



**Australian  
Competition &  
Consumer  
Commission**

# **Draft pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS**

**August 2009**



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# Contents

<b>Summary</b> .....	<b>1</b>
<b>1. Introduction</b> .....	<b>4</b>
Purpose.....	4
Broad pricing principles.....	4
Legislative Framework .....	5
Timetable and Inquiry Process.....	6
<b>2. Inquiry material</b> .....	<b>7</b>
Telstra Efficient Access model .....	7
Analysys fixed network services cost model .....	8
ACCC ‘Specific Costs’ cost model.....	11
International benchmarking .....	11
<b>3. Pricing principles for the declared services</b> .....	<b>15</b>
What is the best approach? .....	15
TSLRIC+.....	18
Implementation of TSLRIC+ .....	19
Pricing Structure .....	20
Adoption of an adjustment path .....	24
ACCC’s view .....	25
<b>5. Local carriage service</b> .....	<b>27</b>
Background .....	27
Past access pricing .....	27
Proposed access pricing .....	28
<b>6. Wholesale line rental</b> .....	<b>30</b>
Background .....	30
Past access pricing .....	30
Proposed access pricing .....	30
<b>7. Public switched telephone network originating and terminating access</b> .....	<b>33</b>
Background .....	33
Past access pricing .....	33
Proposed access pricing .....	35
<b>8. Unconditioned local loop service</b> .....	<b>37</b>
Background .....	37
Past access pricing .....	37
Proposed access pricing .....	38
<b>9. Line Sharing Service</b> .....	<b>41</b>
Background .....	41
Past LSS pricing.....	41
Proposed LSS pricing .....	42
<b>Appendix 1: Draft pricing principles determinations</b> .....	<b>45</b>

<b>Appendix 2:</b>	<b>Model input parameters .....</b>	<b>71</b>
<b>Appendix 3:</b>	<b>Model results .....</b>	<b>76</b>
<b>Appendix 4:</b>	<b>ULLS and LSS discrete charges .....</b>	<b>81</b>
<b>Appendix 5:</b>	<b>ESA Zone classifications.....</b>	<b>90</b>

## Summary

The Australian Competition and Consumer Commission (ACCC) has recently extended the declarations for six declared services and now proposes to set indicative prices for wholesale access to these services until 2012.

These six declared services make up the key wholesale and access services delivered over Telstra's fixed network and include: the unconditioned local loop service (ULLS); the line sharing service (LSS); the public switched telephone network originating access (PSTN OA) service; the public switched telephone network terminating access (PSTN TA) service; the local carriage service (LCS); and the wholesale line rental (WLR) service.

The ACCC considers that setting indicative prices for wholesale access to these services will help to guide industry when negotiating the terms and conditions of access. Facilitating access for third parties to these wholesale and access services is ultimately important for Australian consumers because it affects the provision of fixed voice and broadband services, and is a key driver of choice and competitive prices.

The ACCC has indicated for some time that a move to cost-based pricing for all six fixed services would occur. One stage of that process has been the development of a robust cost model capable of dealing with all the services. The ACCC commissioned Analysys cost model has now been developed and subjected to a rigorous assessment and review process. The ACCC has considered submissions from stakeholders in respect of the model and has made changes to the model that it considers appropriate. The ACCC is satisfied that the model is robust and capable of providing a reliable cost measure for the six declared fixed services. Furthermore, the ACCC has compared these cost estimates against other available cost estimates both internationally and locally and the comparisons suggest they are reasonable.

Consideration of pricing principles and indicative prices for the fixed services has occurred in the context of the Government's National Broadband Network (NBN). This will have a major impact on the future telecommunications regulatory environment, particularly in relation to the regulation of the fixed services. The ACCC notes that the likely eight year transition period for the NBN will be a time of significant structural and competitive change as the industry moves to an environment where an NBN operates alongside, or possibly instead of, Telstra's fixed network infrastructure. Each of these NBN operating environments could have different implications for the regulation of legacy assets and new telecommunications investments.

Furthermore, the ACCC also notes the government is currently considering a range of options for reforming the telecommunications competition and consumer framework, particularly in the transition to the National Broadband Network, and is considering submissions already received on its discussion paper, *Regulatory Reform for 21st Century Broadband*. In that discussion paper the Government established a clear policy framework for the regulation of the National Broadband Network company and its access regime. The Government is also considering options for reform of Part XIC including whether to:

- retain the current negotiate-arbitrate model or replace it with a streamlined regulatory process and provide the ACCC with the ability to make up-front determinations on price and non-price terms of access, and
- allow the ACCC to specify pricing methodologies for declared services which would be used to determine prices over successive regulatory proceedings or successive undertakings in order to create greater regulatory certainty.

The ACCC has also acknowledged in recent pricing and regulatory decisions that it is open to consider other pricing approaches. Specifically, it has flagged the possibility of ‘locking in’ some of the inputs to the cost estimates of certain services; for example, the value of the assets used to provide the services (the regulated asset base).

The ACCC’s openness to these alternative pricing approaches has been prompted by two main considerations. First, ‘locking in’ some of the inputs can provide greater regulatory certainty to both access providers and access seekers. Second, it is now less clear that the build/buy rationale for TSLRIC+ pricing remains as strong. Telstra’s copper customer access network (CAN) appears to display enduring bottleneck characteristics, rather than being a network likely to be bypassed through technological and market developments. Although both Hybrid Fibre Coaxial networks and 3G mobile networks have been deployed in Australia, they have not been widespread enough or had sufficient capacity to represent widespread end-to-end competing infrastructure able to provide services of comparable price and quality to Telstra’s copper CAN. That said, the Government decision to proceed with the NBN, with significantly greater service potential than the copper CAN, might result in bypass of Telstra’s copper CAN. However, whether it actually does so may not be determined for some time.

In that context, in the event of significant changes in the regulatory environment such as might be associated with the NBN during the term of these prices, the ACCC would be open to reconsidering both the pricing principle and the indicative prices for these services. The ACCC is considering the release of a Discussion Paper on future pricing options for new and legacy assets and services.

Nevertheless, the ACCC is currently also conducting numerous arbitrations for fixed line services including ULLS, LSS, WLR and LCS. A number of these are ongoing and consideration of these pricing principles will form the basis for submissions on pricing in some disputes.

Overall, the cost based price structure results in clear incentives to invest in alternative DSLAM infrastructure by taking the ULLS. The pricing structure is such that consumers are still more cost effectively served through a ULLS based service than through a combined line rental and LSS combination (the LSS is a product that is only provided to customers who are already paying voice line rental). Access seekers will continue to determine whether to purchase this service or invest in their own equipment.

Therefore, the ACCC has sought to establish as much regulatory certainty as possible regarding the current access arrangements, given the context of broader regulatory and industry changes, including the price for access to individual declared services.

The ACCC is of the view that indicative prices are useful to provide regulatory certainty regarding access in a period of transition and to achieve the objective of promoting the long-term interests of end-users during the transition to an NBN.

# 1. Introduction

## Purpose

The purpose of this paper is to invite submissions from industry, government and other interested parties on the ACCC's draft determinations in relation to the pricing principles and indicative prices which might be applied when considering an access dispute or assessing an undertaking in relation to pricing for the six fixed services.

The six fixed services are the:

- local carriage service (LCS)
- wholesale line rental (WLR)
- public switched telephone network originating access (PSTN OA)
- public switched telephone network terminating access (PSTN TA)
- unconditioned local loop service (ULLS), and
- line sharing service (LSS).<sup>1</sup>

In July 2009 the ACCC decided to extend the declarations for the above services for a period of five years. In light of the extension of the declaration period for these services the ACCC has reconsidered the pricing principles and developed its preliminary views on the indicative prices that should apply.

It is important to note that while the ACCC must have regard to the final pricing principles determination in arbitrations, it is not binding and parties to arbitrations are still able to address the ACCC on the relevance and applicability of the principles having regard to the particular circumstances of their dispute.

## Broad pricing principles

The ACCC's Access Pricing Principles<sup>2</sup> (the Guide) provides some guidance to the telecommunications industry and other interested parties about the principles that are likely to be relevant in assessing undertakings or in arbitrating access disputes. The Guide sets out the following broad principles:

- the access price should be based on the cost of providing the service
- the access price should not discriminate in a way which reduces efficient competition

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<sup>1</sup> ACCC, *Fixed Services Review Declaration Inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR – Final Decision*, July 2009 (FSR Declaration Inquiry).

<sup>2</sup> ACCC, *Access Pricing Principles: Telecommunications — a Guide* (Access Pricing Principles), July 1997.



- the access price should not be inflated to reduce competition in dependent markets, and
- the access price should not be predatory.

The ACCC also notes that when determining a cost-based price, it would generally seek to determine the Total Service Long-Run Incremental Cost (TSLRIC) of providing the service.

## Legislative Framework

Under Part XIC of the *Trade Practices Act 1974* (TPA), the ACCC is responsible for arbitrating disputes about access to particular declared services and for assessing access undertakings relating to access to declared services. One of the key issues arising under these processes is the determination of an appropriate access price.

Section 152AQA of the TPA states that the ACCC must determine pricing principles for declared services. The ACCC is required to make pricing principles in writing at the same time or as soon as practicable after a service is declared or varied. Pricing principles may include price-related terms and conditions and may specify prices (the indicative prices).

Unlike prices in arbitral decisions, the indicative prices are not binding. In this context, parties to arbitrations and in assessment of undertakings may make submissions relating to the relevance and applicability of its pricing principles having regard to their particular circumstances.

The determination of pricing principles and indicative prices are intended to increase commercial certainty and provide guidance to the ACCC's regulatory decision making, and express its view of reasonable access prices.

In making a determination of final pricing principles, the ACCC is required to publish a draft determination, invite public consultation and consider submissions made during consultation.

The TPA does not specify the matters the ACCC must consider in making pricing principles. However, the ACCC considers that in making pricing principles it should have regard to the object of Part XIC of the TPA, being the promotion of the long-term interests of end-users (LTIE). In determining whether something promotes the LTIE regard must be had to the extent to which the thing is likely to result in the achievement of the objectives of:

- promoting competition
- any-to-any connectivity, and
- encouraging the economically efficient use of, and the economically efficient investment in, infrastructure.

Therefore, in making pricing principles and indicative price determinations the ACCC may have regard to the above considerations.

## Timetable and Inquiry Process

### Making submissions

The ACCC encourages industry participants, other stakeholders and the public more generally to consider the matters set out in this report, and to make submissions to the ACCC to assist it in determining pricing principles and indicative prices for the six fixed line services: PSTN OA and PSTN TA (PSTN OTA), LCS, WLR, ULLS and LSS.

In making submissions, the ACCC is particularly interested in industry participants and other stakeholders' views on:

- the adoption of TSLRIC+ for the six fixed network services
- the implementation of TSLRIC+
- the adoption of a glide path for those services subject to a price shock
- the adoption of two tiered pricing for ULLS and WLR
- the adoption of a single national rate for PSTN OTA, LCS and LSS, and
- other issues which parties consider relevant.

To foster an informed and consultative process, all submissions will be considered as public submissions and will be posted on the ACCC's website. If interested parties wish to submit commercial-in-confidence material to the ACCC they should submit both a public and a commercial-in-confidence version of their submission. The public version of the submission should clearly identify the commercial-in-confidence material by replacing the confidential material with an appropriate symbol or 'c-i-c'.

### Timetable for the Inquiry

In accordance with section 152AQA of the Act, the ACCC invites interested parties to make a written submission in response to the draft pricing principle determinations attached to this report.

The ACCC requests written submissions by no later than **5.00 pm on 25 September 2009**.

After consideration of the submissions from interested parties, the ACCC will issue final pricing principle determinations for the six declared services.

Please forward submissions and enquiries by email to the Contact Officer:

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## 2. Inquiry material

The ACCC considers that it is important to consider a range of sources of information when determining the indicative prices for the six declared fixed line services for 2009 to 2012. In particular, the ACCC has had regard to the following key sources of information used when determining these prices including results from:

- Telstra's Efficient Access (TEA) model Band 1 (version 1.4); Band 2 (version 1.3) and Band 3 (version 1.4), with parameter inputs as outlined in Appendix 2
- the Analysys fixed network services cost model (Analysys cost model), with parameter inputs as outlined in Appendix 2
- the ACCC's 'Specific Costs' cost model, and
- international benchmarking analysis reports.

Relevant inquiry material will be made available on the ACCC website.

### Telstra Efficient Access model

The TEA model seeks to model the cost of providing the ULL service in Telstra's Bands 1 (version 1.4), 2 (version 1.3) and 3 (version 1.4). In doing so, the model adopts a scorched node approach in that it retains customer location, pillars and exchange location. The TEA model allows the user to change a number of the economic parameter values.

The ACCC notes while TEA model information is being used as one input for determining indicative prices, the TEA model for Band 2 is also subject to further scrutiny as part of the Australian Competition Tribunal (Tribunal) review of the ACCC's decision to reject Telstra's ULLS Band 2 undertaking.

The ACCC's preferred parameter input values which have been used in the TEA model to assist in determining prices are consistent with those used in the Analysys cost model and are outlined in Appendix 2.

The ACCC notes that to date indicative prices for a number of services have been based on 'bands' as determined by Telstra where:

- **Band 1** covers the central business districts of New South Wales, Queensland, South Australia, Victoria and Western Australia
- **Band 2** covers areas with more than 108.4 services in operation in a square kilometre area, which is not a Band 1 area.
- **Band 3** covers areas with 6.56 or more, but less than 108.4 services in operation in a square kilometre area.

- **Band 4** covers areas with 6.55 or less services in operation in a square kilometre area.<sup>3</sup>

**Table 1: Telstra’s existing band structure and composition as reported in March 2009<sup>4</sup>**

	SIOs	ESAs	ULL lines
<b>Telstra Band 1</b>	281,813	17	28,993
<b>Telstra Band 2</b>	6,977,403	585	610,608
<b>Telstra Band 3</b>	2,030,612	750	8,407
<b>Telstra Band 4</b>	1,022,718	3,718	139

### **TEA model - Band 2**

The Band 2 Telstra Efficient Access (TEA) model was submitted by Telstra to the ACCC for the purposes of assessing Telstra’s Undertaking application for Band 2 ULLS prices in March 2008.

In April 2009, the ACCC made its final decision to reject Telstra’s monthly charge of \$30 for the ULLS Band 2 Undertaking application.

Despite the rejection of the Undertaking application, the ACCC considers that, provided appropriate adjustments are made to the inputs, the TEA model for Band 2 can be used as one source of information when determining indicative prices.<sup>5</sup>

### **TEA model - Band 1 and Band 3**

On 25 June 2009 the TEA model which costs Bands 1 and 3 ULLS lines per month was provided by Telstra to the ACCC. The Band 1 and 3 TEA model was not lodged through any regulatory process and has not been subject to detailed scrutiny by either the ACCC or other interested parties.

While the ACCC will place less weight on the TEA model results for Band 1 and 3, given the lack of scrutiny, the ACCC considers that it can still be used as a source of information to assist in determining the indicative price for the ULLS.

## **Analysys fixed network services cost model**

The Analysys cost model was commissioned by the ACCC in August 2007 following a Request for Tender to inform the estimation of the cost of providing the declared fixed line services. The Analysys cost model has been designed with reference to Australian conditions, in particular:

<sup>3</sup> Telstra, *Service Quality Strategy*, 23 June 2006, p. 3.

<sup>4</sup> Telstra, *Return for March 2009 under CAN RKR*, March 2009.

<sup>5</sup> ACCC, *Assessment of Telstra’s Unconditioned Local Loop Service Band 2 monthly charge undertaking – Final decision*, April 2009, p. 59.

- the modern core network architecture is similar to the network that has been deployed in Australia
- the scorched-node approach retains the existing locations of local exchanges, local access switches and transit network switches, and
- the model takes into account special network solutions for Australian islands.

In September 2007 major carriers were invited to meet with Analysys and the ACCC to discuss the development and population of the model. A data request was also issued to major carriers.

Following an extensive development process the ACCC released the Analysys cost model for consultation in December 2008. In all, 26 parties requested access to the Analysys cost model during the consultation period and, of those, four made submissions. The issues raised in response to the consultation can be categorised into three groups:

- user variable inputs
- errors in the model design, and
- concerns regarding design assumptions.

Where it was considered necessary and/or appropriate the Analysys cost model has been revised in light of consultation responses and internal review.

Following the close of consultation, the ACCC with Analysys conducted an industry attended workshop to improve industry understanding and operability of the model.

The ACCC considers that the Analysys model is a robust model which should be considered when determining indicative prices, while acknowledging that all models are simplifications of real world systems to provide useful numerical estimates

In contrast to Telstra's band structure, the Analysys cost model has taken a geotype approach to pricing services across the network according to 15 different geographic types of Exchange Service Area. The primary metric used to develop the geotypes has been the *average road length per location* and, where the geotypes are more rural, a density of locations relative to the exchange location is also applied. This allows greater correlation between density and cost of copper networks in the model. Further information on the geotyping can be found in the *Fixed LRIC Model Documentation*<sup>6</sup> report, section 4.

