April 2011 Discussion Paper, reduces the final ULLS prices since these prices are increasing over time (due to the impact of inflation on operating expenditures). It decreases the final WLR price slightly and contributes more than half of the increase in the LCS price. These prices are expected to fall in 2014–15 and 2015-16 due to a fall in switching costs because the assets will soon be fully depreciated and are not being replaced. These two years are now outside the regulatory period. The path of prices over the regulatory period is shown in table 13.2 above.
- The adoption of Telstra's tax asset value and the consequent reduction to the 'ducts and pipes' increment to the RAB value has a minor impact on ULLS and WLR prices as their effects are largely offsetting. However, the lower tax asset value increases the LCS price because the LCS does not use ducts and pipes.

- Adopting a total-SIO weighting method for calculating the nationally averaged WLR price increases the price by 84 cents.
- Higher forecast growth in data traffic (from 20 per cent to 40 per cent annual) reduces the share of transmission costs allocated to voice traffic and therefore reduces the final PSTN OTA price slightly.

14 Connection and disconnection charges

Key points

- The ACCC confirms its methodology for indexing connection and disconnection charges.
- The ACCC has updated the inflators used for indexing connection and disconnection charges for the latest Reserve Bank of Australia (RBA) forecasts released in May 2011.

Connection and disconnection charges relate to the costs of technicians performing jumpering work inside Telstra exchanges, travel and vehicle costs for the technicians, costs of back-of-house management or assistance for technicians, material costs and indirect costs.

This section sets out the connection and disconnection charges for the ULLS and LSS for the regulatory period and the ACCC's views on some related issues.

14.1 April 2011 Discussion Paper view

In the April 2011 Discussion Paper, the ACCC proposed to index connection and disconnection charges by using a combination of:

- the actual change in the consumer price index (CPI), where available
- the RBA's inflation forecast for the year to the date from which the charge applies, and
- the midpoint of the RBA's inflation target range.

Specifically, the ACCC indexed IAD charges by actual CPI inflation for the 12 months to December 2010. The draft FAD charges for 2011–12 were indexed by half of the RBA's CPI inflation forecast (of 2.5 per cent) for the 12 months to June 2011. This indexation was applied to update them for the six months from the commencement of the IADs on 1 January 2011 to the proposed commencement of the FAD regulatory period on 1 July 2011. For the following two financial years, the RBA's inflation forecasts were used to index the charges. The last two financial years of the regulatory period were indexed by the midpoint of the RBA's inflation target range (2.5 per cent).[337]

In addition, the ACCC considered a number of issues related to connection and disconnection charges. Based on outcomes from past arbitration decisions and submissions received in response to the September 2010 Draft Report, the ACCC proposed to adopt the following approaches for the setting of FAD charges:

- LSS disconnection charges are not payable when either:
  - — the disconnection is made pursuant to a Telstra churn process, or
  - — the access seeker is participating in the Telstra LSS churn process and BigPond is not

[337] ACCC, Discussion Paper, April 2011, pp. 172–179.

- costs of after-hour MNMs should be agreed upon between Telstra and the access seekers, and
- the ACT Utilities Tax should be excluded from connection and disconnection charges.

The ACCC also sought submissions from parties on a number of other relevant issues, including:

- whether transfer Managed Network Migrations (MNM) charges should be included, possibly as part of the ULLS and LSS monthly costs
- whether LSS MNM cancellation charge should be applicable, and
- whether LSS and ULLS MNM minimum exchange charges should be applicable in Band 4.

14.2 Submissions

14.2.1 Indexation method

Optus submitted that it disagreed with the ACCC's indexation approach. It stated that the ACCC may not have taken into account a previous expectation that jumpering costs should, in due course, decline for the ULLS and converge towards the connection costs for LSS and PSTN OTA.[338] Optus also submitted that the ACCC incorrectly assumed that the ULLS connection charge was entirely comprised of labour costs. Optus considered that under the ACCC's indexation methodology, the draft FAD prices were likely to over-recover the efficient costs of ULLS connection charges.

14.2.2 LSS disconnections outside the churn process

Telstra submitted that it did not object to the ACCC's proposal to disallow a disconnection charge in the scenario where disconnections take place within the Telstra LSS churn process. However, Telstra stated that the ACCC should not disallow a disconnection charge where the access seeker is participating in the Telstra LSS churn process and BigPond is not, as this would 'prevent Telstra from recouping its direct and efficiently incurred costs in undertaking disconnections.'[339]

Telstra also submitted that the operation of the second provision of the clause was uncertain. Telstra stated that it assumed that the provision does not disallow the levying of a disconnection charge for an end user churn involving an access seeker if that access seeker is a participant in the Telstra LSS churn process and BigPond is not, when BigPond was not in fact involved in that churn.

14.2.3 Transfer Managed Network Migrations

The ACCC received no submissions in relation to transfer MNMs.

14.2.4 Cost of after-hour MNMs

Telstra submitted that it would be unnecessary to set a timeframe for completion of the jumpering work necessary for a MNM.[340] Telstra submitted that the issue had

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338 Optus, Submission, June 2011, p. 66.
339 Telstra, Submission – Part B, 3 June 2011, p. 45.
340 ibid., p. 46.

never been raised by an access seeker or been the subject of a previous dispute. Telstra stated that access seekers do not request the provision of after hours MNMs in order to speed up the jumpering work but as a way to minimise disruption to their end-users.

Telstra submitted that further consultation would be required if the ACCC decided to include such a provision.

14.2.5 LSS MNM cancellation charge

Telstra stated that it supported the inclusion of LSS MNM cancellation charges in the FADs.[341] It submitted a table of proposed charges for the regulatory period, using the Telstra/Chime April 2010 LSS FD figures and applying the indexation methodology used in the April 2011 Discussion Paper.

14.2.6 LSS and ULLS MNM minimum exchange charges in Band 4

Telstra submitted that consistent with previous final determinations, there was no need for minimum exchange charges in Band 4. Telstra submitted that this was because there was virtually no demand for ULLS, LSS or MNMs in Band 4.[342]

14.2.7 ACT Utilities Tax

Optus submitted that it would be inappropriate for the Australian Capital Territory (ACT) Utilities Tax to be included in the revenue requirement of the FLSM, access prices or in connection and disconnection charges because the tax only applied within the ACT and the Jervis Bay area.[343] It proposed that payment of the tax should be commercially negotiated and specified in access agreements.

14.2.8 Band 4 charges for LSS single disconnections, ULLS MNM connections, ULLS cancellations and ULLS call diversion

Telstra submitted that the approach adopted in the April 2011 Discussion Paper for LSS single disconnections, ULLS MNM connections, ULLS cancellations and ULLS call diversion was inconsistent with the charges in the published 2010 Final Determinations (FDs). In the FDs, the charge for each of these services was set as a single national charge that explicitly excluded Band 4.[344] Telstra submitted that the FADs should be amended to exclude Band 4 in the application of these charges.

14.2.9 LSS to ULLS migration charge

Herbert Geer submitted that it supported the ACCC's proposal to include an LSS to ULLS migration process in the FADs.[345] However, Herbert Geer noted that the April 2011 Discussion Paper did not specify a LSS to ULLS migration charge. Herbert Geer submitted that the migration charge 'should be at least no more than a ULLS single or MNM connection charge and should not include an LSS disconnection charge because the connection of the ULLS also in effect disconnects the LSS'.[346]

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341 ibid., p. 47.
342 ibid.
343 Optus, Submission, June 2011, p. 61.
344 Telstra, Submission – Part B, 3 June 2011, p. 47.
345 Herbert Geer, Submission, 3 June 2011, p. 18.
346 ibid.

14.3 ACCC final view

14.3.1 Indexation method

The ACCC confirms its methodology for indexing connection and disconnection charges. It has updated the inflators by incorporating the latest RBA forecasts released in May 2011. Connection and disconnection charges are now indexed on the following basis:

- for 2011–12, charges are indexed by 1.75 per cent (i.e. half of the forecast CPI for the 12 months to June 2011)—as noted in section 14.1 above, this indexation is applied to update charges for the six months from the commencement of the IADs on 1 January 2011 to the commencement of the FADs on 1 July 2011.
- for 2012–13, charges are indexed by 2.5 per cent (i.e. the RBA's CPI forecast for the 12 months to June 2012) and
- for 2013–14, charges are indexed by 3 per cent (i.e. the RBA's CPI forecast for the 12 months to June 2013).

The ACCC has not received cost information from parties that suggests that the ACCC's indexation methodology is likely to over-recover the efficient cost of the relevant connection and disconnection services. Further, the ACCC has not been provided with evidence that jumpering costs have declined for the ULLS or that connection costs for ULLS, LSS and PSTN OTA have converged. The ACCC considers that its methodology is transparent and supported by previous regulatory decisions. The revised inflators are set out in table 14.1 below.

Table14.1: CPI inflators used to index connection and disconnection charges

Year	CPI inflation year used (12 months to)	Inflator
IAD charges		
January 2011–December 2011	December 2010	2.7 per cent[a]
FAD charges		
July 2011–June 2012	June 2011	1.75 per cent[b]
July 2012–June 2013	June 2012	2.5 per cent
July 2013–June 2014	June 2013	3 per cent

Source: Reserve Bank of Australia, *Statement on Monetary Policy,* 5 May 2011, p. 63.
Notes: [a] Actual CPI figures, published by the ABS. [b] Half of the RBA's CPI inflation forecast for the period from July 2010 to June 2011.

14.3.2 LSS disconnection charges outside the churn process

The ACCC accepts Telstra's submission that the relevant clause should be clarified for the purposes of the FADs. The ACCC also accepts Telstra's submission that it should be able to recoup its direct costs incurred in disconnections.

The ACCC notes that the intent of the relevant clause was to ensure that access seekers are not levied twice for the same process. Therefore, during a churn process where a disconnection and re-connection occurred in the same process, a

disconnection charge and a connection charge should not both be payable. The ACCC remains of the view that access seekers should not incur a disconnection charge where the costs of the jumpering work incurred during an end-user churn are covered by the connection charge, which will be paid by the party to whom the customer is churning.

The ACCC understands that Telstra (BigPond) does not participate in the Telstra LSS churn process. Where Telstra (BigPond) is the party to whom the customer is churning, the second provision clarifies that a disconnection fee is not charged to the access seeker from whom the customer is churning where that access seeker is participating in the Telstra LSS churn process. In this case, the costs of the jumpering work incurred in the churn will be covered by Telstra (BigPond).

The ACCC notes that this approach is consistent with previous arbitration decisions, in which the ACCC considered that the provision would encourage efficiency as more downstream services would be likely to fall within the ambit of the Telstra LSS churn process.[347]

In order to clarify the provision, the ACCC has made the following minor change (shown in bold text) to the clause:

> *A disconnection charge is not payable if either:*
>
> *(a) the disconnection is made pursuant to a Telstra LSS churn process; or*
>
> *(b) the access seeker is participating in the Telstra LSS churn process and Telstra (BigPond) is not participating in the Telstra LSS churn process**, where the service is being transferred to Telstra (BigPond)***.

The ACCC has also decided to include a further clarifying provision in response to Telstra's submission. As the ACCC understands Telstra's concerns, it considers that it may be prohibited from levying a disconnection charge where an access seeker participating in the Telstra LSS churn process is transferring to another access seeker that is not participating in the churn process. The new provision is as follows:

> ***A disconnection charge is payable if:***
>
> ***(c) the access seeker is participating in the Telstra LSS churn process and the service is being transferred to an access seeker that is not participating in the Telstra LSS churn process.***

The ACCC considers that the additional provision is unlikely to have a material impact. Telstra publishes a list of access seekers participating in the Telstra LSS churn process, as well as those parties that are not participants.[348] According to the information provided by Telstra for the March 2011 CAN RKR data, none of the non-participants, apart from Telstra (BigPond), currently provide services using the LSS.

The ACCC considers that an effective LSS churn process is in the LTIE as the process is likely to reduce the costs incurred by end-users in changing service providers. Where a LSS disconnection takes place as a result of an end-user churning to another service provider, a churn process allows for removal of the existing jumpers to be

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[347] ACCC. *LSS Access Dispute, Telstra/Chime, Reasons for Final Determination*, April 2010, p. 98.

[348] See Telstra Wholesale website at www.telstrawholesale.com/products/docs/access_broadband_dsltransfer.xls (current as at 6/07/11).

combined with installation of new jumpers on the relevant line.[349] This is a more efficient and less costly process than requiring two technician visits to undertake the removal of existing jumpers and installation of new jumpers on two separate occasions. Combining the two processes also results in reduced downtime in the customer's service as a result of the churn.

14.3.3 Transfer Managed Network Migrations (MNMs)

The ACCC confirms its view that transfer MNMs should be treated as a matter for negotiation between Telstra and access seekers. The ACCC notes that it did not receive any submissions on this issue.

14.3.4 Cost of after-hours MNMs

The ACCC acknowledges that this issue has not been raised in previous access disputes. In addition, access seekers have not made submissions in support of including a provision requiring Telstra to complete jumpering work within a specified timeframe in the FADs.

The ACCC has concluded that a provision specifying a timeframe for completion of jumpering work should not be included in the FADs.

14.3.5 LSS MNM cancellation charge

No submissions were received from access seekers on including LSS MNM cancellation charges in the FADs. The ACCC has concluded that LSS MNM cancellation charges should not be included in the FADs.

14.3.6 LSS and ULLS MNM minimum exchange charges in Band 4

The ACCC notes that while demand for the ULLS is relatively low in Band 4, there are still a number of access seekers who do provide ULLS-based services in these areas. The ACCC notes that maintaining consistency with the provisions in the IADs will provide certainty to Telstra and access seekers in relation to this charge.

The ACCC confirms its view that ULLS MNM minimum exchange charges should apply to Band 4. The ACCC has not set a charge for LSS MNM minimum exchange charges in Band 4 because the number of LSS SIOs in Band 4 is negligible.

14.3.7 ACT Utilities Tax

The ACCC confirms its view that as the tax only applies to services within the ACT and the Jervis Bay area, it is not appropriate to include the tax in charges for work conducted outside those areas. The FADs state that the connection and disconnection charges are exclusive of this tax.

14.3.8 Band 4 charges for LSS single disconnections, ULLS MNM connections, ULLS cancellations and ULLS call diversion

The ACCC confirms its view that these charges should apply to services in Band 4.

The ACCC notes that Telstra was the only party to submit in favour of excluding Band 4 from the relevant charges. While demand for the ULLS is relatively low in Band 4, there are still a number of access seekers who do provide ULLS-based services in these areas. In addition, the ACCC considers that maintaining consistency

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[349] ACCC, *LSS Access Dispute, Telstra/Chime, Reasons for Final Determination,* April 2010, p. 98.

with the provisions in the IADs will promote certainty for Telstra and access seekers in relation to these charges.

14.3.9 LSS to ULLS migration charge

The issue of a LSS to ULLS migration process was included in the non-price terms and conditions section of the April 2011 Discussion Paper.

Apart from Herbert Geer, the ACCC has received no other submissions from parties on the introduction of a LSS to ULLS migration charge. If the ACCC was to receive further information from parties suggesting that a LSS to ULLS migration charge was necessary, it may consider this issue further at a later date.

14.4 Charges for 2011–12 to 2013–14

The ACCC's final connection and disconnection charges for 2011–12 to 2013–14 are set out in table 14.2 below.

Table 14.2 FAD connection and disconnection charges for regulatory period

	IAD charges	FAD Charges		
	Jan 2011–Dec 2011	**Jul 2011–Jun 2012**	**Jul 2012–Jun 2013**	**Jul 2013–Jun 2014**
LSS single connections (excluding Band 4)				
Per connection	$44.26	$45.04	$46.16	$47.55
LSS single disconnections (where payable)[a]				
Per disconnection	$39.74	$40.44	$41.45	$42.69
LSS MNM connection charges – where the service is to be connected on a line Telstra is using to supply a wholesale ADSL service (excluding Band 4)				
Fixed amount (per MNM)	$143.88	$146.40	$150.06	$154.56
Variable amount (per connection)	$33.07	$33.65	$34.49	$35.52
LSS MNM minimum exchange charge (excluding Band 4)				
Per exchange	$805.27	$819.36	$839.85	$865.04
ULLS single connection charges – in use ULLS and transfer ULLS connections				
Band 1	$51.76	$52.67	$53.98	$55.60
Band 2	$54.53	$55.49	$56.88	$58.58
Band 3	$59.26	$60.29	$61.80	$63.66
Charges for ULLS MNM – involving the transfer of end-user data services from a Telstra wholesale PSTN and/or ADSL service, or from a line that Telstra is using to supply a ULLS to another access seeker				
Fixed amount (per MNM)	$141.73	$144.21	$147.81	$152.25
Variable amount (per connection)	$25.68	$26.12	$26.78	$27.58
ULLS MNM minimum exchange charge				
Per exchange	$655.23	$666.69	$683.36	$703.86
ULLS call diversion charge				
Fixed amount (per ULLS call diversion)	$9.55	$9.72	$9.96	$10.26
Variable amount (pro rata per month)	$12.84	$13.06	$13.39	$13.79
ULLS cancellation charges				
Per service where pre-jumpering has occurred	$20.54	$20.90	$21.42	$22.06
Where entire MNM is cancelled	$141.73	$144.21	$147.81	$152.25

Note: [a] A disconnection charge is not payable if either: (a) the disconnection is made pursuant to a Telstra LSS churn process; or (b) the access seeker is participating in the Telstra LSS churn process and Telstra (BigPond) is not participating in the Telstra LSS churn process, where the service is being transferred to Telstra (BigPond). A disconnection charge is payable if: (c) the access seeker is participating in the Telstra LSS churn process and the service is being transferred to an access seeker that is not participating in the Telstra LSS churn process.

15 Fixed principles provisions

Key points

- The FADs contain fixed principles provisions that give form to the building block pricing framework and provide certainty over how the ACCC will estimate prices for the declared fixed line services in future regulatory periods.
- The fixed principles provisions will apply for a ten year period with a nominal termination date on 30 June 2021. This will give the industry pricing certainty during the transition to the NBN.

Setting fixed principles provisions can promote regulatory certainty, including certainty over time about the framework used to estimate access prices. They may also provide greater price stability.

15.1 April 2011 Discussion Paper view

As noted in the April 2011 Discussion Paper, an access determination may contain 'fixed principles provisions' that lock in certain matters until the nominal termination date.[350] Both price and non-price terms and conditions can be designated as fixed principles provisions.

The ACCC proposed to include in the FADs fixed principles provisions that would 'lock in' the pricing framework and provide the industry with certainty over time about how the ACCC would estimate prices for the declared fixed line services. The ACCC did not propose fixed principles provisions in respect of non-price terms and sought industry views on whether any non-price issues should be addressed in fixed principles provisions.

The preliminary fixed principles provisions proposed in the April 2011 Discussion Paper would 'lock in' the initial value of the RAB and specify the RAB roll-forward mechanism, certain processes for assessing forecasts of operating and capital expenditure and demand, and efficiency incentive mechanisms. To ensure consistency with the FLSM, the ACCC proposed to specify in fixed principles provisions the use of a real vanilla WACC and the methodology used to estimate the WACC parameters.

Recognising that the ACCC has not previously consulted explicitly on making fixed principles provisions, the ACCC sought industry submissions on the content of fixed principles provisions as well as specific suggestions on the design of the provisions.

Subsection 152BCD(2) requires that there must be a nominal termination date for fixed principles provisions, which may be later than the expiry date of the FAD. The ACCC's preliminary view was that the nominal termination date should be 30 June 2021.

[350] Subsection 152BCD(1) of the CCA.

15.2 Submissions

Submissions were generally supportive of the inclusion of fixed principles provisions in the FADs. Macquarie Telecom[351], Frontier Economics[352] and Herbert Geer[353] submitted that fixed principles provisions would increase industry certainty and allow for a shorter regulatory period. However, Macquarie Telecom and Optus submitted that since the ACCC has not set out specific fixed principles provisions for consultation, it would be appropriate for the ACCC to consult further before finalising the fixed principles provisions.[354]

Optus submitted that the ACCC should adopt a cautious approach, stating that 'it would be prudent to observe the operation of the regime in its initial stages before 'setting in stone' any principles or rules'.[355] It submitted that the ACCC should not set comprehensive fixed principles provisions in the current consultation but rather make 'a bare minimum number of fixed principles now'.[356] It submitted that the ACCC could make a fixed principles provision specifying the method of estimating prices through a BBM approach and leave open the option of consulting further on possible provisions for each of the BBM-specific parameters.[357]

Optus set out some 'initial views' on matters that could be addressed in fixed principles provisions, including locking in the initial RAB value, the general principles for setting cost allocation factors, and the ACCC's proposed methods for estimating some of the WACC parameters.[358]

Hebert Geer (on behalf of Adam Internet, Aussie Broadband, iiNet and Internode) submitted that the ACCC should only make fixed principles provisions 'if the principles are based upon data that it has verified as being complete and accurate'.[359] It opposed the inclusion of the ACCC's proposed efficiency mechanism provision, stating that 'the fixed principles should not prevent the ACCC from making adjustments to account for the difference between forecast expenditure and actual expenditure'.[360]

Macquarie Telecom also opposed the ACCC's proposed efficiency mechanism provision, stating that 'adjustments should be made for under and over expenditure forecasts'.[361] Macquarie Telecom submitted that without such adjustments, the access provider would have an incentive to continually over-state its forecasts. It also submitted that a cost pass-through provision should be included to deal with 'uncontrollable and unforeseeable events, such as a major natural disaster'.[362] In regard to the WACC parameters, Macquarie Telecom supported a provision that 'sets out the methods for determining the component values of the real vanilla WACC',

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351 Macquarie Telecom, Submission, 3 June 2011, p. 13.
352 Frontier Economics, Submission, June 2011, p. 27.
353 Herbert Geer, Submission, 3 June 2011, p. 28.
354 Macquarie Telecom, Submission, 3 June 2011, p. 13 and Optus, Submission, June 2011, p. 79.
355 Optus, Submission, June 2011, p. 78.
356 ibid.
357 Optus, Submission – Appendix H, June 2011, p. 43.
358 ibid.
359 Herbert Geer, Submission, 3 June 2011, p. 2.
360 ibid., p. 29.
361 Macquarie Telecom, Submission, 3 June 2011, p. 13.
362 ibid., p. 14.

apart from gamma, but stated that 'it would not be appropriate to set actual values for any WACC component'.[363]

Telstra submitted that the fixed principles provisions proposed in the April 2011 Discussion Paper 'do not currently achieve the stated aim of providing regulatory certainty and pricing stability'.[364] It submitted that the provisions need to be 'significantly strengthened'.[365]

Telstra proposed more detailed fixed principles provisions that specified the components of the revenue requirement, the initial RAB value, the RAB roll-forward mechanism (including proposed indexation of the RAB value), the methodology for estimating the WACC parameters (including setting a value for gamma), the process for forecasting expenditure and demand, and the cost allocation factors.[366] It also submitted that the provisions should specify that prices are in nominal terms and are exclusive of taxes.[367] Telstra submitted that the termination date for fixed principles provisions should be 30 June 2021.[368]

15.3 ACCC final view

The ACCC confirms its view that the fixed principles provisions will apply for a ten year period with a nominal termination date of 30 June 2021. The ACCC considers that this will give the industry sufficient certainty during the transition to the NBN.

In formulating fixed principles provisions, the ACCC has had regard to submissions that if the ACCC adopts a shorter regulatory period, it should provide sufficient certainty on its pricing framework through fixed principles provisions. As noted in chapter 4, the ACCC has decided to make FADs for a three-year regulatory period. The ACCC has therefore determined fixed principles provisions that set out in some detail the framework for estimating prices in the next and subsequent regulatory periods.

At the same time, the ACCC has recognised that there has been less consultation on fixed principles provisions than on the estimation of prices for the current regulatory period. The ACCC has therefore balanced industry's desire for certainty over the pricing framework with calls (in some submissions) for further consultation on the fixed principles provisions. If necessary, the ACCC may consider whether the provisions should be expanded during its consultation prior to the next regulatory period. At that time, the ACCC may also consider further whether fixed principles provisions should be made in respect of non-price issues.

The ACCC has included a provision allowing it to modify or remove a fixed principles provision in certain specified circumstances. These circumstances are intended to be strictly limited. In considering whether to revise the provisions, the ACCC must be satisfied that: there is manifest or material error in the provisions; information on which a provision was based was false or misleading; or an amendment is necessary to avoid an unintended consequence.

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363 ibid.
364 Telstra, Submission – Part A, June 2011, p. 73.
365 ibid.
366 ibid., pp. 75–83.
367 ibid., pp. 80–81.
368 ibid., p. 74.

