



Australian
Competition &
Consumer
Commission

Unconditioned Local Loop Service

Access Dispute

Between

Telstra Corporation Limited (access provider)

and

Primus Telecommunications Pty Ltd (access seeker)

(monthly charges)

Statement of Reasons for Final Determination

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Summary

The Australian Competition and Consumer Commission (“ACCC”) has determined certain of the terms on which Telstra Corporation Limited (“Telstra”) supplies the Unconditioned Local Loop Service (“ULLS”) to Primus Telecommunications Pty Ltd (“Primus”). This determination specifies the ULLS monthly charges (also known as annual charges) payable by Primus to Telstra. This follows the parties being unable to agree on those terms and Primus notifying the dispute for ACCC arbitration.

The ACCC has specified ULLS monthly charges on a per service per month basis for Band 1, 2 and 3. The specified charges have been backdated to apply from 3 February 2006 to 30 June 2008. The specified charges are:

| Band | 2005-06 | 2006-07 | 2007-08 |
|------|----------|----------|----------|
| 1 | \$ 5.60 | \$ 6.00 | \$ 6.20 |
| 2 | \$ 12.30 | \$ 13.70 | \$ 14.30 |
| 3 | \$ 25.00 | \$ 27.30 | \$ 28.50 |

The charges result from applying the ACCC’s pricing principles for the ULLS and the ruling of the Australian Competition Tribunal (“Tribunal”).¹

Telstra proposed in previous regulatory proceedings an ULLS annual charge of \$30 per service per month across all geographical bands, which was opposed by access seekers and considered not to be reasonable by both the ACCC (25 August 2006) and the Tribunal (17 May 2007). Following these rulings, Telstra continued to require access seekers to pay a \$30 per service per month charge across all geographical bands.

A key issue in this arbitration is whether the ULLS annual charges payable by Primus should be averaged across all geographical bands or deaveraged. The ACCC determined that prices should be geographically deaveraged.

¹ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007).

1. Introduction

1.1 Purpose

1. Primus and Telstra have been in dispute over annual charges for the supply of the ULLS. This dispute was notified to the ACCC for arbitration on 6 March 2006. The ACCC has made a final determination in this arbitration. This document sets out the reasons for making this final determination.

1.2 Background to arbitration and final determination

2. On 6 March 2006, Primus notified the ACCC under Part XIC of the TPA of an access dispute with Telstra, regarding the annual charges for the supply of the ULLS.
3. On 30 March 2006, the ACCC requested the parties' views on preliminary issues and a draft interim determination. It considered written submissions from the parties received on 7 and 19 April 2006.
4. On 4 May 2006, the ACCC issued an interim determination on ULLS annual charges.
5. On 31 August 2006, the ACCC revoked the first interim determination and made a further interim determination. On 3 May 2007, the ACCC decided to extend the period of operation of this interim determination until 30 November 2007.
6. On 22 December 2006, the ACCC commenced consultations on the making of a final determination.
7. The parties remained unable to resolve the dispute. The terms of access for consideration in this final determination are the annual charges for the supply of the ULLS.

1.3 Consultation Process

8. On 22 December 2006, the ACCC commenced consultations on the making of a final determination.
9. On several occasions the ACCC sought the parties' submissions on various procedural matters (22 December 2006, 26 February 2007 and 5 April 2007). Submissions from parties were received on 25 January 2007, 31 January 2007, 1 February 2007, 15 March 2007 and 20 April 2007. The ACCC provided its views to parties on the procedural matters on 23 May 2007, 25 May 2007, 19 June 2007 and 29 June 2007.
10. Other access disputes have been notified in respect of the ULLS and there is overlap in the terms of access that are disputed. After seeking the parties' views, the ACCC

held a joint arbitration hearing to consider the terms of access that were commonly disputed in eight ULLS access disputes (Chime Communications Pty Ltd (“Chime”)/Telstra, Optus Networks Pty Limited (“Optus”)/Telstra, XYZed Pty Limited (“XYZed”)/Telstra, Primus/Telstra (annual charges), Primus/Telstra (connection charges), PowerTel Ltd (“PowerTel”)/Telstra, Request Broadband Pty Limited (“Request”)/Telstra and Macquarie Telecom Pty Limited (“Macquarie”)/Telstra). The ACCC considered that holding a joint hearing on these matters was likely to result in the disputes being resolved in a more efficient and timely manner. As a result, these reasons for decision on occasion refer to submissions that were advanced by other ULLS access seekers in the joint hearing. Terms of access that were disputed in only a single arbitration were dealt with in a separate hearing involving the relevant parties to that arbitration.

11. On 28 June 2007, the ACCC provided to the parties a draft final determination and an accompanying consultation paper, to assist the parties in providing their submissions. The draft final determination reflected the ACCC’s preliminary views pending consideration of the parties’ submissions.
12. Following requests from Telstra on 26 July 2007 and 24 August 2007, the timetable for parties’ submissions was extended to 16 August 2007 (for principal submissions) and 13 September 2007 (for response submissions). Telstra also provided supporting CDs of material in support of its submissions. The number of CDs varied depending on the number of issues in dispute for each access seeker. The CDs included supporting reports, witness statements, annexures, cost models and other data in support of its submissions. Optus similarly provided supporting CDs of documents.
13. Following its provision of its initial submissions, Telstra provided certain amendments to its submissions on 28 August 2007 and 6 September 2007. On 31 August 2007, Telstra provided a missing document from its supporting material. On 6 December 2007, the ACCC contacted Telstra about a reference to a document in its supporting material that had not been provided to the ACCC. On 7 December 2007, Telstra provided the document to the ACCC. On 13 December 2007, Telstra provided the document to access seekers.
14. Telstra subsequently made further submissions:
 - on 17 October 2007, Telstra provided responses to the reply submissions of access seekers
 - on 26 October 2007, Telstra submitted a report titled “Access regulation and infrastructure investment in the telecommunications sector: an empirical investigation” by LECG Ltd from September 2007, and requested that the ACCC have regard to the report
 - on 31 October 2007, Telstra submitted that the ACCC should have regard to a range of US cases in support of its arguments relating to averaged ULLS prices
 - on 12 November 2007, Telstra submitted that the ACCC’s High Court submissions supported prices not being set in Optus’ HFC network footprint.

15. On 17 August 2007, Telstra made a confidentiality request over some of the information it submitted in its initial submissions. On 22 August 2007, the ACCC consulted with access seekers about Telstra's confidentiality request. On 23 and 24 August 2007 access seekers sought access to the information. On 28 August 2007, the ACCC consulted with Telstra in accordance with section 152DK of the TPA. On 13 September 2007, the ACCC provided its views on the information subject to the confidentiality request.
16. On 22 October 2007, in a separate process, the ACCC sought public comments on its draft ULLS pricing principles.
17. On 22 November 2007, the ACCC issued final ULLS pricing principles in that separate process.
18. On 27 November 2007, the ACCC sought further submissions from parties regarding the application of the final ULLS pricing principles to the ULLS final determination, Telstra's Current cost accounting (CCA) data and Telstra's ability to recover the costs of serving rural areas. The ACCC received the parties' submissions on 5, 7 and 10 December 2007.
19. On 17 December 2007, Telstra wrote to the ACCC submitting that the final determinations should be deferred to allow consideration of Telstra's pending TEA network cost model.
20. On 19 December 2007, Telstra wrote to the ACCC seeking confirmation as to whether the Commission would interpret the statutory criteria consistently with how it proposed in the consultation paper, and whether it would consult the parties on matters relating to 'just terms'. On 19 December 2007, Telstra again wrote to the ACCC on 19 December 2007 to reiterate its previously expressed view that different terms of access should be set for ULLS supplied within the footprint of the Optus Hybrid Fibre Coaxial (HFC) network. Telstra enclosed a submission dated 17 December 2007 relating to an application Telstra had made for an exemption from standard access obligations in the Optus HFC footprint, and statements from Michael G Harris and Professor Martin Cave.
21. In addition to correspondence and submissions set out above, there was correspondence relating to matters other than monthly charges which were also being considered as part of the joint arbitration hearing.

2. Preliminary Matters

2.1 The Unconditioned Local Loop Service (“ULLS”)

22. The ULLS allows access seekers to gain access to the unconditioned cable (typically a copper pair) between an end-user customer and a telephone exchange. The ULLS essentially gives an access seeker the use of the entire copper pair, without any functionality provided by Telstra. The access seeker can use the line in conjunction with its own equipment in the exchange to provide a range of services, including traditional voice services and high-speed xDSL broadband internet access.
23. The ULLS is a declared service. The ACCC first declared the ULLS in August 1999, pursuant to subsection 152AL(3) of the TPA.² The ACCC continued the declaration of the ULLS in July 2006 for a further three years.³ Copies of the declarations were published in the *Commonwealth of Australia Gazette*.⁴
24. The ACCC has made final pricing principles for the declared ULLS pursuant to section 152AQA of the TPA.⁵ These pricing principles follow earlier pricing principles that the ACCC specified for the ULLS in 2002 and which it re-affirmed in its model prices determination in 2003.⁶

2.2 Access obligations and existence of dispute relating to access

25. The ACCC sought the parties’ views on whether access obligations are owed and whether a dispute exists in relation to access.
26. Telstra submits that the ACCC has no jurisdiction to conduct arbitrations on the basis that Part XIC of the TPA is invalid. Subject to this claim, Telstra acknowledges that access obligations would otherwise exist, and that there is a dispute between it and the access seekers to the joint arbitration, which relates to access to the ULLS.⁷

² ACCC, *Declaration of local telecommunications services*, July 1999.

³ ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS – final determination*, July 2006.

⁴ *Commonwealth of Australia Gazette*, GN32, 11 August 1999, pp. 2440-2422; GN31, 9 August 2006, pp. 1982-1983.

⁵ ACCC, *Unconditioned Local Loop Service (ULLS) – Final Pricing Principles – November 2007*.

⁶ ACCC, *Pricing for unconditioned local loop services – final report, March 2002, Chapter 4*; ACCC, *Final determination for model price terms and conditions for the PSTN, ULLS and LCS services*, October 2003. See also *Declaration inquiry for the ULLS, PSTN OTA and CLLS – final determination*, July 2006, Chapter 7.

⁷ Telstra, *Submissions of Telstra Corporation Limited (“Telstra”), Unconditioned Local Loop Service (“ULLS”), Part 2 – Preliminary Matters and General Approach*, 16 August 2007, p. 9.

27. Primus is of the view that Telstra is obliged to supply the ULLS and that Primus and Telstra are unable to agree on terms and conditions of access.⁸
28. The ACCC has formed the view that, with respect to the access dispute, the requirements of subsection 152CM(1) of the TPA are satisfied. That is:
- Telstra is a carrier
 - Telstra supplies the declared ULLS
 - Telstra has an obligation under subsection 152AR(3) of the TPA to supply the ULLS to the access seeker and
 - The access seeker is unable to agree with Telstra about the terms and conditions of access to the ULLS addressed in the final determination.

2.3 Whether the Commission has jurisdiction to arbitrate the access dispute

29. Telstra disputes that the ACCC has jurisdiction to conduct the arbitration and reiterates that its participation in the arbitration should not be taken as a concession that the ACCC has jurisdiction. Telstra refers to proceedings it commenced in the High Court of Australia in which Telstra contends that Part XIC of the TPA is beyond the legislative power of the Commonwealth and invalid.⁹ On this basis, Telstra maintains that the ACCC has no power or jurisdiction to entertain these disputes.¹⁰
30. The ACCC is of the view that it is appropriate for it to proceed to make a final determination in this arbitration. As previously advised to the parties on 2 February 2007, the ACCC considers that it is entitled to proceed on the basis that the legislation is validly enacted. Further, the ACCC considers that the consequences of suspending the arbitration (including the impact delays would be likely to have on end-users) make it inappropriate not to proceed on the basis that Telstra has commenced proceedings challenging the validity of relevant legislative provisions.

2.4 Whether to proceed to make a final determination

31. Telstra submits that in order for the ACCC to fulfil its obligations under the TPA to conduct a proper arbitration hearing, the ACCC should convene an oral hearing.¹¹

⁸ Primus, *Unconditioned Local Loop Service (ULLS), Submission of Primus Telecommunications Pty Ltd (Primus), Part 1 – General Approach*, 16 August 2007, p. 1.

⁹ High Court of Australia, proceedings S. 42 of 2007.

¹⁰ Telstra, above n 7, p. 9.

¹¹ Telstra, *Reply Submissions of Telstra Corporation Limited (“Telstra”), Unconditioned local loop service (“ULLS”), Part 1 – Preliminary matters and general approach*, p. 4.

32. The ACCC is satisfied as to how the arbitration has been conducted. Any question of how an arbitration is to be conducted is for the ACCC to determine (see subsections 152DB(3) and (4)).
33. The ACCC does not consider that it is necessary to conduct an oral hearing. It considers that it has fulfilled its obligations to conduct a proper arbitration hearing by conducting the hearing on the papers. As previously advised to the parties on 5 April 2007, ULLS annual charges have been the subject of public consultation processes before the ACCC and have been considered by the Tribunal.
34. In coming to this view the ACCC has also had regard to the experience of the parties in arbitrations, the time allowed for the provision of written submissions (including submissions in reply) on relevant issues, and the manner in which the ACCC sought and obtained information relating to its decision. The ACCC is satisfied that an oral hearing is not required on any matters.
35. The ACCC is of the view that it has conducted the arbitrations properly, and has satisfied the relevant procedural fairness requirements in reaching a final determination in this dispute. The ACCC considers that conducting an oral hearing in these matters is unnecessary for the parties to put their case and would not bring a material benefit to the ACCC's decision-making. As the ACCC has previously advised on 5 April 2007, requiring the parties to prepare for and participate in an oral hearing would add considerable delay and expense to the parties and the Commission. The Commission has conducted a number of inquiries regarding the ULLS leading up to and following the original declaration of the ULLS in 1999, and is well acquainted with the issues that have been raised by the parties in their written submissions in the current arbitration. The Commission has accordingly conducted these hearings on the papers.

3. General approach

3.1 Use of pricing principles

Introduction

36. The ACCC has determined final pricing principles for the ULLS under section 152AQA of the TPA. This determination, as well as reasons for making it, is contained in ACCC, *Unconditioned Local Loop Service (ULLS) – Final pricing principles – November 2007* and reflects the long-standing pricing principles adopted by the ACCC for the ULLS and other declared telecommunications services.¹²
37. The ACCC’s final ULLS pricing principles are that:
- a Total Service Long Run Incremental Cost (plus a contribution to indirect cost) (“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
 - 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.¹³
38. The ACCC is required to have regard to the ULLS pricing principles in determining prices to apply in respect of the ULLS.¹⁴ At 28 June 2007, the ACCC did not have finalised ULLS pricing principles. Accordingly, when it issued draft final determinations on 28 June 2007, the ACCC sought the parties’ views on whether it should have regard to the draft ULLS pricing principles and the previous ULLS pricing principles. After deciding to make final ULLS pricing principles, on 27 November 2007 the ACCC sought the parties’ views on the draft final determination in light of the finalised pricing principles.

Submissions from parties

¹² See ACCC, above n 5; ACCC, *Access Pricing Principles – Telecommunications*, July 1997.

¹³ ACCC, above n 4.

¹⁴ Subsection 152AQA(6), *Trade Practices Act 1974*.

39. Telstra had stated that the ACCC must have regard to finalised pricing principles in order to make a final determination in the disputes.¹⁵ However Telstra stated that, in general, it did not object to the use of TSLRIC in setting ULLS prices.
40. Following the ACCC's finalisation of its ULLS pricing principles and consultation on those pricing principles, Telstra submits that although the ACCC must have regard to the ULLS pricing principles, it is not bound to apply those principles. Given the evidence before the ACCC, Telstra submits that the ACCC should not apply several aspects of the pricing principles.¹⁶
41. Regarding the use of CCA data, Telstra submits that the ACCC's concerns set out in the ULLS pricing principles are not material in the current context. It submits that its Updated Top Down Model is an accurate calculation of the TSLRIC+ of providing the ULLS and is consistent with the statutory criteria. Therefore, Telstra contends that the ACCC should rely on this model in setting ULLS prices.¹⁷
42. Telstra submits that specific costs should be recovered from ULLS users only. Telstra further submits that while the ACCC has endorsed the principle of including indirect capital costs when using a TSLRIC+ approach, it has failed to include a contribution to indirect capital costs in its calculation of several specific costs for ULLS.¹⁸
43. Further, Telstra submits that the ULLS access prices should be averaged.¹⁹
44. Telstra also expressed its views on the ACCC's discussion of investment levels, price setting and connection charges in its final ULLS pricing principles.²⁰
45. Access seekers are generally in agreement with the approach adopted in the final pricing principles.²¹ Chime and Primus state that they agree with the ACCC's view expressed in the pricing principles that connection charges should be set with reference to third-party contractor costs.²² Optus considers it appropriate to set access prices based on TSLRIC but considers that care should be taken in how the TSLRIC

¹⁵ Telstra, above n 7, p. 11.

