



TELSTRA CORPORATION LIMITED

PUBLIC INQUIRY TO MAKE FINAL ACCESS DETERMINATIONS FOR THE DECLARED FIXED LINE SERVICES

PART A OF TELSTRA'S RESPONSE TO THE COMMISSION'S DISCUSSION PAPER

SCHEDULE A.8: PROPOSED CHANGES TO FIXED PRINCIPLES PROVISIONS

June 2011

6. Fixed principles provisions

6.1 This clause 6 sets out fixed principles provisions that apply to the six FADs contained in this document.

6.2 Subject to clause 6.3, the six FADs contained in this document must not be varied so as to remove or alter any of the fixed principles provisions below.

6.3 The fixed principles provisions may be varied with the written consent of the access provider.

Commencement date and termination date

6.4 The below fixed principles provisions apply from 1 January 2011. The nominal termination date for the fixed principles provisions is 30 June 2021.

Initial value of the regulatory asset base

6.5 The initial opening regulatory asset base (RAB) for the calculation of prices for the six declared fixed line services is \$~~17.75~~^[X] billion as at 1 July 2009 in July 2009 dollars.

Establishment of opening RAB for the first regulatory period

6.6 This clause 6.6 applies to the establishment of the value of the RAB for the declared fixed line services as at the beginning of the first regulatory period.

(a) In this clause 6.6 the term "first regulatory period" refers to the period from 1 July 2011 to 30 June 2016.

(b) The opening value of the RAB for the calculation of prices for the six declared fixed line services as at the beginning of the first regulatory year of the first regulatory period must be calculated by adjusting the initial value of the RAB for those assets, as specified in clause 6.5, as follows:

(i) The initial value of the RAB must be increased by the amount of capital expenditure accepted by the ACCC for financial years 2009 / 2010 and 2010 / 2011 expressed in July 2009 dollars as defined below;

(ii) The initial value of the RAB must be reduced by the amount of depreciation accepted by the ACCC for financial years 2009 / 2010 and 2010 / 2011 expressed in July 2009 dollars as defined below; and

(iii) The initial value of the RAB must be reduced by the amount of asset disposals recorded by the access provider and accepted by the ACCC for financial years 2009 / 2010 and 2010 / 2011 expressed in July 2009 dollars as defined below.

(c) The opening value of the RAB for the assets used to provide the declared fixed line services as at the beginning of the first regulatory year of the first regulatory period must be expressed in July 2009 dollars, by adjusting for compound inflation between the date that a valuation is expressed or cost is incurred and July 2009. For the purpose of performing the adjustment for inflation, capital expenditure shall be assumed to be incurred at the mid-point of each year.

Establishment of opening RAB for the second and subsequent regulatory periods

6.7 This clause 6.7 applies to the establishment of the value of the RAB for the calculation of prices for the six declared fixed line services as at the beginning of the second and subsequent

regulatory periods on the roll forward of the RAB to that regulatory period from the previous regulatory period.

(a) In this clause 6.7 the term:

(i) “first regulatory period” refers to the period from 1 July 2011 to 30 June 2016;

(ii) “second regulatory period” refers to the regulatory period immediately following the first regulatory period;

(iii) “subsequent regulatory period” refers to the regulatory period immediately following the second regulatory period and any further regulatory period.

(b) The value of the RAB for the calculation of prices for the six declared fixed line services as at the beginning of the first regulatory year of the second or subsequent regulatory period must be calculated by adjusting the value of the RAB for those assets as at the conclusion of the last regulatory year of the immediately preceding regulatory period (“closing value”) as follows:

(i) The real closing value of the RAB immediately preceding the first regulatory year must be increased by an amount necessary to maintain the real value of the RAB as at the beginning of the new base year for calculation of prices, by adjusting that value for inflation compounded over the preceding regulatory period.

(ii) No other adjustment is to be made to the closing value of the RAB.

Roll forward of RAB within the same regulatory period

6.8 This clause 6.8 applies to the establishment of the real value of the RAB as at the beginning of the second or a subsequent year in a regulatory period.