The fixed principles provisions included in the FADs specify the framework for estimating prices for fixed line services using a BBM approach. The following provisions have been included in the FADs.

Initial RAB value

The fixed principles provisions specify that the opening RAB value is $15,515,621,288 as at 1 July 2011. During the ACCC's consultation on moving to a BBM approach, there has been general industry agreement that locking in the RAB value will promote pricing certainty for both the access provider and access seekers.

Initial tax asset value

The provisions specify that the opening tax asset value is $10,144,121,785 as at 1 July 2011.

Roll-forward mechanism

After the opening RAB value and opening tax asset value have been set, they are 'locked in' and rolled forward each year to reflect forecast capital expenditure, depreciation and asset disposals.

The roll-forward mechanism involves calculating the closing RAB value for each year by taking that year's opening RAB and adding the forecast for capital expenditure incurred that year and subtracting depreciation and asset disposals for the year. The opening RAB value for any regulatory year (after 2011–12) is equal to the closing RAB value for the previous year. The roll forward formula is discussed in chapter 6 of this report.

In rolling forward land asset values, these values will be indexed by the Consumer Price Index (CPI) where it is available, or by the forecast for the CPI used in the Fixed Line Services Model (FLSM) where the actual CPI is not available, to account for appreciation over time in land values.

In rolling forward RAB values in nominal terms, that is, in the current dollars as at 1 July of the relevant year, any variables that are specified in real terms will be indexed by the actual Consumer Price Index (CPI) where it is available, or by the forecast for the CPI used in the Fixed Line Services Model (FLSM) where the actual CPI is not available, to convert them into nominal terms. Any variables that are specified in nominal terms will not be indexed, with the exception of land values as specified above.

Components of the revenue requirement

The ACCC considers that the fixed principles provisions should specify the components of the revenue requirement as these components form the 'building blocks' of the BBM approach. Specifying the 'building blocks' will lock in the BBM framework for setting prices and provide certainty about the way the ACCC will estimate prices for future regulatory periods.

The annual revenue requirement for each regulatory year will comprise:

- a return on the RAB calculated by multiplying the WACC by the opening RAB for that regulatory year
- a return of the RAB, that is regulatory depreciation, for that regulatory year
- operating expenditure forecast to be incurred in that regulatory year, and

- an allowance for tax liabilities.

Operating expenditure forecasts

Under a BBM approach, forecast operating expenditures should reflect prudent and efficient costs. As noted in chapter 4, the ACCC intends to consult on making a record keeping rule (RKR) to obtain operating expenditure forecasts and supporting documentation from Telstra for future regulatory periods. The fixed principles provisions specify that, in assessing the reasonableness of Telstra's operating expenditure forecasts, the ACCC will take into account:

- the access provider's level of operating expenditure in the previous regulatory period
- the reasons and evidence supporting changes to operating expenditure in the next regulatory period
- any relevant regulatory obligations or requirements applicable to providing the declared fixed line services, and
- any other matters relevant to whether forecasting operating expenditures reflect prudent and efficient costs.

Further details about the required format for the forecasts, including their allocation to asset classes, and the nature of the required supporting documentation will be set out in the proposed RKR.

Capital expenditure forecasts

Under a BBM approach, forecast capital expenditures should reflect prudent and efficient costs. As noted in chapter 4, the ACCC intends to consult on making a record keeping rule (RKR) to obtain capital expenditure forecasts and supporting documentation from Telstra for future regulatory periods. The fixed principles provisions specify that, in assessing the reasonableness of Telstra's capital expenditure forecasts, the ACCC will take into account:

- the access provider's level of capital expenditure in the previous regulatory period
- the reasons and evidence supporting changes to capital expenditure in the next regulatory period
- whether the access provider's asset management and planning framework reflects best practice
- any relevant regulatory obligations or requirements applicable to providing the declared fixed line services, and
- any other matters relevant to whether forecast capital expenditures reflect prudent and efficient costs.

Further details about the required format for the forecasts, including their allocation to asset classes, and the nature of the required supporting documentation will be set out in the proposed RKR.

Demand forecasts

The ACCC considers that a fixed principles provision that specifies the process for assessing the access provider's demand forecasts is appropriate. The ACCC will take

into account any forecasts provided by the access provider and will consider whether the forecasts provided by the access provider:

- are based on an appropriate forecasting methodology
- are based on reasonable assumptions about the key drivers of demand
- utilise the best available information before the ACCC, including historical data that can identify trends in demand; and
- take into account current demand and economic conditions.

As noted in chapter 4, the ACCC intends to consult on making a record keeping rule (RKR) to obtain demand forecasts and supporting documentation from Telstra for future regulatory periods. Further details about the required format for the forecasts and the nature of the required supporting documentation will be set out in the proposed RKR.

Weighted average cost of capital

The fixed principles provisions specify that in calculating the weighted average cost of capital (WACC) used in the FLSM:

- A vanilla WACC is used to estimate the return on capital.
- The cost of equity is estimated using the Capital Asset Pricing Model.

The ACCC considers it is not appropriate to specify values for any of the WACC parameters in fixed principles provisions. In particular, the ACCC notes that 'locking in' a gamma value, as proposed by Telstra, could prevent the ACCC from having regard to potential future changes in the tax system.

Tax liabilities

The fixed principles provisions specify that the tax rate used in estimating tax liabilities in the FLSM will be set equal to the corporate tax rate specified in subsection 23(2) of the *Income Tax Rates Act 1986* (Cth).

Cost allocation factors

In relation to the cost allocation factors used to allocate the revenue requirement to particular declared fixed line services, the fixed principles provisions specify that:

- The allocation of the costs of operating the PSTN should reflect the relative usage of the network by various services.
- Direct costs should be attributed to the service.
- The cost allocation factors for shared costs should reflect causal relationships between supplying services and incurring costs.
- No cost should be allocated more than once to any service.
- The determination of cost allocation factors should reflect the principles above except where reliable information is not available to support the application of the principles.

16 Assessment of pricing approach against the subsection 152BCA(1) criteria

16.1 Adoption of the building block approach

16.1.1 Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE

A building block model (BBM) pricing methodology estimates prices that reflect efficient costs. The ACCC considers that adopting a BBM approach to setting prices for the declared fixed line services meets the objectives of promoting the LTIE because setting prices that reflect efficient costs will promote competition in the markets for carriage services and encourage efficient use of and investment in infrastructure.

Access prices that reflect efficient costs, and do not include any monopoly profits, will facilitate access to the infrastructure services required by access seekers to provide a range of communications services to end-users.

In addition, the ACCC considers that adopting a BBM approach will promote the LTIE for the following reasons:

- Locking-in a value for the RAB fosters predictable revenue and price paths, thereby minimising the likelihood of windfall gains or losses. This certainty promotes efficient use of and investment in infrastructure.
- The BBM approach ensures the access provider is adequately compensated for the cost of providing the declared fixed line services over time. The estimated revenue requirement allows the access provider to recoup its efficiently incurred costs, including a commercial return on its investments.
- Determining prices through a transparent and cost-based pricing model will provide regulatory certainty for both the access provider and access seekers about the way in which the ACCC will set prices. Such certainty promotes efficient investment and competition in the markets for carriage services.
- Using a BBM approach will ensure that prices for the declared fixed line services are based on the costs of providing access. This will promote a level playing field for access to the services needed to provide downstream services and promote competition in downstream markets.

AAPT submitted that it welcomes the ACCC's proposed shift to a BBM on the basis that such an approach will promote the LTIE.[369]

Frontier Economics submitted that it supports the broad thrust of the ACCC's move towards a BBM and 'locking in' a RAB value.[370]

In its submission to the September 2010 Draft Report, Telstra stated that it supported the move to a BBM with a locked-in RAB.[371]

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369 AAPT, Submission, 3 June 2011, p. 2.
370 Frontier Economics, Submission, June 2011, p. 2.
371 Telstra, Submission, 22 October 2010, p. 4.

The objective of achieving any-to-any connectivity is not relevant to adopting a building block approach as it does not concern connectivity between telecommunications networks.

16.1.2 Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

The ACCC considers that the access provider's legitimate business interests are met by adopting a BBM approach for the following reasons:

- The RAB places a value on the network assets used by the access provider in providing the declared fixed line services. The RAB is rolled forward each year to determine the opening value of the RAB for the next year. The roll-forward process updates the RAB to reflect forecasts for capital expenditure, depreciation and asset disposals for that year.
- The ACCC considers that a roll-forward process that allows for the recovery of investment costs will best promote the legitimate business interests of the access provider.
- Capital expenditure is added to the RAB through the roll-forward process. Capital expenditure contributes to the revenue requirement through the return on capital (given by the product of the weighted average cost of capital (WACC) and the RAB value) and through the return of capital (regulatory depreciation). This method ensures that investment costs are recovered over the lives of the relevant assets rather than all at once in the year in which the capital expenditure occurs. (In contrast, operating expenditure is added directly to the revenue requirement in the year in which it occurs.)
- The prices estimated using a BBM approach take into account forecast operating and capital expenditures on assets used to supply the declared fixed line services. Forecast tax liabilities are also taken into account to ensure that the access provider is able to recover all of the costs incurred in supplying the declared fixed line services.
- The BBM includes a return on capital through the WACC. The WACC provides a commercial rate of return that takes into account the commercial risks associated with providing the declared fixed line services. This gives the access provider an incentive to undertake efficient investments in the assets used to provide the declared fixed line services.
- The BBM includes an allowance for regulatory depreciation which enables the access provider to recover its investments in the assets used to provide the declared fixed line services over the lives of those assets.

16.1.3 Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the declared service

As noted in section 3.5.3, the ACCC considers that this criterion requires the ACCC to have regard to the interests of access seekers. The ACCC has had regard to the interests of access seekers in adopting the BBM approach to setting prices for the declared fixed line services.

Adopting a BBM approach provides pricing certainty for access seekers about the cost basis for the prices and the way the ACCC will set prices in future regulatory periods.

This will assist access seekers in making informed decisions on investments in digital subscriber line access multiplexers (DSLAMs) and other assets used to provide competing telecommunications services in downstream markets.

The ACCC has given weight to access seekers' interests in determining the values of the parameters used in the BBM.

16.1.4 Paragraph 152BCA(1)(d) – direct cost of providing access to the declared service

The ACCC considers that the BBM approach ensures that the direct costs of providing access to the declared fixed line services are included in the revenue requirement used to calculate prices. The revenue requirement calculated using a BBM approach includes an allowance for all of the costs incurred in providing the declared fixed line services. These costs are forecast direct and indirect operating costs, a return on and of capital, and tax liabilities.

Where joint and common costs are incurred in providing a number of services, cost allocation factors are used in the BBM to ensure that the aggregate revenue requirement is appropriately allocated to services. The cost allocation factors are based on the directly attributable costs of providing specific services, as well as a share of non-attributable costs.

16.1.5 Paragraph 152BCA(1)(e) – the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else

The ACCC is of the view that this criterion is not relevant to its decision to adopt a BBM approach to setting prices for the declared fixed line services.

16.1.6 Paragraph 152BCA(1)(f) – the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

The ACCC considers that the BBM approach will not compromise the safe and reliable operation of any carriage service, telecommunications network or facility.

The efficient costs of providing the declared fixed line services during the regulatory period are included in the FLSM. This will allow the access provider to recover the costs of necessary maintenance expenditures and network asset replacement costs required to ensure that the declared fixed line services are provided in a safe and reliable manner.

16.1.7 Paragraph 152BCA(1)(g) – the economically efficient operation of a carriage service, a telecommunications network or a facility

The ACCC considers that adopting a BBM approach to setting prices for the declared fixed line services will encourage the efficient operation of carriage services provided on the PSTN.

Under the BBM approach, only efficient costs are included in calculating the revenue requirement that is used in estimating prices. In addition, the proposed efficiency benefit sharing scheme for operating and capital expenditures will give the access provider an incentive to improve its efficiency.

16.1.8 Paragraph 152BCA(2) – the supply of one or more other eligible services

The ACCC considers that the BBM approach takes into consideration the costs and revenues associated with other eligible services supplied using the PSTN.

The cost allocation factors in the BBM ensure that only those costs incurred in providing the declared fixed line services are allocated to the declared fixed line services. The costs and revenues associated with providing other services over the PSTN are not included in the revenue requirement for the declared fixed line services.

16.2 The initial value of the regulatory asset base

16.2.1 Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE

The ACCC considers that the LTIE is promoted by 'locking-in' a value for the RAB as it provides predictable revenue and price paths. This predictability minimises the likelihood of windfall gains or losses to the access provider and access seekers. Certainty about the asset base used in estimating prices will promote economically efficient investment in, and the use of, infrastructure.

In determining an initial RAB value for the CAN and Core assets, the ACCC has had regard to promoting the legitimate business interest of both the access provider and access seekers.

Frontier Economics submitted that it is concerned about the apparent priority placed on maintaining 'price stability' for the ULLS in determining the initial RAB value.[372] It submitted that the ACCC's approach to setting the initial RAB value is not 'likely to meet the section 152BCA legislative criteria, and in particular the long-term interests of end-users (LTIE)'.[373] AAPT submitted that it supported Frontier Economics' analysis.[374]

In determining the initial RAB value, the ACCC was guided by the principle that pricing stability is desirable to the extent that it supports previous investments and promotes industry confidence in making future investments. The ACCC considers that the ULLS pricing stability provided by its approach to setting the initial RAB value is in the LTIE because it will promote economically efficient investment in, and the use of, infrastructure.

The ACCC has consistently sought to promote competition by encouraging access seeker infrastructure investments. As a result, there has been significant growth in DSLAM investments as access seekers have increasingly competed on price and service offerings in downstream markets. The ACCC considers that such competition results in price and service offerings that best meet the needs of end-users and is therefore in the LTIE.

Infrastructure based competition has, to date, occurred predominantly in Band 2 ESAs. Consequently, the ACCC considers that stability in the Band 2 ULLS price in

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372 Frontier Economics, Submission, p. 1.
373 ibid., pp. 1–2.
374 AAPT, Submission, 3 June 2011, p. 6.

transitioning to the BBM approach will support these infrastructure investments and underpin competition in the downstream markets, which is in the LTIE.

Herbert Geer submitted (on behalf of Adam Internet, Aussie Broadband, iiNet and Internode) that setting an initial value of the RAB that does not take into consideration Telstra's past over-recovery will not be in the LTIE.[375] It also submitted that setting an initial RAB value that leads to Telstra over-recovering its past investments will result in end users paying more than once for those investments and this will not promote the LTIE.[376]

In contrast, Telstra submitted that the Regulatory Accounting Framework (RAF) accounts do not accurately reflect actual depreciation received and therefore overstate past recovery. Telstra also submitted that the use of a depreciated actual cost (DAC) approach will be highly misleading, de-linking the network's value from the value of actual historical capital expenditure.[377]

In setting the initial RAB value, the ACCC has taken into account past depreciation received by Telstra to ensure that access seekers, and in turn end-users, are not charged more than once for Telstra's costs of investing in its network assets. The ACCC has concluded that it is impossible to reach definitive conclusions about the level of Telstra's past cost recovery due to the limitations of the available data, particularly in regard to long-lived assets.

The ACCC has considered the available evidence from Telstra's RAF accounts, asset register, annual reports and information provided in submissions. The ACCC's detailed analysis (set out in the April 2011 Discussion Paper) supports a conclusion that Telstra is unlikely, on average, to have under-recovered depreciation on its network assets under the previous TSLRIC+ approach. The ACCC considers that by using the DAC value of Telstra's assets as a starting point for calculating an initial RAB value within the range of suitable values, it has taken into account Telstra's past recovery.

The ACCC considers that the objective of achieving any-to-any connectivity is not relevant to determining the initial RAB value as it does not affect connectivity between telecommunications networks.

16.2.2 Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

In determining an initial RAB value for the CAN and Core assets, the ACCC considered the legitimate business interests of the access provider, Telstra. The ACCC adopted an approach to setting the initial RAB value that would allow the access provider to recover its previous costs of investing in sunk infrastructure as well as its efficient and prudent costs of investment in new network assets.

While there is no uniquely 'correct' value for the initial RAB, the ACCC considers that its approach to developing the initial RAB value protects the legitimate business interest of the access provider. The ACCC used the DAC value that forms the lower bound of the suitable range as a starting point and adjusted this value to (i) reflect the typical appreciation over time of land asset values and (ii) to increase the value of the

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375 Herbert Geer, Submission, 3 June 2011, p. 2.
376 ibid.
377 Telstra, Submission – Part A, 3 June 2011, p. 10.

'ducts and pipes' asset class in recognition of the limitations of Telstra's RAF accounts.

In increasing the value of the 'ducts and pipes' asset class, the ACCC took the view that the economic value of these assets is likely to be substantially higher than their depreciated historic values as recorded in the RAF accounts. Since these assets are long-lived, they are more susceptible to the limitations of past accounting practices than other network assets in establishing a value based on accounting records. In addition, these assets represent infrastructure that will be of use beyond the life of the current copper network. In particular, ducts and pipes are likely to be of continuing economic value for a fibre based network.

Telstra submitted that, like any other infrastructure owner, it has a legitimate interest in recovering the remaining economic value of its fixed network investments.[378] The ACCC considers that its methodology for determining the initial RAB value, and the increment to the value of the 'ducts and pipes' asset class, address Telstra's concern.

Optus submitted that in setting the initial RAB, the guiding principle is that the access provider should be compensated for the actual investment it has made in its assets, and no more.[379] Optus also submitted that by valuing Telstra's assets higher than its residual costs, the proposed RAB value is inconsistent with the 'legitimate business interests'.[380]

The ACCC considers that the two adjustments to the DAC value of Telstra's assets are appropriate and that these adjustments are in the access provider's legitimate business interests.

16.2.3 Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the declared service

As noted in section 3.5.3, the ACCC considers that this criterion requires the ACCC to have regard to the interests of access seekers. The ACCC has considered the interests of access seekers in determining the initial RAB value.

In determining the initial RAB value, the ACCC was guided by the principle that pricing stability is desirable to the extent that it supports previous investments and promotes industry confidence in making future investments. In its previous regulatory decisions, the ACCC has consistently sought to promote competition by encouraging access seeker infrastructure investments. As a result, there has been significant growth in digital subscriber line access multiplexer (DSLAM) investments, predominantly in Band 2 ESAs.

The ACCC considers that this criterion requires the ACCC to have regard to the legitimate business interests of access seekers. The ACCC considers that stability in the Band 2 ULLS price in transitioning to the BBM approach will support access seekers' infrastructure investments. This consideration was relevant to the ACCC's view that a clear justification is required for setting an initial RAB value that results in a significant change to the existing Band 2 ULLS price. The ACCC has, therefore, had regard to a $16.00 'tie-point' for the Band 2 ULLS price in determining the initial RAB value.

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[378] ibid., p. 6.
[379] Optus, Submission, June 2011, p. 7.
[380] ibid., p. 8.

16.2.4 Paragraph 152BCA(1)(d) – direct cost of providing access to the declared service

The BBM approach ensures that the direct costs of providing access to the declared fixed line services are included in the revenue requirement used to calculate prices. The revenue requirement includes an allowance for all of the costs incurred in providing the declared fixed line services, including a return on and of capital. The return on and of capital is calculated on the basis of the initial RAB value, which is subsequently rolled over to add net capital expenditure on new network assets.

The ACCC has set an initial RAB value that allows the access provider to recover its previous costs of investing in sunk infrastructure as well as its efficient and prudent costs of investment in new network assets.

16.2.5 Paragraph 152BCA(1)(e) – the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else

The ACCC is of the view that this criterion is not relevant to determining the initial RAB value.

16.2.6 Paragraph 152BCA(1)(f) – the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

The ACCC considers that the initial RAB value will not compromise the safe and reliable operation of any carriage service, telecommunications network or facility.

The FLSM rolls forward the RAB at the end of each year to determine the opening value of the RAB for the next year. The roll-forward process updates the RAB to reflect forecasts for capital expenditure, depreciation and asset disposals for that year. This will allow the access provider to recover the costs of necessary network asset replacement costs required to ensure that the declared fixed line services are provided in a safe and reliable manner.

16.2.7 Paragraph 152BCA(1)(g) – the economically efficient operation of a carriage service, a telecommunications network or a facility

Setting the initial RAB value to allow the access provider to recover the costs of its past investments promotes confidence by the access provider and other industry participants that the regulatory framework will allow them to recover the costs of future investments. This will in turn promote the economically efficient operation of carriage services provided on the PSTN and the economically efficient operation of the CAN and Core network.

16.2.8 Paragraph 152BCA(2) – the supply of one or more other eligible services

The RAB includes the assets used to provide the declared fixed line services as well as other eligible services supplied on the PSTN. Other services include other declared services that use the PSTN (such as the DTCS and MTAS) and non-regulated services provided using the PSTN, such as Telstra's retail fixed line services, wholesale ADSL, and some transmission and mobile services.

Where assets included in the RAB are used to provide a number of services, cost allocation factors are used in the FLSM to ensure that costs are appropriately allocated to the services supplied using those assets.

16.3 Cost allocation factors

16.3.1 Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE

The ACCC has considered the LTIE in determining the appropriate cost allocation factors used in the FLSM. The FLSM calculates the total costs of supplying all the services provided using the CAN and Core assets included in the RAB. These costs form the aggregate revenue requirement for a broad range of services provided across the PSTN, including the six declared fixed line services.

To calculate the revenue to be recovered from each of the declared fixed line services, an appropriate share of the aggregate revenue requirement must be allocated to each of these services. This is derived by applying cost allocation factors to the total operating, capital and tax costs associated with each of the asset classes in the FLSM. The cost allocation factors represent the share of costs incurred in supplying a particular service. Setting prices that reflect efficient costs will promote competition in the markets for carriage services and encourage efficient use of and investment in infrastructure.

The ACCC has determined cost allocation factors for allocating the costs of the 'ducts and pipes' and 'copper cables' asset classes to the ULLS and WLR service that reflect the differential costs of providing these services in the four geographic bands. Prices for ULLS and the WLR service will therefore reflect the underlying costs of supplying these services in different geographic areas. Cost-reflective prices will encourage the efficient use of, and investment in, infrastructure.

The ACCC considers that the cost allocation factors used in the FLSM ensure that the efficiently incurred costs of providing the declared fixed line services are included in the revenue recovered from each of the declared fixed line services during the regulatory period. By setting wholesale access prices based on efficient costs, access seekers will be better able to compete in downstream markets.

The objective of achieving any-to-any connectivity is not relevant to determining the appropriate cost allocation factors as it does not affect connectivity between telecommunications networks.

16.3.2 Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

The ACCC has had regard to the legitimate business interests of the access provider in determining the cost allocation factors.

The ACCC considers that the cost allocation factors used in the FLSM to derive wholesale access prices will enable the access provider to recover its efficient costs of supplying access to the declared fixed line services.

Telstra submitted that the ACCC assumes unit costs remain constant over time, irrespective of declines in demand. It submitted that this approach allocates unit costs on the basis of fictional levels of SIOs and OTA minutes[381] and stated that:

> This has the effect of allocating costs to services that do not exist such that Telstra:
> - cannot recover the value of its investments as valued by the Commission; and
> - will not recover its actual forward-looking operating and capital expenditure costs.[382]

Telstra also submitted that notwithstanding the reasons for the decline in total demand, it has a legitimate business interest in recovering the unit costs of providing fixed line access services, irrespective of whether they may be higher under a lower service/demand base than they have been in the past.[383]

The ACCC considers that Telstra's legitimate business interests do not require that it should be compensated, through adjustments to the cost allocation factors, for declining demand for the fixed line services or for loss of market share. The ACCC considers that Telstra has been appropriately compensated for these business risks through the risk premium included in the commercial rate of return provided by the WACC.

16.3.3 Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the declared service

The ACCC has had regard to the interests of access seekers in determining the cost allocation factors used in the FLSM.

The cost allocation factors allocate costs to the declared fixed line services used by access seekers and have been determined to reflect the relative usage of the assets in supplying each of the declared fixed line services. The ACCC considers that the cost allocation factors used to derive wholesale access prices will enable the access provider to recover its efficient costs of supplying access to the declared fixed line services. They will also prevent the access provider from shifting additional costs to the declared fixed line services.

Access prices that reflect efficient costs will support efficient investments by access seekers. In addition, such prices will promote efficient investment decisions by the access provider in the network assets used to supply the declared fixed line services. Efficient investment in network assets will, in turn, support the provision of services that meet the needs of access seekers in relation to quality and availability.

16.3.4 Paragraph 152BCA(1)(d) – direct cost of providing access to the declared service

The FLSM calculates the total costs of supplying all the services provided using the CAN and Core assets included in the RAB. These costs form the aggregate revenue requirement for a broad range of services provided across the PSTN, including the six declared fixed line services, other declared services and Telstra's retail services.