¹⁶ Telstra, *Access disputes – Chime, Optus, XYZed, Primus, PowerTel, Request, Macquarie and Telstra – ULLS*, 10 December 2007, p. 1.

¹⁷ Telstra, *op cit*, pp. 1-6.

¹⁸ Telstra, *op cit*, pp. 6-7.

¹⁹ Telstra, *op cit*, pp. 7-8.

²⁰ Telstra, *op cit*, pp. 8-10.

²¹ Chime, *Unconditioned local loop service (ULLS), Submission of Chime Communications Pty Ltd (Chime) regarding supplementary consultation paper on draft final determinations*, 10 December 2007, p. 1; Primus, *Unconditioned local loop service (ULLS), Submission of Primus Telecommunications Pty Ltd (Primus) regarding supplementary consultation paper on draft final determinations*, 10 December 2007, p. 1; Optus, *Telecommunications Access Dispute: Telstra ULLS disputes – Consultation on Pricing Principles and related issues*, 5 December 2007, p. 1; PowerTel and Request, *PowerTel Ltd (“PowerTel”) – Telstra Corporation Limited (“Telstra”): ULLS access dispute, Request Broadband Pty Ltd (“Request”) – Telstra: ULLS access dispute*, 10 December 2007, pp. 1-3; Macquarie, *Unconditioned local loop service (ULLS), Submission of Macquarie Telecom Pty Ltd*, 10 December 2007, pp. 1-3.

²² Chime, above n 21, p. 1; Primus, above n 21, p. 1.

cost measure is implemented. Optus also emphasises that the ACCC should ensure that prices are only set to enable Telstra to recover efficiently incurred costs.²³ PowerTel and Request submit that the ACCC ought to continue to apply the TSLRIC+ pricing methodology in these arbitrations.²⁴

ACCC's views

46. The ACCC is required to have regard to the ULLS pricing principles in an arbitration and considers that it should in this arbitration determine access prices for the ULLS in accordance with those principles. The ULLS pricing principles require that ULLS access prices reflect the TSLRIC+ of providing access to the ULLS.
47. The parties generally agree on the use of a TSLRIC methodology. A detailed discussion of the TSLRIC+ methodology can be found in ACCC, *Access Pricing Principles – Telecommunications - a guide*, 1997.
48. The Tribunal expressed its general agreement with the ACCC's approach to applying the long term interests of end-users ("LTIE") test and its use of TSLRIC pricing.²⁵ In the Tribunal's view, the key principles include:²⁶

The price of a service should not exceed the minimum costs that an efficient firm will incur in the long-run in providing the service.

The costs are the forward-looking costs, including a normal return on efficient investment (which takes into account the risk involved).

Forward-looking means prospective costs using best-in-use technology. The access provider should only be compensated for the costs it would incur if it were using this technology, not what it actually incurs, for example in using out-of-date technology which is more costly. Of course, a firm may be using older technology because it was the best available at the time the investment was made and replacing it cannot be justified commercially. In a competitive market, however, that firm would only be able to charge on the basis of using the most up-to-date technology because, if it did not (in this hypothetical competitive market) access seekers would simply take the service from an alternative service provider.

The cost of providing the service should be the cost that would be avoided in the long-run by not having to provide it. Thus, it is the additional or incremental costs necessarily incurred, assuming other production activities remain unchanged.

²³ Optus, above n 21, pp. 1-3.

²⁴ PowerTel and Request, above n 21, pp. 1-3.

²⁵ See ACCC, *Access Pricing Principles, Telecommunications – a guide (Access Pricing Principles Guidelines)*, July 1997.

²⁶ *Seven Network Limited (No 4)* [2004] ACompT 11 at [135].

49. Further, the Tribunal noted that:²⁷

...in the general case where access prices need to be regulated, unless pricing is on a TSLRIC basis, efficient investment is unlikely to be encouraged.

50. The ACCC notes that the Tribunal went on to state that:²⁸

This discussion should not be taken to suggest that TSLRIC pricing should be imposed at every opportunity. It will often be the case that regulation, including regulated pricing, is not appropriate in given circumstances. It does mean, however, that, in our view, it would generally not be in the LTIE to depart from TSLRIC pricing where access is regulated. Accordingly, where an access regime requires, or creates an unacceptable risk, of non-TSLRIC pricing, the Tribunal considers that such a regime is unlikely to encourage the efficient use of, and investment in, infrastructure.

51. Similarly, the Tribunal has stated that a proper application of the criteria relevant to the assessment of an access undertaking (and which significantly overlap with the subsection 152CR(1) criteria) would require that prices reflect the efficient costs of providing access:²⁹

...we would point out that whenever an access provider seeks approval of an access undertaking from the Commission which involves a consideration of a price term by comparing it with costs, it would be necessary, in order to satisfy the statutory framework, that the access provider establish that its costs are efficient costs.

52. Access seekers generally do not object to TSLRIC being implemented in accordance with the ULLS pricing principles.

53. The ACCC has taken into account the finalised ULLS pricing principles. The ACCC considers that in accordance with these pricing principles it should in this arbitration determine monthly access prices for the ULLS that:

- reflect the TSLRIC+ of providing access to the ULLS and
- include a specific cost component, 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
- are geographically de-averaged.³⁰

²⁷ *Seven Network Limited (No 4)* [2004] ACompT 11 at [136].

²⁸ *Seven Network Limited (No 4)* [2004] ACompT 11 at [137].

²⁹ *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [46].

³⁰ ACCC, above n 5, pp. 17-22.

54. The ACCC has conducted significant analysis on these issues in previous processes under Part XIC. The ACCC considered both the geographic averaging of ULLS prices and the appropriate recovery of specific costs in its decision to reject Telstra's December 2005 ULLS undertaking.³¹ The Tribunal also discussed in some detail the merits of geographically averaged ULLS pricing and the appropriate recovery of specific costs in its decision to uphold the ACCC's view on that undertaking.³²
55. The purpose of ULLS pricing principles is to inform parties of the likely approach that will be adopted by the ACCC in setting prices in arbitrations. However, pricing principles are not the only means by which the ACCC can communicate this to interested parties. The ACCC can also publish reasons for decision in undertaking assessments or in arbitrations that provide further detail regarding currently held views on relevant matters. Where such guidance has been provided in subsequently published decisions, the ACCC considers that it should have regard to those decisions in interpreting the ULLS pricing principles. The ACCC sought submissions from parties in its consultation paper concerning the relevance of previous ACCC decisions.
56. The ACCC notes that Telstra objects to the ACCC applying several aspects of the pricing principles, including geographic de-averaging, the appropriate recovery of specific costs and the setting of prices in Optus' HFC footprint. The ACCC discusses Telstra's objections later in these reasons.

3.2 International Benchmarks

57. Telstra submits that when population density is taken into account, the average of the ACCC's published ULLS prices is low relative to international prices. Telstra contends that this is inconsistent with the LTIE.³³
58. In general, the ACCC considers that international benchmarking should be used cautiously in informing regulatory pricing decisions. In particular, before international benchmarks might be useful, the ACCC would need to be satisfied that, notwithstanding the difference between Australia and the relevant international jurisdictions, the international benchmarks are reasonable comparators. Relevant differences may include matters such as the definition of the regulated service, the applicable regulatory framework, the geographic price structure, the cost of capital, the prescribed cost standard (if any) and population concentration and distribution (as opposed to population density).
59. Accordingly, the ACCC considers that international benchmarks are often of limited informative value and therefore the ACCC does not consider international

³¹ ACCC, *Assessment of Telstra's ULLS monthly charges undertaking – final decision*, August 2006, Appendix C and E.

³² *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [53] to [291], [387] to [414].

³³ Telstra, *Submissions of Telstra Corporation Limited ("Telstra"), Unconditioned local loop service ("ULLS"), Part 1: Overview*, pp. 6-7.

benchmarks are particularly relevant in its determination of ULLS prices.

60. These factors notwithstanding, the ACCC considers that the ULLS prices it has published are well within the range of prices being charged in Europe for the ULLS.³⁴ The ACCC further considers international benchmarks later in these reasons.

3.3 Relevant legislation

Introduction

61. The ACCC sought the parties' views on what they consider to be sections of the TPA that are relevant to the ACCC's making of a final determination.

Submissions from parties

62. The parties identify Part XIC of the TPA, predominantly Division 8 of this Part, as relevant to the making of the final determination.

The ACCC's role and task

63. Telstra has made submissions about the ACCC's role under Part XIC and the processes that the ACCC adopted in conducting this arbitration. In particular, Telstra draws attention to section 152DB of the TPA and submits that this provision obliges the ACCC to provide the parties with a proper opportunity to be heard after it has carried out all proper enquiries and investigations. Telstra submits that the draft final determination ("DFD") in this dispute "constitutes a denial of procedural fairness" for a number of reasons, namely:³⁵

- a DFD should only be made after receiving substantive submissions from parties
- the DFD is tainted by a denial of a proper hearing and/or prejudgement because the DFD is based on prior conclusions of the ACCC rather than parties' submissions in these arbitrations and
- the ACCC has not carried out its subsection 152DB(1) function of carefully inquiring and investigating the dispute because the ACCC has not called for and considered substantive submissions from the parties prior to issuing its DFD.

³⁴ Commission of the European Communities, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, European Electronic Communications Regulation and Markets 2006 (12th Report)*, 29 March 2007, pp. 72-76, Annex 2.

³⁵ Telstra, above n 7, pp. 15-16.

64. Telstra suggests that the DFD's failure to meet the requirements of procedural fairness pursuant to subsections 152DB(1) and 152CP(4) could be cured prior to any final determination being made by the ACCC if the ACCC:³⁶
- provide a further DFD informed by the parties' submissions (again with consultation paper and reasons) for the parties' review and
 - calls for further submissions from the parties in relation to that further DFD.
65. Access seekers submit that they are satisfied that the ACCC has met its obligations and acted appropriately in conducting the arbitration.
66. Chime and Primus oppose Telstra's proposal that the ACCC undertake extensive additional enquiries and then issue a further DFD for comment by the parties. They consider that this would only prolong the dispute and would be contrary to the ACCC's obligations under paragraph 152DC(1)(f) of the TPA to do all such things as are necessary or expedient for the speedy hearing and determination of the access dispute.³⁷ PowerTel and Request submit that they consider the ACCC has met its obligations under the Act.³⁸ Macquarie states that it does not support Telstra's allegations concerning the way in which the ACCC has carried out its role as an arbitrator.³⁹

Legislative Instruments Act 2003 (Cth)

67. Telstra contends that the ULLS declaration is a legislative instrument for the purpose of section 5 of the *Legislative Instruments Act 2003 (Cth)* ("the LI Act") and must be registered pursuant to section 31 of the LI Act to be enforceable. As it has not been registered, Telstra contends that the ULLS declaration is unenforceable; rendering the arbitration process to date invalid.⁴⁰

Utilities (Network Facilities Tax) Act 2006 (ACT)

68. Telstra submits that the *Utilities (Network Facilities Tax) Act 2006 (ACT)* ("the Utilities Act") and any legislation of a similar purpose that may be passed in the future in other states, is also relevant to the final determination. It states that the tax imposed would affect the costs of the network infrastructure which are incurred by

³⁶ Telstra, *op cit*, pp. 15-18.

³⁷ Chime, *Unconditioned local loop service (ULLS), Reply submission of Chime Communications Pty Ltd (Chime), Part 1 – Preliminary Matters and General Approach*, 13 September 2007, p. 2; Primus, *Unconditioned local loop service (ULLS), Response to Part 2 of Telstra's Submission – Preliminary matters and general approach*, 13 September 2007, p. 2.

³⁸ PowerTel and Request, *Unconditioned local loop service—submissions in reply of PowerTel Limited and Request Broadband Pty Ltd in relation to the making of a final determination*, 13 September 2007, p. 14-16.

³⁹ Macquarie, *Unconditioned Local Loop Service (ULLS)—submissions of Macquarie Telecom in response to Telstra submission*, 13 September 2007, p. 3.

⁴⁰ Telstra, *Reply submission of Telstra Corporation Limited ("Telstra"), Unconditioned Local loop Service ("ULLS"), Part 2 – ULLS Monthly Charges*, 13 September 2007, p. 5.

any access provider, including a provider of ULLS.⁴¹ The *Taxation Administration (Amounts payable – Utilities (Network Facilities Tax)) Determination 2006 (No 1)* sets the amount of tax payable under the Utilities Act at \$355 per kilometre of network route length. Telstra notes that it paid an infrastructure tax of \$[c-i-c] on 31 May 2007.⁴² Telstra submits that this should not be the subject of the determination. Rather, the ACCC should expressly exclude it from the monthly price to enable the parties to negotiate on how to appropriately recover this cost.⁴³ Telstra suggests that the ACCC include the following Schedule 1 to the final determination:⁴⁴

This determination does not include any amount which Telstra may levy in order to recover tax paid by Telstra pursuant to the Utilities (Network Facilities Tax) Act 2006 (ACT) or any other tax, duty, levy, charge or impost (whether existing at the time that this determination is made or coming into effect at a later time) in relation to Telstra's infrastructure or facility.

ACCC's views

69. The ACCC considers that Part XIC of the TPA is relevant to the making of the final determination. The ACCC considers that the following sections are of direct relevance to the making of a final determination:
- Subsection 152CP(1) of the TPA, which provides that unless the ACCC terminates the arbitration, the ACCC must make a written determination on access by the access seeker to the declared service.
 - Subsection 152CP(2) of the TPA, which provides that the determination may deal with any matter relating to access by the access seeker to the declared service, including matters that were not the basis for notification of the dispute.
 - Subsection 152CP(4) of the TPA, which requires that before making a determination, the ACCC must give a draft determination to the parties.
 - Subsection 152CP(5) of the TPA, which requires that when the ACCC makes a determination it must give the parties to the arbitration its reasons for making the determination.
 - Section 152CQ of the TPA, which sets out restrictions on access determinations.
 - Subsection 152CR(1) of the TPA, which requires that in making a final determination, the ACCC must take certain matters into account, including the

⁴¹ Telstra, above n 7, p. 28.

⁴² Telstra, *Submissions of Telstra Corporation Limited ("Telstra"), Unconditioned local loop service ("ULLS"), Part 3 – ULLS Monthly charges*, 16 August 2007, pp. 50-51.

⁴³ Telstra, above n 7, p. 3.

⁴⁴ Telstra, above n 42, p. 51.

long-term interests of end-users, which is defined in section 152AB of the Act..

- Subsection 152CR(2) of the TPA, which provides that the ACCC may take into account any other matters that it thinks are relevant.
- Section 152DNA of the TPA, which concerns backdating and interest.
- Subsection 152AQA(6) of the TPA, which requires that the ACCC must have regard to a pricing principles determination (made in accordance with subsection 152AQA(1)) if the ACCC is required to arbitrate an access dispute under Division 8 in relation to the declared service.
- Subsection 152AQB(6) of the TPA, which requires that the ACCC must have regard to a model terms determination (made in accordance with subsection 152AQB(2)) if the ACCC is required to arbitrate an access dispute under Division 8 in relation to a core service.

The ACCC's role and task

70. The ACCC considers that the measures that it has taken in arbitrating this access dispute are in accordance with its obligations under Part XIC. With respect to Telstra's claim that the ACCC has denied it procedural fairness, the ACCC does not agree with this assertion. The requirements of section 152CP of the Act impose upon the ACCC an obligation to make a written determination (unless the arbitration has been terminated).
71. Subsection 152CP(4) requires the ACCC to provide parties with a draft determination before it makes a final determination. Accordingly, before any final determination is made, parties to the arbitration are given an opportunity to be heard on the content of the draft determination. In this case the parties were provided with consultation papers and specifically invited to comment on particular issues. Parties were also able to provide general submissions. The ACCC also provided a supplementary consultation paper seeking comments.
72. The ACCC notes that section 152DB of the Act also provides that the ACCC (in conducting an arbitration) is not bound by technicalities or the rules of evidence and may inform itself of any matter relevant to the dispute in any way it thinks appropriate. The ACCC is satisfied that it has taken into account all submissions received and that it is entitled to inform itself in any way it thinks appropriate. The DFD is a reflection of the ACCC's views at a certain point in time taking into account the submissions that the ACCC had received in respect of this access dispute. The issuing of the DFD is not a prejudgment of issues – it is a draft upon which parties are invited to make further submissions.
73. The consultation process followed is set out above in section 1 of this statement of reasons. The ACCC is satisfied that parties have been given a reasonable opportunity to be heard on the issues in dispute in the arbitration.

