IN THE MATTER OF UNDERTAKINGS DATED 23 DECEMBER 2005 LODGED BY TELSTRA CORPORATION LIMITED WITH THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION IN RESPECT OF UNCONDITIONED LOCAL LOOP SERVICE ("the Access Undertakings")

STATEMENT OF [c-i-c]

On 3 August 2006, I, **[c-i-c]**of **[c-i-c]**, **[c-i-c]**, **[c-i-c]**, state as follows:

1 **[deleted]**

Background

2 I am currently the **[c-i-c]**, Strategic Cost Analysis ("**SCA**") within the Finance and Administration Group at Telstra. I have been in that role since 2004.

3 Prior to that, I was employed in **[c-i-c]** in a number of roles, most recently, as the **[c-i-c]**, Telstra Consumer and Marketing.

4 **[c-i-c]**. The SCA Group created the PIE II model and is responsible for updating and managing the PIE II model for use by Telstra. The SCA Group is also responsible for creating, updating and managing the ULLS Specific Costs Model ("**SC Model**") for use by Telstra.

A ULLS Specific Costs Model

5 I refer to Telstra's Submission in Support of the ULLS Monthly Charges Undertaking dated 23 December 2005 ("**December Submission**") which sets out the ULLS specific costs.

6 The ULLS specific costs are estimated by means of the SC Model.

7 As set out in section E.3 of the December Submission, ULLS specific costs consist of:

(a) capital costs, which are the incremental costs of systems for qualifying and ordering ULLS;

(b) operational & maintenance ("**O&M**") costs, which are the O&M costs associated with ULLS capital expenditure, labour for the front of house connection group and the costs of wholesale product management; and

(c) indirect O&M costs, which are indirect O&M costs associated with the front of house connection group and wholesale product management.

Double Recovery

8 The ULLS specific costs are:

(a) directly attributable to ULLS and are not shared with any other Telstra services; and

(b) not part of the O&M costs calculated by the PIE II model.

Variable Costs

9 The front of house costs and associated indirect costs are variable with the number of ULLS lines.

10 If no ULLS services were supplied the ULLS specific costs would be limited to:

(a) IT Systems costs; and

(b) product management costs and associated indirect costs.

B Capital Costs

11 For ULLS specific costs, the formula by which capital costs are converted to an annual capital charge is as follows:

Tilted annuity = a / b

where:

a = (x1 - p + beta) * (1 + p - beta) ^ (t - 1)

b = 1 - (1 + p - beta) ^ n / (1 + x1) ^ n

where:

x = is the weighted average cost of capital;

p = is the rate of inflation;

beta = is the rate of price change;

t = is the age of the asset; and

n = the asset life for the asset.

C O&M costs in ULLS Specific Costs Model

<u>Front of house connection group</u>

12 The front of house connection group costs are incurred on an ongoing basis.

13 I have been asked to comment on the calculation of per staff costs used in the SC Model to calculate the front of house costs from 2005/06 onwards.

14 In order to calculate costs per staff member costs for 2005/06, 2006/07 and 2007/08 a member of the SCA group:

(a) calculated the pay rates for Customer Sales and Service Work Stream (**"CSSW"**) employees at levels 3, 5 and 8**,** as set out in the 'First Increase' column in the table on page 17 of the Telstra Enterprise Agreement 2005 - 2008 (a copy of which is Annexure A to this statement);.

(b) added the following amounts:

(i) 9.0% for superannuation;

(ii) 6.3% for payroll tax;

(iii) 1.0% for workers compensation payment; and

(iv) 1.3% for leave loading.

15 The resulting pay rates for 2005/06 used in the SC Model are:

	CSSW8	**CSSW5**	**CSSW3**
Annual labour cost	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**

16 To calculate pay rates for 2006/07 and 2007/08, a **[c-i-c]**% pay increase has been included cumulatively for each year from 2005/06 onward.

17 Using the revised staff estimates set out at paragraph 14 of the statement of **[c-i-c]**, dated 26 July 2006, results in front of house costs for 2005/06, 2006/07 and 2007/08 as follows:

Year	Costs
2005/06	**[c-i-c]**
2006/07	**[c-i-c]**
2007/08	**[c-i-c]**

which results in total specific costs as follows:

Year	Cost - Low WACC	Cost - High WACC
2005/06	**[c-i-c]**	**[c-i-c]**
2006/07	**[c-i-c]**	**[c-i-c]**
2007/08	**[c-i-c]**	**[c-i-c]**

<u>Product Management Costs</u>

18 The costs for product management in the SC model are $**[c-i-c]**. However, I understand that the number of personnel involved in product management activities for ULLS are as set out in Annexure B to this statement. This results in product management costs of over $**[c-i-c]**. Using that figure for product management costs results in the ULLS specific costs as follows:

Year	Cost - Low WACC	Cost - High WACC
2005/06	**[c-i-c]**	**[c-i-c]**
2006/07	**[c-i-c]**	**[c-i-c]**
2007/08	**[c-i-c]**	**[c-i-c]**

and combining that with the updated front of house costs, set out at paragraph 17, results in ULLS specific costs as follows:

Year	Cost - Low WACC	Cost - High WACC
2005/06	**[c-i-c]**	**[c-i-c]**
2006/07	**[c-i-c]**	**[c-i-c]**
2007/08	**[c-i-c]**	**[c-i-c]**

O&M IT Costs

19 The O&M costs in the SC Model increase as follows:

Year	IT O&M ($M)
2000/01	**[c-i-c]**
2001/02	**[c-i-c]**
2002/03	**[c-i-c]**
2003/04	**[c-i-c]**
2004/05	**[c-i-c]**
2005/06	**[c-i-c]**
2006/07	**[c-i-c]**
2007/08	**[c-i-c]**

The reason for the increase is due to the growing demand in ULLS as well as the estimated inflation rate of 2.6%.

D Indirect O&M costs loading included in ULLS Specific Costs

20 I refer to page 19 of the December Submission, which states that "*the indirect loading used is* **[c-i-c]***% based on data from the second half of 2003/04*".

21 The indirect O&M costs claimed by Telstra are the indirect costs associated with the front of house connection group and product management group.

22 In order to calculate the indirect O&M cost mark up of **[c-i-c]**% a member of the SCA Group:

(a) extracted the following data from the regulatory accounting framework ("**RAF**") accounts for the period 1 January 2004 to 30 June 2004:

(i) the total expenditure in respect of the following indirect costs: Property Management, Human Resource Management, Accounting & Finance, Business Administration, and Fleet Management ("**Total Indirect Costs**"); and

(ii) total expenditure for all products excluding network costs and miscellaneous accounts such as "Intracompany Transfer", "Depreciation/Amortisation", "Stock Adjustments", "Others", "Invalid Accounts" and "Madrid Adjustments" less the Total Indirect Costs ("**Total Direct Costs**"); and

(b) divided Total Indirect Costs by the Total Direct Costs.

23 The indirect O&M costs do not include any indirect sales and marketing costs.

E Annuity Formula in the SC Model

24 I have been asked to comment on the costs that would result from the use of a flat annuity formula in the SC Model.

25 In order to implement a flat annuity formula, I changed both the **[c-i-c]**% price trend and the 2.6% rate of inflation to 0%.

26 Using a flat annuity formula, the ULLS specific costs are:

	2005/06 H2	**2006/07**	**2007/08**
Low WACC	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
High WACC	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**

F The PIE II Model

<u>Provisioning in the PIE II Model</u>

27 The PIE II model does not employ a fixed mark up to account for future demand. Rather, the model employs region-specific engineering rules for the various network components that takes into account the forecast growth in both PSTN services and non-PSTN services as well as component discreteness and economies of scale.

28 For High Density Urban CAN, the PIE II model employs:

(a) graduated sizes of main (feeder) cable in an Exchange Service Area (**"ESA"**) of **[c-i-c]**, **[c-i-c]**, and **[c-i-c]**pairs;

(b) either **[c-i-c]** pair or **[c-i-c]** pair non-tapered distribution cable in a distribution area (**"DA"**);

(c) in respect of cross-connection of the main and distribution cables in a DA, a standard **[c-i-c]**pair pillar. The pillars are provisioned based on **[c-i-c]**-line modules, plus **[c-i-c]** kept in reserve in the event that a fault develops in the others. They are dimensioned based on the number of distribution cable pairs and the number of main cable pairs that terminate at the pillar.

Network planning costs

29 To calculate network planning costs, the PIE II model uses a network planning mark-up. This is a percentage which is calculated by using Telstra's actual expenditure on network planning for the PSTN and Telstra's direct operating and maintenance expenditure on the PSTN in that year. The model then approximates network planning expenses by applying that percentage to the operations and maintenance expenditures estimated by the model to obtain an annual cost of network planning activities. To avoid double counting, the network operational and maintenance costs included in the PIE II model specifically excluded any network planning costs.

30 As set out above the network planning costs included in the PIE II model are the costs of planning expansions in the existing network, rather than the planning costs associated with building a new network.

31 For the purposes of calculating direct O&M ratios for the CAN costs, only accounts associated with the access network are used. Accounts such as Data Network, Customer Premises Equipment, Mobiles and Sales and Marketing are not included in the analysis for the purposes of determining those ratios. The following accounts **[c-i-c]** are specifically excluded when calculating those direct O&M ratios.

Updating the PIE II Model

32 In estimating the efficient costs of providing ULLS the PIE II model has been updated by the SCA Group as follows:

(a) the starting point was the PIE II model version which included the 2004/05 inputs.