To calculate the revenue to be recovered from each of the declared fixed line services, an appropriate share of the aggregate revenue requirement must be allocated to each of these services. These shares are determined by the cost allocation factors.

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381 Telstra, Submission – Part A, 3 June 2011, p. 84.
382 ibid., p. 36.
383 ibid., p. 38.

The ACCC has identified and included the direct costs of providing access to the declared fixed line services in the FLSM. The cost allocation factors used in the FLSM allocate an appropriate share of directly attributable costs to the relevant service. The share of attributable costs allocated to a particular service is based on usage of the assets used to provide the service. For costs that cannot be attributed to particular services, such as corporate overheads, the cost allocation factors allocate a share of these indirect costs to services based on allocation rules broadly related to each service's usage of network assets.

In regard to connections, disconnections and managed network migrations, the ACCC considers that the proposed charges will cover the access provider's direct costs of providing those services.

16.3.5 Paragraph 152BCA(1)(e) – the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else

The cost allocation factors used in the FLSM do not allocate to the declared services costs that are borne by someone else. The cost allocation methodology ensures that costs are not allocated more than once.

16.3.6 Paragraph 152BCA(1)(f) – the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

The ACCC considers the cost allocation factors used in the FLSM will contribute to promoting the safe and reliable operation of the declared fixed line services and the access provider's CAN and Core networks.

The cost allocation factors used in the FLSM ensure that the revenue requirement for each of the declared fixed line services will cover the efficient costs of providing that service. These costs included the costs of maintenance and asset replacements that are needed to meet the operational and technical requirements necessary for the safe and reliable operation of the declared fixed services and the access provider's CAN and Core networks. By ensuring that the access provider can meet the costs associated with meeting these operational and technical requirements, the cost allocation factors will provide an incentive for the access provider to undertake the necessary expenditures.

16.3.7 Paragraph 152BCA(1)(g) – the economically efficient operation of a carriage service, a telecommunications network or a facility

The ACCC considers that the cost allocation factors used in the FLSM will encourage the efficient operation of carriage services provided on the PSTN. This incentive is created by ensuring that the cost allocation factors only allocate efficient costs to the declared fixed line services.

The ACCC considers that its cost allocation methodology will provide the access provider with an incentive to operate the network efficiently, to provide the declared fixed line services efficiently, and undertake efficient investments in the assets used to provide those services.

16.3.8 Paragraph 152BCA(2) – the supply of one or more other eligible services

The PSTN is used to provide a range of services, including the six declared fixed line services, other declared services and Telstra's retail services.

The cost allocation factors used in the FLSM ensure that costs are allocated to services based on relative usage of assets in supplying each of the services using that asset. Where costs cannot be directly attributable to assets, such as network buildings and indirect capital assets, the cost allocation factor attributes a share of costs based on a proxy measure that broadly reflects expected usage of the relevant assets.

The cost allocation factors allocate an appropriate share of costs associated with a network asset to all of the services provided using that asset.

16.4 Prices for the declared fixed line services

16.4.1 Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE

The ACCC has utilised its FLSM which estimates prices based on the efficient costs of providing the declared fixed line services. The ACCC considers that the prices included in the FADs reflect efficient costs and will promote competition in the markets for carriage services, thereby promoting the LTIE.

By setting wholesale access prices for the declared fixed line services that are based on efficient costs, access seekers will be better able to provide competitive services in retail markets. Moreover, these prices will provide appropriate pricing signals for access seekers' decisions on market entry and infrastructure investments (such as investment in DSLAMs).

Setting prices that allow the access provider to recoup its efficiently incurred costs, including a commercial return on its investments, will also encourage the efficient use of, and investment in, the infrastructure used to provide the declared fixed line services.

The ACCC considers that setting a single price for each declared fixed line service over the regulatory period, by averaging the annual prices estimated by the FLSM, will promote certainty and stability over the regulatory period. This certainty and stability will, in turn, promote competition and the efficient use of, and investment in, the infrastructure, both by the access provider and access seekers.

The ACCC considers that the price structures adopted for each of the declared fixed line services are in the LTIE.

In regard to the ULLS, the ACCC is of the view that an averaged Band 1–3 ULLS price will promote the LTIE in a number of ways, including by simplifying the price structure. Further, setting an averaged price for Bands 1–3 may ease the transition to nationally averaged wholesale pricing for the NBN and promote industry stability. The ACCC considers that these expected industry benefits would underpin competition and the efficient use of, and investment in, the infrastructure.

In addition, the ACCC considers that the reduction in the ULLS price in Band 3 may promote further DSLAM investment, and competition, in Band 3 ESAs. The ACCC has noted Optus' submission that access seekers' investments may not increase

significantly in Band 3.[384] However, the ACCC considers that any additional investment promoted by the Band 3 price reduction will promote the LTIE.

The ACCC considers that the evidence does not support AAPT's submission that an averaged Band 1–3 ULLS price would cause prices to depart significantly from the underlying costs of supplying ULLS in the geographic bands.[385] As the ACCC noted in the April 2011 Discussion Paper, Bands 1–3 share similar characteristics and the ACCC's more robust methodology for estimating geographic costs indicates that the cost differential between Bands 2 and 3 is narrower than previously thought. The ACCC considers that AAPT's concern is addressed by setting a separate Band 4 price that ensures that the much higher cost of providing services in Band 4, compared to the other three bands, is reflected in the price.

Setting WLR prices on a nationally averaged basis is consistent with the Government's current arrangements for setting retail prices. The ACCC considers that consistency between wholesale and retail line rental price structures will promote downstream competition, which is in the LTIE.

In regard to the PSTN OTA service, the ACCC considers that setting a national average price is in the LTIE because the price reflects the underlying costs of providing the service. The ACCC considers that setting a pricing matrix using inaccurate cost relativities would not be in the LTIE.

In reaching this view, the ACCC has considered submissions by Telstra and Frontier Economics that a national average PSTN OTA price would not be in the LTIE. Telstra stated that a national average price would not be economically efficient, would give incorrect price signals, distort consumption patterns, and harm competitive neutrality.[386] Frontier Economics submitted that the LTIE would be better served by specifying geographically differentiated charges. It stated that an average price could deter efficient competition in lower-cost areas, encourage inefficient competition in higher cost areas, and would be unlikely to promote efficient investment or efficient use of infrastructure.[387]

The ACCC considers that it is open to the access provider and an access seeker to negotiate an appropriate pricing structure that takes into account the access seeker's own traffic pattern and average call duration. A negotiated pricing structure could therefore reflect the access seeker's own circumstances, which would be in the LTIE.

Optus submitted that setting a single national PSTN OTA price is consistent with the LTIE criteria because it will enable Telstra to recover its costs and, by better reflecting retail price structures, it will promote competition.[388]

The ACCC also considers that the connection, disconnection and managed network migration charges for the LSS and the ULLS promote the LTIE. Setting the charges to reflect the estimated costs involved in providing these services will promote competition. The charges passed on to end-users who change service providers will therefore be able to reflect the costs incurred in churning to another service provider.

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384 Optus, Submission, June 2011, p. 13.
385 AAPT, Submission, 3 June 2011, p. 4.
386 Telstra, Submission – Part A , 3 June 2011, p. 71.
387 Frontier Economics, Submission, June 2011, pp. 28–30.
388 Optus, Submission, June 2011, p.28.

The objective of achieving any-to-any connectivity is not relevant to estimating prices, as it does not concern connectivity between telecommunications networks.

16.4.2 Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

The ACCC considers that the legitimate business interests of the access provider are promoted by setting access prices that allow it to recover its efficient costs of supplying the declared fixed line services. Wholesale access prices that reflect efficient costs will support efficient investment decisions by the access provider.

Herbert Geer submitted that if Telstra is permitted to recover its reasonable costs, its legitimate business interests will be fulfilled and it will have sufficient incentive to make the necessary investments in its infrastructure.[389]

Frontier Economics submitted that the prices proposed to be included in the FADs would enable the access provider to earn returns greater than those necessary to meet its legitimate business interests, reflecting its view on the initial RAB value.[390] As explained in section 16.2 above, the ACCC considers that the initial RAB value meets the legislative criteria.

Telstra submitted that the ACCC's weighting method for setting a nationally averaged WLR price will result in a price that is lower than the average cost of lines.[391] The ACCC's calculations indicate that the WLR price will allow Telstra to recover its efficient costs, which meets Telstra's legitimate business interests.

Telstra also submitted that a national averaged PSTN OTA price would leave it with a revenue shortfall due to the geographic traffic pattern and that the proposed price would lead to disputation.[392] It stated that these expected outcomes were not in its legitimate business interests. The ACCC's calculations indicate that the PSTN OTA price will allow Telstra to recover its efficient costs, which is in Telstra's legitimate business interests. The ACCC considers that allowing Telstra to negotiate a pricing matrix that takes into account the access seeker's geographic traffic patterns is in Telstra's legitimate business interests.

In its report for Optus on PSTN OTA rate structures, CEG stated that a national average price is consistent with the access provider's legitimate business interests.[393]

The ACCC considers that the charges for connection, disconnection and managed network migration promote the legitimate business interests of the access provider as they are set to recover the costs of providing these services.

16.4.3 Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the declared service

The ACCC has given weight to access seekers' interests in determining the values of the assumptions and inputs used in the FLSM to estimate the prices for the declared fixed line services.

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389 Herbert Geer, Submission, 3 June 2011, p. 7.
390 Frontier Economics, Submission, June 2011, p. 10.
391 Telstra, Submission – Part A, 3 June 2011, p. 72.
392 ibid., 3 June 2011, p. 71.
393 CEG, PSTN OTA rate structures – A report for Optus, June 2011, p. 28.

The prices included in the FADs will prevent the access provider from leveraging its market power by charging wholesale access prices that include monopoly profits. Access prices that included monopoly profits would unfairly disadvantage access seekers in seeking to compete against the access provider in providing communications services to end-users.

Wholesale access prices that reflect efficient costs will support efficient investments by access seekers. In addition, such prices will promote efficient investment decisions by the access provider in the network assets used to supply the declared fixed line services. Efficient investment in network assets will support the provision of services that meet the needs of access seekers in relation to quality and availability.

The ACCC's decision on ULLS price stability will support access seekers' past investments in infrastructure, promote confidence in undertaking future investments, and promote the efficient use of, and investment in, infrastructure.

The ACCC has taken into account the legitimate business interests of access seekers by setting a single price for each of the declared fixed line services for the regulatory period. This price stability should assist access seekers in assessing the commercial viability of market entry and investments in DSLAMs and other assets used to provide competing telecommunications services in downstream markets.

16.4.4 Paragraph 152BCA(1)(d) – direct cost of providing access to the declared service

The ACCC considers that the prices for the declared fixed line services will allow the access provider to recover its direct costs of providing access to these services.

The ACCC has identified and included the direct costs of providing access to the declared fixed line services in the FLSM. The cost allocation factors used in the FLSM allocate directly attributable costs to the relevant service. For costs that cannot be directly attributed to services, the cost allocation factors allocate a share of these indirect costs to services based on allocation rules broadly related to the service's usage of network assets.

The ACCC considers that the proposed charges for connection, disconnection and managed network migration will allow the access provider to recover the direct costs of providing those services.

16.4.5 Paragraph 152BCA(1)(e) – the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else

The ACCC considers that this criterion is not directly relevant to setting prices for the declared fixed line services.

16.4.6 Paragraph 152BCA(1)(f) – the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

The ACCC is of the view that the prices for the declared fixed line services will contribute to promoting the safe and reliable operation of the declared fixed line services and the access provider's CAN and Core networks.

The prices set for each of the declared fixed line services will recover the efficient costs of providing those services. These costs include the costs of maintenance and asset replacements that are needed to meet the operational and technical requirements necessary for the safe and reliable operation of the declared fixed line services and the access provider's CAN and Core networks. By ensuring that the access provider can meet the costs associated with these operational and technical requirements, the prices will provide an incentive for the access provider to undertake the necessary expenditures.

16.4.7 Paragraph 152BCA(1)(g) – the economically efficient operation of a carriage service, a telecommunications network or a facility

The ACCC considers that setting cost-based prices for the declared fixed line services will encourage the efficient operation of carriage services provided on the PSTN.

Setting prices that recover efficient costs provides the access provider with an incentive to operate its network efficiently, to provide the declared fixed line services efficiently, and undertake efficient investments in the assets used to provide those services.

16.4.8 Paragraph 152BCA(2) – the supply of one or more other eligible services

In determining the prices for the declared fixed line services, the ACCC has taken into account the costs and revenues associated with providing other services over the PSTN. The cost allocation factors in the FLSM ensure that only those costs incurred in providing the declared fixed line services are allocated to those services in estimating the relevant prices.

The ACCC has also taken into account the different costs of providing ULLS, WLR and other services (including Telstra's retail services) in different geographic areas. ULLS and WLR prices have been estimated on the basis of the different costs of supplying these services in the four geographic bands.

16.5 Length of the regulatory period

16.5.1 Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE

In determining the length of the regulatory period, the ACCC had regard to the views expressed in submissions. All submissions to the April 2011 Discussion Paper, apart from Telstra's, supported a regulatory period of no more than three years. Telstra's submission did not comment specifically on the length of the regulatory period.

The ACCC considers that a three-year regulatory period should provide sufficient price certainty to support the access provider and access seekers in making efficient investment decisions. This certainty will assist the access provider in assessing the commercial viability of future investments in infrastructure services. It will assist access seekers in assessing the commercial viability of market entry and investments in DSLAMs and other assets used to provide competing telecommunications services in downstream markets.

By reducing the risks associated with these investment decisions, price certainty will promote competition in the supply of communications services to end-users.

The ACCC considers that setting a three-year regulatory period will also reduce the regulatory burden on industry as it will reduce the frequency of consultations and public inquiries. This will in turn reduce the costs of participating in regulatory processes, which will reduce the costs passed on to end-users. The ACCC considers that reducing the regulatory burden on industry is, therefore, in the LTIE.

The objective of achieving any-to-any connectivity is not relevant to the length of the regulatory period as it does not affect connectivity between telecommunications networks.

16.5.2 Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

The ACCC considers that setting a three-year regulatory period is consistent with the legitimate business interests of the access provider. As noted above in regard to the promotion of the LTIE, price certainty will reduce the risks associated with investment decisions. The price information will ensure the access provider has more information to assist it in making commercial decisions.

A three-year regulatory period will also reduce the regulatory burden on the access provider from frequent price reviews, including providing information required by the ACCC (including forecast information) and participating in consultation processes.

16.5.3 Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the declared service

All access seekers submitted that the regulatory period should be no longer than three years.

The ACCC considers that setting a three-year regulatory period is consistent with the legitimate business interests of access seekers. As noted above in regard to the promotion of the LTIE, price certainty will reduce the risks associated with access seeker investments in DSLAMs and other assets used to provide competing telecommunications services in downstream markets.

Price certainty for three years will assist the access provider in making commercial decisions on market entry and the supply of communication services to end-users.

A three-year regulatory period will also reduce the regulatory burden on access seekers from participating in consultation processes on determining prices for the declared fixed line services.

16.5.4 Paragraph 152BCA(1)(d) – direct cost of providing access to the declared service

Under the efficiency incentive mechanisms proposed by the ACCC, the access provider will be allowed to retain any costs savings achieved through efficiency improvements until the next regulatory period. The ACCC considers that a three-year regulatory period will provide the access provider with sufficient efficiency incentives to reduce the direct costs of providing access to the declared fixed line services.

16.5.5 Paragraph 152BCA(1)(e) – the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else

The ACCC is of the view that this criterion is not relevant to its decision to set a three-year regulatory period.

16.5.6 Paragraph 152BCA(1)(f) – the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

The ACCC is of the view that a three-year regulatory period will provide sufficient certainty to the access provider that it will be able to recoup the costs of expenditures necessary to ensure the safe and reliable operation of the carriage services it provides and its PSTN.

16.5.7 Paragraph 152BCA(1)(g) – the economically efficient operation of a carriage service, a telecommunications network or a facility

The ACCC considers that the a three-year regulatory period will provide certainty to the access provider that it will be able to recoup the costs of expenditures necessary to ensure the economically efficient operation of the carriage services it provides and its PSTN.

The certainty provided by a three-year regulatory period will also assist the access provider in assessing the commercial viability of investments which ensure the efficient operation of the PSTN. It will also reduce the risks associated with such investments.

16.5.8 Paragraph 152BCA(2) – the supply of one or more other eligible services

The ACCC is of the view that this criterion is not relevant to its decision to set a three-year regulatory period.

16.6 Fixed principles provisions

16.6.1 Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE

The ACCC considers that making fixed principles provisions will promote the LTIE by providing certainty about how the ACCC will estimate prices for the declared fixed line services after the end of the regulatory period.

The fixed principles provisions included in the FADs specify the cost components (or 'building blocks') used to estimate the revenue requirement. These components determine the key elements of the pricing framework. Certainty over time in the pricing framework will assist industry participants in their business and investment planning, including during the transition to the NBN, and facilitate their capacity to compete in providing telecommunications services.

The fixed principles provisions included in the FADs also specify the initial values for the RAB and the tax asset value as at 1 July 2011. The ACCC considers that locking in these initial RAB values will contribute to continuity and predictability in moving from one regulatory period to the next. The ACCC considers revaluation of an existing RAB could create uncertainty for Telstra and the access seekers. It could also result in price shocks and windfall gains or losses to industry participants. Further, the periodic revaluation of sunk assets could result in the access provider facing an unpredictable revenue stream that could deter efficient investment.

For these reasons, the ACCC considers that the fixed principles provisions included in the FADs are in the LTIE.

Telstra submitted that fixed principles provisions that provide regulatory certainty and pricing stability will be consistent with the relevant legislative criteria in s.152BCA of the CCA, in particular, the promotion of the LTIE and the interests of all persons who have rights to use the relevant declared services.[394]

The objective of achieving any-to-any connectivity is not relevant to the fixed principles provisions included in the FADs as they do not impact on connectivity between telecommunications networks.

16.6.2 Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

The ACCC considers that the fixed principles provisions included in the FADs are consistent with the legitimate business interests of the access provider.

As noted above in relation to the LTIE, the fixed principles provisions specify the cost components (or 'building blocks') used to estimate the revenue requirement. These components determine the key elements of the pricing framework. Certainty over time in the pricing framework will promote confidence by the access provider that it will be able to recover its efficient costs in providing the declared fixed line services. It will also assist the access provider in its business and investment planning and promote confidence by the access provider that it will be able to recover its efficient investments in infrastructure used to provide the declared fixed line services.

As noted above in relation to the LTIE, the fixed principles provisions included in the FADs also specify the initial values for the RAB and the tax asset value as at 1 July 2011. The ACCC considers that locking in these initial RAB values will contribute to continuity and predictability in moving from one regulatory period to the next, which is in the access provider's legitimate business interests.

The ACCC considers revaluation of an existing RAB could create uncertainty for the access provider. It could also result in price shocks and windfall gains or losses to the access provider. Further, the periodic revaluation of sunk assets could result in the access provider facing an unpredictable revenue stream that could deter efficient investment.

16.6.3 Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the declared service

Submissions by access seekers generally supported the inclusion of fixed principles provisions in the FADs although there was some disagreement on what provisions should be included and whether further consultation was needed. Frontier Economics submitted that adopting fixed principles provisions will reduce the risk of a shorter regulatory period.[395]

As noted above in relation to the LTIE, the fixed principles provisions specify the cost components (or 'building blocks') used to estimate the revenue requirement. These components determine the key elements of the pricing framework. Certainty over time in the pricing framework will promote predictability for access seekers in the way

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394 Telstra, Submission – Part A, 3 June 2011, p. 81.

395 Frontier Economics, Submission, June 2011, p. 27.

access prices will be determined over time. It will thereby assist access seekers in their business and investment planning.

As noted above in relation to the LTIE, the fixed principles provisions included in the FADs also specify the initial values for the RAB and the tax asset value as at 1 July 2011. The ACCC considers that locking in these initial RAB values will contribute to continuity and predictability in moving from one regulatory period to the next, which is in access seekers' interests.

The ACCC considers revaluation of an existing RAB could create uncertainty for access seekers. It could also result in price shocks and windfall gains or losses to access seekers.

16.6.4 Paragraph 152BCA(1)(d) – direct cost of providing access to the declared service

As noted above in relation to the LTIE, the fixed principles provisions specify the cost components (or 'building blocks') used to estimate the revenue requirement. These costs include the direct costs of providing access to the declared fixed line services.

Telstra submitted that the proposed fixed principles provisions would help in ensuring that the access provider is afforded an opportunity to recover the direct costs of providing access to the fixed line services.[396]

16.6.5 Paragraph 152BCA(1)(e) – the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else

The ACCC considers that this criterion is not directly relevant to the fixed principles provisions included in the FADs.

16.6.6 Paragraph 152BCA(1)(f) – the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

The ACCC is of the view that the fixed principles provisions included in the FADs will not compromise the safe and reliable operation of any carriage service, telecommunications network or facility.

As noted above in relation to the LTIE, the fixed principles provisions included in the FADs specify the cost components (or 'building blocks') used to estimate the revenue requirement. These components determine the key elements of the pricing framework. By promoting confidence by the access provider that it will be able to recover its efficient costs, these provisions will support expenditures on maintaining and improving the safe and reliable provision of services and operation of the network. By promoting confidence by the access provider that it will be able to recover its efficient investments in infrastructure used to provide the declared fixed line services, these provisions will support investments that underpin the safe and reliable provision of services and operation of the network.

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[396] Telstra, Submission – Part A, 3 June 2011, p. 81.

16.6.7 Paragraph 152BCA(1)(g) – the economically efficient operation of a carriage service, a telecommunications network or a facility

The ACCC considers that the fixed principles provisions included in the FADs will promote certainty about the way access prices will be determined over time. By promoting confidence by the access provider that it will be able to recover its efficient costs, these provisions will support expenditures on providing services and operating the network efficiently.

The certainty provided by the fixed principles provisions will also assist the access provider in assessing the commercial viability of investments to improve the efficient operation of the carriage services it provides and its PSTN. It will also reduce the risks associated with such investments.

16.6.8 Paragraph 152BCA(2) – the supply of one or more other eligible services

The ACCC considers that this criterion is not directly relevant to the fixed principles provisions included in the FADs.

Part B: Non-price terms and conditions

Key points

- The ACCC has included non-price terms and conditions relating to access to the declared fixed line services in the FADs.
- The ACCC has adopted a conservative approach in maintaining the non-price terms and conditions from the IAD while undertaking to consider some of the issues raised in submissions in more detail in the future.
- The ACCC has considered the submissions received in response to the April 2011 Discussion Paper.
- The ACCC is currently considering non-price terms in FADs in the context of the Domestic Transmission Capacity Service and Mobile Terminating Access Service FAD public inquiries. The ACCC proposes to consult industry further on non-price terms and conditions for the declared fixed line service FADs and, if necessary, vary the non-price terms and conditions after the conclusion of these consultations.

This Part B discusses the inclusion of non-price terms and conditions in the FADs for the declared fixed line services.

The non-price terms and conditions are set out in Schedules 8–16 of the FADs. These terms are modelled on the terms contained in the IADs released on 2 March 2010, which were themselves based on the *Model Non-Price Terms and Conditions Determination 2008* (2008 Model Terms). Draft non-price terms and conditions were included in the April 2011 Discussion Paper.

The ACCC has made some changes to the terms and conditions as they appeared in the April 2011 Discussion Paper after taking account of submissions received. These changes were generally made to ensure consistency with industry codes and clarify drafting.

The ACCC considers that some of the issues raised in relation to non-price terms and conditions in submissions require further consultation. However, the ACCC has also formed the view that it is not desirable to delay the publication of its decision on FAD pricing until the non-price issues are resolved.

The ACCC is currently considering non-price terms in FADs in the context of the Domestic Transmission Capacity Service (DTCS) and Mobile Terminating Access Service (MTAS) FAD public inquiries. The results of those inquiries is likely to inform any decision to vary the non-price terms in the FADs of the declared fixed line services.

17 Non-price terms and conditions under previous regime

Under the previous Part XIC access regime, the ACCC was required to consult on and make model terms and conditions relating to access for certain core services.[397] Those model terms and conditions included non-price terms and conditions. The 2008 Model Terms were the culmination of the whole of industry consultation on model non-price terms and conditions for the core services under the previous regime.[398]

The ACCC has also considered certain non-price issues relating to access to some of the declared fixed line services when arbitrating access disputes.

18 Non-price terms and conditions in IADs

The ACCC decided to include non-price terms and conditions in the IADs for all the declared fixed line services in March 2011. The ACCC considered that the inclusion of non-price terms in the IADs would reduce the number of access disputes between parties in the transitional period for areas covered by the non-price terms and conditions.