74. Throughout the arbitration process, the ACCC has inquired where (in the ACCC's view) information was centrally relevant to the ULLS arbitration and the ACCC was able to readily obtain that material. Therefore, the ACCC considers it has made a proper investigation and inquiry into matters which it perceives are in dispute and fulfilled its role as an arbitrator.
75. Accordingly, the ACCC considers that it has conducted the arbitrations in this joint hearing in an unbiased manner, without prejudging any outcome and has satisfied procedural fairness requirements in reaching a final determination in this dispute.

Legislative Instruments Act 2003 (Cth)

76. The ACCC's view is that the ULLS declaration is not a legislative instrument for the purposes of the *Legislative Instruments Act 2003*, and therefore does not need to be registered in accordance with that Act. Accordingly, the ACCC does not consider that the ULLS declaration should be taken to be unenforceable.

Utilities (Network Facilities Tax) Act 2006 (ACT)

77. The ACCC considers that the *Utilities (Network Facilities Tax) Act 2006 (ACT)* could potentially be relevant to the setting of ULLS access prices, to the extent that Telstra is liable to a charge under that Act and that any such cost relates to Telstra's supply of the ULLS.
78. However, Telstra has not made a per line cost claim in respect of liabilities under the Act, but rather seeks the ability to require access seekers to make contributions to liabilities that accrue. The ACCC does not consider that this would be appropriate, as it denies access seekers certainty as to the charges that they face for using the ULLS and impedes competition and is unnecessary to ensure cost recovery. Accordingly, the ACCC has not specified in the final determination that liabilities under the Utilities Act should be passed-through.
79. This means that the contribution that may be appropriate for ULLS access seekers to make (if any) towards such liabilities that may arise remain a matter for the parties to negotiate. The final determination prices do not include any amount to account for the tax.
80. Further, the ACCC does not consider that it is necessary to make allowance for the possible introduction of other laws to which Telstra may become liable.

3.4 Subsection 152CR(1) criteria

Introduction

81. The ACCC must have regard to the criteria specified in subsection 152CR(1) of the TPA in making a final determination. These criteria are:

- (a) whether the determination will promote the LTIE of carriage services or of services supplied by means of carriage services;
- (b) the legitimate business interests of the carrier or provider and the carrier's or provider's investment in facilities used to supply the declared service;
- (c) the interests of all persons who have rights to use the declared service;
- (d) the direct costs of providing access to the declared service;
- (e) the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else;
- (f) the operational and technical requirements necessary for the safe and reliable operation of a carriage service, or a telecommunications network or a facility;
- (g) the economically efficient operation of a carriage service, a telecommunications network or a facility.

82. On 28 June 2007, the ACCC provided the parties with its preliminary views on how these criteria should be interpreted and sought the parties' comment.

83. In its response to access seekers' reply submissions,⁴⁵ Telstra discussed the East Australian Pipeline case.⁴⁶ Telstra contends that principles from the East Australian Pipeline case should be applied by the ACCC when considering the statutory criteria and making a determination in this dispute. In particular, Telstra states that the objective of regulatory certainty is implied into the objective of efficient investment under paragraph 152AB(2)(e) of the TPA. Telstra submits regulatory certainty means the ACCC must give due regard to the statutory criteria set out in section 152CR of the TPA and cannot ignore factors or only give them cursory consideration before putting them to one side. Telstra states the ACCC is required to weigh up all of the statutory criteria against one another when reaching its determination.⁴⁷

ACCC's views

84. The ACCC is satisfied with its approach towards the interpretation of the criteria listed in subsection 152CR(1) of the TPA. Each of the criteria listed in that subsection has been taken into account in making this final determination.

85. Telstra wrote to the ACCC on 19 December 2007 seeking confirmation as to whether the ACCC would interpret the statutory criteria consistently with how it proposed in the consultation paper, and whether it would consult the parties on matters relating to

⁴⁵ Telstra, *Telstra Corporation Limited* ("Telstra"), *Response to access seekers' reply submissions*, 17 October 2007, pp. 2-3.

⁴⁶ *East Australian Pipeline Pty Limited v ACCC* [2007] HCA 44.

⁴⁷ Telstra, above n 45, pp. 2-3.

‘just terms’. The ACCC has considered this submission and does not consider that further consultation or submissions are required.

3.4.1 Paragraph 152CR(1)(a) Whether the determination will promote the long-term interests of end-users (LTIE) of carriage services or of services supplied by means of carriage services

Submissions from parties

86. Telstra considers that in order for the final determination to promote the LTIE, the ACCC must consider that investment decisions by access providers are long-term in nature and therefore short term effects are irrelevant to this criterion. Telstra asserts that the ACCC must ensure that it does not set prices which do not enable the access provider to recover costs from the prices of access services. Telstra contends that below cost pricing would have an adverse impact on long-term investment and discourages competitive build by promoting free-riding. This leads to unsustainable short-term competition and an increased reliance on the existing infrastructure. Below cost pricing also undermines the incentives for access providers to continue to invest and does not promote dynamic efficiency. Telstra submits that the ACCC must also have regard to the objective of promoting competition and considers that competition would not be promoted if the price determined for ULLS is below cost.⁴⁸
87. Access seekers generally agree with the ACCC’s interpretation of paragraph 152CR(1)(a). They seek that charges are based on the forward looking costs of an efficient access provider. Access seekers consider that charges that reflect the efficient cost of supplying the ULLS will best promote the LTIE and regard should be had to the likely effect of access charges on the supply of downstream services.⁴⁹ Broadband (DSL) services and voice services have been identified as relevant downstream services.⁵⁰
88. Most access seekers consider that competition will be promoted by ULLS access prices that are set closer to costs.⁵¹ They consider that permitting Telstra to charge more than efficient costs will inflate costs to access seekers who use the ULLS to compete with Telstra in the voice and DSL markets using their own DSLAM infrastructure. Access seekers contend that setting a price above efficient costs will negate the potential benefits of lower prices and improved service quality for telephony and broadband services provided to end-users.⁵²

⁴⁸ Telstra, above n 7, pp. 21-23; Telstra, above n 11, pp. 9-10.

⁴⁹ Chime, *Unconditioned Local Loop Service (ULLS), Submission of Chime Communications Pty Ltd (Chime), Part 1 – General Approach*, 16 August 2007, pp. 2-3; Primus, above n 7, pp. 2-3; Optus, *Unconditioned local loop service (ULLS), Submission of Optus*, 16 August 2007, [5.1] - [5.10]; XYZed, *Unconditioned Local Loop Service (ULLS), Submission of XYZed*, 16 August 2007, [5.1] – [5.10]; PowerTel and Request, *Unconditioned local loop service, submissions of PowerTel Limited and Request Broadband Pty Ltd in relation to the making of a final determination*, 16 August 2007, pp. 4-5; Macquarie, *Unconditioned Local Loop Service (ULLS), Submission of Macquarie Telecom to the Australian Competition and Consumer Commission*, August 2007, [2.3].

⁵⁰ Chime, above n 49, pp. 2-3; Primus, above n 8, pp. 2-3.

⁵¹ Optus, above n 49, [5.1] - [5.10].

⁵² Chime, above n 49, pp. 2-3; Primus, above n 8, pp. 2-3.

89. Optus submits that it does not agree with the emphases placed on a TSLRIC estimate of network costs. In particular, it considers that a TSLRIC approach does not encourage the economically efficient use of and investment in infrastructure.⁵³

ACCC's views

90. The ACCC has published a guideline explaining what it understands by the phrase “long-term interests of end-users” in the context of its declaration responsibilities.⁵⁴ The ACCC considers that a similar interpretation is appropriate to making a final determination in this arbitration.
91. In the ACCC’s view, particular terms and conditions promote the interests of end-users if they are likely to contribute towards the provision of goods and services at lower prices, higher quality or towards the provision of greater diversity of goods and services.
92. The ACCC also notes that the Tribunal has offered guidance in its interpretation of the phrase “long term interests of end-users” (in the context of access to subscription television services):⁵⁵

Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary to take the following matters into account when applying the touchstone – the long-term interests of end-users:

** End-users: “end-users” include actual and potential [users of the service] ...*

** Interests: the interests of the end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings. ... [T]his would include access to innovations ... in a quicker timeframe than would otherwise be the case ...*

** Long-term: the long-term will be the period over which the full effects of the ... decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the ... industry) to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit – strategies.*

93. As explained further below, the ACCC considers that ULLS access prices that reflect the efficient (as opposed to actual) cost of supplying the ULLS will best promote the LTIE.

⁵³ Optus, above n 49, [5.2] – [5.14].

⁵⁴ ACCC, *Telecommunications services — Declaration Provisions: A Guide to the Declaration Provisions of Part XIC of the Trade Practices Act*, July 1999.

⁵⁵ *Seven Network Limited (no 4)* [2004] ACompT 11 at [120].

94. To consider the likely impact of particular terms and conditions on the LTIE, the TPA requires the ACCC to have regard to whether the terms and conditions are likely to result in:
- promoting competition in markets for carriage services and services supplied by means of carriage services
 - achieving any-to-any connectivity and
 - encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied; and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁵⁶
95. In determining the extent to which terms and conditions are likely to result in the objective of promoting competition, regard must be had to the extent to which the terms and conditions will remove obstacles to end-users of gaining access to listed services.⁵⁷
96. The ACCC considers that, in assessing whether particular terms and conditions will promote competition, it is relevant to consider markets in which DSL and voice services are supplied (retail and/or wholesale) and to consider whether the terms and conditions will remove obstacles to end-users gaining access to DSL and voice services.
97. This is because the ULLS is an input to the provision of a range of services, including fixed-line voice services (such as the provision of line rental, local call and long distance call services) and high-speed xDSL broadband internet access. This approach is consistent with the approach adopted by the Tribunal.⁵⁸
98. Obstacles to accessing fixed-line voice services include the price of the services and the ability of competing providers to provide voice services. Obstacles to accessing DSL services could be in the nature of DSL infrastructure not being available in the end-user's area, or the price of services that are available being too high, or their quality (measured by reference to, for instance, data transfer rates) being too low.
99. The ACCC considers that prices that reflect efficient forward-looking costs of supply will best promote effective competition in the supply of fixed-line voice services and broadband/DSL services. This is because such prices best enable access seekers to

⁵⁶ *Trade Practices Act 1974*, subsection 152AB(2).

⁵⁷ *Trade Practices Act 1974*, subsection 152AB(4).

⁵⁸ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [92]; *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [97], [149].

compete on an equal footing with other suppliers, including the access provider, in the supply of downstream voice and DSL services.

100. The ACCC considers that the terms of access addressed in this final determination do not directly affect the objective of achieving any-to-any connectivity.
101. In determining the extent to which terms and conditions are likely to result in the achievement of the objective of encouraging the economically efficient use of and investment in infrastructure, regard must be had to:
- whether it is technically feasible for the services to be supplied and charged for with regard to technology that is in use, available or likely to become available; and the costs involved in supplying and charging for, the services that are reasonable or likely to become reasonable; and the effects or likely effects that supplying and charging for the services would have on the operation or performance of telecommunications networks
 - the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope
 - incentives for investment in the infrastructure by which services are supplied; and any other infrastructure by which services are or likely to become capable of being supplied and
 - the risks involved in making the investment.⁵⁹
102. In the ACCCs view, the phrase “economically efficient use of and economically efficient investment in ... infrastructure” refers to the concept of economic efficiency that consists of three components:
- Productive efficiency – This is achieved where individual firms produce the goods and services that they offer at least cost
 - Allocative efficiency – This is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e. those that provided the greatest benefit relative to costs) and
 - Dynamic efficiency – This reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.
103. It is relevant here to consider the use of and investment in infrastructure used to supply the ULLS (i.e. the infrastructure necessary to provide the CAN, for example, ordering and provisioning systems and access networks), as well as infrastructure used to supply carriage and/or content services over the ULLS (for example,

⁵⁹ *Trade Practices Act 1974*, sub-sections 152AB(6) and (7A).

DSLAMs). This is consistent with the approach adopted by the Tribunal.⁶⁰

104. Again, the ACCC considers that access charges that reflect the efficient, forward-looking costs best meet these considerations. Such charges are consistent with the access provider's legitimate commercial interests and, in particular, enable access providers to exploit economies of scale and scope. These charges also provide correct incentives for the access provider and access seekers to make efficient investments in infrastructure used to supply the ULLS and downstream services. By promoting competition, these charges also encourage dynamic efficiency.
105. More recently, on the issue of efficient investment, the Tribunal has stated that:⁶¹

...An access charge should be one that just allows an access provider to recover the costs of efficient investment in the infrastructure necessary to provide the declared service.

...efficient investment by both access providers and access seekers would be expected to be encouraged in circumstances where access charges were set to ensure recovery of the efficient costs of investment (inclusive of a normal return on investment) by the access provider in the infrastructure necessary to provide the declared service.

...access charges can create an incentive for access providers to seek productive and dynamic efficiencies if access charges are set having regard to the efficient costs of providing access to a declared service.

3.4.2 Paragraph 152CR(1)(b) The legitimate business interests of the access provider, and the carrier's or provider's investment in facilities used to supply the declared service

Submissions from parties

106. Telstra submits that it is legitimate for it to seek to earn a normal commercial return on its investment and that this requires that access prices enable cost recovery plus a return on investment that is commensurate with risk. Telstra also states that paragraph 152CR(1)(b) does not require that the costs which are taken into account under this criteria be efficient. Telstra asserts that it is in its legitimate business interest to recover the actual costs it incurs and this should be taken into account by the ACCC.⁶² Telstra considers that ULLS prices which reflect forward-looking and efficient costs of providing services will not enable it to satisfy its legitimate business interests.⁶³

⁶⁰ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [159] - [161]; *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [104].

⁶¹ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [159], [164], [176].

⁶² Telstra, above n 7, p. 23.

⁶³ Telstra, above n 11, pp. 9-10.

107. Access seekers submit that it is a legitimate interest for the access provider to receive a normal commercial return, but that higher returns would not be legitimate. ULLS charges above normal commercial returns would be an abuse of Telstra's dominant position and allowing it to derive supra-normal profits would not be in Telstra's legitimate business interests.⁶⁴ Macquarie agrees with the ACCC's interpretation of the criterion in the ACCC's consultation paper.⁶⁵
108. Telstra submits that setting ULLS prices at the commercial rates offered by Telstra would be consistent with the statutory criteria. It contends that the ACCC should set prices for ULLS supplied inside the Optus HFC footprint at commercial rates offered by Telstra. Telstra considers that in the absence of information as to the precise location of the Optus HFC network, this should apply to ULLS prices in Bands 1 and 2.⁶⁶ Telstra further submits that the ACCC's interpretation of section 152CR of the TPA is consistent with this.⁶⁷

ACCC's views

109. As outlined in the ACCC's *Access Dispute Guidelines*, the ACCC considers it is a legitimate interest for an access provider to earn a normal commercial return on its investment.⁶⁸ In this regard, the ACCC is of the view that the concept of 'legitimate business interests' should be interpreted in a manner consistent with the phrase 'legitimate commercial interests' used elsewhere in Part XIC of the TPA.
110. The ACCC notes that it would be a legitimate business interest for an access provider to seek to recover its costs as well as a normal commercial return on investment having regard to the relevant risk involved.
111. The ACCC further notes that an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.⁶⁹
112. Similarly, the Tribunal has stated that:

The expression "legitimate business interests" is a general expression and is somewhat open-textured. What is "legitimate" conduct or a "legitimate" interest in business may be open to a number of differing interpretations. We

⁶⁴ Chime, above n 49, p. 3; Primus, above n 8, p. 3; PowerTel and Request, above n 49, p. 5; Optus, above n 49, [5.11]; XYZed, above n 49, [5.11].

⁶⁵ Macquarie, above n 49, [2.3].

⁶⁶ Telstra, *Submissions of Telstra Corporation Limited ("Telstra"), Unconditioned Local Loop Service ("ULLS"), Lack of telecommunications investment in Australia and prices to be set in the Optus HFC Footprint*, pp. 10-12.