(b) the price indices were changed as follows:

(i) main cable (4.2%);

(ii) main conduit & trenching (4.2%);

(iii) distribution cable (3.9%);

(iv) distribution conduit & trenching (4.1%);

(v) network land & buildings (0.0%);

(vi) indirect capital (0.0%); and

(c) the WACC was updated.

33 Annexed to this statement, at annexure C, are five versions of the PIE II model as follows:

(a) the base model with the 2004/05 input;

(b) a PIE II version which estimates network costs for 2006/07, with a "low" WACC using the updated price indices;

(c) a PIE II version which estimates network costs for 2006/07, with a "high" WACC using the updated price indices;

(d) a PIE II version which estimates network costs for 2007/08, with a "low" WACC using the updated price indices; and

(e) a PIE II version which estimates network costs as at 2007/08, with a "high" WACC using the updated price trends.

34 The "high" and "low" WACC figures reflect WACC estimates with and without a 1 standard deviation increase to the WACC as recommended by Professor Bowman in his report titled *Report on the Appropriate Weighted Average Cost of Capital ULLS and SSS*, dated December 2005 and being Annexure C to the December Submission.

35 For the purposes of running sensitivity analysis, the base model for 2004/05 should be used.

DATED: 3 August 2006

....

[c-i-c]

ANNEXURE A TO [c-i-c] WITNESS STATEMENT

Telstra Enterprise Agreement 2005- 2008

[c-i-c]

ANNEXURE B TO [c-i-c] WITNESS STATEMENT

Product Management Costs

1. The following Telstra business areas include personnel involved in product management activities for ULLS: Sales, Products and Business Operations.

2. In order to estimate the time spent by staff in each of the above areas on ULLS related activities, a member of the SCA group made enquiries of the following Telstra personnel regarding the number and level of staff who undertake ULLS related activities and the average time spent on those activities:

   (a) **[c-i-c]** from the Products area;

   (b) **[c-i-c]** from the Business Operations area; and

   (c) **[c-i-c]** from the Sales area.

   The results of those enquiries are set out in the tables below:

Table 1: Products area

Title	Number of staff undertaking ULLS related activities	Salary level	Average % of time spent on ULLS related activities
Group Managing Director	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Group Manager	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Product Manager	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Additional product management staff	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**

Table 2: Business Operations area

Title	Number of staff undertaking ULLS related activities	Salary Level	Average % of time spent on ULLS related activities
Business Operations Manager	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**

Table 3: Sales

Title	Number of staff	Salary Level	Average % time spent on ULLS related activities
Sales Director	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Sales Manager	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Sales Manager	**[c-i-c]**	**[c-i-c]`**	**[c-i-c]**
Solutions Engineer Manager	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Solutions Engineer	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Accounts Manager	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Accounts Manager	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**

3. In order to calculate costs per staff member for 2005/06, 2006/07 and 2007/08 a member of the SCA group made enquiries of Telstra's Human Resources Department and was provided with the average annual salaries for each salary level identified in Tables 1, 2 and 3 above.

4. The average annual salaries, provided by Telstra's Human Resources Department, for each salary level in the Products, Business Operations and Sales areas are as follows:

Products & Business Operations

Level	Annual Salary
[c-i-c]	**[c-i-c]**
[c-i-c]	**[c-i-c]**
[c-i-c]	**[c-i-c]**

Sales

Level	Annual Salary
[c-i-c]	**[c-i-c]**
[c-i-c]	**[c-i-c]`**
[c-i-c]	**[c-i-c]**

5. The following amounts were added to each average annual salary level:

(i) 6.3% for payroll tax;

(ii) 1.0% for workers compensation payment; and

(iii) 3.0% for Long Service leave allowance

6. The total costs for the Products, Business Operations and Sales areas for 2005/06 to 2007/08 are set out in the table below. The total costs are calculated by multiplying the average percentage of time spent on ULLS related activities by the relevant average annual salary.

	2005/06	2006/07*	2007/08*
Sales	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Business Operations	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Products	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Total Product Management Costs	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**

* To calculate the costs of Product Management costs for 2006/07 and 2007/08, a **[c-i-c]**% pay increase has been included cumulatively for each year from 2005/06 onward.

ANNEXURE C TO [c-i-c] WITNESS STATEMENT

The following versions of the PIE II model are annexed:

(a) the base model with the 2004/05 inputs;

(b) a PIE II version which estimates network costs for 2006/07, with a “low” WACC using the updated price indices;

(c) a PIE II version which estimates network costs for 2006/07, with a “high” WACC using the updated price indices;

(d) a PIE II version which estimates network costs for 2007/08, with a “low” WACC using the updated price indices; and

(e) a PIE II version which estimates network costs as at 2007/08, with a “high” WACC using the updated price trends.

NOTE: The PIE II Model is **[c-i-c].**