The ACCC adopted a conservative approach to drafting the non-price terms and conditions in the IADs. This is because no consultation was required before making an IAD. In addition, non-compliance with an IAD is a breach of a carrier licence condition and a service provider rule. Each breach may result in substantial pecuniary penalties of up to $10 million.

The majority of the non-price terms and conditions in the IADs were drafted in substantively similar terms to the 2008 Model Terms. However, the drafting in some schedules in the IADs were based on terms contained in more recent FDs made in arbitrations in relation to the ULLS and the LSS. The ACCC consulted with industry before making the 2008 Model Terms, and consulted with a number of parties when making the arbitral FDs. The source of the non-price terms and conditions contained in the IADs is outlined in the below table.

Table 18.1 Sources for non-price terms and conditions contained in IADs

Schedule in IAD	Non price terms and conditions	Source
8	Billing and notification	2008 Model Terms
9	Creditworthiness and security	2008 Model Terms
10	General dispute resolution procedures	2008 Model Terms
11	Confidentiality provisions	2008 Model Terms
12	Communication with end-users	2008 Model Terms

397 The core services included PSTN OA, PSTN TA, ULLS and LCS: repealed subsection 152AQB(1) of the CCA.

398 ACCC, *Model Non-Price Terms & Conditions Determination 2008*, 17 November 2008, available on the ACCC website www.accc.gov.au.

Schedule in IAD	Non price terms and conditions	Source
13	Network modernisation and upgrade provisions	FDs made in April 2010 in relation to various ULLS and LSS access disputes. Copies of some of those FDs are available on the ACCC website: LSS: www.accc.gov.au/content/index.phtml/itemId/793060 ULLS: www.accc.gov.au/content/index.phtml/itemId/793062
14	Suspension and termination	2008 Model Terms
15	Changes to operating manuals	2008 Model Terms
16	ULLS ordering and provisioning	Schedule 16 (excluding clauses 16.18 to 16.23) – 2008 Model Terms Clauses 16.18 to 16.23 (LSS to ULLS transfer process section) – FDs made in August 2010 in relation to ULLS access disputes. A copy of a FD and statement of reasons has been published on the ACCC website www.accc.gov.au/content/index.phtml/itemId/793062

19 Non-price terms and conditions in the FADs

The ACCC requested submissions on the draft non-price terms and conditions proposed with the April 2011 Discussion Paper, which were substantially similar to those in the IADs. Additionally, the ACCC requested submissions on draft terms and conditions that addressed liability (risk allocation), the iVULLS process and facilities access.

19.1 Submissions

Submissions on the non-price terms and conditions in response to the April 2011 Discussion Paper were received from:

- Herbert Geer (on behalf of Adam Internet, Aussie Broadband, iiNet and Internode)
- Macquarie Telecom
- Optus, and
- Telstra.

Herbert Geer, Macquarie Telecom and Optus submitted that they supported the inclusion of non-price terms and conditions in the FADs. Optus also proposed the inclusion of an enhanced service assurance for the ULLS. Telstra submitted that the ACCC's analysis of the non-price terms against the criteria in subsection 152BCA(1) of the CCA was not appropriate and that the proposed non-priced terms and conditions should not be included. As an alternative, Telstra provided modified

drafting for the provisions in the event that the ACCC decided to include non-price terms and conditions in the FADs.[399]

Herbert Geer and Macquarie Telecom supported the inclusion of liability (risk allocation), iVULLS process and facilities access provision. However Telstra and Optus submitted that they should not be included in the FADs at this stage.

19.2 ACCC final view

The ACCC has taken into account of the submissions received. Many of the issues raised are complex and require further consideration. Some of the specific alternative drafting suggested in submissions has not been previously considered by industry. The ACCC also notes that non-price terms are also currently the subject of consultation in relation to two other declared services (mobile terminating access service (MTAS) and domestic transmission capacity service(DTCS)).

Until that consideration is completed, the ACCC has decided that it is appropriate to include the non-price terms and conditions as provided in the April 2011 Discussion Paper, subject to the following changes:

- Schedule 8 – Billing and Notifications:
  - clauses 8.3 and 8.7 to reflect drafting proposals put forward by Telstra to make the billing frequency requirement clear and to clarify when interest accrues for late payments, and
  - clause 8.5 to limit the time for back billing to 5 months (whether for a new service or otherwise) to ensure that access seekers can comply with the Telecommunications Consumer Protection code (the TCP code).[400]
- Schedule 10 – General dispute resolution procedures:
  - clause 10.10 in order to provide that the mediation agreement includes procedures to follow, and
  - clause 10.11 to allow parties to a dispute to agree to amend the Expert Committee's timeline.
- Schedule 14 – Suspension and termination – this has been altered at clause 14.6 to clarify the circumstances in which a Breach Notice can follow a Suspension Notice.
- Schedule 16 – Ordering and provisioning – this has been altered at clause 16.25 to bring the terminology used in Connect Outstanding process for the ULLS in line with the Connect Outstanding code.[401]

The ACCC has decided not to include the liability (risk allocation), iVULLS process and facilities access provisions in the FADs at this stage. The ACCC believes that further consultation is required on these matters prior to them being included in the FADs.

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399 Telstra, Submission – Part B, 3 June 2011, p. 7.

400 Communications Alliance Ltd, Industry Code C628:2007, Telecommunications Consumer Protection code, clause 6.5.

401 Australian Communications Industry Forum, Industry Code C617:2005, Connect Outstanding, clauses 8.3 and 8.4.

The ACCC considers it desirable to proceed with the publication of its decision on the FADs at this time. The FAD prices cover the period until 30 June 2014 and have been subject to extensive consultation and consideration by the ACCC as part of the previous pricing principles consultation and the current FAD public inquiry. Finalising price and non-price terms and conditions at this time will provide industry with certainty and stability in the lead up to the NBN.

The ACCC does, however consider that some of the matters raised in response to the April 2011 Discussion Paper in relation to non-price terms and conditions should be the subject of further consideration, without delaying the ACCC's decision on FAD pricing.

Additional consultation on the non-price terms and conditions will be undertaken in the context of the MTAS and DTCS FAD public inquiries (where relevant). Depending on the outcome of these public inquiries the ACCC may then hold a public inquiry to vary the fixed line services FADs to ensure that non-price terms and conditions are consistent across all the FADs. At this time, terms and conditions specific to the fixed line services such as Changes to Operating Manuals and Ordering and Provisioning will be considered further.

Part C: Geographic exemptions

This Part C outlines the ACCC's approach with regards to the inclusion of exemptions in the FADs for the WLR, LCS and PSTN OA services.

The ACCC considers that the future operation of the exemptions requires further investigation and consideration. The ACCC has decided to incorporate the effect of the exemption in the FADs, but will commence a further inquiry and seek further information from industry regarding whether the exemptions should continue in the future. The further consultation and consideration is expected to conclude before 30 December 2011.

20 Background

20.1 Legislative changes

The *Telecommunication Legislation Amendment (Competition and Consumer Safeguards) Act 2010* (CACS Act) repealed the ordinary individual and ordinary class exemption provisions of the CCA.[402]

The transitional provisions in the CACS Act state that once an access determination in relation to a declared service commences, a determination made under the ordinary exemption provisions in relation to that service ceases to have effect.[403]

The ACCC is able to incorporate provisions in access determinations which provide that any or all of the standard access obligations (SAOs) are not applicable to a carrier or carriage service provider. This may be either unconditional or subject to such conditions or limitations as are specified in the determination.[404]

The Explanatory Memorandum to the CACS Bill states that:

> the need for ordinary class exemptions is removed because the ACCC will be able to incorporate provisions in access determinations which remove or limit the obligation of carriers or CSPs to comply with some or all of the standard access obligations (see proposed paragraphs 152BC(3)(h) and (i))[405]
>
> …
>
> at the time when the ACCC is making the first access determination, it will be able to include provisions under the proposed paragraphs 152BC(3)(h) or (i) limiting the application of the standard access obligations. Such provisions may have a similar effect to exemptions.[406]

Before the interim access determinations (IADs) commenced on 1 January 2011, there were eight exemption determinations which affected the WLR, LCS and PSTN OA services:

Australian Competition Tribunal's (Tribunal's) Metropolitan Orders

- Tribunal's 2009 WLR Individual Exemption Order made on 24 August 2009

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402 Repealed sections 152AT (individual exemptions) and 152AS (class exemptions) of the TPA.
403 Items 202 (class exemptions) and 203 (individual exemptions) of the CACS Act.
404 Paragraphs 152BC(3)(h) and (i) of the CCA.
405 Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 170.
406 ibid., p. 215.

- Tribunal's 2009 LCS Individual Exemption Order made on 24 August 2009
- Tribunal's 2009 PSTN OA Individual Exemption Order made on 9 September 2009 (in relation to the supply of the PSTN OA in metropolitan Exchange Service Areas (ESAs))

PSTN OA CBD Orders

- ACCC's Individual Exemption Order No. 6 of 2008 made on 30 October 2008, affirmed and varied by the Tribunal's 2009 PSTN OA CBD Individual Exemption Order made on 9 September 2009 (in relation to the supply of the PSTN OA in 17 CBD ESAs)

ACCC's Class Orders

- ACCC's Class Exemption Determination No. 2 of 2008 made on 22 August 2008 (in respect of the WLR)[407]
- ACCC's Class Exemption Determination No. 1 of 2008 made on 22 August 2008 (in respect of the LCS)[408]
- ACCC's Class Exemption Determination No. 3 of 2008 made on 29 October 2009 (in respect of the PSTN OA)[409]

(together, the Exemption Determinations).[410]

The Exemption Determinations ceased to have effect from 1 January 2011 after the IADs took effect.

20.2 Content of the Exemption Determinations

The Tribunal's Metropolitan Orders provided that any of 380 ESAs (Attachment A ESAs) could become exempt (Exemption ESA) if the following three conditions were met:

- the ESA has three or more ULLS-based competitors (excluding Telstra)
- the ULLS-based competitors have an aggregate market share in the ESA equal to or greater to 30 per cent, and
- the aggregate ULLS spare capacity for that ESA is equal to or greater than 40 per cent of the aggregate number of WLR SIOs in that ESA.

Once an ESA is determined to be an Exemption ESA, it is still subject to further conditions and limitations before the exemption takes effect.

The effect of an ESA becoming exempt is that the SAOs are not applicable to an access provider (including Telstra) when supplying the relevant declared service in that ESA.

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407 This determination was subsequently varied by the ACCC's Class Exemption (Variation) Determination No. 1 of 2009.

408 This determination was subsequently varied by the ACCC's Class Exemption (Variation) Determination No. 2 of 2009.

409 This determination was subsequently varied by the ACCC's Class Exemption (Variation) Determination No. 3 of 2009.

410 Copies of all the Exemption Determinations are available on the ACCC website: www.accc.gov.au.

The PSTN OA CBD Orders made 17 CBD ESAs exempt in relation to the PSTN OA service. There is a carve out for CBD ESAs in the service descriptions for the WLR and LCS services (that is, the WLR and PSTN services are not declared in CBD ESAs).

The Tribunal's Metropolitan Orders were the result of a complex process of consideration by both the ACCC and the Tribunal. In 2007 Telstra applied to be exempt from the SAOs in relation to WLR, LCS and PSTN OA in relation to approximately 380 metropolitan ESAs, and 17 CBD ESAs in relation to the PSTN OA. In 2008 the ACCC granted Telstra an exemption in relation to a lesser metropolitan 248 ESAs subject to conditions and limitations. The ACCC also granted Telstra exemption in relation to the 17 CBD ESAs in relation to the PSTN OA service.

Access seekers sought review of the ACCC's decision by the Tribunal. After receiving direction from the Full Federal Court, the Tribunal made the Metropolitan Orders (which differed from the ACCC's original orders) and also affirmed the ACCC's CBD PSTN OA exemption orders.

A more detailed summary of the background and content of the Exemption Determinations is set out in sections 21.3 to 21.7 of the April 2011 Discussion Paper.

20.3 IADs incorporated the effect of the Exemption Determinations

The ACCC decided to incorporate and continue the effect of the Exemption Determinations into the IADs for the WLR, LCS and PSTN OA services. The ACCC considered that this would promote regulatory certainty and consistency in the transition to the new access regime and is also consistent with the Tribunal's assessment that the Exemption Determinations in relation to those services were in the LTIE. Taking an alternative approach would have effectively led to the 're-regulation' of those services in the currently exempt ESAs without a detailed consideration of whether 're-regulation' was appropriate.

When it released the IADs, the ACCC noted that it would consult with industry on the incorporation of the effect of the Exemption Determinations into the FADs for the WLR, LCS and PSTN OA services.

21 Exemption Determinations and FADs

21.1 April 2011 Discussion Paper view

The ACCC's preliminary view outlined in the April 2011 Discussion Paper was that the effect of the Exemption Determinations should be incorporated into the FADs for the following reasons:

- doing so is likely to promote the LTIE, and
- incorporating exemptions into the FADs in substantively similar terms to those contained in the Exemption Determinations will promote regulatory certainty and consistency.[411]

[411] ACCC, Discussion Paper, April 2011, pp. 218–219.

The April 2011 Discussion Paper set out the ACCC's preliminary views against the matters listed in subsection 152BCA(1) of the CCA. It also proposed that the ACCC would have regard to regulatory certainty and consistency as a relevant matter under subsection 152BCA(3).

The ACCC sought industry submissions on whether the Exemption Determinations should be incorporated into the relevant FADs.

21.2 Submissions

The ACCC received submissions from the following parties in relation to the issue of exemptions:

- AAPT
- Frontier Economics (on behalf of Macquarie Telecom)
- Herbert Geer (on behalf of Adam, Aussie Broadband, iiNet and Internode)
- Macquarie Telecom
- Optus, and
- Telstra.

In summary, Telstra was supportive of the inclusion of the effect of the Exemption Determinations into the FADs. Telstra submitted that the scope of the ESAs that could possibly become exempt should be expanded to include all ESAs instead of the 380 Attachment A ESAs. That is, when the ACCC undertakes its calculations to determine which ESAs meet the three criteria outlined in the Tribunal's Metropolitan Orders to become Exemption ESAs, it would assess *all* ESAs rather than the 380 Attachment A ESAs currently assessed.

Herbert Geer was supportive of the inclusion of the PSTN OA CBD Orders into the PSTN OA FAD, but opposed the inclusion of the Tribunal's Metropolitan Orders. AAPT, Frontier Economics, Macquarie Telecom and Optus were opposed to the inclusion of the Exemption Determinations into the FADs.

In addition to a submission received from Telstra on 3 June 2011, the ACCC received a further "response" submission from Telstra on 15 July 2011 in relation to the issue of exemptions. The ACCC considers that its approach set out in 21.3 below will allow it to further investigate and consider the relevant issues and allow all parties to provide further information to the ACCC.

21.3 ACCC final view

Submissions received in response to the April 2011 Discussion Paper raise complex and contentious issues. The ACCC considers that the issue of the future operation of the exemptions requires further investigation and consideration. In particular, the ACCC has formed a view that further information is required in relation to a number of issues concerning the state of the market for WLR, LCS and PSTN OA. The ACCC considers that it is also appropriate that other parties are given a chance to respond to all submissions made in relation to the April 2011 Discussion Paper.

The ACCC considers that changes affecting the industry, such as the build of a ubiquitous national broadband network (NBN) may affect the rationale for the future continuation of the exemptions. Further, since the exemption orders were made in

August 2009 (WLR and LCS) and September 2009 (PSTN OA) no substantial alternative wholesale provider of voice-only services over the PSTN appears to have emerged. These issues are among those that require further investigation and consideration by the ACCC.

Overall, the ACCC does not consider it has sufficient information before it at this point in time to determine whether the current WLR, LCS and PSTN OA exemptions should be removed.

The ACCC considers that further consultation is appropriate as a decision to remove exemptions would in effect 're-regulate' currently exempt ESAs. The PSTN OA exemption in relation to 17 CBD ESAs has been in operation for almost two years. The WLR, LCS and PSTN OA exemptions in relation to certain metropolitan ESAs have been in operation for over six months. Retaining the exemptions in the FAD at present will promote regulatory certainty and stability until the ACCC concludes its consideration of the exemption issue. The ACCC expects to conclude the further consultation in relation to the exemptions prior to 30 December 2011 (before exemptions in any further metropolitan ESAs are due to take effect).

The ACCC considers it desirable to proceed with the publication of its decision on FAD pricing at this time. The FAD prices cover the period until 30 June 2014 and have been subject to extensive consultation and consideration by the ACCC as part of the previous pricing principles consultation and the current FAD public inquiry. Finalising prices at this time will provide industry with certainty and stability in the lead up to the NBN. The ACCC considers that non-price issues including the issue of the future operation of the exemptions should be the subject of further consideration, without delaying the ACCC's decision on FAD pricing.

Part D: NBN wholesale aggregation services

Part D outlines the issues regarding wholesale services provided over the NBN and states the ACCC's position on the application of the FADs to those services.

22 NBN wholesale aggregation services

In the April 2011 Discussion Paper, the ACCC sought industry submissions regarding wholesale services which are supplied by NBN access seekers using the NBN access network, 'NBN-based wholesale services' or NBN wholesale aggregation services.

In particular, the ACCC sought industry submissions on whether the FADs for the WLR, LCS, PSTN OA and PSTN TA services should apply to NBN wholesale aggregation services.

The ACCC also noted in the Discussion Paper that a transition period of regulation of these services may be necessary for voice providers to be able to interconnect with the PSTN as well as the NBN-based network. The ACCC is seeking to ensure regulatory conditions that will promote positive competition outcomes in the migration period from the CAN to the NBN.

The ACCC also sought industry views on an appropriate method of ascertaining a price for the relevant NBN wholesale aggregation services, if those services were to be covered by the FADs.

22.1 Submissions

Four parties made submissions regarding the regulation of NBN wholesale aggregation services. One submission supported immediate regulation of these services, while the other three submissions were against regulation.

Herbert Geer (on behalf of Adam Internet, Aussie Broadband, iiNet and Internode) submitted that it is appropriate for declared wholesale services provided over the NBN to be subject to the FADs. It argued that the FADs would provide a fall back position when parties cannot reach a commercial agreement. According to Herbert Geer, this will 'promote the LTIE by providing conditions where lower prices and diverse services can be encouraged.'[412]

Macquarie Telecom, Optus and Telstra all submitted that regulation of wholesale services provided over the NBN was not necessary. Macquarie Telecom argued that wholesalers/intermediaries on the NBN will have incentive to compete for the business of retail service providers. It reasoned that the wholesale market will not fail in the short term. Macquarie Telecom suggested that the ACCC should revisit this issue in three years' time to ensure that the market is competitive.[413]

Optus considered that the supply of NBN wholesale aggregation services will be effectively competitive and regulation will not be in the LTIE.[414] Optus noted that there are likely to be many suppliers of wholesale services over the NBN, including Telstra, Optus, Nextgen, AAPT and iPrimus.[415] Because access to the NBN will be

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412 Herbert Geer, Submission, 3 June 2011, pp. 3, 9, 28.
413 Macquarie Telecom, Submission, 3 June 2011, pp. 12–13.
414 Optus, Submission, June 2011, pp. 73–74.
415 ibid., p. 76.

regulated and non-discriminatory, there will be many providers able to offer wholesale services.[416] Optus argued that because the market will be effectively competitive, any further regulation would 'impose unnecessary costs.'[417]

Optus submitted that PSTN TA should continue to be regulated because it may have bottleneck characteristics. It suggested that a transition period may be necessary to 'ensure that voice providers are able to interconnect with the PSTN network as well as the NBN-based network on reasonable terms.'[418] In the event that the ACCC decided to regulate wholesale services provided over the NBN, Optus suggested that the terms and conditions for access should not be set until after the terms for access to NBN layer 2 services are finalised.[419]

Telstra submitted that the retail and wholesale markets for voice and broadband services over the NBN will be highly competitive because many of its current wholesale customers will move to buy services directly from NBN Co. Telstra argued that it will be one of a number of access seekers able to acquire service from NBN Co on a level playing field.[420] Telstra noted that number of industry participants have indicated they will provide wholesale services over the NBN, including AAPT and Optus.[421]

Telstra also argued that the services provided over the NBN will be technically different to WLR, LCS and PSTN OA.[422] It submitted that it would be costly to create 'legacy style resale products in an NBN world.'[423]

In addition, Telstra submitted that the FADs should exempt access providers from the SAOs in respect of WLR, LCS and PSTN OA provided over the NBN using paragraphs 152BC(3)(h) or (i). It stated that exemptions for ULLS and LSS are unnecessary as those are technology specific to copper.[424] Telstra contended that the NBN will remove the bottleneck for the resale of wholesale services so regulation ought to be removed.[425] Telstra argued that continued regulation could lead to lower investment in the infrastructure necessary to provide services over the NBN.[426]

Telstra submitted that in the event that the ACCC does regulate wholesale services provided over the NBN, the ACCC does not have sufficient information or an appropriate method to determine price and non-price terms to apply to these services.[427] Telstra argued that it is not appropriate to use the pricing for the copper network for NBN-based services.[428]

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416 ibid., p. 75.
417 ibid., p. 76.
418 ibid., p. 77.
419 ibid.
420 Telstra, Submission – Part C, 3 June 1022, p. 24.
421 ibid., p. 25.
422 ibid., p. 24.
423 ibid., p. 26.
424 ibid., pp. 23, 26.
425 ibid., p. 26.
426 ibid., p. 28.
427 ibid., pp. 23, 30, 32.
428 ibid., p. 31.

On 6 July 2011, Telstra wrote to the ACCC to highlight that four companies have recently publicly stated they intend to offer NBN wholesale aggregation services.[429]

22.2 ACCC final view

The ACCC has considered the views expressed in submissions in response to the April 2011 Discussion Paper and concluded that the case for access regulation of NBN wholesale aggregation services over the long-term is not clear. The ACCC has decided to specify that these FADs do not apply to services provided by a carrier or carriage service provider over the NBN for the reasons discussed below.

There are a number of regulatory processes to be undertaken by the ACCC in the coming 12 to 18 months. The outcomes of these processes will influence the development of the wholesale aggregation market. These processes include the assessment of Telstra's expected Migration Plan and structural separation undertaking and the assessment of NBN Co's expected special access undertaking. The ACCC will take into account their impacts on competition in the wholesale aggregation market in assessing the reasonableness of the Migration Plan and the undertakings. The ACCC considers that these instruments should contribute to the conditions necessary for a competitive NBN wholesale aggregation market. If competitive markets for NBN wholesale aggregation services and/or retail services do not emerge over time, the ACCC may then reconsider regulation.

Given that the roll-out of the NBN is in its early stages, it is too early to anticipate how competition will develop within the wholesale aggregation market.

Macquarie Telecom, Optus and Telstra submitted that there are likely to be more than three wholesale aggregators providing services over the NBN. They contend that this will mean that the wholesale aggregation market will be effectively competitive requiring no further regulation. The ACCC proposes to monitor the development of competition in this market before making a decision on regulation.

The ACCC considers that a number of factors will influence the development of the NBN wholesale aggregation market:

- The existence of barriers to entry to accessing services directly from NBN Co at the access level.
- The ability and willingness of access level service providers to provide wholesale aggregation services, in particular for vertically integrated retailers to do so in the initial stages of the NBN.
- The profitability of entering the market at the resale level, in the face of competition from access level service providers in the retail market.

The ACCC proposes to re-examine the issue of regulation of the NBN wholesale aggregation market at the end of this regulatory period, when the NBN roll-out has further progressed. This will allow time for the assessment of Telstra's Migration Plan, its structural separation undertaking and NBN Co's special access undertaking. It will also provide sufficient opportunity for the development of the resale market for

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[429] Telstra, *Public inquiry to make final access determinations for the declared fixed line services – exemption for resale services supplied of NBN – Letter to the ACCC*, 6 July 2011, pp. 1–2.

wholesale services without regulation. It may be that a competitive resale market for wholesale services of the NBN will emerge without intervention.

However, the ACCC intends to closely monitor the roll-out of the NBN during the regulatory period. If competition issues emerge regarding the supply of NBN wholesale aggregation services, the ACCC will reconsider what, if any, regulatory response is required.

22.3 Assessment against the subsection 152BCA(1) criteria

22.3.1 Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE

The ACCC considers that allowing the NBN wholesale aggregation market to develop without immediate regulatory intervention will promote the LTIE. It will promote competition by allowing access providers the opportunity to develop their product offerings without undue regulatory burden. Based on submissions, the ACCC anticipates that there may be multiple access providers competing for customers in this market. Since the CCA provides that those access providers must obtain one of their main inputs from NBN Co on non-discriminatory terms,[430] there should be a level playing field in which those providers compete. This is a necessary (although not sufficient) foundation for the emergence of a workably competitive market delivering competitive prices for services.