⁶⁷ Telstra, *Access Disputes – Chime, Optus, XYZed, Primus, PowerTel, Request, Macquarie and Telstra – ULLS*, 12 November 2007. Telstra refers to the ACCC's submission dated 2 November 2007 in proceeding number S42 of 2007 in the High Court of Australia, paragraphs 81 and 88.

⁶⁸ ACCC, *Resolution of telecommunications access disputes – a guide*, March 2004 (revised) ("*Access Dispute Guidelines*"), p. 56.

⁶⁹ *Ibid.*

*consider that a carrier’s “legitimate business interests” is a reference to what is regarded as allowable and appropriate in commercial or business terms. In the context of s 152AH(1)(b), the expression connotes something which is allowable and appropriate when negotiating access to the carrier’s infrastructure. When looked at through the prism of a charge term and condition of access and its relationship to a carrier’s cost structure, it is a reference to the interest of a carrier in recovering the costs of its infrastructure and its operating costs and obtaining a normal return on its capital.*⁷⁰

113. The Tribunal expressly affirmed this approach in its consideration of Telstra’s ULLS undertaking.⁷¹
114. It is the ACCC’s view that the term “legitimate business interests” does not necessarily extend to include costs associated with all investments, as on occasion there will be the potential for the access provider to make investments that were not efficient. The ACCC further notes that an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.⁷²
115. The ACCC is satisfied that the ULLS monthly charges it has determined in this access dispute do not impact on Telstra’s capacity to earn a normal commercial return on its investments.
116. The ACCC notes Telstra’s submission that as the ACCC has interpreted section 152CR of the TPA to “promote the assessment of the price that would be agreed between a reasonably willing seller and a reasonably willing buyer”,⁷³ the ACCC should set prices for the ULLS in Optus’ HFC network footprint at rates commercially agreed between Telstra and access seekers. The ACCC considers that the presence of an imbalance in bargaining power may mean that parties may not be able to reach any agreement on an appropriate selling price. This issue is discussed in detail in Part 4 of this statement of reasons.

3.4.3 Paragraph 152CR(1)(c) The interests of all persons who have the right to use the service

Submissions from parties

117. Telstra asserts that paragraph 152CR(1)(c) refers to “all persons”; which inherently contemplates a balancing of interests between the rights of end users and the rights of the access seeker. Telstra further submits that it is not in the long-term interests of either access seekers or end users who have rights to use the declared service for the

⁷⁰ *Telstra Corporation Limited (ACN 051 775 556) [2006] ACompT 4 (2 June 2006) at [89].*

⁷¹ *Telstra Corporation Limited (No 3) [2007] ACompT 3 (17 May 2007) at [180].*

⁷² ACCC, above n 68, p. 10.

⁷³ ACCC, *Submission in proceeding number S42 of 2007 in the High Court of Australia*, 2 November 2007, at [81], [88].

ULLS to be supplied at below-cost prices.⁷⁴

118. Access seekers agree with the ACCC's and the Tribunal's interpretation of this criterion.⁷⁵ Optus and XYZed consider that the interests of all persons who have the right to use the service will be served if the price terms and conditions are set on a basis that enables access seekers to compete on their merits in downstream markets.⁷⁶ PowerTel and Request consider that these interests are best served by access prices that are set in accordance with TSLRIC pricing principles.⁷⁷ Chime and Primus submit that their rights will be denied if the terms of access are unreasonably or unjustifiably expensive and this will result in diminished competition and detriment to the LTIE.⁷⁸

ACCC's views

119. The ACCC notes Telstra's submission concerning the rights of end users and Telstra's example of its retail customers having rights to indirectly use the declared service by purchasing the retail service. While the ACCC agrees that retail services supplied to end-users involve the use of the ULLS, it does not consider that this gives them a right to use the ULLS. The ACCC considers that it is only the ULLS access seekers that the criterion contemplates. The interests of end-users are already to be considered under other criteria.
120. In *Telstra Corporation Limited* [2006] ACompT 4, the Tribunal provided its views on this criterion, indicating that it considers that "all persons" in paragraph 152CR(1)(c) contemplates the access seekers of the declared service and does not include end-users:⁷⁹

The interests of persons who have a right to use the LSS [Line Sharing Service], access seekers, are served by an access price that enables them to compete on their merits (that is, on the basis of their own efficiency) in downstream markets.

121. The Tribunal expressly affirmed this approach in its consideration of Telstra's ULLS undertaking.⁸⁰
122. In assessing whether Telstra's allocation of its ULLS specific costs across ULLS accessed or forecast accessed lines only was reasonable the Tribunal noted:⁸¹

⁷⁴ Telstra, above n 7, p. 24.

⁷⁵ Optus, above n 49, [5.12]; XYZed, above n 49, [5.12]; Macquarie, above n 49, [2.3]; PowerTel and Request, above n 49, p. 8.

⁷⁶ Optus, above n 49, [5.12]; XYZed, above n 49, [5.12].

⁷⁷ PowerTel and Request, above n 49, p. 8.

⁷⁸ Chime, above n 49, p. 3; Primus, above n 49, p. 3.

⁷⁹ *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [138].

⁸⁰ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [262].

⁸¹ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [410].

The interests of persons who have a right to use the ULLS: s 152AH(1)(c) ... [is] satisfied by giving all relevant parties, that is access seekers to the declared service and access providers of the declared service who are vertically integrated and provide retail products which compete with the products provided by access seekers who gain access to the declared service, the benefit and advantages of economies of scale and scope up to the point of access.

123. As noted in the ACCC's *Access Dispute Guidelines*, people who have rights to currently use a declared service will generally use that service as an input to supply carriage services, or a service supplied by means of carriage services, to end-users.⁸² In the case of the ULLS, the access service could also be used to provide a wholesale service to another service provider.
124. The ACCC considers that this class of persons has an interest in being able to compete for the custom of end-users on the basis of their relative merits. Terms and conditions that favour one or more service providers, including the access provider, over others and thereby distort the competitive process may prevent this from occurring and consequently harm those interests.⁸³

3.4.4 Paragraph 152CR(1)(d) The direct cost of providing access to the declared service

Submissions from parties

125. Telstra refers to the Tribunal's views expressed in *Re Telstra Corporation Ltd* [2006] ACompT 4 and *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 that this criterion is concerned with ensuring that the costs of providing the service are recovered. Further, that the appropriate cost concept to have regard to here is the long-run, such that distinctions between fixed and variable costs are not relevant.⁸⁴ Telstra disagrees with the ACCC's interpretation of "direct costs" and considers that the term is not limited to direct incremental costs. Telstra submits that "direct costs" means actual costs, not efficient or forward-looking costs. Therefore, the ACCC must take into account Telstra's actual costs when making a final determination, even if Telstra's costs are not efficient.⁸⁵
126. The access seekers support the ACCC's use of a TSLRIC+ pricing methodology to calculate direct costs.⁸⁶ PowerTel and Request submit that ULLS prices must be cost-

⁸² ACCC, above n 68, p. 57.

⁸³ Ibid.

⁸⁴ *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [130]; *Application by Optus Mobile Pty Limited & Optus Networks Pty Ltd* [2006] ACompT 8 at [146].

⁸⁵ Telstra, above n 7, pp. 24-25.

⁸⁶ Chime, above n 49, p. 4; Chime, above n 37, p. 3; Primus, above n 8, p. 4; Primus, *Unconditioned local loop service (ULLS), Submission of Primus Telecommunications Pty Ltd (Primus), Response to Part 2 of Telstra's Submission – Preliminary matters and general approach*, 13 September 2007, p. 3; Optus, above n 49, [5.13] – [5.14]; XYZed, above n 49, [5.13] – [5.14]; Macquarie, above n 49, [2.3]; PowerTel and Request, above n 49, p. 6.

based and the ACCC's approach outlined in its ULLS pricing principles is the best available option.⁸⁷

ACCC's views

127. The ACCC considers that the direct costs of providing access to a declared service are those incurred (or caused) by the provision of access and includes the incremental costs of providing access.
128. Consistent with the Tribunal's view, the ACCC has interpreted this criterion and the use of the term "direct costs" as not excluding consideration being given to a contribution to indirect costs.⁸⁸ A contribution to indirect costs can be supported by other of the criteria also.
129. However, the criterion does not extend to permitting compensation for loss of any 'monopoly profits' that occurs as a result of increased competition.
130. In this regard, the *Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996* states:⁸⁹

... the 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.

131. The ACCC also notes the Tribunal considers the direct costs criterion "is concerned with ensuring that the costs of providing the service are recovered",⁹⁰ and that "the effects of competition should not be considered as a direct cost of providing access to the ULLS".⁹¹ The ACCC considers its approach outlined in its *ULLS Access Pricing Principles* is consistent with the Tribunal's view.⁹²
132. The Tribunal noted in its assessment of Telstra's specific cost recovery approach that direct costs could conceivably be allocated (and hence recovered) in a number of ways (for example, across ULLS or LSS lines only, across ADSL lines, across all CAN lines) and that adopting any of those approaches would be consistent with this criterion:⁹³

Telstra's approach to estimating a per unit cost is likely to be consistent with

⁸⁷ PowerTel and Request, above n 49, p. 6.

⁸⁸ *Application by Optus Mobile Pty Limited and Optus Networks Pty Limited* [2006] ACompT 8 at [137].

⁸⁹ *Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996*, p. 44.

⁹⁰ *Telstra Corporation Limited* [2001] ACompT 4 (7 December 2001) at [92].

⁹¹ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007) at [272].

⁹² ACCC, above n 5.

⁹³ *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [139].

ensuring recovery only of direct costs. However, while direct costs will be incurred by Telstra in order to provide the declared service, there are a number of cost allocation methods other than that adopted by Telstra (including those suggested by the Commission and other interveners in this matter) that would enable it to recover the direct costs of investment in infrastructure necessary to provide a LSS.

133. Similarly, the Tribunal in its assessment of Telstra's proposed average ULLS pricing structure noted that the pricing structure chosen would not have an impact on this criterion, as long as overall costs are recovered:⁹⁴

...the direct costs of providing access to the service are likely to remain unchanged irrespective of whether Telstra were to set average or de-averaged charges. Average and de-averaged ULLS charges are merely different ways of seeking to recover these costs.

134. Telstra has raised whether this criterion may support the proposition that an access provider should recover its actual costs, even if these do not reflect efficient forward-looking costs. The actual costs of an access provider are not necessarily higher than efficient costs and can fall somewhat below this level. While this particular criterion could support Telstra's contention that regard should be paid to Telstra's actual costs, other criteria militate against the view that an access provider would be entitled to recover costs above an efficient level in access charges. For instance, the Tribunal has stated the following:⁹⁵

Having regard to the conclusions which we have reached it is not necessary to determine whether Telstra's costs were established as efficient costs. However, we would point out that whenever an access provider seeks approval of an access undertaking from the Commission which involves a consideration of a price term by comparing it with costs, it would be necessary, in order to satisfy the statutory framework, that the access provider establish that its costs are efficient costs.

3.4.5 Paragraph 152CR(1)(e) The value to a party of extensions, or enhancement of capability, whose cost is borne by someone else

Submissions from parties

135. Telstra considers that this criterion is relevant to the consideration of ULLS mass network migrations (MNM) and certain non-price terms.⁹⁶
136. Optus, XYZed, PowerTel, Request and Macquarie agree with the ACCC that this criterion is unlikely to be relevant to this access dispute.⁹⁷ Chime and Primus consider

⁹⁴ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007) at [274].

⁹⁵ *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [46].

⁹⁶ Telstra, above n 7, p. 25.

⁹⁷ Optus, above n 49, [5.15]; XYZed, above n 49, [5.15]; Macquarie, above n 49, [2.3]; PowerTel and Request, above n 49, p. 6.

that, with the exception of costs involved in manual service qualification as a result of Telstra's incomplete cable records, this criterion is not relevant.⁹⁸

ACCC's views

137. The ACCC has previously noted its view that:⁹⁹

This criterion requires that if an access seeker enhances the facility to provide the required services, the access provider should not attempt to recover for themselves any costs related to this enhancement. Equally, if the access provider must enhance the facility to provide the service, it is legitimate for the access provider to incorporate some proportion of the cost of doing so in the access price.

138. The ACCC remains of this view and has applied this approach in setting access prices in the final determination.

3.4.6 Paragraph 152CR(1)(f) The operational and technical requirements necessary for the safe and reliable operation of a carriage service, or a telecommunications network or a facility

Submissions from parties

139. Telstra considers that this criterion can be relevant to setting access prices as operational and technical requirements can have cost implications and these costs need to be recovered in access pricing in order for there to be sufficient funds available for Telstra to maintain a safe and reliable service. Further, this criterion is relevant to the consideration of disconnection costs, ULLS MNMs and several disputed non-price terms.¹⁰⁰ These issues are not being considered in the present dispute.
140. Access seekers agree with the ACCC that this criterion is generally unlikely to be relevant to this access dispute.¹⁰¹

ACCC's views

141. The ACCC considers that this criterion requires that terms of access should not compromise the safety or reliability of carriage services and associated networks or facilities and that this has direct relevance when specifying technical requirements or standards to be followed.

⁹⁸ Chime, above n 37, p. 3; Primus, above n 37, p. 3.

⁹⁹ ACCC, above n 68, p. 11.

¹⁰⁰ Telstra, above n 7, p. 25.

¹⁰¹ Chime, above n 49, p. 4; Primus, above n 8, p. 4; Optus, above n 49, [5.16]; XYZed, above n 49, [5.16]; Macquarie, above n 49, [2.3]; PowerTel and Request, above n 49, p. 7.

142. The ACCC suggested to the parties that this criterion is generally unlikely to be relevant to disputes relating only to the price of access to a service. This is because the access price will have little direct bearing on the adoption of operational and technical requirements necessary for the safe and reliable operation of a carriage service, or a telecommunications network or a facility. However, this criterion may be more relevant to disconnection costs, ULLS MNMs and non-price terms and conditions attaching to the supply of the ULLS that are in dispute (if any).
143. That said, the ACCC acknowledges that, in the long-run, access prices that are persistently below the efficient costs of supplying a service can, indirectly, compromise the safe and reliable supply of the service. Accordingly, the ACCC considers that efficient costs should be based upon a method of supply of the ULLS that meets the relevant operational and technical requirements necessary for the safe and reliable operation of the ULLS and facilities used to supply the ULLS.

3.4.7 Paragraph 152CR(1)(g) The economically efficient operation of a carriage service, a telecommunications network or a facility

Submissions from parties

144. Telstra submits that access prices should never be set below efficient cost recovery levels as this would lead to long-term economic inefficiencies.¹⁰²
145. PowerTel, Request, Optus, XYZed and Macquarie agree with the ACCC's interpretation of this criterion.¹⁰³
146. Chime and Primus contend that where Telstra overcharges, access seekers' costs are unnecessarily raised leading to Telstra's infrastructure being under-utilised and demand for ULLS being discouraged. Further, where operational processes to facilitate access to service are absent, barriers to entry exist leading to underinvestment by Telstra in its infrastructure.¹⁰⁴

ACCC's views

147. As noted in the ACCC's *Access Dispute Guidelines*, the phrase "economically efficient operation" embodies the concept of economic efficiency as discussed earlier under the LTIE. That is, it calls for a consideration of dynamic, productive and allocative efficiency.¹⁰⁵
148. Further, consistent with the approach adopted by the Tribunal, the ACCC considers that in applying this criterion, it is relevant to consider:

¹⁰² Telstra, above n 7, p. 25.

¹⁰³ Optus, above n 49, [5.17]; XYZed, above n 49, [5.17]; Macquarie, above n 49, [2.3]; PowerTel and Request, above n 49, p. 7.

¹⁰⁴ Chime, above n 49, p. 4; Primus, above n 8, p. 4.

¹⁰⁵ ACCC, above n 68, p. 57.

- the economically efficient operation of downstream services provided by access seekers using Telstra's ULLS or by Telstra itself in competition with those access seekers and
- the telecommunications networks and infrastructure used to supply these services.¹⁰⁶

149. The *Access Dispute Guidelines* note that in the context of a determination, the ACCC may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated efficiently. The ACCC considers that, in the context of access prices, prices that reflect the efficient forward-looking costs of the service best meet this criterion.

3.5 Additional matters and information to which the Commission intends to have regard in making the final determinations

150. Subsection 152CR(2) of the TPA allows the ACCC to have regard to additional matters. On 28 June 2007, the ACCC sought the parties' views on whether it should have regard to additional matters.