The table below sets out the breakdown of ESAs in each of the Analysys geotypes, along with the number of SIOs and ULLS lines.

**Table 2: Analysys geotype and ESA breakdown**

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<sup>6</sup> Analysys, *Fixed LRIC Model Documentation – Version 2.0*, August 2009, pp 18-37.

<b>Analysys Geotype</b>	<b>ESAs</b>	<b>Sample ESAs</b>	<b>SIOs</b>	<b>SIOs per ESA</b>	<b>ULL lines</b>	<b>Average kilometre of road per SIO</b>
<b>1</b>	3	3	44,804	14,935	3,827	0.00095
<b>2</b>	14	4	237,009	16,929	25,166	0.00150
<b>3</b>	139	16	1,909,188	13,735	193,101	0.00101
<b>4</b>	219	24	2,825,812	12,903	256,343	0.00081
<b>5</b>	160	30	1,747,611	10,923	131,991	0.00097
<b>6</b>	66	7	494,792	7,497	29,173	0.00108
<b>7</b>	91	8	224,760	2,470	2,528	0.00182
<b>8</b>	107	6	153,554	1,435	62	0.00269
<b>9</b>	86	3	41597	484	3	0.00388
<b>10</b>	181	21	832,708	4,601	4,514	0.00085
<b>11</b>	236	7	608,141	2,577	1,281	0.00111
<b>12</b>	844	22	728,543	863	154	0.00258
<b>13</b>	1936	37	395,470	204	4	0.00832
<b>14</b>	912	12	67,862	74	0	0.01550
<b>15</b>	69	0	695	10	0	0.05010
<b>16</b>	7	0	0	0	0	-

Due to the ability of the model to determine prices across 15 geographic areas the ACCC has a more comprehensive understanding of costs. This provides greater clarity as to the characteristics of each ESA. As such, the ACCC considers that it has better information to adopt an alternative pricing structure to Telstra's older four band approach.

The Analysys cost model estimates the total service long run incremental cost, plus an allocation of common costs, where appropriate, denoted by '+' (TSLRIC+), as the default pricing principle which is consistent with the proposed pricing principles for each of the fixed network services.

When applying the cost model for the purpose of indicative prices, the ACCC has updated and revised a number of user variable inputs in the model. The ACCC's preferred values are outlined in Appendix 2.

In addition, when presenting the results from the Analysys cost model for each of the services, the ACCC has chosen to include a range of inputs where the service can be modelled on the basis of an optimised existing network or on a new-technology forward looking basis. The results from the Analysys cost model for each service are provided in Appendix 3.

## ACCC 'Specific Costs' cost model

The Specific Costs cost model calculates the monthly specific costs charge for the ULLS and LSS. The structure of the model reflects the discrete cost models that Telstra has developed in previous regulatory proceedings for LSS specific costs and ULLS specific costs and combines the data from the two. The ACCC has previously provided the Specific Cost model to parties involved in arbitrations.<sup>7</sup>

The Specific Costs cost model has been updated to provide costs for the period between 2009-10 to 2011-12. The updated Specific Costs cost model reflects the ACCC's approach to specific cost charges such as:

- a forward looking TSLRIC+ basis
- adopting an annual approach rather than a levelisation approach, and
- maintaining a pooling and allocation approach.

The Specific Costs cost model factors in operational expenditure for the ULLS and LSS. Future capital expenditure has been split amongst Telstra's ULLS, LSS and ADSL according to the cost incurred for the investment in each service. The model allows for an additional capital base for Telstra to invest in particular improvements to the ULLS/LSS Operational Support Systems. The ACCC specific costs model and its data are confidential.

## International benchmarking

The ACCC considers that international benchmarking is a useful comparative tool when appropriate regard is had to country specific characteristics. Further, the theory of purchasing price parity (PPP) has shown that comparisons between countries are a logical means of assessing relative prices of homogenous or identical goods.

When assessing the level of cost or price of providing telecommunications services in Australia, it is prudent to conduct an international comparison to gauge the competitiveness of the Australian price of the service. The ACCC considers that international benchmarking provides an indication as to whether the prices being proposed in Australia are within reasonable bounds set by international experience and practice. This is particularly the case given the connectedness of the global economy and the absence of any rigid benchmark or comparative tool isolated to the Australian economy.

In past regulatory decisions, the ACCC acknowledges that less weight has generally been placed on the use of international benchmarks, relative to other information before it, because of difficulties in finding appropriate comparators for areas with a low population density. However, where appropriate, comparisons through the

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<sup>7</sup> ACCC, *LSS Access dispute Telstra/Adam Internet reasons for final determination*, December 2007, pp. 86-87.

process of international benchmarking should be considered in determining indicative prices. International benchmarks can be used as a cross check for model estimates.

### **International Benchmarking reports**

The ACCC commissioned two recent international benchmarking reports in relation to fixed network services:

- Ovum's ULLS international benchmarking<sup>8</sup> (ULLS report) - the ULLS report is focussed on commenting on factors raised by the Ingenious Consulting Group<sup>9</sup> in a report for Telstra on Band 2 ULLS international benchmarks. These factors are set out in table 3 below.
- Analysys Mason's international benchmarking analysis (Analysys Mason report) - the Analysys Mason report conducted benchmark analysis in relation to wholesale line rental, local carriage service, line sharing service and public-switched telephone network originating/ terminating access services in a range of countries.

The ACCC notes that the Tribunal provided guidance on the consideration of international benchmarking in the case of the Optus undertaking for the domestic GSM terminating access service of 2006. In its judgement, the Tribunal stated:

In order to place any reliance upon the international benchmarking analysis it would be necessary to know much more about the regulatory environment within which they were determined, the state of the relevant markets and the socio-economic environment in which the mobile services were operative.<sup>10</sup>

The Ovum and Analysys Mason reports both examined a range of factors to determine the appropriateness of the comparator countries. These factors are listed in Table 3.

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<sup>8</sup> Ovum, *Telstra ULLS Undertaking – ULLS International benchmarking*, February 2009.

<sup>9</sup> Ingenious Consult Network, *Commentary on the use of international benchmarking in setting Interconnection rates*, December 2008.

<sup>10</sup> Australian Competition Tribunal, *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited [2006] ACompT8*, 22 November 2006 at [296].



**Table 3: Factors considered through the international benchmarking**

ULLS	WLR, LCS, LSS, PSTN OTA
<ul style="list-style-type: none"> <li>• general regulatory framework matters</li> <li>• population density (for Band 2 equivalent areas)</li> <li>• copper prices</li> <li>• land use (housing mix)</li> <li>• loop lengths and</li> <li>• pricing structure</li> </ul>	<ul style="list-style-type: none"> <li>• general regulatory framework matters</li> <li>• population density</li> <li>• input prices</li> <li>• geographical terrain</li> <li>• network use and scale and</li> <li>• different pricing structures</li> <li>• different costing methodologies</li> <li>• technological differences</li> </ul>

Following the identification of similarities in the above factors, a selection of European countries (listed in table 4) was chosen for benchmarking purposes.

**Table 4: Countries chosen for benchmark**

ULLS	WLR, LCS, LSS, PSTN OTA
<ul style="list-style-type: none"> <li>• Germany</li> <li>• Austria</li> <li>• France</li> <li>• Denmark</li> <li>• Sweden</li> <li>• Italy</li> <li>• Spain</li> <li>• United Kingdom</li> <li>• Netherlands</li> <li>• Finland</li> </ul>	<ul style="list-style-type: none"> <li>• Germany</li> <li>• Austria</li> <li>• France</li> <li>• Denmark</li> <li>• Sweden</li> <li>• Italy</li> <li>• Spain</li> <li>• United Kingdom</li> <li>• Netherlands</li> <li>• Ireland</li> <li>• Norway</li> <li>• Belgium</li> <li>• Greece</li> <li>• Luxembourg</li> </ul>

The ACCC considers that the results of the international benchmarking should form one consideration when determining the indicative prices for the fixed network services. The weight of the benchmarking will however, be dependent on the level of similarities across the benchmarked countries and services.

The results of the international benchmarking for each service are discussed in each of the respective service chapters.

### 3. Pricing principles for the declared services

#### What is the best approach?

The ACCC's approach to access pricing for declared services has been guided by the principles set out in the Guide.<sup>11</sup> In this document the ACCC stated a broad preference for cost-based pricing<sup>12</sup> and noted that the pricing principles to apply to declared services will be decided on a case by case basis.<sup>13</sup>

There are many variants of cost-based pricing depending upon the costs that are included, how they are allocated and how they are measured.<sup>14</sup> However, the ACCC has previously determined that pricing based on total service long-run incremental cost (TSLRIC) which recovers the efficient costs a firm will incur in the long run of providing the service can, in general, satisfy the broad objectives which underpin the LTIE.<sup>15</sup> The efficient costs are the on-going or forward looking costs of providing the service, which includes a normal commercial return on efficient investment. TSLRIC also includes common costs which are causally related to the access service.<sup>16</sup>

The Guide also notes that TSLRIC is appropriate for services with particular characteristics, specifically:

... where the declared service is well developed, necessary for competition in dependent markets, and where the forces of competition or the threat of competition work poorly in constraining prices to efficient levels, the Commission will, in the usual case, when required to determine the access price, base such a determination on the total service long-run incremental costs (TSLRIC) of providing the service.<sup>17</sup>

This approach is reflected in past pricing principle determinations for the fixed services which adopt a TSLRIC pricing methodology. The exception is LCS and WLR for which a retail minus retail cost (RMRC) pricing principle has been adopted to date, however, the ACCC has indicated that a move to cost-based pricing would be considered once a robust cost model was available.

In the Guide there was a particular focus on TSLRIC pricing based on the key rationale that TSLRIC+ pricing in telecommunications would better send 'build or buy' signals. This objective reflected an expectation that there was a greater potential for infrastructure-based competition in telecommunications than in other regulated infrastructure industries — that is, telecommunications infrastructure may not have been an enduring bottleneck. It was expected that, in telecommunications, the least

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<sup>11</sup> ACCC, *Access Pricing Principles: Telecommunications — a Guide* (Access Pricing Principles), July 1997.

<sup>12</sup> ACCC, *Access Pricing Principles*, p.14.

<sup>13</sup> ACCC, *Access Pricing Principles*, p.13

<sup>14</sup> ACCC, *Access Pricing Principles*, p.28

<sup>15</sup> ACCC, *Access Pricing Principles*, p.29

<sup>16</sup> ACCC, *Access Pricing Principles*, p.14.

<sup>17</sup> ACCC, *Access Pricing Principles: Telecommunications — a Guide* (Access Pricing Principles), July 1997, p. 35.

cost technology would be rapidly and continually changing, so that access seekers would, over time, be able to efficiently deploy their own infrastructure to compete with the incumbent's and provide services in downstream retail markets. It was considered that:

- valuing sunk infrastructure at its efficient replacement cost at the time of a pricing determination would generate a price that would provide investors with correct signals concerning whether to build their own infrastructure to provide services, or to purchase access to the existing infrastructure (i.e. the build or buy signal); whereas
- valuing the sunk assets at their actual/historic cost would over-estimate efficient costs and encourage access seekers to build their own infrastructure, when it would actually be more efficient for them to buy access to the existing infrastructure.

In effect the TSLRIC+ approach means that prices are set on the basis that services are provided from new full cost assets rather than the lower value of the aged and depreciated assets that service provider might actually be using to provide services.

The ACCC's 1997 Pricing Principles Guide stated:

...in telecommunications where technology advances rapidly, historically incurred expenditures often have little relationship with (and generally overstate) the true economic costs of replicating an asset's service potential. As such, it will often inflate the access price and encourage inefficient by-pass.<sup>18</sup>

However, since 1997, the costs of replacing the largest components of fixed line telecommunications networks — for example, copper cables, ducts and pipes, and trenching — have generally been increasing, rather than decreasing, as was assumed would occur when the regime began.

Over the last ten years it has become clearer that Telstra's copper customer access network (CAN), more of the character of an enduring bottleneck, rather than a network subject to bypass through technological and market developments. There has been little evidence of successful competitive infrastructure deployment. Some infrastructure based competition in the form of Optus's Hybrid Fibre Coaxial (HFC) network, several wireless networks, and optical fibre transmission links and quasi-infrastructure based competition (in the form of access seekers installing their own DSLAMs in Telstra exchanges) has developed in limited geographic areas.

Although both HFC networks and 3G mobile networks have been deployed in Australia, they have not been widespread enough or had sufficient capacity to represent widespread end-to-end competing infrastructure able to provide services of comparable price and quality to Telstra's copper CAN.

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<sup>18</sup> ACCC, *Access Pricing Principles 1997 – Telecommunications: A Guide*, p 43.

In other words, it has become clearer that the copper CAN is likely to be an enduring bottleneck, because these networks have not proven to be strong substitutes for fixed-line services provided via the copper CAN.

The enduring bottleneck nature of some telecommunications infrastructure suggests that one of the main rationales for continual re-valuation of the asset base (that of sending efficient build-or-buy signals) may no longer be appropriate.

In other words, many elements of the copper CAN have proven to be enduring bottlenecks for which bypass through duplication would not be economic or desirable. In this environment, it is highly likely to always be more efficient for access seekers to 'buy' rather than 'build'. That said, the Government decision to proceed with the NBN, with significantly greater service potential than the copper CAN, might result in bypass of Telstra's copper CAN. However, whether it actually does so may not be determined for some time.

The ACCC has valued the copper CAN at optimised replacement cost for TSLRIC+ access pricing because it considered that estimating TSLRIC+ requires assets to be valued at their economic cost. The forward looking nature of optimised replacement costs is argued to better capture economic costs than either backward looking historic costs or current costs.<sup>19</sup> This is because forward looking replacement costs reflect the ongoing efficient costs of providing a service, which is no more than a firm could expect to recover in a contestable market.

However, the ACCC recognises that there are alternative methods to value sunk infrastructure, the most common of these being:

- historic cost/actual cost — the original cost of acquiring or building the asset
- depreciated historic/actual cost (DHC/DAC) — adjusts the historic cost of an asset by the proportion of these costs that have been recovered
- optimised replacement cost (ORC) — values the asset at the cost of replacing it with a modern equivalent available asset (MEA);
- current replacement cost — how much it would cost to replace the asset in substantially the same form at today's prices (current costs may also be depreciated), and
- depreciated optimised replacement cost (DORC) — values the asset at the cost of replacing it with an asset that is both a) adjusted for the proportion of the service potential of the existing asset that has expired and b) optimised to provide the required service potential in the most efficient way possible.

Alternatively, the value of network assets could be derived as the net present value of existing prices for services.

For the indicative prices in this document the ACCC proposes to rely on the TSLRIC+ pricing principle of a forward-looking approach to sunk asset valuation

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<sup>19</sup> ACCC, *Access Pricing Principles in Telecommunications — A Guide*, 1997, p. 41.

without a deduction for depreciation (that is, re-valuing the existing sunk network at its optimised replacement cost). As noted above, this approach was originally adopted because it was thought that there was more potential for bypass of telecommunications infrastructure than other regulated infrastructure (e.g. gas pipelines) and therefore a forward-looking approach was implemented to create efficient build or buy signals.

Given that some fixed network telecommunications infrastructure has the features of an enduring bottleneck, one of the main rationales for TSLRIC+ (to send efficient build-or-buy signals) may no longer be appropriate beyond this set of pricing principles and indicative prices. Indeed, in the event of a significant change in the regulatory environment during the term of these prices the ACCC would be open to reconsidering the prices and pricing principles.

Accordingly, the ACCC has indicated in response to the Government's *Regulatory Reform for 21st Century Broadband: discussion paper* its views on the changes that could be made to the existing regulatory framework, including possible areas for reform of the current approach to pricing telecommunications access services to improve the outcome for consumers, which includes setting a regulatory asset base. The ACCC considers that in light of a lack of ubiquitous deployment of fully substitutable infrastructure, locking-in a value for existing sunk assets, rather than continually re-valuing may well better promote regulatory certainty and is likely to explore this further through the release of a discussion paper.

If the ACCC ultimately came to this view then it is recognised that there would be important issues of transition from the existing, well understood, pricing principles reaffirmed in this paper.

## **TSLRIC+**

Despite the concerns outlined above, the ACCC intends to adopt a TSLRIC+ principle for the pricing for the six fixed network services for the period from 1 August 2009 until 30 June 2012.

A TSLRIC+ framework can be understood by breaking it down into its component elements:

- Total service (TS) – meaning the entire access service that is to be costed (as opposed to a particular supply of that service)
- Long run (LR) – meaning the cost assessment has regard to the costs that will be incurred over a period sufficiently long that all production elements can be varied or avoided
- Incremental cost (IC) – meaning it is the additional costs incurred as a consequence of providing the service (as defined); or put another way, would be avoided if the service was not supplied, and
- ‘+’ is contribution is included to common costs, i.e. costs that are incurred by the access provider, but which are not directly caused by, or not attributable to, the supply of a particular service or business activity or group of services / activities.