The ACCC does not consider that the non-application of the FADs will create any obstacles for the achievement of any-to-any connectivity.

Given the roll-out of the NBN, it is likely that the non-application of the FADs will help to promote the efficient use of and investment in infrastructure. It will allow access providers to make decisions about their investments with the knowledge that they are able to set their own prices to recover the costs of those investments.

22.3.2 Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

The ACCC considers that the non-application of the FADs to services provided over the NBN will support the legitimate business interests of carriers and carriage service providers (CSPs). They will be able to set prices at a level of their own choosing. This will enable them to recover their costs and earn a normal commercial return on their investments. Competitive pressures should ensure that prices for services cannot be inflated to recover more than their efficient costs, including a normal commercial return on their investments, or profits that an access provider may lose in a dependent market as a result of the provision of access.

22.3.3 Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the declared service

As noted in section 3.5.3, the ACCC considers that this criterion requires the ACCC to have regard to the interests of access seekers. There are likely to be a number of access providers providing NBN wholesale aggregation services. The ACCC believes

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[430] See section 152AXC of the CCA; also Revised Explanatory Memorandum, National Broadband Network Companies Bill 2010 Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2011, pp. 8–9, 146.

this should enable the emergence of a competitive market, which will in turn lead to competitive prices for services. This will be in the interests of access seekers. Therefore, the ACCC considers that excluding NBN wholesale aggregation services from the FADs at this time is in the interests of access seekers.

22.3.4 Paragraph 152BCA(1)(d) – direct costs of providing access to the declared service

The ACCC considers that excluding the NBN wholesale aggregation services from the FADs allows access providers to recover their direct costs because they are able to charge whatever price they feel is appropriate. Access providers will be able to set their prices to recoup the direct costs of providing access, as well as a contribution to their indirect costs.

22.3.5 Paragraph 152BCA(1)(e) – value to a person of extensions, or enhancement of capability, whose cost is borne by someone else

The ACCC believes that excluding NBN wholesale aggregation services from the FADs will allow access providers to recoup any costs of enhancements that they make on behalf of access seekers because access providers are able to set their own prices.

22.3.6 Paragraph 152BCA(1)(f) – operational and technical requirements necessary for the safe and reliable operation of a carriage service

The ACCC does not consider this criterion relevant to the non-application of the FADs to NBN wholesale aggregation services because this decision is not expected to have an impact on operational and technical requirements.

22.3.7 Paragraph 152BCA(1)(g) – economically efficient operation of a carriage service

The ACCC considers that the non-application of the FADs to services provided over the NBN will help to promote the economically efficient operation of a carriage service because it is anticipated that a competitive market will emerge for these services. In such a market competition should ensure access providers provide services in an efficient manner. Access providers will need to improve their services and lower their costs in order to compete effectively.

Appendix A: Description of the fixed line services

Following are brief descriptions for each of the fixed line services that are covered by this review. The full service descriptions for each service can be found in the ACCC's *Fixed Services Review Declaration Inquiry* (July 2009) (available from the ACCC's website www.accc.gov.au).

ULLS

The ULLS is a service for access to unconditioned cable, usually a copper wire pair, between an end-user and a telephone exchange. The ULLS essentially gives an access seeker the use of the copper pair without any dial tone or carriage service. This allows the access seeker to use its own equipment in an exchange to provide a range of services, including traditional voice services and high speed internet access, to end-users connected at the exchange. The ULLS has been a declared service since 1999 and was redeclared in 2006.[431] In July 2009, the declaration was extended for a further five years until 31 July 2014.[432]

WLR

The WLR service allows access seekers to resell the basic line rental service that allows an end-user to connect to the traditional voice network, make and receive calls and have a telephone number. The WLR was first declared in 2006, excluding the CBD areas of Sydney, Melbourne, Brisbane, Adelaide and Perth.[433] In July 2009, the declaration was extended for a further five years until 31 July 2014.[434]

LSS

Line sharing is where two separate carriers provide separate services over a single copper line. The copper line spectrum is normally split (or shared) so that:

- one carrier or service provider provides the voice services over the line, and
- the LSS access seeker provides high-speed broadband services, through the use of its own xDSL technology, over the higher frequency part of the copper line.

The LSS has been a declared service since 2002 and was redeclared in 2007.[435] In July 2009, the declaration was extended for a further five years until 31 July 2014.[436]

PSTN OTA

The PSTN OA service is the carriage of telephone calls from the calling party to a point of interconnection (POI) within an access seeker's network. The PSTN TA is the carriage of telephone calls from a POI within an access seeker's network to the party receiving the call. Access seekers currently use PSTN OA and TA services to provide the following services:

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431 ACCC, Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final determination, July 2006.

432 ACCC, Fixed Services Review Declaration Inquiry, July 2009.

433 ACCC, Local Services Review–Final decision, July 2006.

434 ACCC, Fixed Services Review Declaration Inquiry, July 2009.

435 ACCC, *LSS – Final decision on whether or not a LSS should be declared under Part XIC of the TPA*, August 2002; ACCC, Review of the Line Sharing Service Declaration – Final Decision, October 2007.

436 ACCC, Fixed Services Review Declaration Inquiry, July 2009.

- national long-distance calls
- international calls
- mobile phone to fixed network calls
- fixed network to mobile network calls, and
- local calls.

The PSTN OTA has been a declared service since 1997 and was redeclared in 2006.[437] In July 2009, the declaration was extended for a further five years until 31 July 2014.[438]

LCS

The LCS is a service for the supply of an end-to-end voice grade carriage service between two points within a standard zone. It allows access seekers to resell local calls to end-users without the need for deploying substantial alternative infrastructure. Commercially, the LCS is generally sold with the WLR. The LCS has been a declared service since 1999[439]and was redeclared in 2006[440] excluding the CBD areas of Sydney, Melbourne, Brisbane, Adelaide and Perth.[441] In July 2009, the declaration was extended for a further five years until 31 July 2014.[442]

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437 ACCC, Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final determination, July 2006.

438 ACCC, Fixed Services Review Declaration Inquiry, July 2009.

439 ACCC, Declaration of local telecommunications services, July 1999.

440 ACCC, Local Services Review – Final Decision, July 2006.

441 Note the variation of the declaration was in recognition of the previous exemption granted to the LCS in the CBD areas. See: ACCC, *Future scope of the local carriage service – final decision*, July 2002.

442 ACCC, Fixed Services Review Declaration Inquiry, July 2009.

Appendix B: Submissions to December 2009 Discussion Paper, September 2010 Draft Report and April 2011 Discussion Paper

Submissions received in response to December 2009 Discussion Paper
Competitive Carriers Coalition, Submission to ACCC Discussion Paper: Review of 1997 Access Pricing Principles for Fixed Line Services, February 2010.
Frontier Economics (on behalf of the Competitive Carriers Coalition), Access pricing principles for fixed line services – A response to the ACCC's Discussion Paper prepared for the CCC, February 2010.
Macquarie Telecom, Submission in response to the ACCC's Discussion Paper, February 2010.
Optus, Optus Submission to Australian Competition and Consumer Commission in response to discussion paper: Telecommunications Access Pricing Principles for Fixed Line Services, February 2010.
Optus, Telecommunications Access Pricing Principles for Fixed Line Services – Letter to the ACCC, 17 May 2010.
Optus, *Review of Access Pricing Principles for Fixed Line services – Letter to the ACCC*, 13 July 2010.
CEG (on behalf of Optus), Reform of Part XIC: Regulatory Certainty – Increasing regulatory certainty for telecommunications assets in Australia – A report for Optus, June 2009.
CEG (on behalf of Optus), Past cost recovery and asset valuation – A report for Optus, March 2010.
CEG (on behalf of Optus), Access price flexibility with a vertically integrated access provider – A report for Optus, March 2010.
NERA (on behalf of Optus), Role of TSLRIC in telecommunications regulation – A report for Optus, July 2003.
Telstra, Review of 1997 Guide to Telecommunications Access Pricing Principles for Fixed Line Services – Telstra's response to the ACCC's Discussion Paper, 26 February 2010.
TransACT, Submission to the ACCC's Discussion Paper: Review of 1997 Access Pricing Principles for Fixed Line Services, 26 February 2010.
VHA, Review of Pricing Principles for Fixed Line Services – Submission to the Australian Competition and Consumer Commission, February 2010.
Submissions received in response to September 2010 Draft Report
AAPT, Submission by AAPT Limited to the Australian Competition and Consumer

Commission's Draft Report Titled Review of the 1997 telecommunications access pricing principles for fixed line services, September 2010.
Frontier Economics (on behalf of the Competitive Carriers Coalition), Submission on the ACCC's draft report – Review of fixed line pricing principles – A Report Prepared for the Competitive Carriers' Coalition, October 2010.
Herbert Geer (on behalf of iiNet, Internode and Adam Internet), Review of the 1997 telecommunications access pricing principles for fixed line services – Submissions on behalf of iiNet, Internode and Adam Internet, October 2010.
Joe Terranova, *Submission on the Review of Access Pricing Principles for Fixed Line Services – draft report*, 5 October 2010.
M2 Telecommunications, Submission to the ACCC in response to the Draft Report: Telecommunications Access Pricing Principles for Fixed Line Services, October 2010.
Macquarie Telecom, Review of the 1997 telecommunications access pricing principles for fixed line services, 22 October 2010.
Optus, Submission to ACCC in response to the Draft Report – Telecommunications Access Pricing Principles for Fixed Line Services, October 2010.
Optus, Draft Pricing Principles for Fixed Line Services – PSTN Rate Structure, September 2010.
CEG (on behalf of Optus), De-averaging ULLS prices – A report for Optus, November 2010.
RBS, Submission on ACCC Review of the 1997 Telecommunications Access Pricing Principles for Fixed Line Services, Draft Report, September 2010, October 2010.
Telstra, Pricing Principles for Fixed Line Services: Response to the ACCC's Draft Report, October 2010.
(D)ORC Calculations spreadsheet (confidential), October 2010.
(D)IHC Calculation spreadsheet (confidential), October 2010.
Documentation for indexed historic cost calculation, October 2010.
Covec (on behalf of Telstra), Approaches to determining Telstra's Regulated Asset Base, October 2010.
Gilbert + Tobin (on behalf of Telstra), Review of the 1997 telecommunications access pricing principles for fixed line services, October 2010.
Schedule 1: Asset valuation, depreciation and cost recovery.
Schedule 2: Deloitte (on behalf of Telstra),: Bruce Porter, Deloitte Touche Tomatsu, Expert advice re: use of written down accounting value of fixed network assets.
Schedule 3: Determining an initial RAB valuation – Implication of Application by Telstra Corporation Limited [2010] ACompT 1.

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	Schedule 5: Trade Practices Act 1974 – BBM framework for declared fixed network services – A working proposal.
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Schedule 3: Statement of **[c-i-c]** [redacted] **[c-i-c]** (confidential), 12 July 2011.
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Appendix C: FAD instruments for the declared fixed line services

Final Access Determination No. 1 of 2011 (LSS)
Final Access Determination No. 2 of 2011 (LCS)
Final Access Determination No. 3 of 2011 (PSTN OA)
Final Access Determination No. 4 of 2011 (PSTN TA)
Final Access Determination No. 5 of 2011 (ULLS)
Final Access Determination No. 6 of 2011 (WLR)

Competition and Consumer Act 2010

The AUSTRALIAN COMPETITION AND CONSUMER COMMISSION makes these final access determinations under section 152BC of the *Competition and Consumer Act 2010.*

Date of decision: 20 July 2011

1. Application

1.1 This instrument sets out final access determinations (FADs) in respect of the declared services ('relevant declared service') specified in the table.

Declared service	Expiry of declaration	Title of final access determination	Applicable schedules
Line Sharing Service ('LSS')	31 July 2014	Final Access Determination No. 1 of 2011 (LSS)	1, 2, 8, 9, 10, 11, 12, 13, 14, 16
Local Carriage Service ('LCS')	31 July 2014	Final Access Determination No. 2 of 2011 (LCS)	1, 3, 8, 9, 10, 11, 12, 13, 14
Domestic PSTN Originating Access Service ('PSTN OA')	31 July 2014	Final Access Determination No. 3 of 2011 (PSTN OA)	1, 4, 8, 9, 10, 11, 12, 13, 14
Domestic PSTN Terminating Access Service ('PSTN TA')	31 July 2014	Final Access Determination No. 4 of 2011 (PSTN TA)	1, 5, 8, 9, 10, 11, 12, 13, 14
Unconditioned Local Loop Service ('ULLS')	31 July 2014	Final Access Determination No. 5 of 2011 (ULLS)	1, 6, 8, 9, 10, 11, 12, 13, 14, 15, 16
Wholesale Line Rental Service ('WLR')	31 July 2014	Final Access Determination No. 6 of 2011 (WLR)	1, 7, 8, 9, 10, 11, 12, 13, 14

1.2 These FADs do not apply to services provided by a carrier or carriage service provider over the National Broadband Network.

1.3 The prices in these FADs are exclusive of tax payable under the *Utilities (Network Facilities Tax) Act 2006* (ACT).

1.4 The prices in these FADs are exclusive of Goods and Services Tax (GST).

Note:

1. From 1 January 2011:
   - a carrier licence held by a carrier is subject to a condition that the carrier must comply with any access determinations that are applicable to the carrier; and
   - a carriage service provider must comply with any access determinations that are applicable to the provider.
2. An Access Provider and Access Seeker may enter into an Access Agreement relating to a declared service. Access Agreements prevail over inconsistent access determinations: section 152BCC of the *Competition and Consumer Act 2010.*
3. The declared services that are the subject of these final access determinations are commonly referred to as the 'fixed line services'.

2. Definitions and interpretation

2.1 Schedule 1 applies to the interpretation of this instrument. The Schedules form part of this instrument.

3. Commencement and duration

3.1 These final access determinations commence on 1 January 2011.

3.2 These final access determinations remain in force up until and including 30 June 2014.

Note:

1. An access determination may come into force on a day which is earlier then the day the determination is made: subsections 152BCF(1), 152BCF(2) and 152BCF(2A) of the *Competition and Consumer Act 2010.*

2. These final access determinations revoke the interim access determinations for these declared services, made on 2 March 2011 by the operation of subsection 152BCF(9A) of the *Competition and Consumer Act 2010*.

4. Terms and conditions of access

4.1 If a carrier or carriage service provider is required to comply with any or all of the standard access obligations in respect of a relevant declared service, the carrier or carriage service provider must comply with those obligations on the terms and conditions set out in this clause 4.

Note: The terms and conditions in a final access determination apply only to those terms and conditions where terms and conditions on that matter in an Access Agreement cannot be reached, no special access undertaking is in operation setting out terms and conditions on that matter and no binding rules of conduct have been made setting out terms and conditions on that matter: section 152AY of the *Competition and Consumer Act 2010*.

4.2 If the carrier or carriage service provider is required to supply the relevant declared service to a service provider, the carrier or carriage service provider must supply the service:

(a) at the price specified in the applicable schedule set out in the table below; and

Declared service	Applicable schedule
LSS	2
LCS	3
PSTN OA	4
PSTN TA	5
ULLS	6
WLR	7

(b) on the non-price terms and conditions specified in the applicable schedules set out in the table below.

Declared service	Applicable schedules
LSS	8, 9, 10, 11, 12, 13, 14, 16
LCS	8, 9, 10, 11, 12, 13, 14
PSTN OA	8, 9, 10, 11, 12, 13, 14
PSTN TA	8, 9, 10, 11, 12, 13, 14
ULLS	8, 9, 10, 11, 12, 13, 14, 15, 16
WLR	8, 9, 10, 11, 12, 13, 14

4.3 This clause 4 is subject to clause 5.

5. Limitation on final access determination – previous exemptions

5.1 This clause applies where a determination ('exemption'):

(a) was made under section 152AS or 152AT of the *Trade Practices Act 1974* (now *Competition and Consumer Act 2010*); and

(b) was in force immediately before the commencement of these final access determinations,

to the extent that the determination relates to a relevant declared service.

5.2 The standard access obligations ('SAOs') in section 152AR of the *Competition and Consumer Act 2010* do not apply to a carrier or carriage service provider in respect of a relevant declared service to the extent that the exemption would have applied under item 202 or 203 of Schedule 1 to the *Telecommunications Legislation (Competition and Consumer Safeguards) Act 2010* prior to an access determination in relation to that service coming into force.

5.3 Clause 5.2 has the effect of providing that the SAOs do not apply as though the following exemptions continued to operate:

(a) LCS, PSTN OA and WLR class exemptions as varied by the ACCC on 18 November 2009; and

(b) The Australian Competition Tribunal's ('Tribunal') LCS, PSTN OA and WLR 2009 individual exemptions orders as made, affirmed and varied on 24 August 2009 (in the case of LCS and WLR) and 9 September 2009 (in the case of PSTN OA)

5.4 For the avoidance of doubt:

(a) clause 5.2 is subject to any conditions or limitations that were specified in the exemptions; and

(b) these final access determinations provide for the ACCC to perform the following functions, and exercise the following powers:

(i) collect data from industry on a six-monthly basis for the purpose of calculating which ESAs are to be 'Exemption ESAs' in accordance with the exemptions;

(ii) make the necessary calculations to determine which ESAs are Exemption ESAs in accordance with the exemptions; and

(iii) publish on its website a list of those Exemption ESAs in accordance with the exemptions.

Note:

1. Prior to 1 January 2011, sections 152AS and 15A2T of the *Competition and Consumer Act 2010* provided for the ACCC to make ordinary class exemptions and ordinary individual exemptions from the standard access obligations. These sections were repealed by the *Telecommunications Legislation (Competition and Consumer Safeguards) Act 2010* from 1 January 2011. Items 202 and 203 of Schedule 1 to that Act set out transitional arrangements. Under these provisions, the exemptions continue to have effect until the first access determination relating to access to the relevant declared service comes into force. An access determination may:

- provide that any or all of the standard access obligations are not applicable to a carrier or carriage service provider (either unconditionally or subject to conditions or limitations); or
- restrict or limit the application to a carrier or carriage service provider of any or all of the standard access obligations.

An access determination may also provide for the ACCC to perform functions, and exercise powers, under the determination: section 152BC of the *Competition and Consumer Act 2010*.

2. These exemptions provide for the ACCC to calculate 'Exemption ESAs' every six Months and publish a list of those Exemption ESAs on the ACCC's website. See: http://www.accc.gov.au/content/index.phtml/itemId/934407

6. Fixed principles provisions

6.1 This clause 6 sets out fixed principles provisions that apply to the six FADs contained in this document.

6.2 The six FADs contained in this document must not be varied so as to alter or remove any of the fixed principles provisions in this clause 6 except when the ACCC is satisfied that:

(a) there is a manifest and material error in these fixed principles provisions;

(b) any information on which these fixed principles provisions was based was false or misleading in a material respect; or

(c) such amendment or adjustment is necessary or desirable to avoid an unintended consequence of these fixed principles provisions.

6.3 The below fixed principles provisions come into force on 1 July 2011.

6.4 The nominal termination date for the fixed principles provisions is 30 June 2021.

6.5 The opening regulatory asset base (RAB) for the calculation of prices for the relevant declared fixed line services is $15,515,621,288 as at 1 July 2011 (in nominal terms).

6.6 The opening tax asset value for the calculation of prices for the relevant declared fixed line services is $10,144,121,785 as at 1 July 2011 (in nominal terms).

6.7 Roll-forward mechanism

(a) The RAB is to be rolled forward each year according to the formula below:

$RAB_{t+1} = RAB_t + capex_t - depreciation_t - asset\ disposals_t$

where RAB_{t+1} = opening RAB for the next regulatory year

RAB_t = opening RAB for the current year

$capex_t$ = forecast capital expenditure during the current year

$depreciation_t$ = regulatory depreciation during the current year

$asset\ disposals_t$ = asset disposals during the current year

(b) Land asset values will be indexed by the Consumer Price Index (CPI) where it is available or by the forecast for the CPI used in the Fixed Line Services Model (FLSM) where actual CPI is not available. This will account for appreciation over time in land values.

(c) To roll forward RAB values in nominal terms, any variables that are specified in real terms will be indexed by the actual CPI where it is available or by the forecast for the CPI used in the FLSM where the actual CPI is not available.

(d) Any variables that are specified in nominal terms will not be indexed, with the exception of land values as specified above.

(e) In these fixed principles provisions ‘the FLSM’ means the FLSM as it may be varied from time to time or similar model used by the ACCC for the calculation of prices for the relevant declared services.

6.8 The annual revenue requirement for each regulatory period will comprise:

(a) a return on the RAB calculated by multiplying the Weighted Average Cost of Capital (WACC) by the opening RAB for the regulatory year;

(b) a return of the RAB, that is regulatory depreciation, for that regulatory year;

(c) operating expenditure forecast to be incurred in that regulatory year; and

(d) an allowance for tax liabilities.

6.9 Under a building block model (BBM) approach, forecast operating expenditures should reflect prudent and efficient costs. The following matters are relevant to whether forecast operating expenditures reflect prudent and efficient costs:

(a) the access provider's level of operating expenditure in the previous regulatory period;

(b) reasons for proposed changes to operating expenditure from one regulatory period to the next regulatory period;

(c) any relevant regulatory obligations, or changes to such obligations, applicable to providing the relevant declared fixed line services; and

(d) any other matters relevant to whether forecast operating expenditures reflect prudent and efficient costs.

6.10 Under a BBM approach, forecast capital expenditures should reflect prudent and efficient costs. The following matters are relevant to whether capital expenditure forecasts reflect prudent and efficient costs:

(a) the access provider's level of capital expenditure in the previous regulatory period;

(b) reasons for proposed changes to capital expenditure from one regulatory period to the next regulatory period;

(c) whether the access provider's asset management and planning framework reflects best practice;

(d) any relevant regulatory obligations, or changes to such obligations, applicable to providing the relevant declared fixed line services; and

(e) any other matters relevant to whether forecast capital expenditures reflect prudent and efficient costs.

6.11 Demand forecasts should:

(a) be based on an appropriate forecasting methodology;

(b) be based on reasonable assumptions about the key drivers of demand;

(c) be determined utilising the best available information before the ACCC, including historical data that can identify trends in demand; and

(d) be determined taking into account current demand and economic conditions.

6.12 Weighted average cost of capital

(a) A vanilla WACC is used to estimate the return on capital.

(b) The cost of equity is estimated using the Capital Asset Pricing Model.

6.13 Tax liabilities

(a) The tax rate used in estimating tax liabilities in the FLSM will be set equal to the corporate tax rate specified in subsection 23(2) of the *Income Tax Rates Act 1986* (Cth) as amended from time to time.

6.14 Cost allocation factors

(a) The allocation of the costs of operating the PSTN should reflect the relative usage of the network by various services.

(b) Direct costs should be attributed to the service to which they relate.

The cost allocation factors for shared costs should reflect causal relationships between supplying services and incurring costs.

(c) No cost should be allocated more than once to any service

(d) The determination of cost allocation factors should reflect the principles in 6.14 (a) – (c) above except where reliable information is not available to support the application of the principles.

6.15 The matters set out in the fixed principles provisions at clauses 6.7 – 6.14 inclusive are subject to assessment, calculation, implementation and/or application, as relevant, by the ACCC in making interim and final access determinations for the relevant declared services.

INDEX TO SCHEDULES

Schedule 1 – Interpretation & Definitions

Interpretation

In these FADs, unless the contrary intention appears:

(a) the singular includes the plural and vice versa;

(b) the words "including" and "include" mean "including, but not limited to"; and

(c) terms defined in the CCA or the *Telecommunications Act 1997* have the same meaning.

Definitions

ACCC means the Australian Competition and Consumer Commission

Access Agreement has the same meaning as given to that term in section 152BE of the CCA

Access Provider has the same meaning as given to that term in subsection 152AR(2) of the CCA

Access Seeker has the same meaning as given to that term in section 152AG of the CCA

ACDC means the Australian Commercial Disputes Centre Limited

ACDC Guidelines means the mediation guidelines of the ACDC as specified in clause 10.10 of Schedule 10

ACMA means the Australian Communications and Media Authority

Band means the geographic classification of exchange service areas (ESAs)

Band 1 means the following ESAs located in central business districts:

(a) NSW (City South, Dalley, Haymarket, Pitt, Kent);

(b) QLD (Charlotte, Edison, Roma Street, Spring Hill);

(c) South Australia (Flinders, Waymouth);

(d) Victoria (Batman, Exhibition, Lonsdale); and

(e) WA (Bulwer, Pier, Wellington)

Band 2 means an ESA with more than 108.4 services in operation in a square kilometre area at the time this determination is made, which is not a Band 1 ESA

Band 3 means an ESA with 6.56 or more, but less than 108.4, services in operation in a square kilometre area at the time this determination is made

Band 4 means an ESA with 6.55 or less services in operation in a square kilometre area at the time this determination is made.