151. The parties nominated:

- decisions of the Tribunal
- the ULLS pricing principles
- previous decisions made by the ACCC in respect of Telstra's ULLS access undertakings
- the final determination and statement of reasons in Chime's line sharing service access dispute with Telstra
- the history of the regulation of LSS and ULLS pricing in Australia
- the model terms and conditions
- the *Utilities (Network Facilities Tax) Act 2006* (ACT) and the possibility of similar legislation eventuating in other jurisdictions, and
- Telstra's need to recover GST costs as part of the ULLS charges.¹⁰⁷

¹⁰⁶ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007) at [279] – [280]; *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [94] – [95].

152. The ACCC has had regard to these additional matters. The ACCC also has had regard to the various documents and matters that are referred to in this statement of reasons.
153. In respect of GST, the ACCC has made it clear in the final determination that all charges are expressed on a GST exclusive basis.

3.6 Period to which the final determination should apply

3.6.1 Backdating period

Introduction

154. Any or all of the provisions of a final determination may be specified to take effect earlier than the date on which the determination takes effect (subsection 152DNA(1)). The specified date must not be earlier than the date on which the parties to the determination commenced negotiations with a view to agreeing on the terms and conditions of access (subsection 152DNA(2)).
155. On 28 June 2007, the ACCC proposed to backdate certain terms of access in dispute to the date of notification of the access dispute. The ACCC advised the parties that it would consider backdating to an earlier time where it could be established that the parties commenced negotiations at a time materially earlier than the date of notification. Also on 28 June 2007, the ACCC sought the parties' views.

Submissions from parties

156. Telstra submits that the final determination should commence 21 days from the date on which the final determination is made, i.e. there should be no backdating.¹⁰⁸
157. Telstra submits that backdating is unnecessary and inappropriate because:¹⁰⁹
- (a) the access seeker has been obstructive in negotiations which preceded or occurred during the arbitration of the dispute
 - (b) an interim determination was made in the dispute, negating the need for backdating
 - (c) backdating would not otherwise be in the LTIE and/or
 - (d) backdating would be inconsistent with published model price terms and

¹⁰⁷ Telstra, above n 7, pp. 25-28; above n 42, p. 51; Chime, above n 49, pp. 4-5, Primus, above n 8, pp. 4-5; PowerTel and Request, above n 49, pp. 7-8; Optus, above n 49, at [6.1] – [6.2]; XYZed, above n 49, at [6.1] – [6.2]; Macquarie, above n 49 at [2.4].

¹⁰⁸ Telstra, above n 7, p. 27.

¹⁰⁹ Telstra, above n 7, p. 28.

conditions.

158. Telstra also believes that the ACCC needs to apply backdating with a degree of consistency and even-handedness.¹¹⁰
159. Telstra considers that negotiations which are entered into by an access seeker merely as “a show” prior to notifying an access dispute cannot be said to promote the rationale of section 152DNA of the TPA.¹¹¹
160. Telstra considers that the ACCC’s decision to make interim determinations on monthly charges in each of the access disputes and on connection charges in the Chime, Optus, Primus, PowerTel and Request disputes alleviates or in some instances negates the need to backdate a final determination.¹¹²
161. Telstra submits that it would be contrary to the LTIE to require Telstra to retrospectively compensate the access seekers with respect to a period in which Telstra was developing more efficient processes. It considers that it is unlikely that access seekers will pass on the amount of compensation it receives to its customers for that period in relation to which the final determination is backdated and therefore will be unlikely to have any effect on the promotion of competition.¹¹³
162. Telstra submits that any determination on monthly prices should not be backdated in circumstances where the ACCC has previously made a determination on ULLS monthly prices and Telstra has taken these determinations into account in its commercial negotiations.¹¹⁴
163. Primus submits that it is appropriate to backdate the final determination to the commencement of negotiations, which began materially before the date of notification of the access dispute.
164. Primus submits that it attempted to enter into reasonable negotiations with Telstra on the issues in dispute before the date of notification, however Telstra consistently rejected Primus’ offer. Primus contends that backdating would provide an incentive for Telstra to negotiate reasonable price and non-price terms and conditions of access going forward, thereby avoiding the preventable costs and allocation of resources that arise from engaging the ACCC to determine the terms and conditions.¹¹⁵
165. In respect of monthly ULLS charges, Primus submits that it commenced negotiations with Telstra on 7 November 2003. On 21 June 2004, Telstra offered to adopt the ACCC’s model price terms and conditions. Primus notes that it accepted this offer, claiming that it had no other guidance that the charges remained in excess of the

¹¹⁰ Telstra, above n 7, pp. 28-32.

¹¹¹ Telstra, *op cit*, pp. 28-31.

¹¹² Telstra, *op cit*, pp. 31.

¹¹³ *Ibid*.

¹¹⁴ Telstra, above n 42, pp. 55-57.

¹¹⁵ Primus, above n 8, p. 5.

TSLRIC+ of providing the ULLS and as such had no basis on which to negotiate competitive pricing.¹¹⁶

166. On 3 February 2006, Telstra increased the monthly charge to \$30 across each band. Primus asserts that while it could be argued that negotiations regarding the monthly charges commenced with Primus' response to Telstra's letter, this does not take into account Primus' reliance on the reasonableness of the ACCC's model price terms and conditions preventing Primus from achieving a better ULLS pricing structure in the November/December 2003 negotiations.¹¹⁷
167. In its reply submission, Telstra states that Primus' submission that prices should be backdated until 7 November 2003 is entirely inconsistent with the provisions of the TPA and the ACCC's model terms.¹¹⁸ Telstra states that acceptance of terms consistent with the model terms is entirely consistent with the purpose of the model terms. Telstra submits that backdating to 7 November 2003 would give Primus a windfall.
168. Telstra also submits that Primus has not provided any evidence that backdating is appropriate.¹¹⁹ Telstra submits again that Primus has been obstructive in negotiations and that an interim determination was made in the dispute, obviating any need to backdate. Telstra submits that Primus clearly had no intent to negotiate.
169. Telstra also submits that it was not responsible for any delays in the arbitral process.¹²⁰
170. Primus' response submission states that it strongly disagrees with Telstra and submits that its primary submissions provide evidence that the commencement of negotiations can clearly be established with certainty.¹²¹
171. Primus submits that Telstra has significant commercial reasons to delay the progress of arbitrations and that Telstra has in fact actively employed tactics designed to delay negotiations and prolong the dispute.¹²² Primus also submits that Telstra has sought to frustrate and delay the arbitral proceedings.

ACCC's views

172. The ACCC is required to formulate guidelines about its approach to backdating and to have regard to those guidelines, as well as any such matters as the ACCC considers relevant.¹²³ In this arbitration, the ACCC has considered the guidelines in deciding

¹¹⁶ Ibid.

¹¹⁷ Primus, *op cit*, p. 6.

¹¹⁸ Telstra, above n 11, p. 1, Annexure 2.

¹¹⁹ Telstra, *op cit*, p. 2.

¹²⁰ Telstra, *op cit*, p. 4.

¹²¹ Primus, above n 86, p. 4.

¹²² Ibid.

¹²³ *Trade Practices Act*, sub-sections 152DNA(7) and (8).

whether to backdate. The Commission has also had regard to the ULLS Pricing Principles and the section 152CR criteria in deciding the terms to apply in the backdating period.

173. The guidelines are set out in sections 7.4.2 to 7.4.6 of the *Access Dispute Guidelines*.¹²⁴
174. As noted in the explanatory memorandum, the backdating provisions are intended to:¹²⁵
- ...encourage commercial agreement and co-operation during access arbitrations by removing incentives for delay and to ensure a considered and reasonable outcome is ultimately applied to the interim period which may otherwise be covered by an interim determination or a commercial agreement which one or more parties may be disputing.*
175. Consistent with this, the *Access Dispute Guidelines* aim to improve incentives to reach commercial agreement and co-operate during access arbitrations.
176. The guidelines provide that the ACCC will, in general, be inclined to backdate determinations. However, each case will be considered on its merits. In particular, the ACCC is likely to consider whether the manner in which the parties have conducted themselves before and during the arbitration provides grounds for not backdating the determination.
177. If, for example, prior to the notification of the dispute the access provider offered the access seeker price and non-price terms and conditions that are substantially similar to those determined by the ACCC and the access seeker refused, then it may not be appropriate to backdate. Similarly, if the access seeker has been tardy in responding to offers put forward by the access provider, then it may not be appropriate to backdate to the start of negotiations.
178. The ACCC will be inclined to backdate determinations to the date on which negotiations began, as demonstrated by the parties. Subsection 152DNA(2) establishes a maximum period of retrospectivity. However, this does not mean that it will always be appropriate to adopt that maximum period and the appropriate period of retrospectivity is likely to depend on the circumstances of the case.
179. The ACCC notes that prior to and after the notification of the dispute, Telstra did not offer Primus terms of access substantially similar to those that have now been determined by the ACCC. Nor does the ACCC consider that Primus acted to delay the arbitration or that Primus had no intention of reaching commercial agreement in relation to the various ULLS charges. Therefore, in accordance with its guidelines, the ACCC considers it would be appropriate to backdate the ULLS charges set out in

¹²⁴ ACCC, above n 68, at [7.4.2] – [7.4.6].

¹²⁵ Supplementary explanatory memorandum for the Telecommunications Legislation Amendment Bill 1998, p. 33.

the final determination.

180. The ACCC considers that ULLS annual charges should be backdated to take effect from 3 February 2006. This was the date that Telstra changed ULLS annual charges to \$30 per month across all geographical bands.
181. The ACCC notes Primus' submission that it accepted the ULLS annual charges set by Telstra prior to 3 February 2006 because it had no other guidance on charges with which to negotiate competitive pricing. However, the ACCC considers that as Primus agreed to Telstra's offer to adopt the ACCC's model price terms and conditions from 21 June 2004 to 3 February 2006, the parties were not in negotiations at that time.
182. The ACCC does not consider that its decision to publish Model Terms and Conditions in October 2003 means that it should not backdate in this instance. By the time the relevant negotiations between Primus and Telstra commenced (by at least 3 February 2006), the ACCC had expressly rejected ULLS monthly charges of \$13 in Band 1, \$22 in Band 2 and \$40 in Band 3 (December 2005).¹²⁶ Therefore, it could not be said that at any time during those negotiations Telstra was following any guidance the ACCC had issued.
183. The ACCC considers that, in the present circumstances, a failure to backdate would have serious adverse consequences. The charges that have applied between the parties in the relevant period are not reasonable when assessed against the subsection 152CR(1) criteria and the ULLS pricing principles, and have adverse consequences for the LTIE. Backdating charges that the ACCC considers to be more consistent with those criteria and principles is a means by which to redress this harm. It also strengthens incentives for the access provider to set more reasonable charges in future, and promotes efficient entry and business planning by access seekers. This is because they have greater assurance that they will face access charges consistent with the ACCC's published approach from the start of access negotiations (should those negotiations fail). Therefore, the ACCC does not accept Telstra's submission that ULLS annual charges should not be backdated.
184. In deciding the ULLS annual charges to apply during the backdated period, the ACCC has considered the subsection 152CR(1) criteria and the ULLS pricing principles. This assessment is provided in section 4 of this statement of reasons.
185. The ACCC does not consider that the making of interim determinations means that it should not backdate in this instance. The interim determination prices were clearly to apply on an interim basis. It was noted at the time that prices could be revised for the final determination.

3.6.2 Expiry date

Introduction

¹²⁶ ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings – Final Decision*, December 2005.

186. A provision of a determination may be expressed to terminate on a specified date (sub-section 152DNA(4)). Although not currently a requirement of the legislation, the ACCC would usually expect to limit the duration of a determination to a certain period in this way. On 28 June 2007, the ACCC proposed to the parties an expiry date for the final determination of 30 June 2008, and sought the parties' views.

Submissions from parties

187. Telstra, Primus, PowerTel and Request accept the expiry date of the final determination and consider it appropriate.¹²⁷ Telstra further submits that the expiry date should not exceed 30 June 2008.¹²⁸
188. Chime considers that if the final determination expires on 30 June 2008, it will not have operated for an adequate duration. Chime proposes an expiry date of 30 December 2008. Chime submits that it will need a lead time of many months to restructure its business operations to provide services over the ULL. It currently has only a few ULLS in operation because it is waiting on the final determination to enable it to invest in the ULLS with certainty and it considers that MNM to the ULL from the LSS is currently almost impossible. Chime submits that without an extension of the expiry date, it will be severely inhibited from taking advantage of the final determination.¹²⁹

ACCC's views

189. The ACCC has decided to maintain the position proposed to the parties on 28 June 2007 and to specify an expiry date for the final determination of 30 June 2008.
190. The ACCC recognises that it would be preferable to provide certainty to the parties over the terms of access that are to apply in future, as this certainty over access best allows parties to plan their business operations and compete in the market for downstream services. This would support the view that the ACCC should set terms of access for future periods where it is reasonably able to do so.
191. This needs to be balanced however against the possibility that the terms of access that would now be set for a future period could depart from the terms that would best reflect the ULLS pricing principles and the section 152CR criteria. This calls for consideration as to whether the available data provides an appropriate basis to forecast the TSLRIC+ of the ULLS for the relevant period.
192. In this case, the Commission considers that the TSLRIC+ of certain cost categories can be forecast for the remainder of 2007-08 and for 2008-09, such as for 'specific-costs' and connection costs.
193. However, it is less clear that the available data allows the Commission to directly measure, or otherwise reliably forecast, the network costs for the ULLS for 2008-09.

¹²⁷ Telstra, above n 7, p 32; Primus, above n 8, p. 6; PowerTel and Request, above n 49, p. 10.

¹²⁸ Telstra, above n 7, p 32.

¹²⁹ Chime, above n 49, pp. 5-6.

The Commission notes that the cost model that it has used to estimate network costs does allow for the TSLRIC+ of the ULLS to be measured for 2007-08 but does not directly allow for 2008-09 costs to be forecast.

194. While the Commission could possibly still forecast 2008-09 costs on a delta approach (whereby the 2007-08 measure would be adjusted having regard to trends in cost levels, demands and productivity), the Commission notes that it is preparing a new fixed-line network cost model that will allow for a direct TSLRIC+ measure of network costs to be made for 2008-09. This model is expected to be available during the first half of 2008. Telstra is also preparing its own cost model. In these circumstances, the Commission considers that it is preferable to await the new network cost models to estimate costs for 2008-09. Accordingly, the Commission has chosen to set access charges up to and including 2007-08 only, and has set the expiry date for the FD at 30 June 2008.

3.6.3 Interest

Introduction

195. Subsection 152DNA(6) of the TPA provides the ACCC with a discretion to require interest to be paid in instances of backdating at a rate specified in the determination. The ACCC proposed to the parties in its consultation paper that interest should be included on under or over payments and suggested this be at the Reserve Bank of Australia (RBA) Large Business Variable Indicator Rate. On 28 June 2007, the ACCC sought the parties' views.

Submissions from parties

196. Telstra submits that the interest rate proposed by the ACCC is not appropriate. It considers that the appropriate rate to use is the 90-day bank bill rate. Further, Telstra submits that interest should be payable from no earlier than the date on which the ACCC issued the interim determinations in each access dispute.¹³⁰
197. In its response submission, Telstra contends that debt financing rates are not reflective of opportunities that access seekers have foregone as a result of making a higher payment to Telstra. It considers that internal rates of return for investment are inappropriate in the context of a final determination because they are not constant over time. Telstra also considers that the interest provisions in each customer relationship agreement ("CRA") are not appropriate for final determinations made pursuant to the arbitration regime in Part XIC of the TPA.¹³¹
198. Chime agrees that interest should be paid in instances of backdating in principle but does not seek backdating or interest, given the number of ULLS lines acquired by

¹³⁰ Telstra, above n 7, pp. 32-33.

¹³¹ Telstra, above n 11, p. 13.