As such, TSLRIC+ represents the costs the firm necessarily incurs in providing the service and captures the value of society's resources used in its production. In a practical sense, TSLRIC+ consists of the sum of the direct operating and maintenance costs, the direct capital costs that the firm incurs in providing the service as a whole and a contribution to indirect or organisation-level costs.

In this calculation, capital costs comprise the cost of capital (the opportunity cost of debt and equity used to finance the firm) and depreciation (the decline in economic value of assets) of capital that is specific to the production of the service. These are expressed as annualised capital costs and depreciation, where annual capital costs are derived by the application of the WACC factor on the estimated costs of fixed assets. While the other components, operating and maintenance costs, are the continuing direct operational costs of providing the service, consisting of the labour and materials costs that are causally related to the provision of the service.

## **Implementation of TSLRIC+**

The ACCC considers TSLRIC+ to be a broad theoretical concept which can be implemented in a number of different ways, depending on how costs are measured and allocated, and the parameter values and underlying network assumptions used to produce cost estimates. Put another way, adopting TSLRIC+ as the appropriate cost concept does not resolve all methodological questions, choices and assumptions that necessarily arise during a costing exercise.

Hence, the ACCC recognises that the choice as to what assumptions are made when estimating the TSLRIC+ means that not all implementations of TSLRIC+ will result in a price, which necessarily meets all the legislative criteria to which the ACCC must have regard.

The ACCC's view is that an efficient, forward looking implementation of TSLRIC+ in estimating network costs would require:

- the costing exercise to be undertaken on a forward-looking and efficient basis
- the modelled access network to use best-in-use forward looking technology or modern equivalent assets (MEA)
- equipment to be costed at full price currently prevailing (and not on a depreciated basis)
- costs not faced by Telstra in building its access network to be excluded, e.g., costs of breaking and reinstating concrete
- costs which are able to be recovered through other charges, e.g., lead-in costs, are excluded
- the use of a tilted annuity to reflect that nominal access charges can vary over time in line with changes in the price of inputs
- allowances for operating and maintenance costs to be set by international benchmarks, and not based on the access provider's actual operating and maintenance costs, and

- allowances for indirect costs to be set by international benchmarks, from which the discrete specific cost allowance is deducted, and not based on the access provider's actual indirect overheads.

## Pricing Structure

As noted above, the ACCC intends to move away from the use of Telstra's four Bands when determining indicative prices. For the proposed indicative pricing period, it is intended that a two tiered structure will be used, based on aggregating the results from the Analysys cost model to price the ULLS and WLR – *Zone A* and *Zone B*, where:

- Zone A includes geotypes 1 through to 10, and
- Zone B includes geotypes 11 through to 15.

The ACCC first declared the ULLS in July 1999 and finalised pricing principles for the ULLS in March 2002. ULLS prices were based on a geographic de-averaged price structure. Since this time a number of events have occurred that are relevant to the future pricing of the ULLS:

- the ACCC has issued model prices for the ULLS
- Telstra submitted numerous sets of undertakings about the price of the ULLS (all of which have been rejected as unreasonable)
- the ACCC has re-declared the ULLS twice
- the Australian Competition Tribunal has considered past Telstra ULLS undertakings and is also currently reviewing the ACCC's 2008 decision to reject Telstra's Band 2 ULLS undertaking
- the ACCC has arbitrated and continues to arbitrate a number of ULLS access disputes.

The geographic de-averaging of prices, in particular ULLS, has been the subject of significant debate in recent years. In various regulatory proceedings prior to 2006, a de-averaged pricing structure for the ULLS was adopted by both Telstra and the ACCC to reflect significant estimated cost differentials between four different geographic regions – CBD, metropolitan, regional and rural areas for services provided over Telstra's copper CAN. The longer copper lines typically associated with regional and rural areas (as well as metropolitan premises located in the extremities of an Exchange Service Area) are associated with a very high cost of deployment. However, they are also typically of low value (in terms of service potential) because the degradation of signal strength across these longer copper lines means that they cannot supply the full range of broadband services to end users.

Previously, when setting indicative prices, the ACCC has stated a preference for geographically de-averaged pricing where appropriate. In broad terms, geographically averaged pricing of access can distort competitive outcomes when there are significant divergences in underlying costs across regions. The practice of the ACCC has been to assess the structure of access pricing on a service by service basis rather than taking a single position on averaging or de-averaging.



In general, access seekers have argued that geographic averaging would adversely affect competition and distort usage and investment decisions. Differences between costs in the different bands are significant to the extent that competition would be materially distorted if prices were averaged. In this sense a de-averaged approach to ULLS pricing is more directly cost reflective and would provide a more appropriate basis for build or buy decisions by prospective competitors than a fully averaged prices.

The ACCC's view has been that it was not satisfied that the averaged ULLS charges proposed by Telstra in undertakings were reasonable. Apart from problems with Telstra's modelling, the ACCC considered that particularly because of the distortionary effects described above, fully averaged pricing would adversely affect competition in the markets for basic telephony and broadband services, and distort usage and investment decisions, resulting in the inefficient use of, and investment in, telecommunications infrastructure.

The ACCC now has a range of cost information available, including Telstra's TEA model. While the ACCC has previously noted that the TEA model included costs it considered were not based on efficient network design and until recently was limited to modelling the ULLS price in Telstra Band 2, with adjustments to input parameters it may provide some useful cost estimates. In 2007 the ACCC commissioned the Analysys fixed network cost model to better inform the estimation of costs of all the declared fixed services. The model was completed in 2009 after substantial industry consultation.

The ACCC considers the Analysys cost model provides a robust framework from which to consider indicative pricing. This includes a band/zone structure that better reflects the costs of providing fixed network services. This approach better utilises the geotype classification of ESAs in the Analysys cost model. By classifying ESAs by geotype, the ACCC has considered that it has better information on the characteristics and costs of each ESA than would be produced by Telstra's four Band structure and population density based definition.

The ACCC proposes to adopt the geotypes from the Analysys cost model to develop two zones. Zone A includes Analysys cost model geotypes 1 through to 10, while Zone B includes geotypes 11 through to 16.

By default the Analysys cost model prices the services on a geotype basis i.e. similar characteristics in relation to the number of locations per kilometre of road and density of population. In geotypes 7 to 15, in addition to determining the classification based on average locations per kilometre the density of services relative to the location of the copper centre is taken into account, whereby geotypes are determined to be *clustered* or *spread*. Geotypes 7 to 9 are deemed to be clustered on the basis that 98 per cent of the locations contained within each ESA are within 4km of the local exchange, while geotypes 10 to 15 are said to be spread as they do not meet the clustered density requirement.

The ACCC considers that geotypes provide a useful basis for determining these broad zones. In determining the zones, the ACCC considered it appropriate to include geotypes 1 to 10 in Zone A on the basis that they share similar characteristics, and by aggregating them into a single zone it is considered that they would not provide a

distortionary effect on investment or competition. Zone B would therefore include the remaining geotypes 11 to 15. In effect, Zone B consists of the higher cost areas of Telstra’s Band 3 and Band 4 Exchange Service Areas.

The services included in Zone B reflect the higher costs of providing services in remote areas. Geotype 11 is also the first point at which the Analysys cost model determines that it is no longer cost-efficient to deploy copper and when efficient, deploys wireless technology instead. The potential for copper network bypass through the deployment of wireless services in Zone B to provide greater service potential than can be supplied over the very long copper wires that would otherwise be required provides some support for the TSLRIC+ build buy signals

The seven ESAs which are currently located in geotype 16 (but do not have any services) will be manually allocated to either Zones A and B. The ACCC intends on allocating the ESAs as set out in table 5.

**Table 5: Geotype 16 zone allocations**

ESA code	ESA	State	Sq km	Road length	Zone
BUMY	Buraminya	WA	6,570.13	310.48	B
EYBY	Eynesbury	VIC	41.98	35.29	A
GGHT	Ginghet	NSW	2,114.58	1,271.89	A
GRDO	Gordon	TAS	3,072.96	190.56	B
KOOH	Koolpinyah	NT	496.76	92.54	B
MTZI	Mount Crozier	VIC	2,364.93	515.21	B
SWST	Southwest	TAS	5,081.25	225.19	B

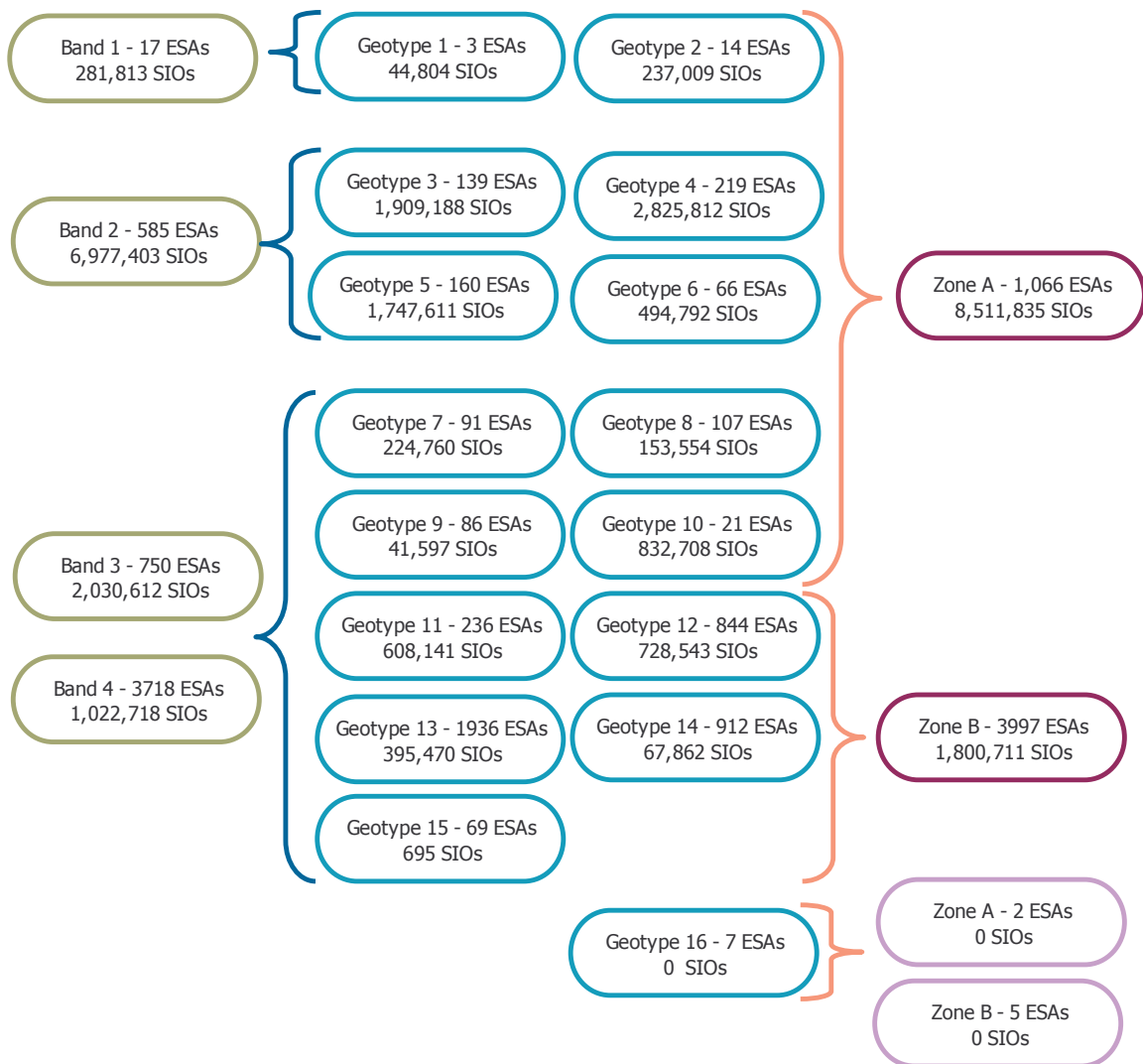
**Table 6: Proposed zone structure and composition**

	SIOs	ESAs	ULLS lines
ACCC Zone A	8,511,835	1,068	646,708
ACCC Zone B	1,800,711	4,002	1,439

Refer to Appendix 5 (attached separately) for a full list of the ESA Zone classifications.

The following diagram sets out the relationship between the existing Telstra bands and how these allocate into Analysys cost model geotypes and ACCC zones.

**Figure 1: Relationship between pricing structures**



The ESAs within *Zone A* share similar characteristics in terms of locations per kilometre of road length and density of locations relative to the exchange. While the balance of the ESAs are in *Zone B* and better reflects the higher costs of providing services in these more remote areas. It is notable that geotype 11 in *Zone B* is the first point at which the Analysys cost model determines that it is no longer cost-efficient to deploy copper in some circumstances and starts to deploy wireless technology to serve some customers.

For PSTN OTA, LSS and LCS, the ACCC intends to adopt a single national price. This approach is consistent with the previous indicative prices for LCS and LSS, however, represents a shift in pricing methodology for the PSTN OTA service which had previously been priced on a geographically disaggregated two part pricing (flagfall and minutes of use) basis. The ACCC considers that the move to a single rate for PSTN OTA is appropriate as the transit costs for the call throughout the network are largely the same regardless of the geographical location of the end-user.

## Adoption of an adjustment path

The ACCC is concerned that immediate implementation of a cost based approach using the Analysys cost model would be likely to lead to very substantial reductions in the price of some services and rises in others within a short period of time. In turn, the ACCC is concerned that this would be likely to generate significant and potentially harmful disruption to the operations and planning of a number of access seekers and access providers. This may have the effect of compromising the business interests of access seekers and providers that have made business decisions on the basis of the ACCC's previous approach to pricing of the fixed services for regulatory purposes.

The ACCC considers that in adopting indicative prices which have regard to the Analysys cost model, prices will have a closer association to the underlying cost of the service. This would significantly promote the LTIE through the promotion of competition in downstream markets and a more efficient use of, and investment in, the infrastructure used to provide telecommunications services. By adopting a gradual adjustment path, the ACCC would also ensure it had properly balanced consideration of the legitimate business interest of access provider and the interests of access seekers.

As a result of these concerns, the ACCC believes it would be inappropriate to immediately move to indicative pricing based on the Analysys cost model where that pricing represents a significant shift in price. While the Analysys cost model has been available for consultation for some time and the ACCC has signalled a shift to cost based pricing once the Analysys model is finalised, the ACCC considers it is prudent to adopt an adjustment path approach.

Given the nature of the telecommunications industry and the potential changes since the announcement of the NBN, the ACCC considers it appropriate for the pricing principles to apply from 1 August 2009 until 30 June 2012. Accordingly, the ACCC believes it is appropriate that the adjustment path should operate over a period from the date of the last indicative prices until the end of the indicative prices. The ACCC considers that this period allows sufficient time for access seekers and providers to amend any business plans in light of these pricing principles.

As such, the ACCC considers that its pricing principles for the fixed services should follow an adjustment path to the TSLRIC+ price of the services in 2011-12. As a general rule, the ACCC intends to adopt an adjustment path for services where it is considered that the change in prices may result in a price shock either for the access seeker or the access provider. The affected services are the ULLS, PSTN OTA and LCS.

The ACCC has not adopted a glide path for the WLR or the LSS. An adjustment path has not been adopted for WLR services as it is not considered that the change in prices result in a price shock for either the access provider or access seekers.

For the LSS, the ACCC notes that the proposed prices are not a product of a revised pricing principle. Rather the "Specific costs" cost model, which has been used in previous LSS indicative pricing decisions, has been used again. As such, it has only been the inputs of this model, the period of application and the move to annual

levelisation which have been varied to determine the LSS price results. These changes were foreshadowed in the 2007 LSS final decision.<sup>20</sup> Within the “Specific cost” cost model, the ACCC has also included an additional \$10 million in the capital base for operation support systems (OSS) enhancements. Even with this allowance for this prospective capital expenditure, the Specific Costs model would result in an LSS price below \$1 per month and a decline through time. Although the ACCC has not adopted an adjustment path for LSS prices, it considers that the price should be rounded up to \$1 to be of a form of a minimum monthly charge now and in the future.

As such the change in the monthly LSS price from \$2.50 to \$1.00 is not considered to result in a price shock because industry participants have been given clear notice of this likely development in the 2007 LSS final decision noted above.

The ACCC considers that the adjustment path (where considered appropriate) should have the following characteristics:

- it should proceed from the ACCC’s most recent indicative price for the service
- the end price should be set at the best estimate of the TSLRIC+ of supplying the service in 2011-12 based on the results of the relevant cost models and international benchmarking
- price changes should be made on an annual basis, and
- each price change should be a straight line over the life of the adjustment, subject to any rounding up of the results.

## ACCC’s view

The ACCC’s preliminary view is that indicative prices for the six fixed services should continue to be, or as in the case of LCS and WLR progress to, pricing based on the TSLRIC+ cost of providing the services.

The ACCC considers for ULLS, LCS and PSTN OTA an adjustment path should be adopted to prevent price shocks for both the access provider and access seekers, with prices reflecting the TSLRIC+ cost by the end of the indicative price period.