(a) The real value of the RAB as at the beginning of the second or a subsequent year in a regulatory period must be calculated by adjusting the real value of the RAB as at the beginning of the immediately preceding regulatory year in that regulatory period (“previous value”) as follows:

(i) The real previous value of the RAB must be increased by the amount of forecast capital expenditure accepted by the ACCC for the previous year, expressed in terms of the price as at the base price date.

(ii) The real previous value of the RAB must be reduced by the amount of depreciation included in annual revenue requirement for the previous year, expressed in terms of the price as at the base price date.

(ii) The real previous value of the RAB must be reduced by the disposal value of any asset included in that value where the asset is forecast to be disposed of during the previous year, expressed in terms of the price as at the base price date.

(b) Expressing values in terms of prices at the base price date means adjusting for compound inflation between the previous base price date (for the opening RAB) or the date that a cost is incurred and the new base price date. For the purpose of performing this adjustment, capital expenditure shall be assumed to be incurred at the mid-point of each year.

(c) The base price date for the first regulatory period is 1 July 2009.

The RAB is to be rolled forward each year according to the formula below:

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

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

RAB_t = opening RAB for the current year

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

$depreciation_t$ = depreciation during the current year

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

Forecasts for operating expenditure

6.9 Forecasts for operating expenditures during the regulatory period must be based on reasonable assumptions of the **efficient costs** actual costs that an efficient entity that has the same assets, service obligations and other relevant characteristics as the access provider would be likely to be incurred incur in this period. In making an assessment of the prudent and efficient operating expenditure for the **next relevant** regulatory period, the ACCC will take into account:

- (a) the access provider's level of operating expenditure in the previous regulatory period,
- (b) the reasons and evidence supporting changes to operating expenditure in the next regulatory period, **and**
- (c) the applicable regulatory obligations or requirements associated with the provision of fixed line services, and
- (d) any other relevant information.

6.10 Forecast operating amounts must be expressed in terms of prices at the relevant base price date.

Forecast capital expenditure

6.11 Forecasts for capital expenditures during the regulatory period must be based on reasonable assumptions of the **efficient costs** actual costs that an efficient entity that has the same assets, service obligations and other relevant characteristics as the access provider would be likely to be incurred incur in this period. In making an assessment of the prudent and efficient capital expenditure for the **next relevant** regulatory period, the ACCC will take into account:

- (a) the access provider's level of capital expenditure in the previous regulatory period,
 - (b) the reasons and evidence supporting changes to capital expenditure in the next regulatory period,
 - (c) whether or not the access provider's asset management and planning framework reflects best practice, **and**
 - (d) the applicable regulatory obligations or requirements associated with the provision of fixed line services, and
 - (e) any other relevant information.
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- 6.12 In paragraphs 6.9(c) and 6.11(d) the term “regulatory obligation or requirement” means an obligation or requirement under:
- (a) this access determination, or
 - (b) an Act or any instrument made or issued under or for the purposes of that Act, that levies or imposes a tax or other levy that is payable by the access provider, or
 - (c) an Act or any instrument made or issued under or for the purposes of that Act, that regulates the use of land by the access provider, or
 - (d) an Act, or any instrument made or issued under or for the purposes of that Act that relates to the protection of the environment, or
 - (e) an Act, or any instrument made or issued under or for the purposes of that Act (other than an Act or instrument referred to in (a) to(d)), that materially affects the provision, by the access provider, of the fixed line services.

No adjustments where forecasts differ from actual

- 6.13 To the extent actual operating or capital expenditure is different to forecast operating or capital expenditure, no adjustments will be made to compensate the access provider for, or to recoup from the access provider, any differences between the actual and forecast amounts or any return on the difference.

Weighted average cost of capital

6.14 A real vanilla weighted average cost of capital (WACC) will be used in estimating prices.

6.15 The cost of equity will be estimated using the domestic Capital Asset Pricing Model.

6.16 The risk free rate will be determined on a moving average basis from the annualised yield on Commonwealth Government bonds with a maturity of 10 years using:

- (a) the indicative mid rates published by the Reserve Bank of Australia; and
- (b) a period of time which is either:
 - (i) a period proposed by the access provider and agreed by the ACCC (such agreement is not to be unreasonably withheld); or
 - (ii) a period specified by the ACCC and notified to the access provider within a reasonable time prior to the commencement of that period, if the period proposed by the access provider is not agreed by the ACCC.
- (c) If there are no Commonwealth Government bonds with a maturity of 10 years on any day in the period referred to in paragraph (b) the ACCC must determine the nominal risk free rate for the regulatory period by interpolating on a straight line basis from the two Commonwealth Government bonds closest to the 10 year term and which also straddle the 10 year expiry date.