Chime.¹³² However, Chime later submitted that backdating should occur for at least any period following the expiry of its interim determination.¹³³

199. Primus submits that the interest proposed by the ACCC is an unreasonable application of guideline 7.4.4 of the ACCC's *Access Dispute Guidelines*. It contends that the appropriate interest rate is the rate specified in Primus' CRA with Telstra. Primus contends that interest should be calculated from the date on which the first overpayment was made to the date the final determination is made. Further, Primus submits that interest should be compounded daily.¹³⁴
200. Optus notes that the approach adopted by the ACCC is consistent with that taken in its recent final determinations on mobile transmission access service (MTAS) prices. Optus considers that it is reasonable to determine interest payments for ULLS charges on a consistent basis. However, Optus does not consider that the ACCC's approach to the interest rate is conceptually correct and contends that the approach is likely to overstate the actual financing costs incurred by the parties to the dispute. Optus submits that the ACCC should base the interest rate on each individual company's credit rating.¹³⁵
201. PowerTel and Request proposes an interest rate of 15% and consider that this is consistent with the Guidelines and is a conservative figure.¹³⁶
202. Macquarie agrees with the ACCC's proposed interest rate and considers it appropriate.¹³⁷

ACCC's views

203. Under subsection 152DNA(7) of the TPA, the ACCC is required to have regard to its *Access Dispute Guidelines* and such other matters as it considers relevant in determining whether or not interest should be charged.
204. The *Access Dispute Guidelines* provide that the ACCC "will generally" provide for the payment of interest on "backdated amounts" (the amounts underpaid or overpaid by an access seeker having regard to the charges and the period of backdating that are specified in the final determination).¹³⁸ The interest component is used in conjunction with backdating to remove the incentive for delay.
205. However, the ACCC evaluates interest on a case-by-case basis and does not consider that interest is automatically payable in every circumstance in which backdating of a

¹³² Chime, above n 49, p. 6.

¹³³ Chime, *Telecommunications Access Dispute – Chime – Telstra ULLS*, 6 December 2007, p. 1.

¹³⁴ Primus, above n 8, p. 7-9.

¹³⁵ Optus, above n 49, [7.12] – [7.15].

¹³⁶ PowerTel and Request, above n 49, pp. 10-11.

¹³⁷ Macquarie, above n 49, [2.5].

¹³⁸ ACCC, above n 68, pp. 63-64.

final determination occurs.

206. As specified in the *Access Dispute Guidelines*, where interest is to be paid, it will be calculated on the amounts of money that have been overpaid (or underpaid) and will usually be calculated by reference to:¹³⁹
- the volume of services supplied by the access provider to the access seeker over the backdating period and
 - the charges that that are specified in the final determination.
207. Further, the rate of interest should reflect the opportunity cost of the overpayment (or underpayment) and, in general, daily compounding will be appropriate. Lastly, the guidelines also suggest that the opportunity cost could be assessed by reference to the rate applicable to debt financing.¹⁴⁰
208. In the current arbitration, the ACCC considers that it is appropriate to specify that interest is charged on the overpayments that have occurred. Given the time value of money, the access seeker would be denied the full benefit of the determination in the absence of an award of interest.
209. Consistent with the approach suggested by the *Access Dispute Guidelines*, the ACCC has specified that the RBA's Large Business Variable Indicator Rate should be used to calculate interest and interest shall be charged on a daily basis and compounded. Interest is to be paid from the date of each overpayment and ends 21 days after the final determination is made.
210. The ACCC considered the parties' suggested alternative rates of interest. The ACCC considers that the 90 day bank bill rate does not represent the opportunity cost of money to the access seeker.
211. The ACCC considered the use of the contractually agreed rate but, while such a rate could be used in the way suggested by Primus, the ACCC has decided not to use the contractually agreed rate.
212. Further, the ACCC does not consider that the investment of all overpayments would yield a rate of return of around 15% per annum.
213. The ACCC considers that the backdated amount is to be paid and not credited against current or future invoices, unless the parties agree otherwise. This is the usual approach. The ACCC accepts that there is the potential for the effects of the final determination being realised by the access seeker and for interest calculations to be unnecessarily complicated, were Telstra's suggested approach to be adopted. Telstra remains able to separately obtain payment on any accounts as they become payable by the access seeker and there is no suggestion that the access seeker would be unable

¹³⁹ Ibid.

¹⁴⁰ Ibid.

to pay these accounts as they fall due.

3.6.4 Date of payment of settlement amount

Submissions from parties

214. Chime and Primus submit that the settlement amount should be paid within 28 days after the date on which the final determination is made, rather than within 42 days as proposed by the ACCC in its draft final determination.¹⁴¹
215. In its response submission, Telstra contends that the date of payment of the settlement amount should be no less than 42 days after the date on which the final determination is made. Telstra claims that this is because the steps involved in determining and negotiating the settlement amount is complex and time-consuming.¹⁴²
216. Further, Telstra submits that instead of paying the settlement amount to access seekers as a lump sum, the settlement amount should be offset against any future payments that the access seeker is required to pay to Telstra.¹⁴³

ACCC's views

217. The ACCC maintains its preliminary position in its draft final determination that except where the parties agree otherwise, the settlement amount is to be paid within 42 days after the date on which this determination is made. A lump sum payment is to be made by Telstra to Primus 21 days after the determination takes effect.

¹⁴¹ Chime, above n 49, p. 6; Primus, above n 8, p. 9.

¹⁴² Telstra, above n 11, pp. 13-14.

¹⁴³ Ibid.

4. Terms & Conditions Addressed in the Joint Hearing

4.1 ULLS annual charges¹⁴⁴

4.1.1 Background to dispute over ULLS annual charges and overview of approach

- 218 Telstra has proposed in previous regulatory proceedings a variety of monthly prices for the ULLS since its declaration in 1999, including undertaking assessments, indicative price determinations and model price processes.
- 219 There are two broad issues in the consideration of ULLS charges, although the two issues are inter-related. The first issue relates to the appropriate level of prices and more specifically to the appropriate cost model to be used, appropriate inputs to cost modelling and assumptions about specific cost allocation. The second relates to the appropriate structure of prices and whether prices should be geographically averaged or de-averaged.
- 220 In December 2004, Telstra proposed in an undertaking to charge ULLS monthly prices of \$13, \$22, \$40 and \$100 in Bands 1, 2, 3 and 4 respectively. Following a public inquiry, the ACCC considered that it could not be satisfied that the prices in that undertaking were reasonable.
- 221 Most recently, in December 2005, Telstra proposed in an undertaking given to the ACCC to charge a \$30 geographically averaged ULLS monthly price in all geographic bands. That undertaking was considered by both the ACCC and on appeal by the Australian Competition Tribunal. Both the ACCC (August 2006) and the Tribunal (May 2007) were not satisfied that the undertaking was reasonable.
- 222 Despite these rulings, Telstra has continued to require access seekers to pay its proposed monthly charges, other than where an interim determination was in place. Telstra generally charged its proposed geographically de-averaged prices until April 2006. From that point on it has generally charged the geographically averaged price of \$30 per month.
- 223 During this time the ACCC has arbitrated a number of ULLS access disputes. The access seekers participating in this joint arbitration hearing all notified ULLS access disputes in the period from November 2005 to July 2006. Around April to June 2006, the ACCC issued interim determinations in three of the disputes that preserved the de-averaged prices of \$13, \$22, \$40 and \$100 that Telstra had charged before 10 April 2006 in Bands 1, 2, 3 and 4 respectively. These interim determinations were issued pending the ACCC's consideration of geographic averaging in its assessment of Telstra's December 2005

¹⁴⁴ ULLS annual charges and ULLS monthly charges are used interchangeably throughout this document.

undertaking.

224 Following those ‘status quo’ interim determinations, the ACCC subsequently issued interim determinations in all access disputes concerning monthly charges for access seekers participating in this joint arbitration hearing from August 2006 to September 2006. Those interim determinations set prices of \$7.20, \$17.70 and \$34.20 per month in Bands 1, 2 and 3 respectively. The decrease in prices reflected decisions made following the Tribunal’s ruling on the appropriate recovery of specific costs in its assessment of Telstra’s LSS undertaking.¹⁴⁵ However the ACCC’s prices were set on a conservative basis as they accepted Telstra’s claimed network costs and only partially adjusted Telstra’s claimed specific costs with updated data.¹⁴⁶

225 On 28 June 2007, the ACCC provided to the parties a DFD specifying the following ULLS monthly charges to apply up until 30 June 2008:

| Band | 2005-06 | 2006-07 | 2007-08 |
|------|----------|----------|----------|
| 1 | \$ 5.50 | \$ 5.80 | \$ 6.00 |
| 2 | \$ 12.60 | \$ 13.90 | \$ 14.40 |
| 3 | \$ 27.00 | \$ 29.20 | \$ 30.30 |

226 The ACCC did not specify prices to apply in Band 4.¹⁴⁷ The ACCC proposed that level of charges as a result of further analysis of:

- Telstra’s incremental costs of supplying ULLS and LSS to access seekers and of supplying line sharing to itself consistent with the Tribunal’s ruling
- Telstra’s network costs of the copper line over which the ULLS is supplied.

227 The ACCC proposed not to geographically average the ULLS monthly charges, given the views of the Australian Competition Tribunal in its decision on Telstra’s ULLS monthly charge undertaking.¹⁴⁸

228 The ACCC consulted the parties in its consultation paper accompanying the DFD on the appropriate level and structure of prices.

229 Both these issues are discussed further below.

¹⁴⁵ *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006).

¹⁴⁶ See, for example, ACCC, *Access dispute between Chime Communications and Telstra—Unconditioned Local Loop Service—reasons for interim determination*, August 2006, published 1 Sep 06, available at <<http://www.accc.gov.au/content/index.phtml?itemId=760353>>, pp. 3-7.

¹⁴⁷ The reasons for this were set out in the ACCC’s consultation paper that was issued with the DFDs.

¹⁴⁸ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007).

4.1.2 Participants

230 Telstra, Chime, Optus, XYZed, Primus, PowerTel, Request, and Macquarie all participated in a joint hearing regarding ULLS monthly charges.

4.1.3 Current charges

231 Chime, Optus, XYZed, Primus, PowerTel, Request, and Macquarie are each in dispute with Telstra over ULLS monthly charges. These charges are addressed in Customer Relationship Agreements (“CRAs”) or access agreements between each party and Telstra. The parties are currently paying either those charges or charges specified in the interim determinations for their disputes, although certain of the interim determinations expired during the course of the arbitrations.

4.1.4 Prior consideration

232 ULLS monthly charges (also referred to as annual charges) have been considered by the ACCC in a number of proceedings. Recent decisions include:

- *ACCC, Assessment of Telstra’s ULLS monthly charge undertaking—final decision*, August 2006.
- *ACCC, Assessment of Telstra’s ULLS and LSS monthly charge undertakings – final decision*, December 2005.
- *ACCC, Assessment of Telstra’s undertakings for PSTN, ULLS and LCS—draft decision*, October 2004.

233 The ACCC also considered ULLS monthly charges in setting interim determinations in each of the access disputes involved in this joint arbitration hearing.

234 ULLS monthly charges have also been considered by the Tribunal.¹⁴⁹ The appropriate recovery of LSS specific costs, which are relevant to the consideration of the appropriate recovery of ULLS specific costs, was also considered by the Tribunal in an earlier decision.¹⁵⁰

235 The ACCC conducted a public inquiry into the appropriate pricing principles to apply to the ULLS in October 2007. The ACCC’s final pricing principles were published in November 2007.¹⁵¹ The ACCC did not finalise its pricing principles prior to this time given that there were a number of issues relevant to pricing being considered in undertakings and subsequently on appeal to the Tribunal.

¹⁴⁹ Ibid.

¹⁵⁰ *Telstra Corporation Limited (ACN 051 775 556) [2006] ACompT 4 (2 June 2006)*.

¹⁵¹ ACCC, above n 5.

4.1.5 Principles to apply

236 The ACCC initially proposed to the parties as part of the DFD consultation paper that ULLS monthly charges should be determined by reference to the draft ULLS pricing principles, as set out in:

- ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS—final determination*, July 2006, Chapter 7

and the previous ULLS pricing principles, as set out in:

- ACCC, *Pricing of unconditioned local loop services (ULLS)—final report* March 2002.

237 Both these documents state that the ACCC will apply a TSLRIC pricing principle to the pricing of the ULLS. In practice, the ACCC typically includes a contribution to indirect or organisational costs (TSLRIC+).

238 The ACCC's view was that, in correct application of those principles and in order to reflect a TSLRIC+ approach to ULLS monthly charges, consideration should be given to two components of the ULLS monthly charge:

- the efficient costs of the line over which the ULLS is supplied ('network costs')
- the efficient incremental (or 'specific') costs associated with the ordering, provisioning and qualifying of lines for ULLS, LSS or Telstra's equivalent use of the copper pair.

239 Following the issuing of final ULLS pricing principles in November 2007, the ACCC consulted with the parties again on the applicability of those new pricing principles, as set out in:

- ACCC, *Unconditioned Local Loop Service—final pricing principles*, November 2007.

240 The final pricing principles contained the following conclusions relevant to ULLS monthly charges:

- 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.

241 The parties' submissions regarding the use of these principles have been discussed earlier in these reasons. The parties are generally supportive of the use of the ULLS pricing

principles, although as noted elsewhere, Telstra makes submissions against applying certain aspects of the ULLS pricing principles.

4.1.6 Level of ULLS monthly charges

242 As noted above at 4.1.1, the ACCC considers that there are effectively two broad issues in the consideration of ULLS monthly prices. The first of these is the appropriate level of prices.

243 The ULLS pricing principles provide that ULLS prices should be cost based, with necessary cost estimates derived from a TSLRIC+ methodology. The ULLS pricing principles provide additional guidance on certain matters that arise in implementing the TSLRIC+ methodology for the ULLS. Under the principles, it is only the efficient, forward-looking level of costs that are brought to account in setting ULLS monthly charges.

244 A variety of issues relevant to the appropriate level of ULLS monthly prices have been the subject of significant debate since declaration, including:

- the appropriate cost model(s) for use in estimating ULLS costs
- the appropriate cost components to be included in cost models and the method of recovery of these cost components
- the appropriate inputs for cost models, such as trench sharing, asset lives and cost of capital inputs.

245 In its consultation paper that accompanied the DFDs, the ACCC proposed to estimate the level of costs for the ULLS with reference to two cost components:

- network costs, which refer to the capital, operational and maintenance, and indirect costs of Telstra's fixed line network. In particular, for the ULLS, the relevant efficient network costs are the efficient costs attributable to the copper lines between the end-user and the exchange.
- specific costs, which refer to incremental costs incurred by Telstra to allow for supply of the declared ULLS and other products, and include costs incurred in connection with ordering, provisioning and qualifying the ULLS or other product.

246 The ACCC advised parties in its consultation paper of its preliminary view to estimate the level of ULLS costs through the use of two cost models:

- Telstra's PIE II network cost model, adjusted for certain preferred ACCC input variables
- a specific cost model developed by the ACCC, giving effect to the Tribunal's views on the appropriate recovery of specific costs, and using data from Telstra's previously submitted specific cost models.

- 247 Parties' submissions were sought on the appropriateness of the ACCC's proposed approach and on the inputs used in calculating the appropriate level of costs.
- 248 The views reached on these issues have the potential to influence (to varying degrees) the measurement of TSLRIC+. These are discussed in turn below.
- 249 For those matters considered to have a material bearing on TSLRIC+, and hence the ULLS monthly charges set in this arbitration, and where alternative approaches that could be practically implemented have been advanced, the ACCC has considered these approaches against the matters in subsection 152CR(1) of the TPA.

4.1.7 Appropriate cost model to apply

- 250 The ACCC's consultation paper proposed to use the PIE II network cost model, populated with the ACCC's preferred inputs, and a specific cost model to estimate ULLS costs, and sought parties' submissions on the appropriate inputs for such models.
- 251 Telstra put forward an alternative cost model based on current cost accounting ("CCA") data in its initial submissions. Telstra provided a copy of the Excel spreadsheet model as part of the supporting material provided on CDs. Following that, the ACCC sought supplementary views from the parties on the appropriateness of using CCA data, such as whether CCA balances were likely to represent efficient forward-looking costs, whether the cost categories Telstra identified were necessary for supply of the ULLS and whether any costs were likely recovered through other charges.
- 252 Following the release of the ACCC's supplementary consultation paper to the parties on 27 November 2007, which sought parties' submissions on (among other things) Telstra's CCA data, Telstra submitted an updated version of its alternative cost model based on CCA data.¹⁵²

Submissions from parties

- 253 Telstra provided submissions on appropriate inputs, changes and exogenous adjustments relevant to the estimates of costs generated by the PIE II network cost model and ACCC specific cost model.¹⁵³ These submissions are discussed further in this statement of reasons.
- 254 However, Telstra also submitted that the ACCC have regard to certain alternative cost modelling approaches:
- a cost model, described by Telstra as "Telstra's model", based on a top-down valuation of costs using CCA data from Telstra's regulatory accounts¹⁵⁴

¹⁵² Telstra, above n 16.