The ACCC is also proposing the adoption of a two tiered pricing structure, *Zone A* and *Zone B*, for the ULLS and WLR, noting however that an indicative price will not be set for WLR Zone B. A single rate will be set for PSTN OTA, LCS and LSS. Table 7 sets out a summary of the pricing approach and structure for each service.

**Table 7: Pricing structure for fixed network services**

Service	Past pricing approach	Proposed pricing approach	Adoption of adjustment path	Pricing structure
ULLS	TSLRIC+	TSLRIC+	Yes	Zone A and Zone B

<sup>20</sup> ACCC, *LSS access dispute – Telstra / Agile, Reasons for Final Determination*, December 2007.

<b>WLR</b>	RMRC*	TSLRIC+	No	Zone A, no price for Zone B
<b>LCS</b>	RMRC	TSLRIC+	Yes	Single rate
<b>PSTN</b>	TSLRIC	TSLRIC+	Yes	Single rate
<b>LSS</b>	TSLRIC+	TSLRIC+	No	Single rate

Note: \* RMRC is retail minus retail cost

The ACCC considers that the approach outlined above is in the legitimate interest of both the access seeker and the access provider as it allows sufficient time for previous business decisions to be realised.

The ACCC considers that the re-declaration of the six fixed network services in July 2009 for five years, combined with pricing principles and indicative prices until 30 June 2012 provides increased certainty during the initial stages of transition to the roll out of the NBN.

However, to the extent that it is concluded that some elements of fixed network telecommunication infrastructure are enduring bottlenecks, the ACCC's approach to pricing principles and indicative prices may no longer be appropriate beyond this period of this determination.

## 5. Local carriage service

### Background

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 service is generally sold with the WLR (discussed in chapter 6). The LCS has been a declared service since 1999<sup>21</sup> and was re-declared in 2006<sup>22</sup> excluding the CBD areas of Sydney, Melbourne, Brisbane, Adelaide and Perth.<sup>23</sup> In July 2009, the declaration was extended for a further five years until July 2014.<sup>24</sup>

### Past access pricing

The ACCC has adopted a retail-minus-retail-cost (RMRC) pricing principle since releasing its first indicative prices for LCS in 2002. Using the RMRC methodology, the ACCC determined the LCS indicative price by subtracting retail costs from the retail price (the initial starting point was the 22c (GST incl) retail price cap for a local call).<sup>25</sup> In practice, retail pricing for local calls has tended to be lower than the indicative prices because LCS has been offered as part of a bundle with other line rental products and wholesale pricing has generally been agreed at a lower per call basis.<sup>26</sup>

The previous indicative prices based on the RMRC pricing principle are set out below:

**Table 8: LCS - Past indicative prices**

	LCS (per call)
<b>2006–2007</b>	17.92c
<b>2008–2009</b>	17.36c

Despite the ACCC's adoption of RMRC, it has consistently indicated a likely move to cost-based pricing. The ACCC first signalled in October 2003 that it would examine a

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<sup>21</sup> ACCC, *Declaration of local telecommunications services*, July 1999.

<sup>22</sup> ACCC, *Local Services Review – Final Decision*, July 2006.

<sup>23</sup> 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.

<sup>24</sup> ACCC, *FSR Declaration Inquiry*.

<sup>25</sup> Refer to: *Telstra Carrier Charges – Price Control Arrangements, Notification and Disallowance Determination No. 1 of 2005*, Part 3, Div. 1, clause 16.

<sup>26</sup> See: Telstra, *Response to the Commission's draft pricing principles for LCS and WLR dated April 2008*, Public version, 14 May 2008, p. 2.

TSLRIC+ approach to pricing LCS as an alternative to RMRC, once a robust cost model was developed.<sup>27</sup> In 2006<sup>28</sup> and again in 2008<sup>29</sup> the ACCC emphasised the transitional nature of indicative prices based on the RMRC principle and again stated the likelihood of a move to cost-based pricing approach.

## Proposed access pricing

With the development of the Analysys cost model and having regard to other sources of information, the ACCC is now in a position to develop cost-based pricing for the LCS and sets out its preliminary views on the indicative prices that should apply for this service below.

### Material relied upon to develop future pricing principles

In setting indicative prices for the LCS and WLR, the ACCC has had regard to the following key sources of information:

- the Analysys cost model which generates a range of all area estimates for LCS from 7.82 c in 2009–10 to 7.81 c for 2011–12,<sup>30</sup> and
- international benchmarking which provides all area benchmark prices for LCS of between 7.06 c and 10.56 c.<sup>31</sup>

In determining the international benchmark prices for LCS, the following factors were considered:

- a directly comparable wholesale product for LCS did not exist in the selected comparator countries
- local and single tandem originating/termination products were selected
- blended peak and off-peak rates using the OECD basket were assumed, on the basis of the medium residential user, and
- an average call duration of 5 minutes is assumed.<sup>32</sup>

The ACCC also considered the prices that would result if an RMRC approach was maintained. Under RMRC, the LCS price when calculated using Telstra's first half

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<sup>27</sup> ACCC, *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003, p. 92.

<sup>28</sup> ACCC, *Pricing principles and indicative prices: local carriage service, wholesale line rental and PSTN originating and terminating access service – Final Determination and Explanatory Statement*, 29 November 2006.

<sup>29</sup> ACCC, *Local carriage service and wholesale line rental – final pricing principles and indicative prices for 2008–2009*, 6 August 2008.

<sup>30</sup> Refer to Appendix 2 for an outline of the relevant model input parameters.

<sup>31</sup> See: Analysys Mason, *Report for the Australian Competition and Consumer Commission, International benchmarking analysis, Analysis of WLR, LCS, LSS and PSTN OTA*, 18 August 2009, pp. 18–19.

<sup>32</sup> Analysys Mason, *Report for the Australian Competition and Consumer Commission, International benchmarking analysis, Analysis of WLR, LCS, LSS and PSTN OTA*, 18 August 2009, pp. 16–17.



2008–09 regulatory accounting framework (RAF) data would be 17.35 cents. The ACCC notes that this estimate may change when using full year data from the RAF.

### Adjustment path

As discussed in Chapter 3 the ACCC proposes to adopt an adjustment path for services where it is considered that the change in prices may result in a price shock either for the access seeker or the access provider. For LCS the ACCC proposes to adopt an adjustment path with the following characteristics:

- the adjustment path should proceed from the ACCC’s indicative price of 17.36 c for the previous year ending on 31 July 2009
- the end price should be set at the best estimate of the TSLRIC+ cost of supplying the service of 7.90c
- decrements should be made on an annual basis, and
- each decrement should be of an approximately equal percentage.

The ACCC sets out its draft indicative prices for LCS below. The ACCC proposes an all area price for LCS.

**Table 9: Indicative prices**

LCS	2009–10	2010–11	2011–12
All areas (cents)	13.30	→ 10.20	→ 7.90

## 6. Wholesale line rental

### Background

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.<sup>33</sup> In July 2009, the declaration was extended for a further five years until July 2014.<sup>34</sup>

### Past access pricing

The ACCC has adopted a retail-minus-retail-cost (RMRC) pricing principle since releasing its first indicative prices for WLR in 2006.<sup>35</sup> For WLR the ACCC used residential and business products as retail benchmarks and determined the indicative price by subtracting avoidable retail costs. The indicative prices which resulted are set out below:

**Table 10: WLR -Past indicative prices**

	WLR residential (per month)	WLR business (per month)
1 August 2006–31 December 2007	\$23.12	\$25.84
1 January 2008–31 July 2009	\$25.57	\$26.93

Although the ACCC's adoption of RMRC prevailed for some time it has consistently indicated a likely move to cost-based pricing. In 2006<sup>36</sup> and again in 2008<sup>37</sup> the ACCC emphasised the transitional nature of indicative prices based on the RMRC principle and indicated a move towards a cost-based pricing approach informed by a robust model.

### Proposed access pricing

With the development of the Analysys cost model and having regard to other sources of information, the ACCC is now in a position to develop cost-based pricing for the

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<sup>33</sup> ACCC, *Local Services Review—Final decision*, July 2006.

<sup>34</sup> *FSR Declaration Inquiry*.

<sup>35</sup> ACCC, *Pricing principles and indicative prices—LCS, WLR and PSTN OTA* (Nov 06).

<sup>36</sup> ACCC, *Pricing principles and indicative prices: local carriage service, wholesale line rental and PSTN originating and terminating access service – Final Determination and Explanatory Statement*, 29 November 2006.

<sup>37</sup> ACCC, *Local carriage service and wholesale line rental – final pricing principles and indicative prices for 2008–2009*, 6 August 2008.

WLR and sets out its preliminary views on the indicative prices that should apply for this service below.

### **Material relied upon to develop future pricing principles**

In setting indicative prices for the WLR the ACCC has had regard to the following key sources of information:

- the Analysys cost model estimates of \$23.26 for 2009–10 increasing to \$23.76 for 2011–12 for Zone A,<sup>38</sup> and
- international benchmarking which provides a geographically averaged benchmark of \$20.51 for a product comparable to WLR.<sup>39</sup>

In determining the international benchmark for WLR the following factors were considered:

- a residential offer was selected as the benchmark offer, and
- connection and disconnection costs were amortised over three years to present a standalone price for monthly rental and a lifetime price.<sup>40</sup>

The ACCC also considered the prices that would result if an RMRC approach was maintained for WLR. Under RMRC, the WLR price when calculated using first half 2008–09 RAF data would fall to \$22.82. The ACCC notes that this estimate may change when using full year data from the RAF.

The ACCC does not currently have information on the number of WLR services on a disaggregated basis. It is difficult to assess the impact of the proposed pricing structure in the absence of information on the number of WLR services in each zone. The ACCC seeks further information and data on this point in submissions on its draft pricing principle determination.

The ACCC sets out its draft indicative prices for WLR below. The ACCC does not propose to apply an adjustment path for WLR as it does not consider the proposed indicative prices will lead to a rate shock for either the access provider or the access seeker.

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<sup>38</sup> Refer to Appendix X for an outline of the relevant model input parameters.

<sup>39</sup> Calculated by averaging the AUD equivalent basic monthly rental charge of 10 comparator countries.

<sup>40</sup> Analysys Mason, *Report for the Australian Competition and Consumer Commission, International benchmarking analysis, Analysis of WLR, LCS, LSS and PSTN OTA*, 18 August 2009, pp. 13 – 15.

**Table 11: Indicative prices**

WLR (per month)	2009–10	2010–11	2011–12
Zone A	\$23.30	\$23.60	\$23.80

### **Retail price parity obligation**

The ACCC is conscious that the retail price control arrangements oblige Telstra to provide a basic line rental service in non-metropolitan areas at the same price as it offers to customers in metropolitan areas.<sup>41</sup> The ACCC also notes that the retail price controls, including the above pricing parity requirement, have recently been extended for 12 months while a detailed review is undertaken.<sup>42</sup>

The current retail price for HomeLine Part and HomeLine Business are \$34.45 (or \$31.32 excluding GST) and \$39.95 (or \$36.32 excluding GST) respectively. The Analysys cost model produces estimates for WLR in Zone B ranging from \$67.72 for 2009–10 to \$68.90 for 2011–12. In these circumstances, the ACCC does not consider it appropriate to set a cost-based indicative wholesale price for Zone B at this time. To some extent this decision reflects the deployment of wireless solutions in Zone B and which in turn are included in the cost base for WLR in Zone B. The ACCC is yet to confirm the reliability of costing and access to WLR on wireless deployments in Zone B.

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<sup>41</sup> See: *Telstra Carrier Charges — Price Control Arrangements, Notification and Disallowance Determination No. 1 of 2005*. By virtue of Part 3, Div. 1, clause 19A.

<sup>42</sup> See: Explanatory Statement: *Telecommunications (Consumer Protection and Service Standards) Act 1999* Telstra Carrier Charges – Price Control Arrangements, Notification and Disallowance Determination No. 1 of 2005 (Amendment No. 1 of 2009).

## 7. Public switched telephone network originating and terminating access

### Background

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:

- 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 re-declared in 2006.<sup>43</sup> In July 2009, the declaration was extended for a further five years until July 2014.<sup>44</sup>

### Past access pricing

The ACCC has adopted a TSLRIC pricing principle since releasing its first indicative prices for PSTN OTA in 1997. In 2003, the ACCC considered that a gradual movement in regulatory pricing of the PSTN OTA services towards efficient TSLRIC+ conveyance only charges would be appropriate.<sup>45</sup> At the time, the ACCC expected that by 2006–07 PSTN access prices would be expected to be well below 1 cpm.

Using the TSLRIC methodology the ACCC determined the PSTN OTA headline rates by calculating the sum of the operating and maintenance costs as well as the capital costs the firm incurs in providing the service as a whole. The ACCC set out disaggregated and de-averaged PSTN indicative prices including derived disaggregated flagfall and per-minute charges (EMOU – End Minute of Use). The disaggregated indicative prices which resulted for the services are set out below:

**Table 12: PSTN - Past Indicative prices**

2006–2007	Flagfall	EMOU* Charge	Headline rate
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<sup>43</sup> ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final determination*, July 2006.

<sup>44</sup> *FSR Declaration Inquiry*.

<sup>45</sup> ACCC, *Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003, pp.3–4.

<b>CBD</b>	0.85	0.35	0.57
<b>Metropolitan</b>	0.84	0.49	0.70
<b>Provincial</b>	0.94	0.68	0.91
<b>Rural</b>	2.06	3.66	4.18

At the time the primary driver in the disaggregation of the headline rates outlined above was the overall preservation of a flagfall:EMOU charge ratio similar to that reflected in Telstra's own retail pricing at that time. However, it should be noted that the disaggregated rates were indicative rates and only approximated the appropriate disaggregation of indicative headline rates. In practice, the ACCC understands that commercial negotiations for PSTN rates have been considered on the basis of an average headline rate as set out in the table below.

**Table 13: Average 2006–07 PSTN**

<b>2006–2007</b>	<b>Flagfall</b>	<b>EMOU* Charge</b>	<b>Headline rate</b>
<b>Average</b>	0.95	0.76	1.00

The ACCC notes the declining trend in PSTN calls and the implications for increasing unit costs. The Analysys cost model factors in declining demand for PSTN. Further detail on how demand is treated can be found in the *Fixed LRIC model documentation*,<sup>46</sup> section 3 and the *Cost.xls workbook: inputs.demand worksheet*.<sup>47</sup>

Over the past ten years, the ACCC has scrutinised the pricing of PSTN OTA on numerous occasions.<sup>48</sup> The ACCC considers TSLRIC+ is the appropriate pricing principle to ascertain PSTN OTA prices at this time.

The ACCC has considered for some time that a movement in regulatory pricing of the PSTN OTA access services towards efficient conveyance only charges would be in the LTIE where prices would reflect TSLRIC+.<sup>49</sup>

With the development of the Analysys cost model, the ACCC considers that it is now an appropriate time to move towards single uniform pricing for PSTN OTA. The

<sup>46</sup> Analysys, *Fixed LRIC model documentation*, August 2009.

<sup>47</sup> Available at: [www.accc.gov.au](http://www.accc.gov.au)

<sup>48</sup> ACCC, Assessment of Telstra's Undertaking for Domestic PSTN Originating and Terminating Access, Final Decision, June 1999; ACCC, A report on the assessment of Telstra's undertaking for the Domestic PSTN Originating and Terminating Access services, July 2000; The Need for an ADC for PSTN Access Service Pricing, February 2003; Final Determination for model price terms and conditions of the PSTN, ULLS and LCS services, October 2003; Assessment of Telstra's undertakings for PSTN, ULLS and LCS, Final Decision, December 2004.

<sup>49</sup> ACCC, *Model price terms and conditions* October 2003.p.3

ACCC considers that the costs associated with transit are likely to be the same throughout the CAN and/or inter-exchange network (CORE) notwithstanding the geographical location of the end-user. This is similar to the approach taken in regard to the Mobile Terminating Access Service (MTAS) where a single per minute rate is set as the indicative price across the country.

## **Proposed access pricing**

### **Material relied upon to develop future pricing principles**

In setting indicative prices for PSTN OTA, the ACCC has had regard to the following key sources of information:

- the Analysys cost model which generates a range of estimates between 0.74 c per minute for 2009–10 and 0.79 c per minute for 2011–12, and
- international benchmarking which provides a geographically averaged benchmark for the PSTN OTA of: between 0.78c / 0.75c (local OTA) and 1.16c / 1.11c (single transit OTA).

In determining the benchmark prices for PSTN OTA, the following factors were considered:

- local and single tandem originating/termination products were selected
- where prices differed between two benchmark products, a 50:50 distribution was assumed
- blended peak and off-peak rates using the time distribution in the OECD basket, on the basis of the medium residential user
- an average call duration of four minutes is assumed (consistent with the ACCC's previous approach of presenting an average rate), and
- the average rates have been presented as disaggregated prices are not offered in the surveyed countries.