Note: These Band definitions are taken from Annexure A (Key Performance Indicators Operational Document) to Telstra's Service Quality Strategy dated 23 June 2006 (available at http://telstrawholesale.com//dobusiness/customer-commitment/docs/op_sep_quality_strategy.pdf).

Billing Dispute means a dispute relating to a Charge or an invoice issued by the Access Provider

Billing Dispute Notice means a notice given pursuant to clause 8.11 in Schedule 8

Billing Dispute Procedures means the procedures set out in clauses 8.11 to 8.29 in Schedule 8

Breach Notice has the meaning set out in clause 14.5 of Schedule 14

Business Hours means 8.00 am to 5.00 pm Monday to Friday, excluding a day which is a gazetted public holiday in the place where the relevant transaction or work is to be performed

Business Day means any day other than Saturday or Sunday or a day which is a gazetted public holiday in the place concerned

Calendar Day means a day reckoned from midnight to midnight

CAN means a customer access network

Capped Exchange means an exchange that is included on a list that the Access Provider has published of exchanges that are subject to capacity constraints

Carriage Service has the same meaning given to that term in section 7 of the *Telecommunications Act 1997* (Cth)

CCA means the *Competition and Consumer Act 2010* (Cth)

Charge means a charge for the supply of a Service

Common Infrastructure Works means where an Access Seeker increases the capacity of existing Facilities at an Exchange that could be used by itself and other service providers.

Complex Service means any service which is not a fixed service comprising:

(a) a connection from a carrier or carriage service provider network boundary to the local exchange;

(b) a telephone number; and

(c) access to other kinds of telecommunication services which is indicated by dial-tone

Connect Outstanding process has the meaning set out in clauses 16.24 and 16.25 of Schedule 16

Confidential Information means all information, know-how, ideas, concepts, technology, manufacturing processes, industrial, marketing and commercial knowledge of a confidential nature (whether in tangible or intangible form and whether coming into existence before or after the commencement of this FAD) relating to or developed in connection with or in support of the business of a party (the **first mentioned party**) but does not include:

(a) information which is or becomes part of the public domain (other than through any breach of this FAD or a breach of any other obligation of confidence in favour of the provider of the Confidential Information or by any other unlawful means of which the acquirer of the confidential information is aware;

(b) information rightfully received by the other party from a third person without a duty of confidentiality being owed by the other party to the third person, except where the other party has knowledge that the third person has obtained that information either directly or indirectly as a result of a breach of any duty of confidence owed to the first mentioned party; or

(c) information which has been independently developed or obtained by the other party

Coordinated Capital Works Program means a planned Major Network Modernisation and Upgrade that extends across more than one exchange service area but does not include an Emergency Network Modernisation and Upgrade

Coordinated Capital Works Program Forecast has the meaning set out in clause 13.10 of Schedule 13

Coordinated Capital Works Program Schedule has the meaning set out in clause 13.14 of Schedule 13

Disclosing Party has the meaning set out in clause 11.5 in Schedule 11 of this FAD

Emergency means an emergency due to an actual or potential occurrence (such as fire, flood, storm, earthquake, explosion, accident, epidemic or war-like action) which:

(a) endangers or threatens to endanger the safety or health of persons; or

(b) destroys or damages, or threatens to destroy or damage property,

being an emergency which requires a significant and co-ordinated response

Emergency Network Modernisation and Upgrade means a Major Network Modernisation and Upgrade that is required and is reasonably necessary and a proportionate response to address an Emergency

Equivalent Period of Notice means a period of notice commencing at the time that the Access Provider has approved and allocated the capital expenditure or otherwise approved and made a decision to commit to a Major Network Modernisation and Upgrade

ESA means an exchange service area which is a geographic area generally serviced by a single Exchange

Exchange means a building in which telephone switching or other equipment of an Access Provider or Access Seeker has been installed for use in connection with a telecommunications network

Exemption ESA has the same meaning given to that term in the Australian Competition Tribunal's 2009 WLR, LCS and PSTN OA Individual Exemption Orders.

Expert Committee means a committee established under clause 10.11 in Schedule 10

Facility has the same meaning given to that term in section 7 of the *Telecommunications Act 1997* (Cth)

FAD means Final Access Determination

Fault means:

(a) a failure in the normal operation of a Network or in the delivery of a Service; or

(b) any issue as to the availability or quality of a Service supplied to an end-user via the Access Seeker, notified by the end-user to the Access Seeker's help desk,

that has been reasonably assessed by the Access Provider as being the Access Provider's responsibility to repair

General Notification has the meaning set out in clause 13.1

Independent Auditor means a person appointed as an independent auditor in accordance with clause 11.11 of Schedule 11

Individual Notification has the meaning set out in clause 13.1 of Schedule 13

Initiating Notice has the meaning as set out in clause 10.11 of Schedule 10

LCS means local carriage service

Limitation Notice has the meaning set out in clause 16.10 of Schedule 16

Listed Carriage Service has the same meaning given to that term in section 7 of the *Telecommunications Act 1997* (Cth)

LSS means line sharing service

Major Network Modernisation and Upgrade means a modernisation or upgrade that:

(a) involves the installation of Telstra customer access modules closer to end-users than a Telstra exchange building;

(b) requires the removal/relocation of the LSS or the ULLS provided from Telstra exchange buildings and the establishment of a new POI (or relocation of an existing POI) for the LSS or the ULLS, or alteration of deployment classes of equipment used on the LSS or the ULLS; or

(c) results in a Service no longer being supplied or adversely affects the quality of that Service (or any services supplied by an Access Seeker to their end-users using the Service), but does not mean, or include, an Emergency Network Modernisation Upgrade or an national broadband network (NBN) related upgrade

MDF means a main distribution frame

MNM means managed network migration

Month means a period commencing at the beginning of any day of a named month and ending:

(a) at the end of the day before the corresponding day of the next named month; or

(b) if there is no such corresponding day – at the end of the next named month

National Broadband Network means a national telecommunications network for the high-speed carriage of communications, where NBN Co has been, is, or is to be, involved in the creation or development of the network. To avoid doubt, it is immaterial whether the creation or development of the network is, to any extent, attributable to:

(a) the acquisition of assets that were used, or for use, in connection with another telecommunications network; or

(b) the obtaining of access to assets that are also used, or for use, in connection with another telecommunications network.

NBN Co means NBN Co Limited (ACN 136 533 741), as the company exists from time to time (even if its name is later changed).

Network of a party, means that party's system, or series of systems, that carries, or is capable of carrying communications by means of guided or unguided electromagnetic energy

Non-Billing Dispute means a dispute other than a Billing Dispute

Ongoing Creditworthiness Information has the meaning as set out in clause 9.7 of Schedule 9 of this FAD

POI means point of interconnection. A point of interconnection is a physical point of interconnection in Australia between a network operated by a carrier or carriage service provider and another network operated by a service provider.

Prohibited Traffic means traffic offered across a POI for which there is no agreement between the Access Provider and the Access Seeker that the Access Provider will carry such traffic or provide a related service to the Access Seeker

Proof of Occupancy means a document that verifies occupancy by the end-user at the service address

PSTN means public switched telephone network

PSTN OA means public switched telephone network originating access service

PSTN TA means public switched telephone network terminating access service

Security means the amount and type of security provided, or required to be provided, to the Access Provider in respect of the provision by the Access Provider of Services, as set out in Schedule 9

Service means a service declared under section 152AL of the CCA

Service Qualification is a desktop process where the Access Provider checks:

(a) the availability of the ULLS from the end user side of the customer access module to the end-user's property boundary point; and

(b) that the use on that ULLS of the Access Seeker nominated deployment class complies with the *Network Deployment Rules* Industry Code

Suspension Event has the meaning set out in clause 14.2 of Schedule 14

Suspension Notice has the meaning set out in clause 14.2 of Schedule 14

TEBA space means Telstra Exchange Building Access space

Transfer means the transfer of a LSS to a ULLS where there is no change of service provider.

ULL means unconditioned local loop

ULLS means unconditioned local loop service

WLR means wholesale line rental service

Schedule 2 – Price terms for Line Sharing Service (LSS)

2.1. The prices for LSS for the period 1 January 2011 to 30 June 2011 are:

LSS Monthly charge per service

LSS Monthly charge per service
$1.80

LSS single connections

LSS single connections
$44.26 per connection

Note: These charges do not apply to connections in Band 4

Note: These charges do not apply where the line on which the LSS is connected was being used to supply a ULLS.

LSS single disconnections (where payable)

LSS single disconnections
$39.74 per disconnection

Note: These charges are not payable for:

- a disconnection made pursuant to the Telstra churn process by which services can be transferred between LSS, and between LSS and DSL services, or
- any period in which the Access Seeker was participating in the Telstra LSS churn process and Telstra (Bigpond) was not participating in the Telstra LSS churn process.

LSS managed network migration (MNM) connection charges – where the service is to be connected on a line Telstra is using to supply a wholesale ADSL service

	LSS MNM connection charge
Fixed amount (per MNM)	$143.88
Variable amount (per connection)	$33.07

Note: These charges do not apply to MNMs in Band 4

LSS MNM minimum exchange charge

LSS minimum exchange charge
$805.27 per exchange

Note: These charges do not apply to MNMs in Band 4

2.2. The prices for LSS for the period 1 July 2011 to 30 June 2014 are:

LSS Monthly charge per service

LSS Monthly charge per service
$1.80

LSS single connections

	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
Per connection	$45.04	$46.16	$47.55

Note: These charges do not apply to connections in Band 4

Note: These charges do not apply where the line on which the LSS is connected was being used to supply a ULLS.

LSS single disconnections (where payable)

	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
Per disconnection	$40.44	$41.45	$42.69

Note: A disconnection charge is not payable if either:

(a) the disconnection is made pursuant to the Telstra LSS churn process; or

(b) the access seeker is participating in the Telstra LSS churn process and Telstra (BigPond) is not participating in the Telstra LSS churn process, where the service is being transferred to Telstra (BigPond).

A disconnection charge is payable if:

(c) the access seeker is participating in the Telstra LSS churn process and the service is being transferred to an access seeker that is not participating in the Telstra LSS churn process.

LSS managed network migration (MNM) connection charges – where the service is to be connected on a line Telstra is using to supply a wholesale ADSL service

	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
Fixed amount (per MNM)	$146.40	$150.06	$154.56
Variable amount (per connection)	$33.65	$34.49	$35.52

Note: These charges do not apply to MNMs in Band 4

LSS MNM minimum exchange charge

	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
Per exchange	$819.36	$839.85	$865.04

Note: These charges do not apply to MNMs in Band 4

Schedule 3 – Price terms for Local Carriage Service (LCS)

3.1. The price for LCS for the period 1 January 2011 to 30 June 2011 is:

Local Calls
9.1c

3.2. The price for LCS for the period 1 July 2011 to 30 June 2014 is:

Local Calls
8.9c

Schedule 4 – Price terms for Public Switched Telephone Network Originating Access service (PSTN OA)

4.1. The prices for PSTN OA for the period 1 January 2011 to 30 June 2011 are:

	Flagfall (cents per call)	EMOU charge (cents per minute)	Headline rate (cents per minute)
CBD	0.85	0.35	0.57
Metropolitan	0.84	0.49	0.70
Provincial	0.94	0.68	0.91
Rural	2.06	3.66	4.18
Average	**0.95**	**0.76**	**1.00**

4.2. The national average price for PSTN OA for the period 1 July 2011 to 30 June 2014 is 0.95 cents per minute.

Schedule 5 – Price terms for Public Switched Telephone Network Terminating Access service (PSTN TA)

5.1. The prices for PSTN TA for the period 1 January 2011 to 30 June 2011 are:

	Flagfall (cents per call)	EMOU charge (cents per mintute)	Headline rate (cents per minute)
CBD	0.85	0.35	0.57
Metropolitan	0.84	0.49	0.70
Provincial	0.94	0.68	0.91
Rural	2.06	3.66	4.18
Average	**0.95**	**0.76**	**1.00**

5.2. The national average price for PSTN TA for the period 1 July 2011 to 30 June 2014 is 0.95 cents per minute.

Schedule 6 – Price terms for Unconditioned Local Loop Service (ULLS)

6.1. The prices for ULLS for the period 1 January 2011 to 30 June 2011 are:

ULLS Monthly charges on a per service per Month basis for Bands 1, 2, 3 and 4

Band	Monthly price per service
1	$16.00
2	$16.00
3	$16.00
4	$48.00

ULLS single connection charges – in use ULLS and transfer ULLS connections

Band	Per connection
1	$51.76
2	$54.53
3	$59.26

Note: No price is set for the ULLS in Band 4.

Note: No price is set for a Vacant ULLS connection.

Charges for ULLS MNM – involving the transfer of end user data services from a Telstra wholesale PSTN and/or ADSL service, or from a line that Telstra is using to supply a ULLS to another Access Seeker

	Charge for ULLS MNM
Fixed amount (per MNM)	$141.73
Variable amount (per connection)	$25.68

ULLS cancellation charges

	ULLS cancellation charge
Per service where pre-jumpering has occurred	$20.54
Where entire MNM is cancelled	$141.73

ULLS MNM minimum exchange charge – per MNM

ULLS MNM minimum exchange charge
$655.23 per exchange

ULLS call diversion charges for the initial connection/activation of ULLS

	ULLS call diversion charge for initial connection/activation of ULLS
Fixed amount (per ULLS call diversion)	$9.55
Variable amount (pro rata per month)	$12.84

6.2. The prices for ULLS for the period 1 July 2011 to 30 June 2014 are:

ULLS Monthly charges on a per service per Month basis for Bands 1, 2, 3 and 4

Band	Monthly price per service
1	$16.21
2	$16.21
3	$16.21
4	$48.19

ULLS single connection charges – in use ULLS and transfer ULLS connections

Band	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
1	$52.67	$53.98	$55.60
2	$55.49	$56.88	$58.58
3	$60.29	$61.80	$63.66

Note: No price is set for the ULLS in Band 4.

Note: No price is set for a Vacant ULLS connection.

Charges for ULLS MNM – involving the transfer of end user data services from a Telstra wholesale PSTN and/or ADSL service, or from a line that Telstra is using to supply a ULLS to another Access Seeker

	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
Fixed amount (per MNM)	$144.21	$147.81	$152.25
Variable amount (per connection)	$26.12	$26.78	$27.58

ULLS cancellation charges

	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
Per service where pre-jumpering has occurred	$20.90	$21.42	$22.06
Where entire MNM is cancelled	$144.21	$147.81	$152.25

ULLS MNM minimum exchange charge – per MNM

	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
Per exchange	$666.69	$683.36	$703.86

ULLS call diversion charges for the initial connection/activation of ULLS

	Jul 2011 – Jun 2012	Jul 2012 – Jun 2013	Jul 2013 – Jun 2014
Fixed amount (per ULLS call diversion)	$9.72	$9.96	$10.26
Variable amount (pro rata per Month)	$13.06	$13.39	$13.79

Schedule 7 – Price terms for Wholesale Line Rental service (WLR)

7.1. The price for WLR for the period 1 January 2011 to 30 June 2011 is:

Monthly price per service
$22.10

7.2. The price for WLR for the period 1 July 2011 to 30 June 2014 is:

Monthly price per service
$22.84

Schedule 8 – Billing and Notifications

8.1. The Access Seeker's liability to pay Charges for a Service to the Access Provider arises at the time the Service is supplied by the Access Provider to the Access Seeker, unless the parties agree otherwise.

8.2. The Access Seeker must pay Charges in accordance with this FAD, including but not limited to this Schedule 8.

8.3. Subject to clause 8.4, the Access Provider shall provide the Access Seeker with an invoice each month in respect of Charges payable for Services unless the parties agree otherwise.

8.4. As a statement of general principle, the Access Provider may invoice the Access Seeker more frequently than once a Month, where there has been a decline in the Access Seeker's creditworthiness as assessed in accordance with Schedule 9.

8.5. The Access Provider shall be entitled to invoice the Access Seeker for previously uninvoiced Charges or Charges which were understated in a previous invoice, provided that:

(a) the Charges to be retrospectively invoiced can be reasonably substantiated to the Access Seeker by the Access Provider; and

(b) subject to clause 8.6, no more than five Months have elapsed since the date the relevant amount was incurred by the Access Seeker's customer, except:

(i) where the Access Seeker gives written consent to a longer period (such consent not to be unreasonably withheld); or

(ii) to the extent that the Charges relate to services supplied by an overseas carrier and the Access Provider has no control over the settlement arrangements as between it and the overseas carrier, in which case the Access Provider shall invoice such amounts as soon as is reasonably practicable.

8.6. The parties must comply with the provisions of any applicable industry standard made by the ACMA pursuant to Part 6 of the *Telecommunications Act 1997* (Cth) and the provisions of any applicable industry code registered pursuant to Part 6 of the *Telecommunications Act 1997 (*Cth) in relation to billing.

8.7. Subject to any Billing Dispute notified in accordance with this FAD, an invoice is payable in full 30 Calendar Days after the date the invoice was issued or such other date as agreed between the parties. The Access Seeker may not deduct, withhold, or set-off any amounts for accounts in credit, for counter-claims or for any other reason or attach any condition to the payment, unless otherwise agreed by the Access Provider. All amounts owing and unpaid after the due date shall accrue interest daily from the due date up to and

including the date it is paid at the rate per annum of the 90 day authorised dealers bank bill rate published in the *Australian Financial Review* on the first Business Day following the due date for payment, plus 2.5%.

8.8. In addition to charging interest in accordance with clause 8.7 or exercising any other rights the Access Provider has at law or under this FAD, where an amount is outstanding and remains unpaid for more than 20 Business Days after it is due for payment, and is not an amount subject to any Billing Dispute, the Access Provider may take action, without further notice to the Access Seeker, to recover any such amount as a debt due to the Access Provider. For the avoidance of doubt, this clause 8.8 shall be subject to the Billing Dispute Procedures.

8.9. Unless the parties otherwise agree, there shall be no setting-off (i.e. netting) of invoices except where a party goes into liquidation, in which case the other party may set-off. However, in order to minimise the administration and financial costs, the parties shall consider in good faith set-off procedures for inter-party invoices which may require the alignment of the parties' respective invoice dates and other procedures to allow set-off to occur efficiently.

8.10. The Access Provider must, at the time of issuing an invoice, provide to the Access Seeker all information reasonably required by the Access Seeker to identify and understand the nature and amount of each component of the invoice. Nothing in this clause 8.10 is intended to limit subsections 152AR(6) and 152AR(7) of the CCA.

8.11. If the Access Seeker believes a Billing Dispute exists, it may, by written notice to the Access Provider, invoke the Billing Dispute Procedures (**Billing Dispute Notice**). A Billing Dispute must be initiated only in good faith.

8.12. Except where a party seeks urgent injunctive relief, the Billing Dispute Procedures must be invoked before either party may begin legal or regulatory proceedings in relation to any Billing Dispute.

8.13. If a Billing Dispute Notice is given to the Access Provider by the due date for payment of the invoice containing the Charge which is being disputed, the Access Seeker may withhold payment of the disputed Charge until such time as the Billing Dispute has been resolved. Otherwise, the Access Seeker must pay the invoice in full in accordance with this FAD (but subject to the outcome of the Billing Dispute Procedures).

8.14. Except where payment is withheld in accordance with clause 8.13, the Access Provider is not obliged to accept a Billing Dispute Notice in relation to an invoice unless the invoice has been paid in full.

8.15. A Billing Dispute Notice may not be given to the Access Provider in relation to a Charge later than six Months after the due date for the invoice for the Charge issued in accordance with 8.7.

8.16. The Access Provider shall acknowledge receipt of a Billing Dispute Notice within two Business Days by providing the Access Seeker with a reference number.

8.17. Each party shall, as early as practicable after a Billing Dispute Notice, provide to the other party any relevant materials on which it intends to rely (provided that this obligation is not intended to be the same as the obligation to make discovery in litigation).

8.18. The Access Provider shall try to resolve any Billing Dispute as soon as practicable and in any event within 30 Business Days of receipt of a Billing Dispute Notice (or longer period if agreed by the parties), by notifying the Access Seeker in writing of its proposed resolution of a Billing Dispute. That notice shall explain the Access Provider's proposed resolution and any action to be taken by:

(a) the Access Provider (e.g. withdrawal, adjustment or refund of the disputed Charge); or

(b) the Access Seeker (e.g. payment of the disputed Charge).

8.19. Any withdrawal, adjustment or refund of the disputed Charge by the Access Provider or payment of the disputed Charge by the Access Seeker (as the case may be) must occur within as soon as practicable and in any event within one Month of the Access Provider's notice, unless the Access Seeker escalates the Billing Dispute under clause 8.23.

8.20. Where the Access Provider is to refund a disputed Charge, the Access Provider shall pay interest (at the rate set out in clause 8.7) on any refund. Interest shall accrue daily from the date on which each relevant amount to be refunded was paid to the Access Provider, until the date the refund is paid.

8.21. Where the Access Seeker is to pay a disputed Charge, the Access Seeker shall pay interest (at the rate set out in clause 8.7) on the amount to be paid. Interest shall accrue daily from the date on which each relevant amount was originally due to be paid to the Access Provider, until the date the amount is paid.

8.22. If the Access Seeker is not satisfied with the Access Provider's proposed resolution in relation to a Billing Dispute, or if the Access Provider has not provided the Access Seeker with a proposed resolution to the Billing Dispute within the timeframe set out in clause 8.18, the Access Seeker may escalate the matter under clause 8.23. If the Access Seeker does not do so within 30 Business Days of being notified of the Access Provider's proposed resolution (or a longer period if agreed by the parties), the Access Seeker shall be deemed to have accepted the Access Provider's proposed resolution and clauses 8.20 and 8.21 shall apply.

8.23. If the Access Seeker wishes to escalate a Billing Dispute, the Access Seeker must give the Access Provider a written notice:

(a) stating why it does not agree with the Access Provider's proposed resolution; and

(b) seeking escalation of the Billing Dispute.

8.24. A notice under clause 8.23 must be submitted to the nominated billing manager for the Access Provider, who shall discuss how best to resolve the Billing Dispute with the Access Seeker's nominated counterpart.

8.25. If the escalated matter cannot be resolved under clause 8.24 within five Business Days of notice being given under clause 8.23:

(a) either party may provide a written proposal to the other party for the appointment of a mediator to assist in resolving the dispute. Mediation shall be conducted in accordance with the mediation guidelines of the ACDC and concluded within three Months of the proposal (unless the parties agree to extend this timeframe); or

(b) if the parties either do not agree to proceed to mediation or are unable to resolve the entire Billing Dispute by mediation, either party may commence legal or regulatory proceedings to resolve the matter.

8.26. The parties shall ensure that any person appointed or required to resolve a Billing Dispute shall take into account the principle that the Access Seeker shall be entitled to be recompensed in circumstances where the Access Seeker is prevented (due to regulatory restrictions on retrospective invoicing) from recovering from its end-user an amount which is the subject of a Billing Dispute (a **Backbilling Loss**), provided that:

(a) such principle shall apply only to the extent to which the Billing Dispute is resolved against the Access Provider; and

(b) such principle shall apply only to the extent to which it is determined that the Backbilling Loss was due to the Access Provider unnecessarily delaying resolution of the Billing Dispute.

8.27. Each party must continue to fulfill its obligations under this FAD while a Billing Dispute and the Billing Dispute Procedures are pending.

8.28. All discussions and information relating to a Billing Dispute must be communicated or exchanged between the parties through the representatives of the parties set out in clause 8.24 (or their respective nominees).

8.29. There shall be a presumption that all communications between the parties during the course of a Billing Dispute are made on a without prejudice and confidential basis.

8.30. If it is determined by the Billing Dispute Procedures, any other dispute resolution procedure, or by agreement between the parties, that three or more out of any five consecutive invoices for a given Service are incorrect by 5% or more, then, for the purposes of clause 8.20, the interest payable by the Access Provider in respect of the overpaid amount of the invoices in question shall be

the rate set out in clause 8.7, plus 2%. The remedy set out in this clause 8.30 shall be without prejudice to any other right or remedy available to the Access Seeker.

8.31. If three or more out of any five consecutive invoices for a given Service are incorrect by 5% or more, then without prejudice to any other right or remedy available to the Access Seeker, the Access Provider shall be deemed to have breached this FAD and the Access Seeker shall have a right to damages for such a breach.