6.17 The debt risk premium for the regulatory period is the premium determined for that regulatory period by the ACCC as the margin between the annualised nominal risk free rate and the access provider’s estimated cost of debt over the regulatory period.

Tax

- 6.18 The initial opening tax RAB at 1 July 2009 is ~~to be set equal to the initial opening RAB as at 1 July 2009, as specified in clause 6.4~~ [\$Y] billion in July 2009 dollars. Tax depreciation on this amount is to be calculated using the rates that an efficient entity in the access provider's position would adopt. The tax RAB is to be rolled forward by deducting tax depreciation and disposals and adding in additions in a manner that is consistent with the relevant tax laws and accepted practice.
- 6.19 The tax rate used in determining tax liabilities in the building block model will be set equal to the corporate tax rate as specified in subsection 23(2) of the *Income Tax Rates Act 1986* (Cth).
- 6.20 The assumed value of imputation credits (gamma) is 0.25.

Demand

- 6.21 The forecasts of demand for the declared fixed line services must reflect the best forecast of the actual demand for those services. In forecasting demand for the declared fixed line services for the ~~relevant~~ next regulatory period, the ACCC will take into account any forecasts provided by the access provider. In assessing the access provider's forecasts, the ACCC will consider whether the forecasts provided by the access provider:
- (a) are based on an appropriate forecasting methodology,
 - (b) are based on reasonable assumptions about the key drivers of demand,
 - (c) utilise the best available information, including historical data that can identify trends in demand, and
 - (d) take account of current demand and economic conditions.

No variation or substitution of forecast amounts once accepted by the ACCC

- 6.22 Following the acceptance by the ACCC of forecast amounts for the purposes of making a final access determination, those forecast amounts will not be varied or substituted by other amounts for the period to which those forecasts relate.

Calculation of the annual revenue requirement

- 6.23 The annual revenue requirement for each regulatory year must include:
- (a) an allowance for depreciation of the RAB, calculated on a straight line basis;
 - (b) a return on the remaining value of the RAB, calculated by multiplying the opening value of the RAB for that regulatory year by the weighted average cost of capital;
 - (c) forecast operating expenditure for that regulatory year; and
 - (d) an allowance for tax liabilities.
- 6.24 The annual revenue requirement for each regulatory year of a regulatory period must be calculated in the dollars of the base price date for that regulatory period.
- 6.25 For the first regulatory period, the base price date for the calculation of the annual revenue requirement for each regulatory year is 1 July 2009.
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- 6.26 For the second and subsequent regulatory periods, the base price date for calculation of the annual revenue requirement for each regulatory year must be as close as practicable to the commencement of the new regulatory period.

Cost allocation factors

- 6.27 This clause 6.27 applies to the cost allocation factors used to allocate the annual revenue requirement and estimate prices.

- (a) The allocation of the costs of operating the PSTN should reflect the relative usage of the network by various services to the extent that it is possible to obtain reliable information on their usage of the network.
- (b) To the extent it is possible to obtain reliable information on the direct costs incurred in providing specific services, direct costs should be attributed to the service to which they relate and not more than once to any category of service.
- (c) The cost allocation factors for shared costs should reflect causal relationships between supplying services and incurring costs where such relationships can be reliably identified without undue cost and effort.
- (d) No cost should be allocated more than once to any service.

- (e) The entire annual revenue requirement for each regulatory year must be allocated between the fixed line services and the allocation factors applied to a category of cost must sum to 100 per cent.

Prices to be in current (nominal) dollars

- 6.28 Prices for the fixed line services must be expressed in nominal dollars of the regulatory year in which they are to take effect.
- 6.29 The amounts of the real annual revenue requirement allocated to each service (which are expressed in terms of prices as at the base price date) must be converted into nominal prices for each service in each regulatory year by adjusting those amounts for compound inflation between the base price date and the relevant regulatory year.