### **Adjustment path**

As discussed in Chapter 3, the ACCC proposes to adopt an adjustment path for services where it is considered that the change in prices may result in a price shock either for the access seeker or the access provider. For PSTN the ACCC proposes to adopt an adjustment path with the following characteristics:

- the adjustment path should proceed from the ACCC's previous indicative price. For PSTN OTA this means the glide path will commence in principle from 2006-2007 when the last indicative price was in place
- the end price should be set at the best estimate of the TSLRIC+ cost of supplying the service of 0.80 c
- decrements should be made on an annual basis, and
- each decrement should be of an approximately equal percentage.

The ACCC sets out its draft indicative prices for PSTN OTA below. The ACCC proposes a single price for PSTN OTA.

**Table 14: Indicative prices**

<b>PSTN OTA</b>	<b>2009–10</b>	<b>2010–11</b>	<b>2011–12</b>
All zones (cents)	0.90	→ 0.85	→ 0.80



## 8. Unconditioned local loop service

### Background

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 re-declared in 2006.<sup>50</sup> In July 2009, the declaration was extended for a further five years until July 2014.<sup>51</sup>

### Past access pricing

A TSLRIC pricing methodology has been maintained for the ULLS since the first pricing principles for the service were released in March 2002.<sup>52</sup> In June 2008, the ACCC released indicative prices for the ULLS for the period 2005-06 until 31 July 2009 as set out below.<sup>53</sup> At the same time, the ACCC determined that indicative prices based on TSLRIC+ pricing principles should be estimated using the PIE II network cost model until such time as the ACCC had developed its own fixed network cost model.<sup>54</sup>

### Past indicative prices<sup>55</sup>

**Table 15: Previous ULLS monthly charges**

Band	2005–2006	2006–2007	2007–2008	2008–2009
1	\$5.60	\$6.00	\$6.20	\$6.60
2	\$12.30	\$13.70	\$14.30	\$16.00
3	\$25.00	\$27.30	\$28.50	\$31.30

Note: Prices include the specific cost component of \$2.50  
The ACCC decided not to issue indicative prices for the ULLS in Band 4.<sup>56</sup>

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<sup>50</sup> ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS – Final determination*, July 2006.

<sup>51</sup> *FSR Declaration Inquiry*.

<sup>52</sup> ACCC, *Pricing of unconditioned local loop services (ULLS) – final report*, March 2002.

<sup>53</sup> ACCC, *Unconditioned local loop service – pricing principles and indicative prices*, June 2008.

<sup>54</sup> *ibid.*, p. 7.

<sup>55</sup> *ibid.*, pp.44 & 45.

<sup>56</sup> *ibid.*, p. 22.

**Table 16: ULLS Single Connection Charges**

Band	2004-05	2005-06	2006-07	2007-08	2008-09
1	\$38.10	\$38.10	\$44.00	\$50.10	\$50.40
2	\$43.10	\$43.10	\$47.80	\$52.80	\$53.10
3	\$51.50	\$51.50	\$54.10	\$57.40	\$57.70

**Table 17: ULLS Managed Network Migration (MNM) Connection Charges**

(a) For the period from 1 July 2007 to 30 June 2008:

Component	Charge
– Fixed amount	\$ 135.60 (per MNM)
– Variable amount	+ \$ 24.90 (per connection)

(b) For the period from 1 July 2008 to 31 July 2009:

Component	Charge
– Fixed amount	\$ 138.00 (per MNM)
– Variable amount	+ \$ 25.00 (per connection)

In addition to the above indicative prices, the ACCC has set additional price terms in arbitrations. The draft determination attached in Appendix 1 adopts the past indicative prices and arbitral price terms.

## Proposed access pricing

### Material relied upon to develop future pricing principles

In setting the indicative monthly access charge, excluding the specific costs component, for the ULLS the ACCC has had regard to the following key sources of information:

- Analysys cost model which generates a range of estimates for:
  - Zone A from \$22.03 for 2009-10 to \$22.54 for 2011-12
  - Zone B from \$60.41 for 2009-10 to \$61.70 for 2011-12.
- Telstra's Efficient Access (TEA) model which generates 2008-09 prices based on the ACCC's input assumptions as outlined in Appendix 2 of:
  - \$6.75 for Band 1
  - \$22.64 for Band 2
  - \$63.64 for Band 3.

- International benchmarking undertaken by Ovum<sup>57</sup>:

The ACCC requested Ovum to comment on factors raised in the Telstra supplied report from the Ingenious Consulting Network.<sup>58</sup> The Ingenious Consulting Network's report described factors that limited the weight that could be placed on the use of international benchmarking to assess ULLS Band 2 pricing. These factors include:

- the general regulatory framework
- population density (for Band 2 equivalent areas)
- land use (housing mix)
- copper prices
- loop length, and
- pricing structure.

Using available data to control for the above factors where possible, Ovum provided the following broad observations regarding Telstra's ULLS Band 2 monthly charge undertaking:

- Telstra's proposed ULLS charge is not in line with LRIC-based determinations in other countries
- taking population density into account, Telstra's proposed ULLS charge is not consistent with the countries referenced in the ACCC's Assessment of Telstra's ULLS Band 2 monthly charge undertaking draft decision
- taking local loop lengths into account, Telstra's proposed ULLS charge is not in line with those of like countries, and
- using a pricing proxy approach such as the margin of typical retail internet access charges against ULLS monthly charges, the current Australian monthly charge appears to be broadly consistent with most LRIC-based ULLS charges in other countries.

The Ovum report demonstrates that the range of regulated ULLS monthly charges for those countries where LRIC is the basis for regulatory cost calculation is between \$13.22 to \$16.89.<sup>59</sup>

### **Indicative prices**

As discussed in Chapter 3, the ACCC proposes to adopt an adjustment path for services where it is considered that the change in prices may result in a price shock either for the access seeker or the access provider. For Zone A ULLS the ACCC proposes to adopt an adjustment path with the following characteristics:

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<sup>57</sup> Ovum, *Telstra ULLS Undertaking – ULLS International benchmarking*, February 2009.

<sup>58</sup> Ingenious Consulting Network, *Commentary on The use of international benchmarking in setting interconnection rates*, December 2008.

<sup>59</sup> Ovum, *Telstra ULLS Undertaking – ULLS International benchmarking*, February 2009, p.6.

- The glide path should proceed from the ACCC’s indicative price for the previous year ending on 31 July 2009
- The end price should be set at the best estimate of the TSLRIC+ cost of supplying the service
- For the purposes of indicative prices the glide path should commence on 1 August 2009 and conclude on 31 July 2012
- Increments should be made on an annual basis, and
- Each increment between the start price and end price should be of an approximately equal percentage.

The ACCC proposes the following indicative prices for ULLS for 2009–2012, including a \$1.00 specific cost component.

**Table 18: ULLS monthly charges**

ULLS	2009-10	2010-11	2011-12
Zone A	\$16.90	→ \$20.00	→ \$23.60
Zone B	\$61.50	\$62.30	\$62.70

The remaining discrete charges related to the ULL service are discussed and detailed in Appendix 4.

## 9. Line Sharing Service

### Background

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.

### Past LSS pricing

The ACCC has applied a TSLRIC+ methodology in setting charges for the LSS since it was declared in 2002. Since that time, the ACCC has provided additional guidance on how it considers TSLRIC+ pricing should be applied in setting LSS access charges. This guidance was provided progressively during undertaking assessments and in making final determinations of access disputes. In 2007, following the re-declaration of the LSS, the ACCC issued revised pricing principles that consolidated this guidance.

The ACCC first published indicative prices for the LSS as part of a 2007 pricing principles determination as follows:

**Table 19: LSS - Past indicative prices**

	Charge
LSS monthly charge	\$2.50 per service (1 Jan 2008 to 31 Jul 2009).
LSS connection not made in a managed network migration	\$41.40 per connection (1 Jan 2008 until 30 Jun 2008) \$43.10 per connection (1 Jul 2008 until 31 Jul 2009)
LSS disconnection not made in a managed network migration	\$37.10 per connection (1 Jan 2008 until 30 Jun 2008) \$38.70 per disconnection (1 Jul 2008 until 31 Jul 2009)  However a disconnection charge will not be payable where: <ul style="list-style-type: none"> <li>▪ the disconnection is made pursuant to the Telstra LSS churn process, or</li> <li>▪ the access seeker is participating in the Telstra LSS churn process and Telstra (Bigpond) is not participating in the Telstra churn process</li> </ul>

LSS managed network migration – fixed amount	\$134.50 per MNM (1 Jan 2008 until 30 Jun 2008) \$140.10 per MNM (1 Jul 2008 until 31 Jul 2009)
LSS managed network migration – variable amount	\$30.90 per connection (1 Jan 2008 until 30 Jun 2008) \$32.20 per connection (1 Jul 2008 until 31 Jul 2009)
LSS managed network migration – minimum charge	\$752.50 per exchange per MNM (1 Jan 2008 until 30 Jun 2008) \$784/10 per exchange per MNM (1 Jul 2008 until 31 Jul 2009)
LSS managed network migration – disconnection charge	\$0 (1 Jan 2008 to 31 Jul 2009)

Although the 2002 LSS pricing principles did not contain indicative prices, the ACCC then noted that an appropriate rental charge for the LSS could be around \$2.50 per month.<sup>60</sup>

In addition to the above indicative prices, the ACCC has set additional price terms in arbitrations. The draft determination attached in Appendix 1 adopts the past indicative prices and arbitral price terms.

## Proposed LSS pricing

### Material relied upon to develop future pricing principles

In developing indicative prices for the LSS, the ACCC has regard to various cost and demand data. These data include the cost to Telstra of developing and operating relevant business support systems (BSS), or of connecting and disconnecting services; relevant demand data; and an appropriate weighted average cost of capital. The data is contained in cost models that the ACCC has developed.

The nature of these data and how they are used to derive access charges for the LSS are discussed further in Appendix 4.

These cost models support the following indicative prices for the LSS rental charge per month.

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<sup>60</sup> ACCC, LSS – *Final decision on whether or not a LSS should be declared under Part XIC of the Trade Practices Act 1974*, August 2002, pp. ii-iii.

**Table 20: Indicative prices**

LSS	2009-10	2010-11	2011-12
<b>Rental charge per month</b>	\$1.00	\$1.00	\$1.00

The ACCC notes that the LSS model prices are not a result of a revised pricing principle. Rather the “Specific costs” cost model, which has been used in previous LSS indicative pricing decisions, has been used. As such, it has only been the inputs of this model, the period of application and the adoption of annual levelisation which have determined the LSS price results.

In the 2007 LSS final decision,<sup>61</sup> the ACCC indicated that it would be likely to adopt an annual approach to the levelisation of costs for future LSS pricing while maintaining the pooling and allocation approach. Within the “Specific cost” cost model, the ACCC has also included an additional \$10 million in the capital base for operation support systems (OSS) enhancements. Even with this allowance for this prospective capital expenditure, the Specific Costs model would result in an LSS price below \$1 per month and a decline through time. Although the ACCC has not adopted an adjustment path for LSS prices, it considers that the price should be rounded up to \$1 to be of a form of a minimum monthly charge now and in the future. The ACCC emphasises however, that to maintain the allowance for this investment in the charge, Telstra must bring into operation the LSS and ULLS OSS enhancements.

Accordingly, the ACCC considers that industry was made well aware of the likely price drop through the 2007 LSS decision noted above. As such the change in price from \$2.50 to \$1.00 is not considered to result in a price shock.

The ACCC also intends to have regard to an international benchmarking report on the LSS.

The Analysys Mason report provides:

- A range of monthly rental charges from \$0.31 to \$4.94, and a simple average of \$3.09, and
- An average of \$114.17 for connection and disconnection charges.

In calculating the above simple average of LSS charges:

- countries that permit the incumbent operator to recover part of the line cost through the LSS charge have been removed from the sample, as a line rental contribution is not included in LSS rental charges in Australia.<sup>62</sup>
- Where different residential and non-residential charges apply, the residential charge is used.

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<sup>61</sup> ACCC, *LSS access dispute – Telstra / Agile, Reasons for Final Determination*, December 2007.

<sup>62</sup> These countries are: Austria, Denmark, Ireland, Norway, Sweden and Luxembourg.

- Line testing charges are not included.

When WLR charges are included, the average access revenue for LSS lines across all countries included in the report with available data is \$26.23. When those countries that allow LSS charges to contribute to the recovery of line costs are excluded, the average access charge becomes \$22.54. This can be compared with the ACCC proposed indicative charges for WLR and LSS, which total to \$24.30.

The remaining discrete charges related to the LSS service are discussed and detailed in Appendix 4.



# Appendix 1: Draft pricing principles determinations

This Appendix contains draft pricing principles determinations for:

- LCS
- WLR
- PSTN OTA
- LSS
- ULLS



# Draft Pricing Principles for the Local Carriage Service Determination 2009

*Trade Practices Act 1974*

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The AUSTRALIAN COMPETITION AND CONSUMER COMMISSION makes this Determination under section 152AQA of the *Trade Practices Act 1974*.

Dated

[DRAFT NOT FOR SIGNATURE]

Graeme Samuel  
Chairman

Australian Competition and Consumer Commission

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## **1 Name of Determination**

This Determination is the *Pricing Principles for the Local Carriage Service (LCS) Determination 2009*.

## **2 Commencement**

This Determination commences on the day it is made.

Note: The Australian Competition and Consumer Commission must have regard to this Determination if it required to arbitrate an access dispute under Division 8 of the *Trade Practices Act 1974* in relation to the declared services covered by this Determination (see subsection 152AQA(6)). An arbitral determination may be backdated (see section 152DNA).

## **3 Pricing principles and indicative prices**

The pricing principles specified in Schedules 1, 3 and 5 and the indicative prices specified in Schedules 2, 4 and 6 are to apply to the Local Carriage Service (LCS) declared by the Australian Competition and Consumer Commission (Commission) under section 152AL of the *Trade Practices Act 1974* (Act).

#### **4 Repeal of earlier Pricing Principles for the LCS**

This Determination repeals any earlier Pricing Principles determinations for the LCS.

### **Schedule 1 Pricing principles for the LCS for the period to 31 December 2007**

An interim retail-minus-retail-costs (RMRC) pricing principle should be adopted until such time as the Commission has a robust cost model available. In implementing the interim RMRC pricing principle, the Commission will use:

- avoidable retail costs for the LCS rather than avoided retail costs
- unbundled benchmark retail prices, and
- separate pricing of the LCS.

The Commission will seek to implement a cost-based pricing approach once a robust cost model, capable of producing reliable estimates of costs in all geographic regions, is available.

### **Schedule 2 Indicative prices for the LCS for the period to 31 December 2007**

The indicative price for the LCS for the period to 31 December 2007 is:

	<b>Local Calls</b>
<b>Telstra Retail Prices</b>	20c ex GST
<b>Unit Avoidable Retail Costs</b>	2.29c/call
<b>GST Adjustment</b>	0.21c
<b>Indicative Price</b>	17.92c

### **Schedule 3 Pricing principles for the LCS for the period 1 January 2008 to 31 July 2009**

An interim retail–minus–retail–costs (RMRC) pricing principle should be adopted until the Commission has a robust cost model available. In implementing the interim RMRC pricing principle, the Commission will use:

- avoidable retail costs for the LCS rather than avoided retail costs
- unbundled benchmark retail prices, and
- separate pricing of the LCS.

The Commission will seek to implement a cost-based pricing approach once a robust cost model, capable of producing reliable estimates of costs in all geographic regions, is available.

### **Schedule 4 Indicative prices for the LCS for the period 1 January 2008 to 31 July 2009**

The indicative price for the LCS for the period from 1 January 2008 to 31 July 2009 is:

	<b>Local Calls</b>
<b>Telstra Retail Prices</b>	20c ex GST
<b>Unit Avoidable Retail Costs</b>	2.90c/call
<b>GST Adjustment</b>	0.26c
<b>Indicative Price</b>	17.36c

## Schedule 5 Pricing principles for the LCS for the period 1 August 2009 to 30 June 2012

The price of the LCS should follow an adjustment path such that there is a closer association of the price and TSLRIC+ of the service.

This adjustment path should have the following characteristics:

- The starting point for the adjustment path should be the Commission's indicative price for the previous year. For LCS, this means the adjustment path will commence from the indicative price on 31 July 2009.
- The end price should be set at the best estimate of the TSLRIC+ of supplying the service.
- For the purposes of indicative prices:
  - the adjustment path should commence on 1 August 2009 and conclude on 30 June 2012;
  - decrements should be made on an annual basis; and
  - each decrement between the start price and end price should be of an equal percentage.

### Definitions

In this Determination:

**TSLRIC+** means the total service long run incremental cost including an allocation for common costs

## Schedule 6 Indicative prices for the LCS for the period 1 August 2009 to 30 June 2012

The indicative prices for the LCS for the period 1 August 2009 to 30 June 2012 are:

LCS	2009-10	2010-11	2011-12
All areas (cents)	13.30	→ 10.20	→ 7.90



# Draft Pricing Principles for the Wholesale Line Rental Determination 2009

*Trade Practices Act 1974*

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The AUSTRALIAN COMPETITION AND CONSUMER COMMISSION makes this Determination under section 152AQA of the *Trade Practices Act 1974*.