¹⁵³ Telstra, above n 42, pp. 28-50.

¹⁵⁴ Telstra, *op cit*, pp. 21-28.

- the ACCC’s previous network cost model, the n/e/r/a model¹⁵⁵
- international benchmarks.¹⁵⁶

255 Telstra submitted that, in the absence of accurate bottom-up cost information (although it did not agree that such information was absent), it would be appropriate to have regard to a top-down valuation of costs in assessing TSLRIC+. ¹⁵⁷ Telstra’s model identified various asset and expense categories in its CCA Regulatory accounting framework (“RAF”) accounts that it considered should be included in such a top-down valuation. ¹⁵⁸ These cost categories can largely be categorised into:

- network asset and expense categories, namely CAN ducts and pipes and CAN copper cables (which Telstra submits make up the ‘vast majority’ of costs attributed to ULLS in its CCA data).¹⁵⁹
- organisational assets, such as non-communications plant and equipment, other non-current assets and current assets and free funds, and organisational expenses such as general administration and IT
- product and customer costs.

256 Telstra’s model does not explicitly separately calculate network and specific costs.

257 Connection/installation costs were excluded by Telstra as these costs are recovered through connection charges. The model then annualises the opening undepreciated value of the assets and adds operating, product and customer costs to obtain a total ULLS cost, which it then converts to a per-ULLS cost.¹⁶⁰

258 Telstra acknowledges that its accounts are prepared on a fully distributed cost basis rather than a TSLRIC+ methodology, but submits that its measure would still approximate TSLRIC+. ¹⁶¹ Further, while Telstra acknowledges that its cost claim has been derived from actual historic costs, it considers these costs to be forward-looking, in the sense that the costs represent actual replacement costs and are annualised.¹⁶²

259 Telstra submits that its CCA costs are efficiently incurred. It provides estimates of its business-wide total factor productivity (TFP) over time and compared to other carriers, and also a measure of its fixed-line TFP. Telstra submits that these results support the view that its actual costs were efficiently incurred.¹⁶³ Telstra also submits that there is

¹⁵⁵ Telstra, *op cit*, pp. 39-40.

¹⁵⁶ Telstra, *op cit*, p. 54.

¹⁵⁷ Telstra, *op cit*, p. 21.

¹⁵⁸ Telstra, *op cit*, Annexure 6.

¹⁵⁹ Telstra, above n 16, pp. 2-3.

¹⁶⁰ Telstra, above n 42, p. 21.

¹⁶¹ Telstra, *op cit*, p. 22.

¹⁶² Telstra, *op cit*, pp. 26-7.

¹⁶³ Telstra, *op cit*, pp. 23-5.

evidence that its model in fact understates efficient current costs, in that it argues that the omitted asset bias in the model is greater than the obsolete asset bias in the accounting data.¹⁶⁴

260 Telstra further submits that the inefficiency of Telstra's operations that is implied by the ACCC's most recent estimates of ULLS costs is not credible due to a lack of evidence of any inefficiency and Telstra's TFP study. Telstra contends that the ACCC's ULLS cost estimates suggest inefficiency in the order of [c-i-c] per cent to [c-i-c] per cent, or that there is an additional [c-i-c] to [c-i-c] centimetres of unnecessary ducts, pipes and cable for every metre in Telstra's CAN.¹⁶⁵ In any event, Telstra also notes that its proposed price of \$30 is lower than the costs calculated by Telstra's top down model and, accordingly, even if Telstra's deployment of CAN ducts pipes or copper cables was as much as [c-i-c] per cent to [c-i-c] per cent inefficient (which is denied) this would not invalidate Telstra's proposed \$30 ULLS monthly (average) price.

261 In respect of the ACCC's concerns regarding the allocation of costs to the ULLS under the CCA framework Telstra notes that:

- Costs are allocated to ULLS in Telstra's CCA according to the Regulatory Accounting Rules agreed to by the ACCC;
- Telstra's CCA is independently audited;
- The vast majority of the costs that Telstra relies upon from its CCA are CAN ducts and pipes and CAN copper cables, which the ACCC has acknowledged are relevant to the ULLS cost; and
- reiterates that the other CCA data categories (which Telstra further details) included in Telstra's alternative model are immaterial to the ULLS price but does make some downward adjustments in response to issues raised by the ACCC in the supplementary consultation paper.¹⁶⁶

262 Telstra acknowledges that the Tribunal declined to accept Telstra's CCA costs as a measure of efficient forward-looking costs. Telstra considers that the Tribunal's reasons for doing so are distinguishable. Telstra advises that in its view the Tribunal was noting that it could not be positively satisfied that Telstra had provided sufficient evidence that the CCA costs were efficient, and that its use of an annuity formula in the present arbitrations overcomes this.¹⁶⁷

263 Telstra advises that costs recovered from exchange cabling charges and Telstra Exchange Building Access charges have been removed. Telstra also submits that there is no evidence that it has included cost categories that are unnecessary to the supply of the ULLS. Telstra reiterates a number of its views, including that the ACCC's proposed cost

¹⁶⁴ Telstra, *op cit*, pp. 27-8, Annexure 11.

¹⁶⁵ Telstra, above 16, p. 2.

¹⁶⁶ Telstra, *op cit*, p. 3.

¹⁶⁷ Telstra, *op cit*, p. 11.

model excludes relevant cost categories, and that the ACCC should adopt the CCA as the best available evidence of efficient costs. Telstra notes that its alternative cost model is consistent with the statutory criteria because it is an accurate calculation of the TSLRIC+ of providing the ULLS.¹⁶⁸

- 264 In relation to the use of CCA data in the PIE II model, PowerTel and Request refer to consultant's advice that current costs do not provide appropriate build/buy signals or encourage competitive outcomes.¹⁶⁹ They separately refer to the Tribunal's view that it did not consider that the current cost of building an existing CAN is necessarily likely to be an accurate guide to the forward-looking TSLRIC of providing the ULLS.¹⁷⁰ This is also submitted by both Chime and Primus.¹⁷¹
- 265 PowerTel and Request also submit that the results of Telstra's model, which produces cost estimates [c-i-c that exceed the \$30 a month price per month] while Telstra is seeking a \$30 a month price, demonstrate that Telstra's claim is made without any real basis.¹⁷² An equivalent submission is made by Macquarie in its reply submission.¹⁷³
- 266 PowerTel and Request submit that the TFP study should not be given weight by the ACCC as it is irrelevant, lacks independence and cannot be tested.¹⁷⁴ Chime submits in reply that Telstra's TFP study should not be given weight by the ACCC.¹⁷⁵ Chime refers to concerns about the independence of the study, the lack of primary evidence and the fact that international comparisons can often be limited in their usefulness. Primus raises the same concerns.¹⁷⁶ Telstra rejects the submissions about independence and provides underlying data that it considers would allow testing to occur.¹⁷⁷
- 267 Chime and Primus both note the ACC's previous positions regarding the use of Historic Cost Accounting ("HCA") and CCA pricing approaches. They submit that it is very unlikely that any cost accounting based upon Telstra's CCA would do anything but entrench Telstra's inefficient costing, and as such is unlikely to encourage the efficient use of and investment in infrastructure. Chime and Primus support the ACCC's view in its ULLS pricing principles report that while CCA might provide some indication of a possible upper bound of access prices, it is not an appropriate pricing principle for the

¹⁶⁸ Telstra *op cit*, pp. 6-7, 11-12.

¹⁶⁹ PowerTel and Request, above n 49, p. 19.

¹⁷⁰ PowerTel and Request, *Unconditioned Local Loop Service, Submissions in reply of PowerTel Limited and Request Broadband Pty Ltd in relation to the making of a final determination*, 13 September 2007, p. 42.

¹⁷¹ Chime, above n 21, pp. 1-2; Primus, above n 21, pp. 1-2.

¹⁷² PowerTel and Request, above n 170, p. 24.

¹⁷³ Macquarie, *Unconditioned Local Loop Service (ULLS), Submissions of Macquarie Telecom in response to Telstra submission*, 13 September 2007, p. 1.

¹⁷⁴ PowerTel and Request, above n 170, p. 36.

¹⁷⁵ Chime, *Unconditioned Local Loop Service (ULLS), Reply submission of Chime Communications Pty Ltd (Chime), Part 2 – ULLS monthly charges*, 13 September 2007, p. 3.

¹⁷⁶ Primus, *Unconditioned Local Loop Service (ULLS), Submission of Primus Telecommunications Pty Ltd (Primus), Response to Part 3 of Telstra's Submission – ULLS monthly charges*, 13 September 2007, p. 3.

¹⁷⁷ Telstra, above n 45, pp. 17-18, 21.

ULLS.¹⁷⁸

- 268 Similarly, Macquarie supports the ACCC's view in its ULLS pricing principles report that CCA is not a desirable pricing principle for the ULLS. Macquarie submits that some of the categories identified in the ACCC's letter of 30 November 2007 "would appear to be dubious" and that costs related to "other non-current assets" and "other current assets and related receivables" are extremely unlikely to have a direct nexus to the provision of ULLS. Macquarie submits that these categories should be disregarded for the purposes of the dispute.¹⁷⁹
- 269 PowerTel and Request note the ACCC's observations in its Supplementary Consultation Paper and the ULLS pricing principles report and submit that the ACCC ought to disregard Telstra's claimed CCA costs.¹⁸⁰
- 270 Optus submits that whilst in other circumstances CCA analysis might provide a useful basis for setting access prices, it should not be used in the case of ULLS given Telstra's position as a monopoly operator. Optus further submits that Telstra has put forward no evidence to suggest the costs in its CCA reports are efficient and that a number of cost items are of a general nature and would appear to have little relevance to the efficient provision of ULLS.¹⁸¹

n/e/r/a model

- 271 Telstra has separately submitted that the ACCC should take into account the ACCC's previous cost model, the n/e/r/a model.¹⁸² The n/e/r/a model is a model commissioned by the ACCC for assessing PSTN OTA prices in 1999 and modified for use in assessing ULLS prices in 2002.¹⁸³ Telstra notes that the n/e/r/a model estimated prices of around \$33 in 2000/01 and 2001/02, and submits that the model would demonstrate higher costs than those put forward by the ACCC. Telstra submitted that the ACCC had an obligation to "invoke its investigatory powers and update and adjust the n/e/r/a model".¹⁸⁴
- 272 In their reply submissions, PowerTel and Request submit that the Tribunal dismissed Telstra's attempt to rely upon the n/e/r/a model.¹⁸⁵

International benchmarks

- 273 Telstra has also separately submitted that its averaged \$30 price falls at the middle to lower range of prices for the ULLS service, after adjusting prices for purchasing power

¹⁷⁸ Chime, above n 21, pp. 1-2; Primus, above n 21, pp. 1-2.

¹⁷⁹ Macquarie, above n 21, p. 2.

¹⁸⁰ PowerTel and Request, above n 21, pp. 3-4.

¹⁸¹ Optus, above n 21, p. 3.

¹⁸² Telstra, above n 42, p. 39.

¹⁸³ ACCC, *Pricing of unconditioned local loop services (ULLS)—final report*, March 2002.

¹⁸⁴ Telstra, above n 42, p. 40.

¹⁸⁵ PowerTel and Request, above n 170, p. 41.

parity and line density.¹⁸⁶ It also submits that the ACCC's proposed draft prices are so low that they do not accord with international benchmarks.¹⁸⁷

274 PowerTel and Request refer to the Tribunal's views on international benchmarking, where the Tribunal stated that there were a number of factors that could explain prices in different jurisdictions, and that it was not satisfied that adjusting for purchasing power parity and line density accounted for all relevant factors.¹⁸⁸

275 Primus disputes Telstra's submissions that Telstra's proposed prices are more appropriate based on international benchmarks.¹⁸⁹ It submits that international benchmarks must be treated with caution, but submits that Telstra's proposed price is out of line with the rest of the world. Chime makes an equivalent submission.¹⁹⁰

276 Macquarie submits that it disagrees with Telstra's position that the ACCC's proposed prices do not accord with international benchmarks. It also submits that the ACCC should reject Telstra's contention that population density should be taken into account in comparing international benchmarks on the basis that Australia has one of the most highly urbanised populations in the world.¹⁹¹

Access seeker criticisms of the PIE II model

277 Optus noted that the ACCC used the PIE II model as the basis for its determinations of network costs in the DFD, despite its previously expressed concerns and the concerns of the Tribunal.¹⁹² Optus states that it has concerns about the ACCC's approach and accordingly suggests a number of adjustments to the model.¹⁹³ Optus also raised adjustments and specific concerns with the model in its reply submissions.¹⁹⁴ These specific submissions are considered further below.

278 PowerTel and Request accept the ACCC's use of the PIE II model but note that they do not accept Telstra's methodology or estimation approach as embodied in PIE II, nor do they concede any previous criticisms of PIE II.¹⁹⁵ They also set out a number of criticisms of the model, and contend that it does not represent an efficient, forward-looking network used to supply ULLS.¹⁹⁶ More specifically, they submit that the model has methodological defects, a lack of transparency and usability, that it is not forward-looking

¹⁸⁶ Telstra, above n 42, p. 54.

¹⁸⁷ Telstra, *op cit*, p. 6.

¹⁸⁸ PowerTel and Request, above n 21, p. 43.

¹⁸⁹ Primus, above n 176, p. 4.

¹⁹⁰ Chime, above n 175, p. 4.

¹⁹¹ Macquarie, above n 173, p. 3.

¹⁹² Optus, above n 49, p. 8.

¹⁹³ Optus, *op cit*, pp. 8-19.

¹⁹⁴ Optus, *Unconditioned Local Loop Service (ULLS), Reply submission of Optus*, 13 September 2007, pp. 15-25.

¹⁹⁵ PowerTel and Request, above n 49, p. 12.

¹⁹⁶ *Ibid.*

and that there are a number of problems with its input variables.¹⁹⁷

279 PowerTel and Request's reply submission also makes criticisms of the PIE II model and submits that Telstra has ignored the Tribunal's criticisms of the model.¹⁹⁸ PowerTel and Request make further criticisms of the model based on the Tribunal's comments, relating to both the model in general, roll-forward, selective parameters and exogenous adjustments.¹⁹⁹

280 Chime questions the ACCC's approach to using Telstra's PIE II model.²⁰⁰ Chime noted that the ACCC has had a number of concerns with PIE II but has elected to use the model in the absence of an alternative cost model. Chime submits that the ACCC should make allowances for each of its concerns by applying an appropriate deduction to the PIE II cost estimates.²⁰¹ Chime does not specify what it would consider to be appropriate deductions.

281 Primus makes similar comments to Chime.²⁰² However it raises specific criticisms of PIE II raised by its consultants Gibson Quai-AAS in relation to dimensioning, asset lives and lead-in costs.²⁰³

282 Macquarie submitted that it supported setting ULLS prices with reference to network costs calculated using the PIE II model with revised ACCC inputs.²⁰⁴ However it submitted that the adoption of the PIE II model may be likely to result in an overestimation of the efficient network costs.

283 In its reply submissions, Telstra submits that the PIE II model is an appropriate model for the estimation of ULLS network costs.²⁰⁵ It provides responses on the various specific criticisms made by access seekers about inputs or assumptions in the model.²⁰⁶

TEA Model

284 On 17 December 2007, Telstra submitted that the ACCC should have regard to its pending Telstra Efficient Access ("TEA") model.²⁰⁷ Telstra submitted that it was intending to submit an undertaking which was partially supported by the TEA model and

¹⁹⁷ PowerTel and Request, *op cit*, pp. 13-19.

¹⁹⁸ PowerTel and Request, above n 170, p. 36.

¹⁹⁹ PowerTel and Request, *op cit*, pp. 36-41.

²⁰⁰ Chime, *Unconditioned Local Loop Service (ULLS), Submission of Chime Communications Pty Ltd (Chime), Part 2 – Annual Charges*, 16 August 2007, p. 1.

²⁰¹ Chime, *op cit*, p. 2.

²⁰² Primus, *Unconditioned Local Loop Service (ULLS), Submission of Primus Telecommunications Pty Ltd (Primus), Part 2 – Annual Charges*, 16 August 2007, pp. 1-2.

²⁰³ Primus, *op cit*, pp. 2-3.

²⁰⁴ Macquarie, above n 49, p. 5.

²⁰⁵ Telstra, above n 40, p. 3.

²⁰⁶ Telstra, *op cit*, pp. 3-8.

