Confidential Communication

19 January 2015

Robert Wright
Communications Group
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001

Email: Robert.Wright@accc.gov.au

Cc: Jane.Goldwater@accc.gov.au
Annette.Weier@accc.gov.au
fixedservices@accc.gov.au

Dear Mr Wright

Fixed line services final access determination inquiry: ACCC request for information

I refer to your request for further information dated 18 December 2014. This letter and the attached documents respond to your fixed line services request for information; specifically the additional information regarding internal interconnect cable (IIC) and TEBA (the first five questions). As agreed at the meeting between Telstra and ACCC staff on Thursday 15 January, Telstra will respond separately to questions pertaining to the DTCS.

In response to the points raised in your letter:

1. The assets used to supply IIC and TEBA rack services are Other Communications Plant and Equipment (asset class CO07), Network Land (CO08) and Network Buildings and Support (CO09). Written down values for these assets as at 30 June 2009 have previously been provided to the ACCC and were used to determine the opening RAB value for the fixed line network assets as at 1 July 2011.

2. A revised version of the cost allocation framework, including allocation factors for assets used to supply IIC and TEBA rack services, is provided as Attachment 1.

   The revised version of the cost allocation framework includes new allocation factors for TEBA for those asset classes used by TEBA services – i.e. asset classes CO07 (Other Communications Plant and Equipment), CO08 (Network Land), CO09 (Network Buildings / Support) and CO10 (Indirect Capital Assets).

   For the CO07, CO08 and CO09 asset classes, the share of costs previously allocated to Third Party Access has now been split between TEBA and Other Third Party Access (referred to as 'Other TPA'). Previously, this allocation of costs for these asset classes between Fixed Line Services and Third Party Access had been based on the number of racks. In order to identify usage by the TEBA service, the Third Party Access share has been split into TEBA and Other TPA, again based on the number of racks (row 851 of the 'Allocations' worksheet).

For asset class CO10, the allocation to TEBA services is based on the general allocator applied to that asset class.

3. Historical revenue data for IIC and rack services, drawn from the Telstra Economic Model (**TEM**), is set out in Table 1 below. TEM does not provide for reporting of costs at the level of these services, and so Telstra is unable to provide historical cost data for IIC and rack services individually, on a consistent basis with historical revenues.

Table 1: Revenue from rack and interconnection cable charges, FY2010 – FY2014

Service	FY2010	FY2011	FY2012	FY2013	FY2014
Rack Charges	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Interconnection Cable Charges	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: TEM

4. Total costs for the Telstra Wholesale business unit, and a breakdown of costs attributable to each of the fixed line services and TEBA services, is provided in Table 2 below.

Table 2: Telstra Wholesale business unit costs for fixed line services and TEBA, FY2010 – FY2014 ($ million)

	FY2010	FY2011	FY2012	FY2013	FY2014
WLR	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
LCS	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
LSS	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ULLS	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Wholesale DSL	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
FOAS/FTAS	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
TEBA	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Other wholesale products	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: TEM

5. Telstra notes that the ACCC has requested further information in relation to connection and disconnection costs in its letter dated 14 January 2015. Telstra will provide a response to all of the ACCC's connection/disconnection cost queries in its response to the ACCC's 14 January letter.

Consequential changes to the Forecast Model and Cost Allocation Framework

In responding to the ACCC's request for information, Telstra identified a number of inputs into its Cost Allocation Framework and Forecast Model which required consequential adjustment, correction or updating. These are outlined below.

Update to attribution of network power costs to isolate power costs for IIC and TEBA rack services

In augmenting the Cost Allocation Framework to cover IIC and TEBA rack /power services, Telstra has identified certain refinements which need to be made to the attribution of network power costs to ensure an appropriate sharing of these costs between TEBA and other services.

In the Forecast Model provided to the ACCC in October 2014, all network power costs were attributed to the Network Buildings and Support asset class (CO09). This meant that network power costs were allocated among users of the fixed-line network – including TEBA users – in accordance with the general allocator used for the CO09 asset class.