Dated

[DRAFT NOT FOR SIGNATURE]

Graeme Samuel  
Chairman

Australian Competition and Consumer Commission

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## **1 Name of Determination**

This Determination is the *Pricing Principles for the Wholesale Line Rental Service (WLR) Determination 2009*.

## **2 Commencement**

This Determination commences on the day it is made.

Note: The Australian Competition and Consumer Commission must have regard to this Determination if it required to arbitrate an access dispute under Division 8 of the *Trade Practices Act 1974* in relation to the declared services covered by this Determination (see subsection 152AQA(6)). An arbitral determination may be backdated (see section 152DNA).

## **3 Pricing principles and indicative prices**

The pricing principles specified in Schedule 1, 3 and 5 and indicative prices specified in Schedule 2, 4 and 6 are to apply to the Wholesale Line Rental

(WLR) declared by the Australian Competition and Consumer Commission (Commission) under section 152AL of the *Trade Practices Act 1974* (Act).

#### **4 Repeal of earlier *Pricing Principles for the WLR***

This Determination repeals any earlier Pricing Principles determinations for the WLR.

### **Schedule 1 Pricing principles for the WLR for the period to 31 December 2007**

An interim retail-minus-retail-costs (RMRC) pricing principle should be adopted until such time as the Commission has a robust cost model available. In implementing the interim RMRC pricing principle, the Commission will use:

- avoidable retail costs for the WLR rather than avoided retail costs
- unbundled benchmark retail prices, and
- separate pricing of the WLR.

The Commission will seek to implement a cost-based pricing approach once a robust cost model, capable of producing reliable estimates of costs in all geographic regions, is available.

### **Schedule 2 Indicative prices for the WLR for the period to 31 December 2007**

The indicative prices for WLR for the period to 31 December 2007 are:

	<b>HomeLine Part</b>	<b>BusinessLine Part</b>
<b>Telstra Retail Prices</b>	\$29.05	\$31.77
<b>Unit Avoidable Retail Costs</b>	\$5.93/mth	\$5.93/mth
<b>Indicative Price</b>	\$23.12	\$25.84

### **Schedule 3 Pricing principles for the WLR for the period 1 January 2008 to 31 July 2009**

An interim retail-minus-retail-costs (RMRC) pricing principle should be adopted until the Commission has a robust cost model available. In implementing the interim RMRC pricing principle, the Commission will use:

- avoidable retail costs for the WLR rather than avoided retail costs
- unbundled benchmark retail prices, and
- separate pricing of the WLR.

The Commission will seek to implement a cost-based pricing approach once a robust cost model, capable of producing reliable estimates of costs in all geographic regions, is available.

### **Schedule 4 Indicative prices for the WLR for the period 1 January 2008 to 31 July 2009**

The indicative prices for the WLR for the period 1 January 2008 to 31 July 2009 are:

	<b>HomeLine Part</b>	<b>BusinessLine Part</b>
<b>Telstra Retail Prices</b>	\$30.41 ex GST	\$31.77 ex GST
<b>Unit Avoidable Retail Costs</b>	\$4.84/mth	\$4.84/mth
<b>Indicative Price</b>	\$25.57	\$26.93



## **Schedule 5 Pricing principles for the WLR for the period 1 August 2009 to 30 June 2012**

The price of the WLR should be determined on the basis of TSLRIC +.

### **Definitions**

In this Determination:

**TSLRIC+** means the total service long run incremental cost including an allocation for common costs.

**exchange service area** or **ESA** means the exchange service area covered by a telecommunications network exchange.

**Zone A** refers to all ESAs classified as being in Zone A as set out in the Commission's *Pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS*, 2009, Appendix 5: ESA Zone classifications.

**Zone B** refers to all ESAs classified as being in Zone B as set out in the Commission's *Pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS*, 2009, Appendix 5: ESA Zone classifications.

## **Schedule 6 Pricing principles for the WLR for the period 1 August 2009 to 30 June 2012**

The indicative prices for WLR for the period 1 August 2009 to 30 June 2012 are:

<b>WLR</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
Zone A	\$23.30	\$23.60	\$23.80



# Draft Pricing Principles for the Public Switched Telephone Originating Access and Terminating Access Services (PSTN OTA) Determination 2009

*Trade Practices Act 1974*

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The AUSTRALIAN COMPETITION AND CONSUMER COMMISSION makes this Determination under section 152AQA of the *Trade Practices Act 1974*.

Dated

[DRAFT NOT FOR SIGNATURE]

Graeme Samuel  
Chairman

Australian Competition and Consumer Commission

---

## **1 Name of Determination**

This Determination is the *Pricing Principles for the Public Switched Telephone Originating Access and Terminating Access Services (PSTN OTA) Determination 2009*.

## **2 Commencement**

This Determination commences on the day it is made.

Note: The Australian Competition and Consumer Commission must have regard to this Determination if it required to arbitrate an access dispute under Division 8 of the *Trade Practices Act 1974* in relation to the declared services covered by this Determination (see subsection 152AQA(6)). An arbitral determination may be backdated (see section 152DNA)

## **3 Pricing principles and indicative prices**

The pricing principles specified in Schedules 1 and 3 and indicative prices specified in Schedules 2 and 4 are to apply to the PSTN Originating Access

and the PSTN Terminating Access Services (PSTN OTA) declared by the Australian Competition and Consumer Commission (Commission) under section 152AL of the *Trade Practices Act 1974* (Act).

#### **4 Repeal of earlier Pricing Principles for PSTN OTA**

This Determination repeals any earlier Pricing Principles determinations for the PSTN OTA.

#### **Schedule 1 Pricing principles for the PSTN OTA for the period to 31 December 2007**

The price of the PSTN OTA Service should be determined on the basis of total service long run incremental cost (TSLRIC).

#### **Schedule 2 Indicative prices for the PSTN OTA for the period to 31 December 2007**

The indicative prices for PSTN OTA for the period to 31 December 2007 are:

<b>2006-07</b>	<i>Flagfall</i>	<i>EMOU charge</i>	<i>Headline rate</i>
<i>CBD</i>	0.85	0.35	0.57
<i>Metropolitan</i>	0.84	0.49	0.70
<i>Provincial</i>	0.94	0.68	0.91
<i>Rural</i>	2.06	3.66	4.18
<b>Average</b>	<b>0.95</b>	<b>0.76</b>	<b>1.00</b>

### **Schedule 3 Pricing principles for the PSTN OTA for the period 1 August 2009 to 30 June 2012**

The price of the PSTN OTA should follow an adjustment path such that there is a closer association of the price and the TSLRIC+ of the service.

This adjustment path should have the following characteristics:

- The starting point for the adjustment path should be the Commission's indicative price for the previous period. For PSTN OTA this means the adjustment path will commence in principle from 2006-2007 when the last indicative price was in place.
- The end price should be set at the best estimate of the TSLRIC+ of supplying the service for 2011-12.
- For the purposes of indicative prices:
  - the adjustment path should commence on 1 August 2009 and conclude on 30 June 2012;
  - decrements should be made on an annual basis; and
  - each decrement between the start price and end price should be of an approximately equal percentage.

#### **Definitions**

In this Determination:

**TSLRIC+** means the total service long run incremental cost including an allocation for common costs.

### **Schedule 4 Indicative prices for the PSTN OTA for the period 1 August 2009 to 30 June 2012**

The indicative prices for PSTN OTA for the period 1 August 2009 to 30 June 2012 are:

<b>PSTN OTA</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
All areas (cents)	0.90	0.85	0.80



# Draft Pricing Principles for the Unconditioned Local Loop Service (ULLS) Determination 2009

*Trade Practices Act 1974*

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The AUSTRALIAN COMPETITION AND CONSUMER COMMISSION makes this Determination under section 152AQA of the *Trade Practices Act 1974*.

Dated

[DRAFT NOT FOR SIGNATURE]

Graeme Samuel  
Chairman

Australian Competition and Consumer Commission

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## **1 Name of Determination**

This Determination is the *Pricing Principles for the Unconditioned Local Loop Service (ULLS) Determination 2009*.

## **2 Commencement**

This Determination commences on the day it is made.

Note: The Australian Competition and Consumer Commission must have regard to this Determination if it required to arbitrate an access dispute under Division 8 of the *Trade Practices Act 1974* in relation to the declared services covered by this Determination (see subsection 152AQA(6)). An arbitral determination may be backdated (see section 152DNA).

## **3 Pricing principles and indicative prices**

The pricing principles specified in Schedule 1 and 3 and indicative prices specified in Schedule 2 and 4 are to apply to the Unconditioned Local Loop Service (ULLS) declared by the Australian Competition and Consumer Commission (Commission) under section 152AL of the *Trade Practices Act 1974* (Act).

#### **4 Repeal of earlier *Pricing Principles for the ULLS***

This Determination repeals any earlier Pricing Principles determinations for the ULLS.

### **Schedule 1 Pricing principles for ULLS for the period to 31 July 2009**

The Commission's pricing principles for the ULLS for the period to 31 July 2009 are:

- a TSLRIC+ pricing principle should be applied to the ULLS
- a specific cost component should be included in the ULLS monthly price, calculated by combining 'ULLS specific costs' with 'LSS specific costs' and Telstra's internal equivalent costs for ADSL, and allocating those costs across the number of active ULLS, LSS and ADSL lines
- the ULLS charges should be geographically de-averaged, and
- connection charges should be set with reference to the amounts charged by third party contractors to Telstra for jumpering work in exchanges, indirect costs and back-of-house costs.

### **Schedule 2 Indicative prices for the ULLS for the period to 31 July 2009**

#### **ULLS Monthly Charges**

The indicative prices for ULLS monthly charges on a per service per month basis for Band 1, 2 and 3 for the period to 31 July 2009 are:

<b>Band</b>	<b>Until 30 June 2006</b>	<b>2006-07</b>	<b>2007-08</b>	<b>1 July 2008 – 31 July 2009</b>
<b>1</b>	\$ 5.60	\$ 6.00	\$ 6.20	\$ 6.60
<b>2</b>	\$ 12.30	\$ 13.70	\$ 14.30	\$ 16.00
<b>3</b>	\$ 25.00	\$ 27.30	\$ 28.50	\$ 31.30

Note: No indicative price is set for Band 4.

## ULLS Single Connection Charges – In use ULLS and Transfer ULLS connections

The indicative prices for ULLS Single Connection Charges (in-use ULLS and transfer ULLS connections) for the period to 31 July 2009 are:

Band	Until 30 June 2006	2006-07	2007-08	1 July 2008 – 31 July 2009
1	\$ 38.10	\$ 44.00	\$ 50.10	\$ 50.40
2	\$ 43.10	\$ 47.80	\$ 52.80	\$ 53.10
3	\$ 51.50	\$ 54.10	\$ 57.40	\$ 57.70

Note: No indicative price is set for the ULLS in Band 4.

Note: No indicative price is set for a Vacant ULLS connection.

## Charges for ULLS Managed Network Migration – 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 ('MNM')

The indicative prices for ULLS connections in an MNM for the period to 31 July 2009 are:

Component	Until 30 June 2006	2006-07	2007-08	1 July 2008 – 31 July 2009
– Fixed amount (per MNM)	\$126.00	\$130.20	\$ 135.60	\$ 138.00
– Variable amount (per connection)	+ \$24.30	+ \$24.60	+ \$ 24.90	+ \$ 25.00

The indicative prices for the cancellation of a ULLS order that was to be connected as part of a MNM are:

- \$20 per service on which pre-jumpering has occurred;
- plus, in those cases where the entire MNM scheduled for the exchange is cancelled, an additional charge per MNM that equals the fixed amount that was payable in respect of that MNM.

The indicative prices for the minimum exchange charge per MNM are:

	<b>Until 30 June 2006</b>	<b>2006-07</b>	<b>2007-08</b>	<b>1 July 2008 – 31 July 2009</b>
Per exchange	\$612.00	\$622.20	\$ 633.60	\$ 638.00

### **ULLS Call Diversion Charges**

The indicative prices for the initial connection/activation of ULLS call diversion for the period to 31 July 2009 are:

<b>Component</b>	<b>Until 30 June 2006</b>	<b>2006-07</b>	<b>2007-08</b>	<b>1 July 2008 – 31 July 2009</b>
– Fixed amount (per ULLS call diversion)	\$ 8.50	\$ 8.80	\$ 9.20	\$ 9.30
– Variable amount (pro rata per month)	\$12.50	\$12.50	\$12.50	\$12.50



### **Schedule 3 Pricing principles for the ULLS for the period 1 August 2009 to 30 June 2012**

The Commission's pricing principles for the ULLS for the period 1 August 2009 to 30 June 2012 are:

- ULLS access charges are to be based upon the TSLRIC+ of providing access to the service.
- ULLS annual charges are to include a contribution to 'specific costs' which are to be calculated by combining 'LSS specific costs', 'ULLS specific costs' and Telstra's internal equivalent costs it incurs in connection with its supply of DSL services, and allocating those costs across the number of active ULLS, LSS and DSL lines.
- ULLS annual charges are to include a contribution to network costs whereby:
  - The amount of this contribution for a particular ULLS depends upon whether it is located in Zone A or Zone B
  - The amount of this contribution for ULLS in Zone A is to follow a adjustment path which:
    - proceeds from the weighted average of ULLS network costs in Bands 1, 2 and 3 that were used in setting the indicative ULLS Monthly Charges for 2008-09, and
    - ends with the 2011-12 estimate for ULLS network costs.
- ULLS connection and disconnection charges are to be based on the amounts charged by third party contractors to Telstra for jumpering work in exchanges, indirect costs and back-of-house costs.
- A disconnection charge should not be levied until appropriate end-user churn arrangements involving the ULLS are in effect, from which time a disconnection charge may be levied where the ULLS is disconnected outside those churn arrangements.

#### **Definitions**

In this Determination:

**TSLRIC+** means the total service long run incremental cost including an allocation for common costs

**exchange service area** or **ESA** means the exchange service area covered by a telecommunications network exchange.

**Zone A** refers to all ESAs classified as being in Zone A as set out in the Commission's *Pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS, 2009*, Appendix 5: ESA Zone classifications.

**Zone B** refers to all ESAs classified as being in Zone B as set out in the Commission's *Pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS*, 2009, Appendix 5: ESA Zone classifications.

#### **Schedule 4      Indicative prices for the ULLS for the period 1 August 2009 to 30 June 2012**

##### **ULLS monthly charges**

The indicative prices for ULLS for the period 1 August 2009 to 30 June 2012 are:

	<b>1 August 2009 – 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Zone A	\$16.90	\$20.00	\$23.60
Zone B	\$61.50	\$62.30	\$62.70

##### **ULLS Single Connection Charges – In use ULLS and Transfer ULLS connections**

The indicative prices for ULLS for the period 1 August 2009 to 30 June 2012 are:

	<b>1 August 2009 – 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Zone A	\$53.20	\$53.80	\$54.50
Zone B	\$64.70	\$65.30	\$65.90

Note: No indicative price is set for a Vacant ULLS connection.

**Charges for ULLS Managed Network Migration – 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 (‘MNM’)**

*ULLS (MNM) connection charges*

The indicative prices for ULLS for the period 1 August 2009 to 30 June 2012 are:

	<b>1 August 2009 – 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Fixed (per MNM)	\$144.60	\$149.50	\$154.70
Variable (per connection)	\$ 25.80	\$ 25.90	\$ 26.10

*ULLS MNM minimum exchange charge*

The indicative prices for ULLS for the period 1 August 2009 to 30 June 2012 are:

	<b>1 August 2009 – 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Per exchange	\$660.60	\$667.50	\$676.70

*ULLS MNM Cancellation charges*

The indicative prices for the cancellation of a ULLS order that was to be connected as part of a MNM are:

- \$20 per service on which pre-jumpering has occurred;
- plus, in those cases where the entire MNM scheduled for the exchange is cancelled, an additional charge per MNM that equals the fixed amount that was payable in respect of that MNM.

## ULLS Call Diversion Charges

The indicative prices for ULLS for the period 1 August 2009 to 30 June 2012 are:

	<b>1 August 2009 – 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
– Fixed amount (per ULLS call diversion)	\$ 9.80	\$10.10	\$10.50
– Variable amount (pro rata per month)	\$12.50	\$12.50	\$12.50



# Draft Pricing Principles for the Line Sharing Service (LSS) Determination 2009

*Trade Practices Act 1974*

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The AUSTRALIAN COMPETITION AND CONSUMER COMMISSION makes this Determination under section 152AQA of the *Trade Practices Act 1974*.

Dated

[DRAFT NOT FOR SIGNATURE]

Graeme Samuel  
Chairman

Australian Competition and Consumer Commission

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## **1 Name of Determination**

This Determination is the *Pricing Principles for the Line Sharing Service (LSS) Determination 2009*.

## **2 Commencement**

This Determination commences on the day it is made.