Schedule 9 – Creditworthiness and Security

9.1. Unless otherwise agreed by the Access Provider, the Access Seeker must (at the Access Seeker's sole cost and expense) provide to the Access Provider and maintain, on terms and conditions reasonably required by the Access Provider and subject to clause 9.2, the Security (as shall be determined having regard to clause 9.3 and as may be varied pursuant to clause 9.4) in respect of amounts owing by the Access Seeker to the Access Provider under this FAD.

9.2. The Access Seeker acknowledges that unless otherwise agreed by the Access Provider, it must maintain (and the Access Provider need not release) the Security specified in clause 9.1 for a period of six Months following the last to occur of: cessation of supply of a Service or Services under this FAD, and payment of all outstanding amounts under this FAD.

9.3. The Security (including any varied Security) shall only be requested when it is reasonably necessary to protect the legitimate business interests of the Access Provider and shall be of an amount and in a form which is reasonable in all the circumstances. As a statement of general principle the amount of any Security shall be calculated by reference to:

(a) the aggregate value of all Services likely to be provided to the Access Seeker under this FAD over a reasonable period; or

(b) the value of amounts invoiced under this FAD but unpaid (excluding any amounts in respect of which there is a current Billing Dispute).

For the avoidance of doubt, any estimates, forecasts or other statements made or provided by the Access Seeker may be used by the Access Provider in determining the amount of a Security.

9.4. Examples of appropriate forms of security, having regard to the factors referred to in clause 9.3, may include without limitation:

(a) fixed and floating charges;

(b) personal guarantees from directors;

(c) bank guarantees;

(d) letters of comfort;

(e) mortgages;

(f) a right of set-off; or

(g) a combination of the forms of security referred to in paragraphs (a) to (f) above.

9.5. The Access Provider may from time to time where the circumstances reasonably require, request Ongoing Creditworthiness Information from the

Access Seeker to determine the ongoing creditworthiness of the Access Seeker. The Access Seeker must supply Ongoing Creditworthiness Information to the Access Provider within 15 Business Days of receipt of a request from the Access Provider for such information. The Access Provider may, as a result of such Ongoing Creditworthiness Information, having regard to the factors referred to in clause 9.3 and subject to clause 9.7, reasonably require the Access Seeker to alter the Security, and the Access Seeker must provide that altered Security within 20 Business Days of being notified by the Access Provider in writing of that requirement.

9.6. The Access Seeker may from time to time request the Access Provider to consent (in writing) to a decrease in the required Security and/or alteration of the form of the Security. The Access Provider must, within 15 Business Days of the Access Seeker's request, comply with that request if, and to the extent, it is reasonable to do so (having regard to the factors referred to in clause 9.3). The Access Provider may request, and the Access Seeker shall promptly provide, Ongoing Creditworthiness Information, for the purposes of this clause 9.6.

9.7. In the event that the Access Seeker provides Ongoing Creditworthiness Information to the Access Provider as required by this Schedule 9, the Access Seeker must warrant that such information is true, fair, accurate and complete as at the date on which it is received by the Access Provider.

9.8. For the purposes of this Schedule 9, **Ongoing Creditworthiness Information** means:

(a) a copy of the Access Seeker's most recent published audited balance sheet and published audited profit and loss statement (together with any notes attached to or intended to be read with such balance sheet or profit and loss statement);

(b) a credit report in respect of the Access Seeker or, where reasonably necessary in the circumstances, any of its owners or directors (Principals) from any credit reporting agency, credit provider or other independent party. The Access Seeker shall co-operate and provide any information necessary for that credit reporting agency, credit provider or other independent party to enable it to form an accurate opinion of the Access Seeker's creditworthiness. To that end, the Access Seeker agrees to procure written consents (as required under the *Privacy Act 1988* (Cth)) from such of its Principals as is reasonably necessary in the circumstances to enable the Access Provider to:

(i) obtain from a credit reporting agency, credit provider or other independent party, information contained in a credit report;

(ii) disclose to a credit reporting agency, credit provider or other independent party, personal information about each Principal; and

(iii) obtain and use a consumer credit report;

(c) a letter, signed by the company secretary or duly authorised officer of the Access Seeker, stating that the Access Seeker is not insolvent and not under any external administration (as defined in the *Corporations Act 2001* (Cth)) or under any similar form of administration under any laws applicable to it in any jurisdiction; and

(d) the Access Seeker's credit rating, if any has been assigned to it.

9.9. The Access Seeker may require a confidentiality undertaking to be given by any person having access to confidential information contained in its Ongoing Creditworthiness Information prior to such information being provided to that person.

9.10. Subject to this Schedule 9, the Access Provider may, in its absolute discretion, deem a failure by the Access Seeker to provide Ongoing Creditworthiness Information or an altered Security in accordance with clause 9.5 as:

(a) an event entitling the Access Provider to alter the Security of the Access Seeker; or

(b) a breach of a material term or condition of this FAD.

9.11. Any disputes arising out of or in connection with Schedule 9 shall be dealt with in accordance with the procedures in Schedule 10.

Schedule 10 – General dispute resolution procedures

10.1. If a dispute arises between the parties in connection with or arising from the supply of a Service under this FAD, the dispute shall be managed as follows:

(a) in the case of a Billing Dispute, the dispute shall be managed in accordance with the Billing Dispute Procedures; or

(b) subject to clause 10.2, in the case of a Non-Billing Dispute, the dispute shall be managed in accordance with the procedures set out in this Schedule 10.

10.2. To the extent that a Non-Billing Dispute is raised or arises in connection with, or otherwise relates to, a Billing Dispute, then unless the Access Provider otherwise determines, that Non-Billing Dispute shall be resolved in accordance with the Billing Dispute Procedures.

10.3. If a Non-Billing Dispute arises, either party may, by written notice to the other, refer the Non-Billing Dispute for resolution under this Schedule 10. A Non-Billing Dispute must be initiated only in good faith.

10.4. Any Non-Billing Dispute notified under clause 10.3 shall be referred:

(a) initially to the nominated manager (or managers) for each party, who shall endeavour to resolve the dispute within 10 Business Days of the giving of the notice referred to in clause 10.3 or such other time agreed by the parties; and

(b) if the persons referred to in paragraph (a) above do not resolve the Non-Billing Dispute within the time specified under paragraph (a), then the parties may agree in writing within a further five Business Days to refer the Non-Billing Dispute to an Expert Committee under clause 10.11, or by written agreement submit it to mediation in accordance with clause 10.10.

10.5. If:

(a) under clause 10.4 the Non-Billing Dispute is not resolved and a written agreement is not made to refer the Non-Billing Dispute to an Expert Committee or submit it to mediation; or,

(b) under clause 10.10(f), the mediation is terminated; and

(c) after a period of five Business Days after the mediation is terminated as referred to in paragraph (b), the parties do not resolve the Non-Billing Dispute or agree in writing on an alternative procedure to resolve the Non-Billing Dispute (whether by further mediation, written notice to the Expert Committee, arbitration or otherwise) either party may terminate the operation of this dispute resolution procedure in relation to the Non-Billing Dispute by giving written notice of termination to the other party.

10.6. A party may not commence legal proceedings in any court or commence any arbitration (except proceedings seeking urgent interlocutory relief) in respect of a Non-Billing Dispute unless:

(a) the Non-Billing Dispute has first been referred for resolution in accordance with the dispute resolution procedure set out in this Schedule 10 or clause 10.2 (if applicable) and a notice terminating the operation of the dispute resolution procedure has been issued under clause 10.5; or

(b) the other party has failed to substantially comply with the dispute resolution procedure set out in this Schedule 10 or clause 10.2 (if applicable).

10.7. Each party must continue to fulfill its obligations under this FAD while a Non-Billing Dispute and any dispute resolution procedure under this Schedule 10 are pending.

10.8. There shall be a presumption that all communications between the parties during the course of a Non-Billing Dispute are made on a without prejudice and confidential basis.

10.9. Each party shall, as early as practicable after the notification of a Non-Billing Dispute pursuant to clause 10.3, provide to the other party any relevant materials on which it intends to rely (provided that this obligation is not intended to be the same as the obligation to make discovery in litigation).

10.10. Where a Non-Billing Dispute is referred to mediation by way of written agreement between the parties, pursuant to clause 10.4(b):

(a) any agreement shall include:

(i) a statement of the disputed matters in the Non-Billing Dispute; and

(ii) the procedure to be followed during the mediation,

and the mediation must take place within 15 Business Days upon the receipt by the mediator of such agreement;

(b) it must be conducted in accordance with the mediation guidelines of the ACDC in force from time to time (**ACDC Guidelines**) and the provisions of this clause 10.10. In the event of any inconsistency between them, the provisions of this clause 10.10 shall prevail;

(c) it is to be conducted in private;

(d) in addition to the qualifications of the mediator contemplated by the ACDC Guidelines, the mediator should:

(i) have an understanding of the relevant aspects of the telecommunications industry (or have the capacity to quickly come to such an understanding);

(ii) have an appreciation of the competition law implications of his/her decisions; and

(iii) not be an officer, director or employee of a telecommunications company or otherwise have a potential for a conflict of interest;

(e) the parties must notify each other no later than 48 hours prior to mediation of the names of their representatives who shall attend the mediation. Nothing in this subclause is intended to suggest that the parties are able to refuse the other's chosen representatives or to limit other representatives from the parties attending during the mediation;

(f) it shall terminate in accordance with the ACDC Guidelines;

(g) the parties shall bear their own costs of the mediation including the costs of any representatives and shall each bear half the costs of the mediator; and

(h) any agreement resulting from mediation shall bind the parties on its terms.

10.11. The parties may by written agreement in accordance with clause 10.4(b), submit a Non-Billing Dispute for resolution by an Expert Committee (**Initiating Notice**), in which case the provisions of this clause 10.11 shall apply as follows:

(a) The terms of reference of the Expert Committee shall be as agreed by the parties. If the terms of reference are not agreed within five Business Days after the date of submitting the Initiating Notice (or such longer period as agreed between the parties), the referral to the Expert Committee shall be deemed to be terminated.

(b) An Expert Committee shall act as an expert and not as an arbitrator.

(c) The parties shall each be represented on the Expert Committee by one appointee.

(d) The Expert Committee must include an independent chairperson agreed by the parties or, if not agreed, a nominee of the ACDC. The chairperson must have the qualifications listed in paragraphs 10.10(d)(i), (ii) and (iii).

(e) Each party shall be given an equal opportunity to present its submissions and make representations to the Expert Committee.

(f) The Expert Committee may determine the dispute (including any procedural matters arising during the course of the dispute) by unanimous or majority decision.

(g) Unless the parties agree otherwise the parties shall ensure that the Expert Committee uses all reasonable endeavours to reach a decision within 20 Business Days after the date on which the terms of reference are agreed

or the final member of the Expert Committee is appointed (whichever is the later) and undertake to co-operate reasonably with the Expert Committee to achieve that timetable.

(h) If the dispute is not resolved within the timeframe referred to in clause 10.11(g), either party may by written notice to the other party terminate the appointment of the Expert Committee.

(i) The Expert Committee shall have the right to conduct any enquiry as it thinks fit, including the right to require and retain relevant evidence during the course of the appointment of the Expert Committee or the resolution of the dispute.

(j) The Expert Committee must give written reasons for its decision.

(k) A decision of the Expert Committee is final and binding on the parties except in the case of manifest error or a mistake of law.

(l) Each party shall bear its own costs of the enquiry by the Expert Committee including the costs of its representatives, any legal counsel and its nominee on the Expert Committee and the parties shall each bear half the costs of the independent member of the Expert Committee.

Schedule 11 – Confidentiality provisions

11.1. Subject to clause 11.4 and any applicable statutory duty, each party must keep confidential all Confidential Information of the other party and must not:

(a) use or copy such Confidential Information except for the purposes of this FAD; or

(b) disclose or communicate, cause to be disclosed or communicated or otherwise make available such Confidential Information to any third person.

11.2. For the avoidance of doubt, information generated within the Access Provider's Network as a result of or in connection with the supply of the relevant Service to the Access Seeker or the interconnection of the Access Provider's Network with the Access Seeker's Network (other than the aggregate Network information of the Access Provider and all Access Seekers to whom the relevant Service is supplied) is the Confidential Information of the Access Seeker.

11.3. The Access Provider shall upon request from the Access Seeker, disclose to the Access Seeker quarterly aggregate traffic flow information generated within the Access Provider's Network in respect of a particular Service provided to the Access Seeker, if the Access Provider measures and provides this information to itself. The Access Seeker must pay the reasonable costs of the Access Provider providing that information.

11.4. Subject to clause 11.5, Confidential Information of the Access Seeker:

(a) referred to in clause 11.2; or

(b) relating to or concerning the Access Seeker's end-users,

may be:

(c) used by the Access Provider:

(i) for the purposes of undertaking planning, maintenance, provisioning, operations or reconfiguration of its Network;

(ii) for the purposes of this FAD;

(iii) for the purpose of billing; or

(iv) for another purpose agreed to by the Access Seeker; and

(d) disclosed only to personnel directly involved in the purposes referred to in paragraph (c) above.

11.5. A party (**Disclosing Party**) may to the extent necessary disclose the Confidential Information of the other party:

(a) to those of its directors, officers, employees, agents and representatives to whom the Confidential Information is reasonably required to be disclosed for the purposes of this FAD;

(b) to any professional person acting for the Disclosing Party to permit that person to protect or advise on the rights of the Disclosing Party in respect of the obligations of the Disclosing Party under this FAD;

(c) to an auditor acting for the Disclosing Party to the extent necessary to permit that auditor to perform its audit functions;

(d) in connection with legal proceedings, arbitration, expert determination and other dispute resolution mechanisms set out in this FAD or for the purpose of seeking advice from a professional person in relation thereto;

(e) as required by law provided that the Disclosing Party has first given as much notice (in writing) as is reasonably practicable to the other party, that it is required to disclose the Confidential Information so that the other party has an opportunity to protect the confidentiality of its Confidential Information;

(f) with the written consent of the other party provided that if required by the other party as a condition of giving its consent, the Disclosing Party must comply with clause 11.6;

(g) in accordance with a lawful and binding directive issued by a regulatory authority which is duly authorised to do so;

(h) if reasonably required to protect the safety of personnel or property;

(i) as required by the listing rules of any stock exchange where that party's securities are listed or quoted; or

(j) as reasonably required to facilitate an Access Seeker gaining access to Services (including by undertaking Common Infrastructure Works) at a particular Exchange, provided that the Disclosing Party must comply with clause 11.6.

11.6. If required by another party as a condition of giving its consent to the disclosure of the Confidential Information of that other party, or where the information is reasonably required to facilitate an Access Seeker gaining access to Services (including by undertaking Common Infrastructure Works) at a particular Exchange, the Disclosing Party, before disclosing Confidential Information to a third person, must:

(a) impose an obligation upon the disclosee by way of a confidentiality undertaking in the form set out in Annexure 1 of this Schedule 11:

(i) to use the Confidential Information disclosed solely for the purposes for which the disclosure is made and to observe appropriate confidentiality requirements in relation to such information; and

(ii) not to disclose the Confidential Information without the prior written consent of the other party;

(b) obtain an acknowledgment by way of a confidentiality undertaking in the form set out in Annexure 1 of this Schedule 11 from such a disclosee that:

(i) the Confidential Information is and at all times remains proprietary to the other party; and

(ii) that misuse or unauthorised disclosure of the Confidential Information may cause serious harm to the other party.

11.7. Each party must co-operate in any action taken by the other party to:

(a) protect the confidentiality of the other party's Confidential Information; or

(b) enforce its rights in relation to its Confidential Information.

11.8. Each party must establish and maintain security measures to safeguard the other party's Confidential Information from unauthorised access, use, copying, reproduction or disclosure.

11.9. Confidential Information provided by one party to the other party is provided for the benefit of that other party only. Each party acknowledges that no warranty is given by the Disclosing Party that the Confidential Information is or will be correct.

11.10. Each party acknowledges that a breach of this Schedule by one party may cause another party irreparable damage for which monetary damages would not be an adequate remedy. Accordingly, in addition to other remedies that may be available, a party may seek injunctive relief against such a breach or threatened breach of this Schedule 11.

11.11. If the Access Seeker believes there is *prima facie* evidence which tends to show that the Access Provider has used, is using or is likely to use Confidential Information relating to the Access Seeker's end-users for a purpose other than as permitted under clause 11.4, the Access Seeker may invoke the audit procedures set out in this clause 11.11 as follows:

(a) The audit procedures in this clause 11.11 must be initiated only in good faith.

(b) The Access Seeker shall give the Access Provider a written notice that it intends to initiate an audit in accordance with this clause 11.11.

(c) The Access Seeker shall nominate an Independent Auditor to conduct an audit of the Access Provider's systems for the purpose of determining whether the Access Provider has used, is using or is likely to use Confidential Information relating to the Access Seeker's end-users for a purpose other than as permitted under clause 11.4.

(d) If the Access Provider objects to the person nominated by the Access Seeker or the parties have not agreed on an Independent Auditor within five Business Days of the notice given under clause 11.11(b), then the Independent Auditor shall be a person nominated by the President for the time being of the Institute of Chartered Accountants in the state in which the Access Provider holds its registered office.

(e) The Access Seeker shall bear all reasonable costs of the Access Provider relating to the audit, as well as the costs of the Independent Auditor.

(f) The Independent Auditor shall be required to give a confidentiality undertaking to the Access Provider in terms as set out in Annexure 1 of this Schedule 11.

(g) The Independent Auditor's first task shall be to determine whether there is *prima facie* evidence which tends to show that the Access Provider has used, is using or is likely to use Confidential Information relating to the Access Seeker's end-users for a purpose other than as permitted under clause 11.4. The Independent Auditor may obtain advice from a barrister or solicitor (who does not act for and has not acted for either of the parties in relation to any matter in question) in determining whether such *prima facie* evidence exists.

(h) If the Independent Auditor so determines, then he/she shall be required to proceed with the audit.

(i) If the Independent Auditor is required to proceed with the audit in accordance with clause 11.11(h), he/she shall be required to consult the Access Provider over the most expeditious means by which to conduct an audit of the Access Provider's systems (including but not limited to its computer systems, databases, records and processes) for the purpose specified in clause 11.11(c), and to thereafter conduct the audit as he/she considers appropriate.

(j) The audit shall be conducted expeditiously and in any event for no longer than 20 Business Days (excluding any delays caused by the Access Provider).

(k) The Access Provider must permit the Independent Auditor to audit and inspect its systems (including but not limited to its computer systems, databases, records and processes) and the Access Provider must provide the Independent Auditor with such assistance as he/she reasonably requires in order to conduct the audit.

(l) At the conclusion of the audit, the Independent Auditor shall be required to provide a report to both parties setting out his/her findings and conclusions as to whether the Access Provider has used, is using or is likely to use Confidential Information relating to the Access Seeker's end-users for a purpose other than as permitted under clause 11.4.

(m) If the Independent Auditor's report contains Confidential Information of the Access Provider, then he/she will mask such information in the version of the report provided to the Access Seeker, provided that the Access Seeker's solicitors are given an unmasked copy of the report (subject to them first giving a confidentiality undertaking to the Access Provider in terms as set out in Annexure 1 of this Schedule 11 to the FAD).

(n) The parties acknowledge that the Independent Auditor's report shall be prima facie evidence of the matters contained in the report and (subject to any obligation of confidence attaching to the report or the information contained therein) may be used in connection with any dispute concerning whether the Access Provider has used, is using or is likely to use Confidential Information relating to the Access Seeker's end-users for a purpose other than as permitted under clause 11.4.

Annexure 1 of Schedule 11

Confidentiality undertaking form

[Amend where necessary]

CONFIDENTIALITY UNDERTAKING

I, of [employer's company name] ([**undertaking company**]) undertake to [full name of party who owns or is providing the confidential information as the case requires] ([**Provider**]) that:

1 Subject to the terms of this Undertaking, I will keep confidential at all times the information listed in Attachment 1 to this Undertaking (**Confidential Information**) that is in my possession, custody, power or control.

2 I acknowledge that:

(a) this Undertaking is given by me to [Provider] in consideration for [Provider] making the Confidential Information available to me for the Approved Purposes (as defined below);

(b) all intellectual property in or to any part of the Confidential Information is and will remain the property of [Provider]; and

(c) by reason of this Undertaking, no licence or right is granted to me, or any other employee, agent or representative of [undertaking company] in relation to the Confidential Information except as expressly provided in this Undertaking.

3 I will:

(a) only use the Confidential Information for:

(i) the purposes listed in Attachment 2 to this Undertaking; or

(ii) any other purpose approved by [Provider] in writing;

(**the Approved Purposes**);

(b) comply with any reasonable request or direction from [provider] regarding the Confidential Information.

4 Subject to clause 5, I will not disclose any of the Confidential Information to any other person without the prior written consent of [Provider].

5 I acknowledge that I may disclose the Confidential Information to which I have access to:

(a) any employee, external legal advisors, independent experts, internal legal or regulatory staff of [undertaking company], for the Approved Purposes provided that:

(i) the person to whom disclosure is proposed to be made (**the person)** is notified in writing to [Provider] and [Provider] has approved the person as a person who may receive the Confidential Information, which approval shall not be unreasonably withheld;

(ii) the person has signed a confidentiality undertaking in the form of this Undertaking or in a form otherwise acceptable to [Provider]; and

(iii) a signed undertaking of the person has already been served on [Provider];

(b) if required to do so by law; and

(c) any secretarial, administrative and support staff, who perform purely administrative tasks, and who assist me or any person referred to in paragraph 5(a) for the Approved Purpose.

6 I will establish and maintain security measures to safeguard the Confidential Information that is in my possession from unauthorised access, use, copying, reproduction or disclosure and use the same degree of care as a prudent person in my position would use to protect that person's confidential information.

7 Except as required by law and subject to paragraph 10 below, within a reasonable time after whichever of the following first occurs:

(a) termination of this Undertaking;

(b) my ceasing to be employed or retained by [undertaking company] (provided that I continue to have access to the Confidential Information at that time); or

(c) my ceasing to be working for [undertaking company] in respect of the Approved Purposes (other than as a result of ceasing to be employed by [undertaking company]);

I will destroy or deliver to [Provider] the Confidential Information and any documents or things (or parts of documents or things), constituting, recording or containing any of the Confidential Information in my possession, custody, power or control.

8 Nothing in this Undertaking shall impose an obligation upon me in respect of information:

(a) which is in the public domain; or

(b) which has been obtained by me otherwise than from [Provider] in relation to this Undertaking;

provided that the information is in the public domain and/or has been obtained by me by reason of, or in circumstances which do not involve any breach of a confidentiality undertaking or a breach of any other obligation of confidence in favour of [Provider] or by any other unlawful means, of which I am aware.

9 I acknowledge that damages may not be a sufficient remedy for any breach of this Undertaking and that [Provider] may be entitled to specific performance or injunctive relief (as appropriate) as a remedy for any breach or threatened breach of this Undertaking, in addition to any other remedies available to [Provider] at law or in equity.

10 The obligations of confidentiality imposed by this Undertaking survive the destruction or delivery to [Provider] of the Confidential Information pursuant to paragraph 7 above.

Signed: _____ Dated: _____

Print name: _____

ATTACHMENT 1

Any document, or information in any document provided by [provider] to [undertaking company] which [provider] claims is confidential information for the purposes of this Undertaking.

ATTACHMENT 2

[Approved purpose(s)]

Schedule 12 – Communications with end users

12.1. The Access Provider may communicate and deal with an Access Seeker's end-users as expressly provided in clauses 12.2 to 12.4 and as otherwise permitted by law.

12.2. Subject to clause 12.3, the Access Provider may communicate and deal with the Access Seeker's end-users:

(a) in relation to goods and services which the Access Provider currently supplies or previously supplied to the end-user;

(b) as members of the general public or a part of the general public or members of a particular class of recipients of carriage or other services;

(c) where the Access Provider performs wholesale operations which require communications or dealings with such end-users, to the extent necessary to carry out such operations;

(d) in a manner or in circumstances agreed by the parties; or

(e) in an Emergency, to the extent it reasonably believes necessary to protect the safety of persons or property.

12.3. If:

(a) an end-user of the Access Seeker initiates a communication with the Access Provider in relation to goods and/or services supplied to that end-user by the Access Seeker, the Access Provider must:

(i) advise the end-user that they should discuss any matter concerning the Access Seeker's goods and/or services with the Access Seeker; and

(ii) not engage in any form of marketing or discussion of the Access Provider's goods and/or services;

(b) an end-user of the Access Seeker initiates a communication with the Access Provider in relation to goods and/or services supplied to that end-user by the Access Provider, the Access Provider may engage in any form of marketing or discussion of the Access Provider's goods and/or services; and

(c) an end-user of the Access Seeker initiates a communication with the Access Provider in relation to goods and/or services supplied to that end-user by the Access Provider and the Access Seeker, the Access Provider must advise the end-user that they should discuss any matter concerning the Access Seeker's goods and/or services with the Access Seeker, but may otherwise engage in any form of marketing or discussion of the Access Provider's goods and/or services.