In reviewing the allocation of costs for TEBA services, Telstra has identified that certain power costs are directly attributable to TEBA power, while other power costs are directly attributable to asset classes not used by TEBA services. Specifically, it has been identified that:

- around [redacted] of total power consumption by network equipment is attributable to TEBA power usage;
- around [redacted] of total power consumption by network equipment is attributable to other third party access;
- around [redacted] of total power consumption by network equipment is attributable to FLSM asset classes which are not used by TEBA services, including the 'Switching Equipment – Local', 'Switching Equipment – Trunk', 'Data Equipment' and 'Transmission Equipment' asset classes; and
- only [redacted] of total power consumption by network equipment is attributable to the Network Buildings and Support asset class.

Given this, it would not be appropriate for all network power costs to be attributed to the Network Buildings and Support asset class and allocated to services using the general allocator. Rather, power costs should be attributed to the asset class or service which causes these costs to be incurred.

Therefore Telstra has updated the Forecast Model to refine the method for attribution of network power costs. Rather than all power costs being attributed to the Network Buildings and Support asset class, these costs are now allocated between Third Party Access – TEBA, Third Party Access – Other, and the FLSM asset classes.

This has involved the following amendments to the Opex Forecasts worksheet in the Forecast Model:

- the table titled 'Power consumption by FLSM telco equipment (kWh)' has been amended to modify the classification of some equipment and add two new equipment types associated with supply of third party access services. The two new equipment types are 'Third Party Access – TEBA' and 'Third Party Access – Other';

- all equipment types in this table are now associated with an FLSM asset class, with the exception of the two new equipment types associated with supply of third party access services;

- a new table titled 'Total Electricity expenditure by Asset Class' has been added, showing the allocation of network power costs to asset classes in each year;

- formulae in the table titled 'Networks Indirect and Direct Operating Expenditure by Asset Classes' have been amended to look up this new table; and

- the split of power consumption between CAN and Core (rows 353 and 354) has been updated to reflect relative power usage between CAN and Core asset classes (based on the refined attribution methodology).

An updated version of the Forecast Model with the revised power cost attribution is provided as Attachment 2.

Update to forecast power and network building costs to include third party usage share

In the Forecast Model provided to the ACCC in October 2014, forecast network power costs, rent and building outgoings had excluded costs attributable to third party use of network buildings.

Given that a portion of these costs are to be allocated to third party use of network buildings (including use by TEBA services), the forecasts of these building-related costs need to be updated to include those costs attributable to third party use.

Telstra has therefore made the following updates to the Forecast Model:

- total power consumption by equipment in kWh (cell F356) and the total power cost for FY2014 (cell F439) has been updated to include power costs attributable to all third party access usage;

- a new table calculating power usage for all third party usage has been inserted (row 459);

- the amounts for rent (row 497) and building outgoings (rows 500 and 501) for FY2014 have been updated to include the share of these costs attributable to third party usage of network buildings.

Under the attribution and allocation rules applied in the Forecast Model and Cost Allocation Framework, the portion of these costs attributable to third party use of the network will be allocated away from fixed line services – i.e. fixed line services will not bear any portion of network power or building costs attributable to third party access. For power costs this will be effected through the refined attribution methodology referred to above, whereby power costs attributable to third party usage will not be assigned to any FLSM asset class (rather these costs will be attributed to either Third Party Access – TEBA or Third Party Access – Other). For rent and building outgoings, this will be effected through the allocator for the CO09 asset class which provides for a proportionate allocation of these costs to third party usage.

Amendment to allocation of Telstra Wholesale business unit costs

Telstra has also identified an error in the way Telstra Wholesale business unit costs have been allocated in the Forecast Model and FLSM.

In the Forecast Model provided to the ACCC in October 2014, Telstra Wholesale business unit costs are classified as indirect operating expenditure. This means that these costs are effectively applied across all asset classes in the FLSM and allocated among all services using the fixed-line network in accordance with the individual asset class allocators.

However as explained in Telstra's Forecast Model Documentation, the Telstra Wholesale business unit costs that are included in Telstra's forecasts are only those that are attributable to the supply of declared services. The proportion of Telstra Wholesale business unit costs attributable to delivery of declared services is forecast based on expected demand for the declared fixed-line services over the next five years, and the unit cost to Telstra Wholesale of delivering those services only. Telstra Wholesale business unit costs attributable to the supply of other (non-declared) wholesale services are not included in the Forecast Model.

This means that it is not appropriate for the Telstra Wholesale business unit costs that are included in the Forecast Model to be smeared across all asset classes and allocated among all network services in accordance with the individual asset class allocators. This would mean that some of the Telstra Wholesale business unit costs attributable to delivery of declared services would be allocated to non-declared services, and a bias in allocation since no costs attributable to non-declared services are allocated to declared services.