Note: The Australian Competition and Consumer Commission must have regard to this Determination if it required to arbitrate an access dispute under Division 8 of the *Trade Practices Act 1974* in relation to the declared services covered by this Determination (see subsection 152AQA(6)). An arbitral determination may be backdated (see section 152DNA).

## **3 Pricing principles and indicative prices**

The pricing principles specified in Schedule 1 and 3 and indicative prices specified in Schedule 2 and 4 are to apply to the Line Sharing Service (LSS)

declared by the Australian Competition and Consumer Commission (Commission) under section 152AL of the *Trade Practices Act 1974* (Act).

#### **4 Repeal of earlier Pricing Principles for the LSS**

This Determination repeals any earlier Pricing Principles determinations for the LSS.

### **Schedule 1 Pricing principles for the LSS for the period to 31 July 2009**

The Commission's pricing principles for LSS for the period to 31 July 2009 are:

- a TSLRIC+ pricing principles should be applied to the LSS
- a specific cost component should be included in the LSS monthly price, calculated by combining 'LSS specific costs' with 'ULLS specific costs' and Telstra's internal equivalent costs for ADSL, and allocating those costs across the number of active ULLS, LSS and ADSL lines
- a contribution for line costs will not be recovered in the LSS monthly price
- connection and disconnection charges should be set with reference to the amounts, and
- charged by third party contractors to Telstra for jumpering work in exchanges, indirect costs and back-of-house costs.

### **Schedule 2 Indicative prices for the LSS for the period to 31 July 2009**

The indicative prices for the LSS for the period to 31 July 2009 are:

#### **LSS monthly charge**

	<b>Until 30 June 2006</b>	<b>2006-07</b>	<b>2007-08</b>	<b>1 July 2008 to 31 July 2009</b>
Per service	\$2.50	\$2.50	\$2.50	\$2.50

### LSS single connections

	<b>Until 30 June 2006</b>	<b>2006-07</b>	<b>2007-08</b>	<b>1 July 2008 to 31 July 2009</b>
Per connection	\$38.70	\$39.30	\$41.40	\$43.10

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)

	<b>Until 30 June 2006</b>	<b>2006-07</b>	<b>2007-08</b>	<b>1 July 2008 to 31 July 2009</b>
Per disconnection	\$34.70	\$35.10	\$37.10	\$38.70

Note: These charges are not payable for:

(a) a disconnection made pursuant to a Telstra LSS churn process by which services can be transferred between LSS, and between LSS and DSL services, or

(b) 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 that Telstra is using to supply a wholesale ADSL service

	<b>Until 30 June 2006</b>	<b>1 July 2006 to 31 May 2007</b>	<b>2007-08</b>	<b>1 July 2008 to 31 July 2009</b>
Fixed (per MNM)	\$126.00	\$130.20	\$134.50	\$140.10
Variable (per connection)	\$ 28.70	\$28.70	\$ 30.90	\$ 32.20

Note: These charges do not apply to MNMs in Band 4

### LSS MNM minimum exchange charge

	<b>Until 30 June 2006</b>	<b>1 July 2006 to 31 May 2007</b>	<b>2007-08</b>	<b>1 July 2008 to 31 July 2009</b>
Per exchange	\$700.00	\$704.20	\$752.50	\$784.10

Note: These charges do not apply to MNMs in Band 4

### **Schedule 3      Pricing principles for the LSS for the period 1 August 2009 to 30 June 2012**

The Commission's pricing principles for LSS for the period 1 August 2009 to 30 June 2012 are:

- LSS access charges are to be based upon the TSLRIC+ of providing access to the service.
- LSS annual charges are to comprise only a contribution to 'specific-costs' which are to be calculated by combining 'LSS specific costs', 'ULLS specific costs' and Telstra's internal equivalent costs it incurs in connection with its supply of DSL services, and allocating those costs across the number of active ULLS, LSS and DSL lines.
- A contribution for line costs is not to be recovered in the LSS annual charge.
- LSS connection and disconnection charges are to be based on the amounts charged by third party contractors to Telstra for jumpering work in exchanges, indirect costs and back-of-house costs.
- A disconnection charge should not be levied until appropriate end-user churn arrangements involving the LSS are in effect, from which time a disconnection charge may be levied where the LSS is disconnected outside those churn arrangements.

#### **Definitions**

In this Determination:

**TSLRIC+** means the total service long run incremental cost including an allocation for common costs

**exchange service area** or **ESA** means the exchange service area covered by a telecommunications network exchange.

**Zone A** refers to all ESAs classified as being in Zone A as set out in the Commission's *Pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS, 2009*, Appendix 5: ESA Zone classifications.

**Zone B** refers to all ESAs classified as being in Zone B as set out in the Commission's *Pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS, 2009*, Appendix 5: ESA Zone classifications.



## Schedule 4      Indicative prices for the LSS for the period 1 August 2009 to 30 June 2012

The indicative prices for the LSS for the period 1 August 2009 to 30 June 2012 are:

### LSS monthly charge

	<b>1 August 2009 to 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Per service	\$1.00	\$1.00	\$1.00

### LSS single connections

	<b>1 August 2009 to 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Zone A	\$37.90	\$38.35	\$38.82
Zone B	\$44.17	\$45.16	\$45.63

### LSS single disconnections (where payable)

	<b>1 August 2009 to 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Zone A	\$33.31	\$33.60	\$33.91
Zone B	\$40.12	\$40.42	\$40.72

Note: These charges are only payable from the time that appropriate end-user churn arrangements involving the LSS are in effect, and are payable only where the LSS is disconnected outside those churn arrangements.

### LSS managed network migration (MNM) connection charges – where the service is to be connected on a line that Telstra is using to supply a wholesale ADSL service

	<b>1 August 2009 to 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Fixed (per MNM)	\$144.54	\$149.50	\$154.63
Variable (per connection)	\$ 32.26	\$ 32.26	\$ 32.26

**LSS MNM minimum exchange charge**

	<b>1 August 2009 to 30 June 2010</b>	<b>2010-11</b>	<b>2011-12</b>
Per exchange	\$790.60	\$795.50	\$800.70

## Appendix 2: Model input parameters

### Model input parameters

This chapter describes a select number of user variable inputs which have been changed in both the Analysys cost model, and where they are comparable, the Telstra's Efficient Access (TEA) model.

The ACCC acknowledges that not all of the input parameters which could be changed by users have been detailed in this chapter. Where the parameter has not been detailed, the ACCC has chosen to maintain the default parameters contained in the Analysys cost model. However, should interested parties have better cost estimates, with supporting evidence, which could be used in the model the ACCC will consider this. When providing additional parameters interested parties are requested to detail the file name, sheet and cell reference where the changed parameter should be entered.

The following is the list of changes made to both models:

- WACC
- Lead-in costs
- Trenching costs
- O&M
- Trench sharing
- Asset lives

### Weighed Average Cost of Capital

The WACC is used to calculate a normal return on capital employed. There are a number of inputs relevant to deriving a WACC. The ACCC has used a 'post-tax vanilla' WACC<sup>63</sup> of 9.87 per cent for each relevant year. These rates and inputs are based on the analysis and evidence discussed in the ACCC's assessment of WACC, as part of its consideration of Telstra's ULLS Band 2 monthly charge undertaking,<sup>64</sup> noting however updated values have been used for the risk-free rate and debt premium. The ACCC's views on the appropriate WACC parameters are:

**Risk-free rate:** The ACCC considers that the risk-free rate should be the 10 year government bond rate, averaged in the period leading up to the relevant observation date rather than the point estimate to address day-to-day market volatility.

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<sup>63</sup> Vanilla WACC is defined as the weighted average cost after-tax return on equity plus pre-tax return on debt or the opportunity cost of capital.

<sup>64</sup> ACCC, *Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking – Final Decision*, April 2009.

In order to calculate the prices, the risk-free rate as of 30 June 2009 was applied to determine the appropriate WACC. The ACCC will update the risk-free rate prior to the finalisation of indicative prices.

**Market Risk Premium (MRP):** The ACCC considers that up-to-date historical estimates with an imputation credit factor of 0.5 estimated over the long-term estimation periods of 1883-2008 and 1958-2008 falls slightly above 6 per cent. Given this, the ACCC has used the value of 6.5 per cent for the purposes of estimating the WACC.

**Debt ratio:** The ACCC is using a 40 per cent debt to 60 per cent equity gearing ratio. It considers that this is reflective of the target debt ratio for a company that provides services over a fixed network to itself and others. The 40 per cent is in accordance with the Telstra-wide historic book value.

**Asset beta:** The asset beta used is 0.5, leveraged to provide an equity beta of around 0.83. The ACCC is of the view that the appropriate WACC for the indicative prices is one based on a business providing access to a fixed network, either to itself or to other service providers. The ACCC has applied the same WACC to both networks and specific costs.

**Debt premium:** The ACCC considers that using Bloomberg's A-Rated cost of debt benchmark to estimate the WACC, is appropriate. A rate of 2.6 per cent as of 30 June 2009 has been used.

**Issuance costs:** The ACCC is using a value of 0.083 per cent for debt issuance, reflecting the benchmark debt issuance costs for a company which provides fixed network services to itself and others. Equity issuance costs are not included in the WACC.

**Imputation credits:** The possible values range from 0 to 1. The ACCC adopted a value of 0.5, the mid-point of the range.

**Tax-rate:** The ACCC considers that the effective tax rate is the appropriate tax rate for determining the pre-tax WACC as the use of the higher tax rate will over compensate first for present value of their expected future tax liabilities. The ACCC has used an effective tax rate of 24 per cent.

**Resulting WACC values:** Based on the inputs outlined above, a post-tax vanilla WACC of 9.87 per cent results, while the pre-tax WACC is 10.77 per cent. These WACC results have been used in determining access prices and specific costs.

## **Lead-in costs**

Consistent with the ACCC's recent ULLS Band 2 undertaking rejection and recent arbitral final decisions, the ACCC does not consider that lead-in costs should be included in network costs as:

- the ACCC considers that lead-in costs, being once-off costs associated with connecting a service are more appropriately recovered through connection charges, and

- the ACCC is not satisfied that the cost of lead-ins is not already fully or partially recovered by Telstra’s connection charges.

Accordingly, the ACCC has removed the cost of lead-ins from the Analysys cost model and the TEA model for the purposes of determining draft indicative prices.

### Trenching costs

When determining the trenching costs, the ACCC has used the default values included in the Analysys cost model. These costs are:

	Urban trench (\$/metre)	Urban Open (\$/metre)	Rural ploughed (\$/metre)
<b>Duct: 28</b>	641	401	241
<b>Duct: 24</b>	601	361	241
<b>Duct: 20</b>	541	301	241
<b>Duct: 16</b>	361	241	121
<b>Duct: 12</b>	301	181	121
<b>Duct: 8</b>	181	121	61
<b>Duct: 6</b>	150	90	61
<b>Duct: 4</b>	105	75	31
<b>Duct: 2</b>	89	59	31
<b>Duct: 1</b>	60	30	31
<b>Duct: 1 road-crossing</b>	60	30	31
<b>Duct: 1 (PB &gt;&gt; DP/ Serving pit)</b>	31	16	31

*Cost.xls; UnitCost.Access; Cells: H11: H48*

### Operations and maintenance costs

In determining the draft indicative prices, the ACCC has used the operation and maintenance values which are included in the Analysys cost model. The Analysys cost model determines an ‘opex as a percentage of capex’ across each of the assets in the CAN and the CORE.

The following tables set out the opex as a percentage of capex for cost categories in the CAN and CORE.

## CAN OPEX

Cost category	Opex as a percentage of capex (%)
Duct	0.21
Cable	2.93
Other CAN	0.02
LPGS	3.16
Radio	4.63
Total	1.52

## CORE OPEX

Cost category	Opex as a percentage of capex (%)
Switching equipment	6.49
Transmission	3.24
Data equipment	5.70
Satellite equipment	8.61
Total	4.92

## Trench sharing

There can be cost savings through sharing routes between the network layers:

- within the CORE layers (intra)
- between the CORE layers (inter), and
- between the CAN and the CORE.

In addition, trench sharing can also include the sharing of trenches with utilities in new estates.

The overlap analysis which takes place in the Analysys cost model indicated that:

- 19 per cent of trenches within the CORE are shared, and
- 38 per cent of trenches between the CORE are shared.

The overlap parameter between the CAN and the CORE is set at 4km. Therefore, within 4km from the exchange, both CORE and CAN cables share the trench.

Finally, the ACCC considers that it is reasonable when considering trench sharing to expect that the provider would share trenches with utilities in new estates. In the past,

the ACCC has considered that 13-17 per cent as a reasonable range for the level of trenches which are open. As this is based on Band 2, the ACCC considers that this estimate is conservative.

### **Asset lives**

The ACCC has chosen the following values as the appropriate asset lives for determining the draft indicative prices.

<b>Asset</b>	<b>Life</b>
Building	50
Network equipment	10
Line card	5
Core network equipment	20
Building equipment	15
Copper	25
Fibre	25
Trench	40
Duct	40
IT systems	3
Licence	5
Business overheads	10

## Appendix 3: Model results

### Analysys cost model results

#### Analysys cost model assumptions:

- Updated WACC of 9.87 (post-tax)
- Tilt of 2.5% on all CAN and CORE assets
- No lead-ins (copper or duct)
- No provisioning costs for ULLS/LSS
- LPGS deployed for routes at 6.9km
- WLR demand in Band 1
- Clustered defined as 98% of locations within 4km on the exchange.

#### **ULLS (excludes specific costs component)**

##### *Zone A and Zone B - Analysys cost model results*

	2008-09	2009-10	2010-11	2011-12
<b>Zone A</b>	\$21.62	\$22.01	\$22.35	\$22.52
<b>Zone B</b>	\$59.39	\$60.40	\$61.28	\$61.69

##### *Telstra Bands 1 to 4 - Analysys cost model results\**

	2008-09	2009-10	2010-11	2011-12
<b>Telstra Band 1</b>	\$3.29	\$3.30	\$3.34	\$3.35
<b>Telstra Band 2</b>	\$20.04	\$20.39	\$20.71	\$20.87
<b>Telstra Band 3</b>	\$37.40	\$38.04	\$38.61	\$38.88
<b>Telstra Band 4</b>	\$61.81	\$62.90	\$63.83	\$64.27



## **WLR**

### *Zone A and Zone B - Analysys cost model results*

	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>Zone A</b>	\$22.88	\$23.26	\$23.60	\$23.77
<b>Zone B</b>	\$66.69	\$67.74	\$68.58	\$68.92

### *Telstra Bands 1 to 4 - Analysys cost model results\**

	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>Telstra Band 1</b>	\$8.99	\$9.01	\$9.07	\$9.08
<b>Telstra Band 2</b>	\$20.79	\$21.15	\$21.46	\$21.62
<b>Telstra Band 3</b>	\$38.99	\$39.64	\$40.20	\$40.47
<b>Telstra Band 4</b>	\$76.32	\$77.50	\$78.38	\$78.72

## **LCS**

### *Analysys cost model results*

	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>All Area</b>	6.79	7.33	7.67	7.81

## **PSTN OTA**

### *Analysys cost model results*

	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>All areas</b>	0.69	0.74	0.77	0.79

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\* Based on weighting via geotype to re-create Telstra bands.

## TEA Model Results

The TEA model allows the user to select engineering requirements for pricing either the ULLS or a basic service cost. Model documentation on what comprises the basic service cost is limited.

The following results are based on running one exchange in each band to demonstrate the differences in price between the ULLS and the basic service.

### TEA Model Results - 2008-09

	ULLS cost	Basic service cost
<b>Band One (Batman exchange)</b>	\$7.15	\$7.27
<b>Band Two (Zillmere exchange)</b>	\$35.41	\$37.17
<b>Band Three (Yarrowonga exchange )</b>	\$79.20	\$85.42

The ULLS results below are based on running the TEA model for all available ESAs in Telstra's band 1 to 3 respectively.

### TEA Model ULLS Results - 2008-09

Band (full model run)	TEA model - Telstra results	TEA model - ACCC adjusted results
1	\$11.90	\$5.38
2	\$37.71	\$22.90
3	\$71.48	\$57.50

A consistent WACC of 9.87% has been applied to both the Telstra and ACCC results.

