CONFIDENTIAL TELSTRA SUBMISSION IN SUPPORT OF THE ULLS SPECIFIC COSTS MODEL IN THE MATTER OF THE ULLS MONTHLY CHARGES UNDERTAKINGS DATED 23 DECEMBER 2005 (PUBLIC VERSION)

A INTRODUCTION

1 On 23 December 2005, Telstra gave to the Australian Competition and Consumer Commission ("**Commission**") two undertakings for the Unconditioned Local Loop Service ("**ULLS**") pursuant to section 152BS of the *Trade Practices Act 1974* ("**TPA**") ("**ULLS Undertakings**"). The ULLS Undertakings relate to the 6 month period from 1 January 2006 to 30 June 2006 and the 2006/07 and 2007/08 financial years. At the same time, Telstra provided to the Commission a submission in support of the ULLS Undertakings ("**Telstra's ULLS submission**").

2 On 14 March 2006 Telstra provided to the Commission Telstra's confidential submission in response to the Commission's Discussion Paper in respect of ULLS dated January 2006 ("**Telstra's Discussion Paper Response**") and the ULLS specific costs model relied on by Telstra to support the ULLS Undertakings ("**the December SC model**").

3 Telstra has subsequently made two minor amendments to the December SC model. As set out in the table below these amendments have a minimal impact on the underlying ULLS specific costs. The revised specific cost model is referred to throughout this submission as the "**the August SC model**".

	1 January 2006 to 30 June 2006	**2006/07**	**2007/08**
Specific costs in the December SC Model	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**
Specific costs in the August SC model	**[c-i-c]**	**[c-i-c]**	**[c-i-c]**

4 This submission explains the nature of the amendments to the December SC model which have been incorporated in the August SC model. **[c-i-c]**.

B CONFIDENTIALITY

5 **[removed]**

6 **[removed]**

7 **[removed]**

C CHANGES TO THE DECEMBER SC MODEL

8 The following modifications have been made to the December SC Model:

(a) the WACC used in the tilted annuity formula has been changed to be based on the investment year; and

(b) the timing of the capital charge has been delayed by one year.

9 These changes are further explained below.

D CHANGES TO THE WACC

10 The WACC value is used in the tilted annuity formula to calculate the capital charge factor for each year.

11 Telstra has modified the manner in which the WACC estimate is applied in the annuity calculations in the August SC model. The WACC applied now is the WACC calculated as at the beginning of the asset's useful life, and that WACC is held constant across all years in the asset's useful life included in the annuity calculation. The rationale for this revised approach is that the WACC is designed to measure the opportunity cost caused by committing to the particular asset which is occasioned at the time the asset is built. This means that there is an inter-dependence between the timing of the WACC estimate and the timing of the asset valuation.

12 For example, in the August SC model, to calculate the capital charge factor for investments made in 2000/2001, the calculation of the capital charge factor for each year now uses the WACC value for 2000/2001. In the same way, to calculate the capital charge factor for investment made in 2001/2002, the calculation for each year now uses the WACC value for 2001/2002.

E CHANGES TO THE TIMING OF CAPITAL CHARGE FACTORS

13 The December SC model has been changed by delaying the timing of the capital charge factors by one year. The December SC model and the August SC model assume that Telstra has invested in capital expenditure for the ULLS ordering and provisioning systems over the period 2000/01 to 2005/06. In Telstra's ULLS Submission, Telstra reports the capital expenditures to be:

- **[c-i-c]** in 2000/01;
- **[c-i-c]** in 2001/02;
- **[c-i-c]** in 2002/03;
- **[c-i-c]** in 2004/05; and
- **[c-i-c]** in 2005/06.

14 These capital investments have been made throughout, not at any particular date within, each relevant financial year. In both models, it is assumed that the capital expenditure for each financial year is on average incurred at the midpoint of that year, that is, at 1 January.

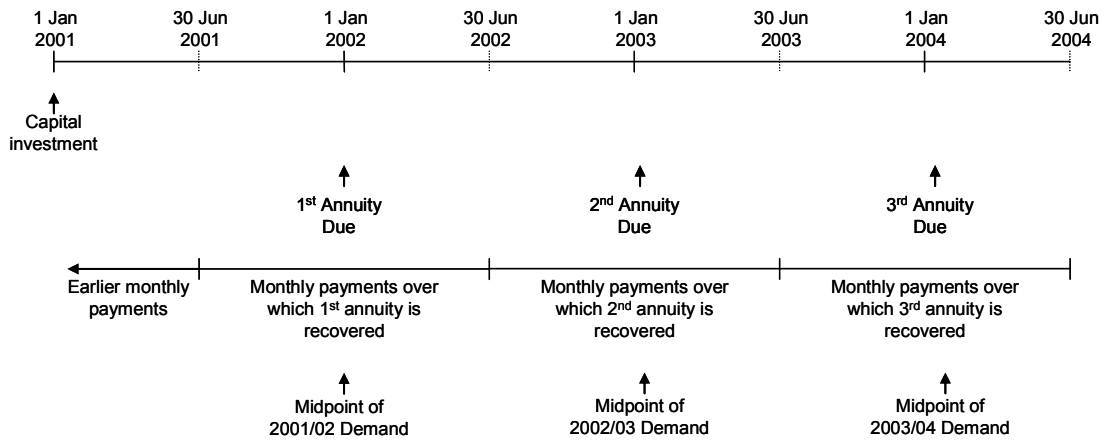
15 Both SC models calculate annuities for each capital investment, which is an annual payment that ensures Telstra recovers the financial costs of the capital investment.[1] The annuity formula assumes that the annual payments are made at the end of each year after the capital investment is made, that is, 31 December. Hence, the first annuity associated with each investment is payable in the financial year after the investment is incurred. For example, the first annuity for an investment made on 1 January 2001 (incurred in the 2000/01 financial year) will be payable on the 31 December 2001 (in the 2001/02 financial year).

16 The December SC model has been changed to reflect that, since investments are assumed to be made on the 1 January of each year, the first annuity for each investment is payable in the financial year following the time when the investment is made.

[1] The annuity is tilted to consider changes in asset prices and inflation.

17 The figure below illustrates the timing of an investment and associated annuities in the August SC model for a capital expenditure made on 1 January 2001. The August SC model calculates annuities for many capital investments and over a longer time period than what is illustrated below.

Figure 1: Timing of Capital Investments in the August SC Model



F ANNUITY FORMULA IN THE AUGUST SC MODEL

18 The capital costs are converted to an annual capital charge (which includes depreciation and cost of capital) using a formula. An incorrect formula was inadvertently included at paragraph 8 of Annexure B to Telstra's Discussion Paper Response. The formula at paragraph 8 of Annexure B is not the formula which was used in the December SC model and is not the formula used in the August SC model. Rather, the formula used in both of the SC models is as follows:

Titled annuity = a/b

Where:

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

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.

G. REVISED FIGURES BASED ON AUGUST SC MODEL

19 Annexure B of Telstra's Discussion Paper Response also included a number of tables with output from the December SC model. Using the revised August SC model, the following figures apply.

The table at paragraph 10 of Annexure B is revised as follows:

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Annual Capital Costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]

The table at paragraph 13(d) of Annexure B is revised as follows:

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Unrecovered ULLS-specific costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
NPV of unrecovered ULLS-specific costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]

Dated 10 August 2006