A more appropriate approach is to add the proportion of Telstra Wholesale business unit costs attributable to delivery of each declared service directly to the calculation of service costs. This requires removing Telstra Wholesale business unit costs from the calculation of indirect operating expenditure in the Forecast Model, and addition of these costs to the 'Service Costs' worksheet in the FLSM.

Telstra has modified the calculation of indirect operating expenditure in the attached version of the Forecast Model to remove Telstra Wholesale business unit costs. The result is a decrease in the costs contained in the table 'Total Direct and Indirect Operating Expenditure by Asset Classes - including indirect' equivalent to the Telstra Wholesale business unit cost per year.

Other changes have been made to the 'Opex Forecasts' worksheet of the Forecast Model to provide for calculation of Telstra Wholesale business unit costs per service which can be added to total service costs the 'Service Costs' worksheet of the FLSM. These include:

- the table titled 'Telstra Wholesale Group Indirect Operating Expenditure' was moved be the last set of calculations in the worksheet;
- the order of the services in this table was changed to match the order in the list 'Services' in the FLSM worksheet '3. Masterlists', and a new service called 'TEBA' was added to the list;
- a table containing the calculation of the total Telstra Wholesale business unit costs per service was added and the table with a row per FLSM Asset Class was removed;
- a table converting the costs per service to FY2009 values was added;
- the calculation of the Unattributable Indirect Costs was amended to refer to the Total Telstra Wholesale business unit costs per year.

Additionally, the following changes would be required to the FLSM worksheet '7. Service Costs' in order to add Telstra Wholesale business unit costs into the calculation of total cost per service and service prices:

- a new Table 7.1.4 (TW BU Indirect Operating Costs) would need to be inserted containing the total Telstra Wholesale business unit costs per service per year in 2009 dollars. This has calculated for each service (including TEBA) in the attached revised version of the forecast model (rows 1057 to 1069);

- a new Table 7.3.3 (Summary of costs transposed) would need to be inserted containing the transposed values of Table 7.3.2 (Summary of cost allocation) which previously were contained in Table 7.2.1 (Revenue Requirement Allocated to Services); and

- Table 7.2.1 (Revenue Requirement Allocated to Services) would need to be amended to sum the values in Tables 7.1.4 (TW BU Indirect Operating Costs) and Table 7.3.3 (Summary of costs transposed) to get the final cost per service per year.

Telstra considers that the above changes must be made in order to provide for an appropriate allocation of Telstra Wholesale business unit costs.

Updated LSS operating expenditure in the Forecast Model

As explained in the Forecast Model Documentation, operating expenditure for the Line Sharing Service is forecast using the historical costs recorded in the RAF accounts.

The forecasts provided to the ACCC were based on data up to and including the RAF reported as at December 2013, as this was the most recent data available at that time.

The RAF report for June 2014 has now become available. Therefore, forecast operating expenditure for the Line Sharing Service has been updated using this data in the attached version of the Forecast Model.

Since the forecast operating expenditure for the Line Sharing Services is based on the RAF accounts, which include the Telstra Wholesale business unit costs, the allowance for Telstra Wholesale business unit costs for LSS has been removed.

Use of the FLSM to estimate service costs and prices for TEBA services

Finally, Telstra notes that although IIC charges form part of the current FAD terms, this is not the case for related TEBA rack and TEBA power services. These services are currently provided by Telstra on commercial terms – as has been the case for a number of years. The ACCC should carefully consider whether it is necessary and in the LTIE to institute regulated pricing for these services. See further Telstra's submissions to the ACCC's 2014 Position Paper on Non-Price Terms and Supplementary Pricing.

Please contact Alister Montgomery (03 8649 2008 / alister.montgomery@team.telstra.com) or Jodi Gray (03 8649 6264 or jodi.gray@team.telstra.com) should you have any queries.

Yours sincerely,

Iain Little
Deputy Executive Director – Regulatory Affairs
Corporate Affairs

Attachments:

1. Revised Cost Allocation Framework, including allocation factors for assets used to supply IIC and TEBA services.

2. Updated Forecast Model with updated power cost allocation and revised treatment of Telstra Wholesale business unit costs.