Additional adjustments made to the ACCC simulation results from the TEA model include:

- Tilt of 2.5% on all CAN assets
- No lead-ins (copper or duct)
- Trenching through turf

## Specific Costs cost model results: ULLS and LSS

### Specific costs

	2009-10	2010-11	2011-12
Unit costs	\$0.95	\$0.94	\$0.92

### Connection charges

#### ULLS single connections

	2009-10	2010-11	2011-12
Zone A	\$53.20	\$53.80	\$54.50
Zone B	\$64.70	\$65.30	\$65.90

#### ULLS MNM

	2009-10	2010-11	2011-12
Fixed (per MNM)	\$144.60	\$149.50	\$154.70
Variable (per connection)	\$25.80	\$25.90	\$26.10

#### ULLS MNM minimum charge

	2009-10	2010-11	2011-12
	\$660.60	\$667.50	\$676.70

#### LSS single connections

	2009-10	2010-11	2011-12
Zone A	\$37.90	\$38.35	\$38.82
Zone B	\$44.17	\$45.16	\$45.63

**LSS single disconnections**

	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>Zone A</b>	\$33.31	\$33.60	\$33.91
<b>Zone B</b>	\$40.12	\$40.42	\$40.72

**LSS MNM**

	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>Fixed (per MNM)</b>	\$144.54	\$149.50	\$154.63
<b>Variable (per connection)</b>	\$32.26	\$32.26	\$32.26

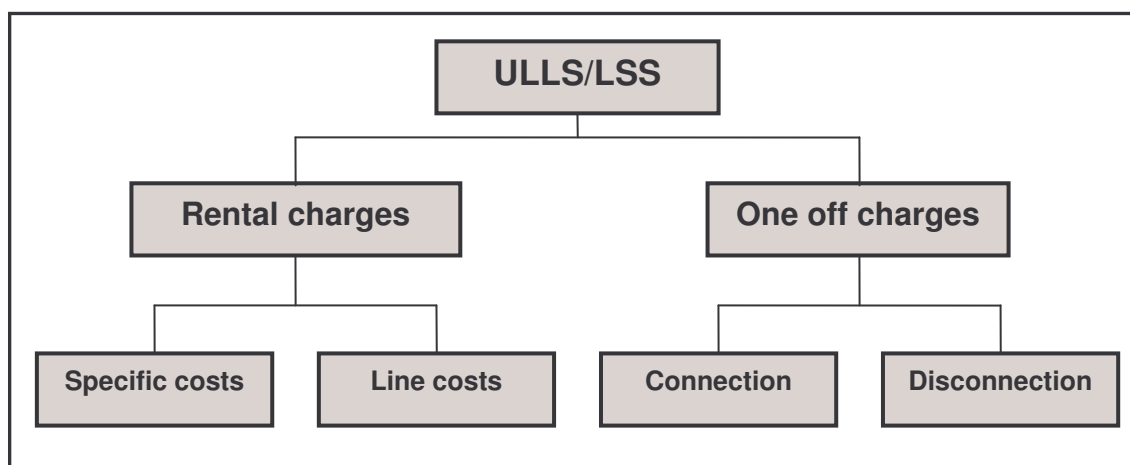
**LSS MNM minimum charge**

	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>Minimum Charge</b>	\$790.60	\$795.50	\$800.70

## Appendix 4: ULLS and LSS discrete charges

Access seekers pay a range of discrete charges to access the ULLS/LSS which includes both annual rental and one off charges.

### Components in ULLS/LSS rental and one off charges



There are two types of costs that are potentially relevant to the annual rental charges payable for the ULLS/LSS:

- The ‘specific costs’ of providing a ULLS/LSS, and
- The costs of the line over which a ULLS/LSS is provided.

This appendix discusses common issues in setting ULLS/LSS one off charges (connection and disconnection) and annual rental charges (line costs for LSS and specific costs for both ULLS/LSS). Line costs are also discussed in greater detail in chapter 8.

### Specific costs

The following cost categories comprise the ‘specific costs’:

- Business Support System (BSS) development and operational costs
- Front of house staff
- Wholesale product management costs
- Indirect costs.

These cost categories are also within the scope of the indirect capital and operating costs that are typically estimated within TSLRIC+ models of network services. Consequentially, there is the potential to simply treat these costs in the same way as other indirect costs and provide for their recovery only within an overall allowance for

indirect costs. However, treating these costs in a discrete manner can provide greater assurance that costs will be recovered and that appropriate investments in the underlying systems and processes will be made.

A number of matters influence the contribution that a service makes to the recovery of these costs, including

- The general cost concept to apply in estimating the costs
- The method by which costs are to be allocated to different services
- The period over which costs are to be estimated and averaged (levelisation), and
- The allowances to be made for possible future investment.

### **Cost concept to use**

Consistent with its previous practice, the ACCC considers that these costs should be estimated on a TSLRIC+ basis. This is because allowances based upon the TSLRIC+ of providing the underlying business support systems and processes will provide better incentives to Telstra to efficiently maintain and where appropriate extend the functionality of those systems and processes.

The ACCC also considers TSLRIC+ can be implemented in a number of different ways, depending on how costs are measured and allocated, and the parameter values and underlying network assumptions used to produce cost estimates. Further guidance may be necessary at the time of applying the pricing principles.

### **Allocation of specific costs**

Telstra incurs 'specific costs' when it supplies the LSS and the ULLS. Telstra also incurs costs of the same nature as the ULLS/LSS 'specific costs' when it uses a line – either the entire spectrum or higher frequency spectrum of that line – for its own use; i.e., when Telstra supplies a retail or wholesale DSL service. The relevant production process in each case is undertaken by Telstra and is essentially the same – qualifying and provisioning the access service in Telstra's systems.

The ACCC considers that each of these services – the ULLS, LSS and Telstra's internal equivalent use of the line – should make an equal unit contribution to the recovery of the 'specific costs' incurred in respect of these services.

This approach ensures that Telstra and ULLS/LSS access seekers each face the same unit costs for what are essentially common production processes that Telstra undertakes. Telstra and access seekers then compete from that base over the remaining stages of production that are necessary in order to supply wholesale or retail DSL and/or voice services.

The ACCC considers that this requires that individual estimates of the 'specific costs' for each service are 'pooled' and allocated over demand for all the respective services.

The ACCC notes that, arguably, costs could be allocated over a greater number of lines. However the ACCC considers that it is more appropriate to allocate these costs over only active ULLS, LSS and DSL lines.

This is consistent with the ACCC's position on this issue since December 2005 whenever it has arisen in setting indicative prices, assessing proposed access undertakings and in arbitration determinations.<sup>65</sup>

The Australian Competition Tribunal has also found that the 'pooling and allocation approach' is preferable to a narrow approach to cost estimation and allocation as Telstra had then proposed.<sup>66</sup> Further, the Federal Court has confirmed that the ACCC's position on this issue is lawful.<sup>67</sup>

## Levelisation

Levelisation refers to setting an average charge to recover the costs of providing a service over a given timeframe, so that the charge does not vary from one period to the next within that timeframe. The rationale for levelisation is that in a competitive market a supplier would look to recover new service establishment costs over a longer period, rather than to seek to recover them in full in the initial period.

Levelisation can be appropriate for the period following the introduction of a service, or in other circumstances where demand levels are changing, and annualised costs attributed to various periods differ significantly. In these circumstances, the choice of time frame over which to levelise costs can have a significant bearing on the per unit cost estimate.

In previous regulatory decisions, the ACCC has levelised specific costs since the time they were first incurred. However, the ACCC has previously signalled that it would be unlikely to continue to levelise these costs beyond 31 July 2009.<sup>68</sup>

This reflects that demand for LSS, ULLS and Telstra's internal equivalent use is now significant (there are currently over 1.1 million ULLS/LSS in operation) and demand is expected to increase during 2009-10.

Consequently, the ACCC proposes to cease to levelise these cost measures, and instead estimate unit costs on an annual basis, for 2009-10 and following years.

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<sup>65</sup> The relevant decisions include:  
ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings – final decision*, December 2005  
ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006.  
ACCC, *Review of Line Sharing Service Declaration, Final Decision*, October 2007  
ACCC, *Unconditioned Local Loop Service - Pricing Principles*, November 2007  
ACCC, *LSS access dispute between Telstra and Adam Internet – Statement of reasons*, December 2007  
ACCC, *ULLS access dispute between Telstra and Optus – statement of reasons for final determination*, March 2008  
ACCC, *Unconditioned Local Loop Service - Pricing Principles and Indicative Prices*, June 2008

<sup>66</sup> Australian Competition Tribunal, *Telstra Corporation Ltd (CAN 051 775 556)* [2006] ACompT 4 at [161]; Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3

<sup>67</sup> *Telstra Corporation Limited v Australian Competition and Consumer Commission* [2008] FCA 1436; *Telstra Corporation Limited v Australian Competition and Consumer Commission* [2009] FCA 757

<sup>68</sup> ACCC, *LSS Access dispute Telstra/ Adam Internet reasons for final determination*, December 2007 p. 69.

This will reduce unit costs, as the very high cost, low demand, periods that immediately followed the introduction of the LSS and ULLS are removed from the cost pool.

### **Potential for future investments in BSS**

The ACCC has previously allowed the estimated cost of pending investments in the 'specific cost' pool. There are several improvements to Telstra's business support systems (used to order and provision services and handle faults) that have been identified in previous regulatory proceedings. Consequently, there is potential for an allowance to be again included in the 'specific cost' pool to cover potential investments.

Examples of the investments that could be provided for are:

- Implementing an integrated LSS to ULLS migration process, i.e., for connecting ULLS on a line currently being used to supply a LSS.
- Implementing a ULLS provisioning process for 'intact vacant lines', i.e., for using an intact copper path not currently being used to supply a service to an end-user.
- Permitting Telstra's cable records systems to record multiple cable pair groups to better support provisioning of LSS in exchanges with multiple MDFs.

The ACCC has indicated in its 2008 model non-price terms determination and other regulatory decisions that it supports BSS improvements being made.

The ACCC's preliminary view is that an allowance for future capital expenditure should be made within the specific cost pool, and that this should be based upon the cost estimates that Telstra has provided for relevant projects.

The possible risk in this approach is that the allowance may prove to differ materially from the cost of investments actually made. For instance, investments in BSS that Telstra previously proposed and which have been admitted into the specific cost pool were simply never built. On the other hand, currently available cost estimates of making potential investments may be incomplete. Consequently, there may be merit in revising the indicative prices in future to apply prospectively based upon the investments which have in fact been made.

That said, the resulting specific cost allowance is not overly sensitive to the allowed cost of future investment. This reflects the relatively modest cost of these investments, and the demand base over which the associated capital charge can be recovered.



## Line costs contribution by LSS

An issue of significant debate in the pricing for the LSS has been whether the LSS monthly charge should include an allocation of the costs of the copper line over which the LSS is supplied. The ACCC's position has been that LSS charges should not contribute to the costs of the line.<sup>69</sup>

This is because Telstra is only obliged to supply an LSS when an underlying voice band PSTN service operates on the line. Hence Telstra is already earning revenues by which to recover the line costs and including an allowance for line costs in LSS annual charges would lead to the line costs being recovered twice.

For instance, if the underlying voice service is provided to the end-user by another carrier, Telstra will receive wholesale line rental charges, and wholesale call revenues including local carriage service and PSTN OT charges. Alternatively if Telstra is the retail provider of the underlying voice service, it will receive retail line rental charges and retail call charges.

Consequently, Telstra receives significantly more access revenues from a LSS line than simply the LSS rental charge. Further, Telstra will earn higher access revenues from LSS lines than it would from a ULLS line.

## Connection and disconnection charges

The section outlines the factors that are considered by the ACCC when determining charges for ULLS/LSS connections and disconnections.

The following cost categories are potentially relevant to connection and disconnection charges for the ULLS/LSS:

- Technicians performing jumpering work inside Telstra exchanges
- Travel and vehicle costs for the technicians
- Back-of-house management or assistance for technicians
- Materials, and
- Indirect costs.

The ACCC has previously considered these charges when assessing access undertakings<sup>70</sup>, and in specifying earlier pricing principles and indicative prices, in and in making final determination in access disputes in 2007 and 2008.

The connection-related charges include:

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<sup>69</sup> ACCC, *LSS – Final decision on whether or not a LSS should be declared under Part XIC of the Trade Practice Act 1974*, August 2002, p. 96; This view was re-affirmed in the *Review of the line sharing service declaration – final decision*, October 2007 and has been applied in making final determinations concerning the LSS in July 2007, August 2007 and December 2007.

<sup>70</sup> ACCC, *Assessment of Telstra's LSS undertaking relating to connection and disconnection charges – final decision*, April 2006.

- the charge for the connection itself – which can differ depending upon whether or not the service is connected as part of a managed network migration
- a possible charge of making a preliminary service qualification, and
- a charge for a short term call diversion that is made as a consequence of provisioning the service – which can be necessary to preserve the number associated with the end-user service during the provisioning process.

The ACCC's preliminary view is that connection charges could continue to be deaveraged however the ACCC is open to reconsidering deaveraged connection charges.

### **Technician labour, vehicles, travel, tool and materials (copper wire) costs**

Consistent with the approach taken previously, the ACCC considers the charges paid by Telstra to third party contractors to perform jumpering work in Telstra exchanges generally provide a reliable measure of the efficient costs of associated labour, vehicles, travel, tool and materials (copper wire) expenses.

This is because Telstra tenders out this work to contractors on a competitive basis, and hence the rates it pays to contractors can generally be expected to reflect efficient cost levels.

The ACCC considers that the resulting allowances will be sufficient to recover jumpering costs even where contractors are not used, i.e., those situations where Telstra staff performs the jumpering work. This is because contractors would recover their incremental costs (such as labour, travel and materials) and a contribution towards overheads and profit from their charges. Consequently, there is clear potential for Telstra to incur costs of a similar order when its staff jumpers the service.

Accordingly, the ACCC intends to continue to calculate the allowance for these costs within connection charges based upon third party contractor rates.

### **Back-of-house costs**

Back-of-house activities include Telstra's data activation centre providing manual service qualifications or validating points of interconnection (POI) data, and its infrastructure deployment support group allocating tickets of work to technicians to perform jumpering works.

As these activities are performed by Telstra staff, costs cannot be estimated by reference to an external tender process. Consistent with the approach taken previously, the ACCC considers a simple bottom-up cost model can be used to estimate the costs that an efficient operator would incur in performing these activities.

This cost models relies upon estimates of the likely labour cost (inclusive of salary overheads) associated with these functions and an estimate of the amount of time required to perform them on average.

There is potential for inputs to this cost model to be revised to reflect more current observations – such as to ensure that productivity gains are being reflected in the time

allowances. However, the back-of-house costs are not overly significant, and hence there is limited potential for allowances to differ materially.

### **Indirect costs**

Indirect costs, including contract management costs, are allowed for by a mark-up over direct costs. The ACCC considers that an allowance of 10 per cent above contract rates is an appropriate allowance for these costs.

### **Disconnection charges**

The ACCC’s preliminary view is that there should not be a disconnection charge when a ULLS or LSS is cancelled.

This reflects firstly that service cancellations will often be due to customer churn, and in this instance there is potential to align the necessary work to disconnect the service with the connection of the new service to be provided on the line without any material incremental cost. Consequently, where disconnection costs can be avoided by a churn process, the ACCC considers that disconnection charges should not be payable.

There is the potential for a disconnection charge to still apply on those particular occasions where a churn process would not be possible, e.g., where the relevant service is simply being discontinued by the end user, and the jumpers are to be removed.

However, presently significant limits remain to Telstra’s support of end-user churn arrangements involving the ULLS/LSS, and disallowing disconnection charges more generally can provide added incentive on Telstra to increase its level of support for those churn processes. Consequently, the ACCC’s considers that it should not provide for disconnection charges at this time even where a disconnection occurs outside an existing churn process.

### **Proposed discrete charges**

Based on the discussion outlined above, the ACCC’s preliminary views on pricing the specific costs and connection charges is outlined in the tables below.<sup>71</sup>

#### **Specific costs: ULLS and LSS**

##### **Specific costs**

	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
Unit costs	\$1.00	\$1.00	\$1.00

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<sup>71</sup> Note: The connection charges do not reflect data obtained in 2009 in the course of arbitration hearings and there is potential for the charge terms to be revised when final indicative prices are determined.

## Connection charges

### ULLS single connections

	2009-10	2010-11	2011-12
Zone A	\$53.20	\$53.80	\$54.50
Zone B	\$64.70	\$65.30	\$65.90

### ULLS MNM

	2009-10	2010-11	2011-12
Fixed (per MNM)	\$144.60	\$149.50	\$154.70
Variable (per connection)	\$25.80	\$25.90	\$26.10

### ULLS MNM minimum charge

	2009/10	2010/11	2011/12
	660.60	667.50	676.70

### ULLS Call Diversion Charges

Component	1 August 2009 – 30 June 2010	2010-11	2011-12
Fixed amount (per ULLS call diversion)	\$ 9.80	\$10.10	\$10.50
Variable amount (pro rata per month)	\$12.50	\$12.50	\$12.50

### LSS single connections

	2009-10	2010-11	2011-12
Zone A	\$37.90	\$38.35	\$38.82

<b>Zone B</b>	\$44.17	\$45.16	\$45.63
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**LSS single disconnections**

	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>Zone A</b>	\$33.31	\$33.60	\$33.91
<b>Zone B</b>	\$40.12	\$40.42	\$40.72

**LSS MNM**

	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>
<b>Fixed (per MNM)</b>	\$144.54	\$149.50	\$154.63
<b>Variable (per connection)</b>	\$32.26	\$32.26	\$32.26

**LSS MNM minimum charge**

	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>
	790.60	795.50	800.70

## **Appendix 5: ESA Zone classifications**

Please see separate document attached.