12.4. Where a party communicates with the end-user of the other party, that first mentioned party must, where practicable, make and maintain records of that communication with the other party's end-user in circumstances where that communication discusses anything concerning the other party's goods or services with the end-user. For the avoidance of doubt, the obligation in this paragraph does not include a requirement to provide such records to the other party (however such a requirement may arise pursuant to any dispute resolution procedure).

12.5. For the purposes of clauses 12.2 to 12.4, a "communication" shall include any form of communication, including without limitation telephone discussions and correspondence.

12.6. Neither party may represent that:

(a) it has any special relationship with or special arrangements with the other party;

(b) there are consequences for an end-user when an end-user signs an authority to transfer their accounts or services;

(c) a Service has any characteristics or functionality other than as specified in a relevant standard form of agreement or the service description for the Service or in any specifications, collateral or brochures published in relation to the Service; or

(d) the other party participates in the provision of the first mentioned party's services, provided that a party may, upon enquiry by an end-user, inform the end-user of the nature of its relationship with the other party.

12.7. Where a party communicates with an end-user of either party, the first mentioned party shall ensure that it does not attribute to the other party:

(a) blame for a Fault or other circumstance; or

(b) the need for maintenance of a Network; or

(c) the suspension of a Service,

provided that this requirement does not require a party to engage in unethical, misleading or deceptive conduct.

12.8. This Schedule 12 shall be subject to any applicable industry standard made by the ACMA pursuant to Part 6 of the *Telecommunications Act 1997* (Cth) and any applicable industry code registered pursuant to Part 6 of the *Telecommunications Act 1997* (Cth) in relation to communications or dealings with end-users.

Schedule 13 – Network modernisation and upgrade provisions

Notice to be provided where Access Provider undertakes a Major Network Modernisation and Upgrade

13.1. Except were the parties agree otherwise, the Access Provider may make a Major Network Modernisation and Upgrade by:

(a) providing the Access Seeker with notices in writing in accordance with clauses 13.2 and 13.4 (**General Notification**) and clauses 13.3 and 13.5 (**Individual Notification)**; and

(b) consulting with the Access Seeker, and negotiating in good faith, any reasonable concerns of the Access Seeker, in relation to the Major Network Modernisation and Upgrade.

This clause 13.1 does not apply to an Emergency Network Modernisation and Upgrade.

13.2. The period of notices given under a General Notification provided by the Access Provider to the Access Seeker:

(a) must be an Equivalent Period of Notice; and

(b) in any event, must not be less than 30 weeks before the Major Network Modernisation and Upgrade is scheduled to take effect.

13.3. An Individual Notification must be provided by the Access Provider to the Access Seeker as soon as practicable after the General Notification, but, in any event, not less than 26 weeks prior to the anticipated commencement date of the Major Network Modernisation and Upgrade.

Information to be provided in the notices

13.4. A General Notification must include information on:

(a) the ESA affected by the proposed Major Network Modernisation and Upgrade;

(b) the distribution area affected by the proposed Major Network Modernisation and Upgrade; and

(c) a general description of the proposed Major Network Modernisation and Upgrade, including the indicative timing for the implementation of the Major Network Modernisation and Upgrade.

13.5. An Individual Notification must include the following information in addition to the information provided in the relevant General Notification:

(a) the anticipated commencement date for implementing the Major Network Modernisation and Upgrade;

(b) details of the Access Seeker's activated Services, or Services in the process of being activated at the date of the notice, that are likely to be affected by the Major Network Modernisation and Upgrade;

(c) the likely action required by the Access Seeker as a result of the Major Network Modernisation and Upgrade (including the possible impact of the Major Network Modernisation and Upgrade upon the Access Seeker's Services); and

(d) details of who the Access Seeker may contact to obtain further information about the Major Network Modernisation and Upgrade.

13.6. An Individual Notification only needs to be given where a Service has been activated or the Access Provider is in the process of activating a service as at the date of the Individual Notification, and:

(a) the Major Network Modernisation and Upgrade will require the Access Seeker to take particular action in order to continue to use the Service; or

(b) the Major Network Modernisation and Upgrade will result in the Service no longer being supplied.

13.7. Where the Access Provider has provided the Access Seeker with an Individual Notification, the Access Provider must provide the Access Seeker with:

(a) updates about the Major Network Modernisation and Upgrade covered by the notice, including:

(i) any update or change to the information provided in the Individual Notification;

(ii) any new information available at the time of the update about:

1. services provided by the Access Provider in the relevant ESA that may be available to the Access Seeker;

2. how the Access Seeker may be impacted by the Major Network Modernisation and Upgrade; and

3. what steps the Access Seeker will be required to take to facilitate the Major Network Modernisation and Upgrade; and

(b) weekly reports about the anticipated cutover dates for the Access Seeker's affected services, beginning no less than five weeks prior to the anticipated commencement date for the Major Network Modernisation and Upgrade.

13.8. The updates referred to in subclause 13.7(a) are to be provided regularly (which is not required to be any more frequently than Monthly) after the Individual Notification.

Emergency Network Modernisation and Upgrade

13.9. In the event of an Emergency, the Access Provider may conduct an Emergency Network Modernisation and Upgrade, and

(a) will use its best endeavours to provide the Access Seeker with an Individual Notification prior to the Emergency Network Modernisation and Upgrade being implemented; or

(b) where it is not practicable for prior notice to be given, the Access Provider will provide the Access Seeker with an Individual Notification as soon as reasonably practicable after the Emergency Network Modernisation and Upgrade is implemented.

Coordinated Capital Works Program forecast

13.10. The Access Provider must provide the Access Seeker with a written three year Coordinated Capital Works Program forecast in accordance with clause 13.11 14 Calendar Days from the date this Schedule 13 of the FAD takes effect between the parties (**Coordinated Capital Works Program Forecast)**.

13.11. The Coordinated Capital Works Program Forecast will:

(a) be for the three year period commencing on the date the forecast is provided;

(b) describe generally the Access Provider's indicative investment plans (as at the date of the forecast) for its Coordinated Capital Works Program over the next three years;

(c) include an evaluation of the impact that the Access Provider's indicative investment plans may have on individual ESAs areas and distribution areas; and

(d) specify anticipated timeframes for implementation.

13.12. The Access Provider must update the Coordinated Capital Works Program Forecast (and provided the update forecasts in writing to the Access Seeker) regularly, at not less than six Month intervals.

13.13. At the same time as the Access Provider provides a Coordinated Capital Works Program Forecast under clause 13.10, the Access Provider must provide a copy of the Coordinated Capital Works Program Forecast to the ACCC.

Coordinated Capital Works Program Schedule

13.14. The Access Provider must provide a written Coordinated Capital Works Program schedule to the Access Seeker by giving notice not less than 12 Months before the anticipated commencement date of the Coordinated Capital Works Program in accordance with clause 13.15 (**Coordinated Capital Works Program Schedule)**.

13.15. The Access Provider must provide the Coordinated Capital Works Program Schedule and make its best endeavours to identify:

(a) the ESAs and distribution areas affected;

(b) the Access Provider's plan for the Coordinated Capital Works Program for each ESA;

(c) the Access Seeker's Service(s) in that Exchange that will be affected and the expected impact of the Coordinated Capital Works Program on the Access Seeker's Service(s); and

(d) the anticipated timeframe for the implementation of the Coordinated Capital Works Program.

13.16. At the same time as the Access Provider provides a Coordinated Capital Works Program Schedule under clause 13.14, the Access Provider must provide a copy of the Coordinated Capital Works Program Schedule to the ACCC.

13.17. For the avoidance of doubt, the Access Provider must also comply with clauses 13.1–13.8 when complying with clauses 13.10–13.16.

Negotiations in good faith

13.18. Except where the parties agree otherwise, the Access Provider must not commence implementation of a Major Network Modernisation and Upgrade unless:

(a) it complies with clauses 13.1 to 13.8; and

(b) it has consulted with the Access Seeker and has negotiated in good faith, and addressed the reasonable concerns of the Access Seeker in relation to the Major Network Modernisation and Upgrade.

13.19. Except where the parties agree otherwise, the Access Provider must not commence the implementation of a Coordinated Capital Works Program unless:

(a) it complies with clauses 13.14 to 13.16; and

(b) it has consulted with the Access Seeker and has negotiated in good faith, and addressed the reasonable concerns of the Access Seeker in relation to the Major Network Modernisation and Upgrade.

13.20. Notwithstanding any continuing negotiations between the Access Provider and the Access Seeker pursuant to clauses 13.1, 13.18 and 13.19, if the Access Provider has complied with this Schedule 13, a Major Network Modernisation and Upgrade may proceed 26 weeks after an Individual Notification has been issued, unless both parties agree otherwise.

13.21. In attempting to reach a mutually acceptable resolution in relation to a variation under clauses 13.1, 13.18 and 13.19, the parties must recognise any need that the Access Provider may have to ensure that the specifications for the Services which the Access Providers supplies to more than one of its customers need to be consistent (including, without limitation having regard to the incorporation by the Access Provider of any relevant international standards).

Dispute Resolution

13.22. If a dispute arises in relation to a Major Network Modernisation and Upgrade, then the matter may be resolved in accordance with the dispute resolution procedures set out in Schedule 10 of this FAD.

Application

13.23. This Schedule 13 commences 21 Calendar Days after the day this FAD is published by the ACCC.

Miscellaneous

13.24. A requirement for the Access Provider to provide information in written form includes provision of that information in electronic form.

13.25. Any information provided by the Access Provider in electronic form must be in a text-searchable and readable format.

Schedule 14 – Suspension and termination

14.1. The Access Provider may immediately suspend the supply of a Service or access to the Access Provider's Network, provided it notifies the Access Seeker where practicable and provides the Access Seeker with as much notice as is reasonably practicable:

(a) during an Emergency; or

(b) where in the reasonable opinion of the Access Provider, the supply of that Service or access to the Access Provider's Network may pose a threat to safety of persons, hazard to equipment, threat to Network security or is likely to impede the activities of authorised persons responding to an Emergency; or

(c) where, in the reasonable opinion of the Access Provider, the Access Seeker's Network or equipment adversely affects or threatens to affect the normal operation of the Access Provider's Network or access to the Access Provider's Network or equipment (including for the avoidance of doubt, where the Access Seeker has delivered Prohibited Traffic onto the Access Provider's Network),

and is entitled to continue such suspension until (as the case requires) the relevant Emergency or threat has passed or until the normal operation of the Access Provider's Network or access to the Access Provider's Network or equipment is no longer adversely affected or threatened.

14.2. If:

(a) the Access Seeker has failed to pay monies owing under this FAD;

(b) the Access Seeker's use either of its Facilities or the Access Provider's Facilities is in contravention of any law;

(c) the Access Seeker breaches a material obligation under this FAD; or

(d) any of the events described in clause 14.8 occurs in respect of the Access Seeker,

(**Suspension Event**) and:

(e) within 20 Business Days after becoming aware of the Suspension Event, the Access Provider gives a written notice to the Access Seeker:

(i) citing this clause;

(ii) specifying the Suspension Event and the Service in respect of which the event has occurred;

(iii) requiring the Access Seeker to institute remedial action (if any) in respect of that event; and

(iv) specifying the action which may follow due to a failure to comply with the notice,

(**Suspension Notice**) and:

(f) the Access Seeker fails to institute remedial action as specified in the Suspension Notice within 20 Business Days after receiving the Suspension Notice (in this clause 14.2, the **Remedy Period**),

the Access Provider may, by written notice given to the Access Seeker within 20 Business Days after the expiry of the Remedy Period:

(g) refuse to provide the Access Seeker with the Service:

(i) of the kind in respect of which the Suspension Event has occurred; and

(ii) a request for which is made by the Access Seeker after the date of the breach,

until the remedial action specified in the Suspension Notice is completed or the Suspension Event otherwise ceases to exist; and

(h) suspend the provision of any Service of the kind in respect of which the Suspension Event has occurred, until the remedial action specified in the Suspension Notice is completed.

14.3. For the avoidance of doubt, subclause 14.2(a) does not apply to a Billing Dispute that has been notified by the Access Seeker.

14.4. In the case of a suspension pursuant to clause 14.2, the Access Provider shall reconnect the Access Seeker to the Access Provider's Network and recommence the supply of any suspended Services as soon as practicable after there no longer exists a reason for suspension and the Access Provider shall do so subject to payment by the Access Seeker of the Access Provider's reasonable costs of suspension and reconnection.

14.5. If:

(a) a party ceases to be a carrier or carriage service provider; or

(b) a party ceases to carry on business for a period of more than 10 consecutive Business Days without the prior written consent of the other party (such consent not to be unreasonably withheld); or

(c) in the case of the Access Seeker, any of the reasonable grounds specified in subsection 152AR(9) of the CCA apply; or

(d) a party breaches a material obligation under this FAD, and:

(i) that breach materially impairs or is likely to materially impair the ability of the other party to deliver Listed Carriage Services to its customers; and

(ii) the other party has given a written notice to the first-mentioned party within 20 Business Days of becoming aware of the breach (**Breach Notice**); and

(iii) the other party fails to institute remedial action as specified in the Breach Notice within 20 Business Days after receiving the Breach Notice (in this clause 14.5, the **Remedy Period**),

the other party may cease supply of the Service(s) under this FAD by written notice given to the first-mentioned party within 20 Business Days after becoming aware of the cessation, reasonable grounds or expiry of the Remedy Period specified in the Breach Notice (as the case may be).

14.6. A party must not give the other party both a Suspension Notice under clause 14.2 and a Breach Notice under clause 14.5 in respect of:

(a) the same breach; or

(b) different breaches that relate to or arise from the same act, omission or event or related acts, omissions or events;

except:

(c) where a Suspension Notice has previously been given to the Access Seeker by the Access Provider in accordance with clause 14.2 in respect of a Suspension Event and the Suspension Event has not been rectified by the Access Seeker within the relevant Remedy Period specified in clause 14.2; and

(d) where an Access Seeker has not rectified a Suspension Event, notwithstanding clause 14.5(d)(ii), the Access Provider has given written notice to the Access Seeker within 20 Business Days of the expiry of the time available to remedy the Suspension Event.

14.7. For the avoidance of doubt, a party shall not be required to provide a Suspension Notice under clause 14.2 in respect of a breach before giving a Breach Notice in respect of that breach under clause 14.5.

14.8. Notwithstanding any other provision of this FAD, either party may at any time immediately cease the supply of one or more Services under this FAD by giving written notice of termination to the other party if:

(a) an order is made or an effective resolution is passed for winding up or dissolution without winding up (otherwise than for the purposes of solvent reconstruction or amalgamation) of the other party and the order or resolution remains in effect for a continuous period of five Business Days; or

(b) a receiver, receiver and manager, official manager, controller, administrator (whether voluntary or otherwise), provisional liquidator, liquidator, or like official is appointed over the whole or a substantial part of the undertaking and property of the other party and the appointment remains in effect for a continuous period of five Business Days; or

(c) a holder of an encumbrance takes possession of the whole or any substantial part of the undertaking and property of the other party, or the other party enters or proposes to enter into any scheme of arrangement or any composition for the benefit of its creditors; or

(d) the other party is or likely to be unable to pay its debts as and when they fall due or is deemed to be unable to pay its debts pursuant to section 585 or any other section of the *Corporations Act 2001* (Cth); or

(e) as a result of the operation of section 459F or any other section of the *Corporations Act 2001* (Cth), the other party is taken to have failed to comply with a statutory demand; or

(f) a force majeure event substantially and adversely affecting the ability of a party to perform its obligations to the other party, continues for a period of three Months; or

(g) the other party breaches any of the terms of any of its loans, security or like agreements or any lease or agreement relating to significant equipment used in conjunction with the business of that other party related to the supply of a Service under this FAD; or

(h) the other party seeks or is granted protection from its creditors under any applicable legislation; or

(i) anything analogous or having a substantially similar effect to any of the events specified above occurs in relation to the other party.

14.9. The cessation of the operation of this FAD:

(a) shall not operate as a waiver of any breach by a party of any of the provisions of the FAD; and

(b) is without prejudice to any rights, liabilities or obligations of any party which have accrued up to the date of cessation.

14.10. Without prejudice to the parties' rights upon termination of the supply of a Service under this FAD, or expiry or revocation of this FAD, the Access Provider must refund to the Access Seeker a fair and equitable proportion of those sums paid under this FAD by the Access Seeker which are periodic in nature and have been paid for a Service for a period extending beyond the date on which the supply of a Service under this FAD terminates, or this FAD ceases to have effect, subject to any invoices or other amounts outstanding from the Access Seeker to the Access Provider. In the event of a dispute in relation to the calculation or quantum of a fair and equitable proportion, either

party may refer the matter for dispute resolution in accordance with the dispute resolution procedures set out in Schedule 10 of this FAD.

Schedule 15 – Changes to operating manuals

15.1. Operational documents concerning the ULLS may be amended:

(a) by the Access Provider from time to time to implement or reflect a change to its standard processes, subject to:

(i) giving 20 Business Days prior written notice to the Access Seeker including a documented list of all amendments, and a marked-up copy of the proposed new operational document that clearly identifies all amendments; and

(ii) allowing the Access Seeker to provide comments during the notice period on the proposed amendments, and giving reasonable consideration to any comments which the Access Seeker has made on the proposed amendments; and

(b) otherwise, by agreement of the parties.

Note: operational documents concerning the ULLS include (i) *The Telstra Operations and Maintenance Manual Part 16 Fault Management Procedures for Telstra Unconditioned Local Loop Service;* and (ii) *The Telstra Ordering and Provisioning Manual Part 16 Telstra Unconditioned Local Loop Service Operations Manual and any replacement document*

15.2. Upon completion of the process set out in clause 15.1, the Access Provider must give the Access Seeker a copy of the new operational document.

15.3. Where operational documents concerning the ULLS are amended in accordance with clause 15.1 and the Access Seeker believes that the amendments:

(a) are unreasonable; or

(b) deprive the Access Seeker of a fundamental part of its rights contained in this FAD;

the Access Seeker may seek to have the matter resolved in accordance with the dispute resolution procedures set out in Schedule 10 of this FAD.

Schedule 16 – Ordering and provisioning

Provisions to apply to Managed Network Migrations (MNM) to the ULLS and the LSS

Minimum number of services

16.1. Except where the parties agree otherwise, it is at the discretion of the Access Seeker whether a particular Service is to be connected as part of an MNM, or outside of a MNM.

16.2. The Access Seeker will notify the Access Provider at the time the order is made whether a particular Service is to be connected as part of an MNM or outside of a MNM.

16.3. Except where the parties agree otherwise, there is no minimum number of services required as a pre-requisite for requesting an MNM.

Migration plan terms (forecasting timeframes)

16.4. Unless the parties agree otherwise, the period of notice that an Access Seeker must give for an MNM is 56 Calendar Days.

16.5. Subject to clause 16.6, the Access Provider must not cancel an MNM where the number of Services to be cutover as specified in the 20 Business Day forecast differs to the number of Services specified in the 56 Calendar Day forecast.

16.6. If the cutover of Services cannot occur within the 56 Calendar Day forecast period because of a significant variation between the 56 Calendar Day forecast and the 20 Business Day forecast, the Access Provider must to take all reasonable steps to ensure that cutover occurs as soon as practicable following the conclusion of that period.

16.7. For the purpose of this determination a reference to a significant variation refers to a variation of more than 10 per cent of the MNM forecast.

Note: For instance the cutover may not occur because of a significant variation between the 56 Calendar Day forecast and the 20 Business Day forecasts

Connections outside Business Hours

16.8. Except where the parties agree otherwise, it is at the discretion of the Access Seeker whether a particular Service is to be connected within Business Hours or outside of Business Hours.

Note: additional charges may be payable for work done outside of Business Hours.

Limits on number of exchanges per state per day at which MNM cutovers can be scheduled

16.9. Except where the parties otherwise agree, and subject to clause 16.10, the Access Provider must not refuse to schedule a cutover for an MNM at an Exchange because the Access Seeker has requested an MNM cutover at another Exchange or other Exchanges in that state on the same day.

16.10. The Access Provider may refuse a requested MNM cutover date where it would be inconsistent with a capacity limitation notice (**Limitation Notice**) it has published.

16.11. The Limitation Notice must specify:

(a) the limit that is to apply;

(b) the period and the ESAs to which it applies; and

(c) the reasons for the limit being necessary by reference to forecast demand and available capacity.

16.12. The Limitation Notice lapses 60 Calendar Days after it is published, unless withdrawn earlier.

Note: Another Limitation Notice may be issued to replace a lapsed notice.

16.13. The Access Provider must not unreasonably refuse to vary or withdraw the Limitation Notice on the request of an Access Seeker.

16.14. Where an Access Seeker disagrees with a decision made by the Access Provider not to vary or withdraw the Limitation Notice, the Access Seeker may seek dispute resolution in accordance with the dispute resolution procedures set out in Schedule 10 of this FAD.

Capacity Limits on ULLS provisioning

16.15. Except where the parties otherwise agree, and subject to clause 16.16, the Access Provider must not unreasonably limit the number of Services that can be provisioned per day at a particular Exchange and must use its best endeavors to supply all requested cutovers for a particular day.

16.16. The Access Provider may refuse a requested cutover for a Service at a particular Exchange where it is not reasonably able to perform the cutover on that day having regard to the volume of work orders, for that Exchange or for all Exchanges, and the labour that is available on that day, subject to the Access Provider performing the cutover the following Business Day.

Advice regarding Complex Services affecting ULLS orders

16.17. Except where the parties agree otherwise, where:

(a) an Access Seeker has submitted a ULLS request; and

(b) the Service Qualification query fails due to the presence of Complex Services on the line,

the Access Provider will provide to the Access Seeker a list of the Complex Services present on the line at the time it advises the Access Seeker of the results of the Service Qualification query.

New ULLS ordering and provisioning processes

LSS to ULLS Transfer processes

Scope

16.18. Except where the parties subsequently agree otherwise, clauses 16.18 to 16.23 apply where an Access Seeker requests the Transfer of a LSS to a ULLS from the Access Provider.

Terms

16.19. The Access Seeker must provide instructions about whether or not the Transfer should occur as part of a MNM in accordance with the MNM forecasting timeframes and notice periods specified in clauses 16.4 to 16.7 of this FAD, or as otherwise agreed between the parties.

16.20. The Access Provider must take all reasonable efforts to comply with the Access Seekers instructions provided pursuant to clause 16.19.

16.21. Both the Access Provider and the Access Seeker must allow for the Transfer of the LSS to ULLS in accordance with the following minimum characteristics:

(a) the period in which a LSS to ULLS Transfer is performed (that is, the period in which a LSS is disconnected and a ULLS is connected) will be no longer than four hours;

(b) a Transfer must not require end-user involvement with the Access Provider (including, without limitation, the making of a telephone call or sending of correspondence by the end-user to the Access Provider). A request for a LSS to ULLS Transfer will be deemed a cancellation of any existing PSTN line rental and LSS provided the Access Seeker has obtained the necessary customer authority for the cancellation of end-user PSTN services;

(c) a Transfer is commenced and executed by a single provisioning order from the Access Seeker to the Access Provider; and

(d) the Access Provider will charge the Access Seeker a single charge for undertaking a LSS to ULLS Transfer whether the Transfer occurs as a single connection or as part of an MNM.

16.22. The Access Provider must ensure that the development and implementation of the LSS to ULLS Transfer process will result in no changes to how the Access Seeker currently interfaces to the ULLS Carrier Interface System (ULLCIS).

Application

16.23. Clauses 16.19 to 16.22 commence on 15 September 2011, unless a prescribed LSS to ULLS Transfer process is established on an earlier date by the Access Provider, in which case clauses 16.19 to 16.22 commence on the date the prescribed LSS to ULLS Migration process is established by the Access Provider.

Note: The commencement date of this clause aligns with similar provisions contained in final determinations between Telstra and a number of Access Seekers in the context of access disputes involving the ULLS. Some of these final determinations have been published by the ACCC and are available on its website.

See: http://www.accc.gov.au/content/index.phtml?itemId=793062

Connect Outstanding process for ULLS orders

16.24. Except where the parties agree otherwise, the Access Provider will support a Connect Outstanding process for the ULLS, by no later than six Months from the Commencement Date.

16.25. The Connect Outstanding process for the ULLS must:

(a) support the cancellation of an existing service on a line upon the Access Provider receiving from the Access Seeker advice that the Access Seeker has obtained Proof of Occupancy; and,

(b) facilitate the connection of a ULLS in response to a ULLS request submitted by an Access Seeker in respect of that line.