²⁰⁷ Telstra, *Access Disputes – Chime, Optus, XYZed, Primus, PowerTel, Request, Macquarie and Telstra – ULLS*, 17 December 2007.

submitted that the model was a superior model to PIE II.

- 285 Accordingly, Telstra submitted that the ACCC should have regard to the TEA model in the ULLS access disputes and undertake a further round of submissions to consider the model. Telstra submitted that such submissions were capable of being dealt with in a reasonable timeframe. Telstra further stated that it would maintain interim determination pricing for access seekers until such time as final determinations were made.
- 286 Optus opposed the ACCC having regard to the TEA model in the arbitrations.²⁰⁸ Primus also opposed the ACCC having regard to the TEA model in the arbitrations.²⁰⁹

ACCC's views

Telstra's model compared to PIE II and the specific cost model

- 287 Telstra has proposed that the TSLRIC+ for Telstra's ULLS monthly charges can be estimated from particular data drawn from its RAF reports that have been prepared on a CCA basis.
- 288 Accounting data can provide a useful starting point for deriving TSLRIC+ based access charges. The ACCC has regard to replacement costs in estimating network costs using Telstra's PIE II model. However, the ACCC has not previously accepted the use of unadjusted CCA, or HCA data, as a basis for estimating the TSLRIC+ of a service.
- 289 Recently, the Tribunal cautioned against the use of CCA data concerning Telstra's CAN for the purpose of deriving a TSLRIC measure of the ULLS:²¹⁰

The Commission contended that Telstra's current costs were of little or no relevance to our assessment of Telstra's proposed \$30 monthly charge because current costs reflected neither the actual network costs incurred by Telstra in supplying the ULLS nor the efficient forward looking network costs of supplying the ULLS. Telstra submitted that the current costs were a better reflection of the costs that an access seeker would incur today if it were to supply the ULLS than historic costs, as they reflected the purchase price of assets today.

We do not consider that the current cost of building an existing CAN is necessarily likely to be an accurate guide to the forward looking TSLRIC of providing the ULLS. It is not clear to us that an access provider building a network today would choose the same assets as it uses in its current network. We do not accept that Telstra's current cost estimate of providing the ULLS constitutes sufficient evidence as to the likely TSLRIC of providing the ULLS, nor, therefore, to the reasonableness of Telstra's ULLS access charge for the periods

²⁰⁸ Optus, *ULLS Access Disputes – Chime, Optus, XYZed, Primus, PowerTel, Request, Macquarie and Telstra*, 18 December 2007.

²⁰⁹ Primus, *Access Dispute – Chime, Optus, XYZed, Primus, PowerTel, Request, Macquarie and Telstra - ULLS*, 19 December 2007.

²¹⁰ *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 (17 May 2007).

covered by the undertakings.

- 290 The ACCC notes the parties hold conflicting views as to whether the Tribunal's comments are applicable here. The ACCC considers that the comments are applicable, and that they caution against the adoption of CCA data as a measure of efficient, forward-looking costs. The ACCC notes that Telstra submits that its model uses a TSLRIC+ calculation.²¹¹ The ACCC does not consider that the inherent limitations of CCA cost data to measure efficient forward-looking costs can be overcome simply by annualising the cost data. The annualised costs are still likely to be inflated above efficient, forward-looking levels.
- 291 Nor does the fact that the CCA reports are prepared by Telstra under a rule that the Commission has issued (pursuant to a Ministerial direction to do so) mean that the CCA balances would represent TSLRIC+ values. Similarly, an external audit of Telstra's compliance with the rule does not provide any assurance that the resulting accounts are representative of TSLRIC+ values.
- 292 Similarly, the ACCC considered in its pricing principles that the use of CCA data could be problematic:²¹²

Prices based on a CCA methodology will be unlikely to encourage the efficient use of and investment in infrastructure. CCA assumes current technology, as opposed to best-in-use technology. Accordingly it will incorporate existing inefficiencies, but price this inefficient technology at higher current prices. Where HCA-based prices might at least inform as to the level of cost recovery needed to ensure the access provider's legitimate business interests, CCA does not achieve this. Furthermore, CCA is a static analysis that does not provide a measure of forward-looking costs and is hence of limited benefit in considering future pricing. These concerns are particularly relevant for a long-established network such as Telstra's CAN, which has been deployed over a number of years.

The ACCC also notes the data limitations of accounting data, as discussed above. While Telstra's Regulatory Accounting Framework (RAF) data is provided in accordance with the reporting requirements set out in the RAF, the relevant Record Keeping Rules (RKR) do not set out in detail how costs relating to a particular service should be allocated. Rather, the RKR provide general principles and 'high level' allocation methods which telecommunications carriers can apply in a number of different ways. The ACCC does not accept or reject a particular carrier's cost allocation method or assess the efficiency of the resulting cost allocation, it merely raises issues where there is non-compliance with the high-level principles set out in the RKR. Accordingly, there may be an absence of reliable accounting cost data attributed to particular services on which to base a CCA approach, even if total cost amounts were appropriate.

- 293 The ACCC has reviewed the CCA data that Telstra submitted. As discussed below, the ACCC does not consider that these data would support an increase to the TSLRIC+

²¹¹ Telstra, above n 16, p. 2.

²¹² ACCC, above n 5, p. 10.

measure above the level proposed by the ACCC.

- 294 Telstra has also submitted that the ACCC should have regard to Telstra's actual costs as well as the TSLRIC+ measure in setting ULLS monthly charges. The ACCC does not consider that ULLS monthly charges should be set by reference to actual costs. This is consistent with the position long held by the ACCC and Tribunal.
- 295 In any case, Telstra's CCA balances do not record Telstra's actual costs, as they measure costs on the premise that Telstra was required to rebuild its network and repurchase capital equipment it already owns, and that the rebuilt network and purchased capital equipment would be of the same type as that operated today. Unlike TSLRIC+ measures, however, Telstra's model costs the existing technology and capital equipment, and not the capital that would be efficiently deployed. As a result, CCA measures overstate actual costs, and also TSLRIC+ measures.
- 296 As Telstra notes, the CCA totals are above the TSLRIC+ values used in the cost models that the ACCC circulated to the parties. While Telstra points to this to question whether the values produced by the ACCC provide a reasonable or credible TSLRIC+ measure, the opposite conclusion could equally be drawn from the discrepancy. That is, the discrepancy could reinforce the view that CCA balances will tend to overstate TSLRIC+ measures.
- 297 Further support for this view arises from Telstra's CCA balances exceeding the TSLRIC+ measures that Telstra has advocated in prior regulatory proceedings (and, as submitted by access seekers, the \$30 ULLS price that Telstra is advocating). In this regard, the ACCC notes that data contained in the specific cost model that it circulated are values that Telstra itself advocated in previous regulatory proceedings. The data are contained in TSLRIC+ models that Telstra then advocated for specific costs, inclusive of an allowance for efficiently incurred indirect costs, for the LSS and the ULLS in previous regulatory proceedings. In this regard, the operating and maintenance expenses, capital costs, mark-ups for indirect costs and demand data for the LSS and the ULLS are sourced from TSLRIC+ models annexed to the statement of Andrew Briggs of August 2006. Similarly, the network costs put forward by the ACCC were based on Telstra's PIE II model with some revised ACCC inputs.
- 298 Telstra points to TFP studies to support its view that its CCA balances are likely to represent efficient, forward-looking levels incurred. However, the ACCC does not consider that a TFP study can support Telstra's submission that these costs were efficiently incurred. TFP is the ratio of the change of outputs to inputs, generally over time, or in respect of one aspect of Telstra's submissions, across businesses. High TFP growth can be influenced either by cost efficiency or scale economies from demand surges, or by reductions in inefficiencies over time, or as compared to other businesses.
- 299 Furthermore, in the context of ULLS pricing, the relevant question is the extent to which the business-wide TFP value or fixed-line TFP value imply forward-looking efficiencies in the provision of the ULLS. Firstly, the ACCC considers that business-wide TFP incorporates significant other investments that are not relevant to the ULLS. Notably, the output categories specified by Telstra include revenues relating to services unrelated to

the ULLS, such as local calls, switched access, long distance and mobile services.²¹³ While the CAN could be expected to make up a significant part of Telstra's overall assets, the inclusion of non-fixed-line services and significant fixed-line services not related to the ULLS limits the relevance of the results.

- 300 The ACCC further notes that Telstra has updated an ACCC fixed line TFP methodology used for assessing TFP measures for use in a retail price control report.²¹⁴ Similarly, the services included in that study cover the entire fixed-line network, reflecting services that use both the CAN and inter-exchange network ("IEN") and including non-voice services such as ADSL.²¹⁵ Telstra's update similarly includes a wide range of fixed line services. Again, the ACCC considers that the wide range of services included limit the relevance of the results.
- 301 Telstra also contends that the ACCC should infer that all its costs were efficiently incurred if it reports strong TFP growth, including costs such as these that are immaterial to its TFP measures. The ACCC does not accept that such an inference can reasonably be drawn. TFP is a relative measure of efficiency compared to previous efficiency, using historical data, but does not particularly provide insight into absolute efficiency. In particular, the ACCC does not consider that the TFP results can demonstrate that the network is efficiently designed or forward-looking. The TFP measures simply examine the efficiency of use of the network as it exists. The ACCC notes Telstra's submission that its studies provide comparisons of absolute productivity, but considers that the results present difficulties. For example, the ACCC notes that adjusting for line density may not be appropriate without accounting for line distribution.
- 302 The ACCC notes that Telstra has submitted that concerns about the efficiency and relevance of current cost information can be addressed by examining the omitted asset bias and obsolete asset bias in the data (which would respectively cause current costs to underestimate and overestimate replacement costs).²¹⁶ It also provides an analysis that its submits show that the current costs understate the replacement costs.²¹⁷ The ACCC considers that the analysis does not demonstrate that the data understates replacement costs.
- 303 In particular, the ACCC notes that in estimating the omitted asset bias, Telstra scales up the amount of assets in its accounts based on the number of services in operation ("SIOs") in the initial year that the assets were first accounted for in Telstra's accounts. The ACCC considers that this may significantly overstate the appropriate mark-up as it accounts for assets that "could also be used for the operation of the CAN in 2005/06".²¹⁸ The ACCC considers that this takes no account for what assets are actually used or would be needed in an efficient forward-looking network structure. Further, Telstra's calculation of the omitted asset bias only excludes assets that are listed as abandoned in Telstra's physical asset database. The ACCC considers that this does not recognise the inefficiencies in the

²¹³ Telstra, above n 42, p. 36, Annexure 9; Telstra, above n 45, Annexure 1.

²¹⁴ Telstra, above n 42, p. 49, Annexure 10.

²¹⁵ ACCC, *Review of Telstra's price control arrangements—an ACCC report*, February 2005, p. 120.

²¹⁶ Telstra, above n 45, p. 27.

²¹⁷ Telstra, *op cit*, p. 56, Annexure 11.

²¹⁸ Telstra, *op cit*, p. 57, Annexure 11.

existing network that continue to operate, and that it does not account for assets that would actually no longer be needed in an efficient forward-looking network structure.

- 304 Based on the above analysis, the ACCC does not consider that the CCA costs provide a reliable measure of the relevant TSLRIC+ of the ULLS, or that it is the best available measure before the ACCC.
- 305 Accordingly, the ACCC has continued to use Telstra's previously submitted TSLRIC+ cost models, in preference to its CCA account balances, in specifying ULLS monthly charges in the final determination.
- 306 It can be noted that Telstra's claimed costs in its bottom-up TSLRIC+ models have also not been shown to have been efficiently incurred. Certain access seekers have made submissions along those lines, particularly criticising the PIE II model. The possibility therefore remains that inefficient costs could be admitted into the cost base through the use of those two cost models. However, the extent to which admitted costs would exceed efficient costs is much more limited under this approach, given that a TSLRIC+ methodology was used and the comparative level of sophistication in modelling techniques. This is reliant on appropriate inputs being used in the models. The ACCC notes that the appropriate inputs have been the subject of significant debate in the past. The ACCC assesses particular inputs into the model in more detail below.
- 307 That said, the ACCC notes that access seeker parties all had a number of criticisms relating to the PIE II model. However, they all also submitted that it would be appropriate to use the model in setting prices for these final determinations. Similarly, Telstra also submitted that the PIE II model is an appropriate model for the estimation of ULLS network costs. The ACCC believes that, with reservations and appropriately considered inputs, the PIE II model can be used to set prices in this final determinations.

Specifics of Telstra's CCA cost claim

- 308 The ACCC has decided not to adopt Telstra's CCA balances in setting ULLS monthly charges in this arbitration on the basis that the CCA methodology overstates TSLRIC+ values.
- 309 In recent LSS final determinations, the ACCC has also raised other concerns about particular cost categories claimed by Telstra in estimating LSS costs using CCA data. In particular, the ACCC concluded that, as Telstra's cost claim and the underlying regulatory accounts have been prepared on a fully distributed cost ("FDC") basis, adopting the CCA values would risk introducing cost categories to be recovered through LSS charges even though they have no relationship with the supply of the LSS.²¹⁹ The ACCC considered that such cost categories would overstate efficient costs, as they introduce cost categories unnecessary to the supply of the LSS. Further, in a competitive market, a supplier of the LSS would be unable to recover a portion of these costs in LSS access charges, as other

²¹⁹ See, for example, ACCC, *Access dispute between Chime Communications and Telstra—LSS—publication of final determination and associated statement of reasons, Jun 07*, published 8 August 07, available at <http://www.accc.gov.au/content/index.phtml?itemId=793060>, p. 39.

LSS suppliers would be able to offer lesser charges.

- 310 In particular, the ACCC expressed concern about asset categories such as current accounts receivables, long term investments and ‘other assets not expected to be developed, utilised or received within the next twelve months and which have not already been included’, where the relationship of the asset items to provision of the LSS was not clear.
- 311 The ACCC asked parties to the ULLS arbitrations in its supplementary consultation paper about whether similar concerns were evident here.
- 312 The concerns expressed in the LSS final determinations about inappropriate asset categories are perhaps less relevant to the ULLS case. This is because by far the largest categories of assets (around [c-i-c] per cent) are either CAN ducts and pipes or CAN copper cables. The ACCC considers that the relevance of these cost categories to the provision of the ULLS is not controversial (although as noted above, it does not consider that the level of costs claimed will be efficient or forward-looking).
- 313 However, the ACCC notes that, for the small level of organisational assets, but more relevantly for the expense categories claimed, using CCA data may be of a concern given that the particular assets or expenses are not ones that have been identified as being directly caused by the ULLS, but rather comprise a share of a higher level cost pool. Including Telstra’s claimed CCA balances would risk admitting costs at a level that are not representative of TSLRIC+ levels.
- 314 There are two reasons for this. The FDC approach may use allocators that do not align with incremental costs of the ULLS, and/or a reasonable allocation of overheads necessary to the supply of the ULLS. This risk is increased given that the relevant CCA expense amounts for the ULLS are comprised entirely by allocations made from higher-level cost pools, and not directly allocated costs. For instance, Telstra’s claimed marketing and sales expenses represent a share of Telstra’s marketing and sales expenses for a pool of services, and not expenses that have been identified as being caused by marketing of the ULLS. Telstra agrees that certain of those marketing costs that had been allocated to ULLS could be seen as costs that would not be incurred by a provider of the ULLS, although it submits that the level of costs is immaterial.²²⁰ The ACCC notes that all of the other expense categories are only allocated from higher-level cost pools and similar cost categories unrelated to the ULLS could be included in the claimed cost categories.
- 315 Similarly, within the small class of organisational assets, the ACCC noted to the parties that it is not clear why “other assets not expected to be developed, utilised or received within the next twelve months and which have not already been included” or “all other current assets held for conversion within the next twelve months and not already included except for cash and short term investments” are relevant to the ULLS. Telstra submits that these are appropriate items to be incurred, submitting that the first category largely relates to completed software assets and that the second relates largely to prepaid operating expenditure, inventory balances and deferred expenditures on connections or installations.

²²⁰ Telstra, above n 16, p. 5.

It removes the last category in its updated model. Telstra submits that all of these values would be incurred by any provider of ULLS. However, the ACCC notes that, for example, while the ULLS clearly requires some software assets, the amount recorded for software assets do not relate to the ULLS in particular, but are a portion of software assets generally. The ACCC considers that its concerns remain about the usefulness of CCA data for TSLRIC+ modelling.

316 Secondly, as noted previously, current cost accounts have the potential to update the prices of existing equipment, including adopting costs associated with modern equivalent assets for assets no longer commercially available. However, as noted by the Tribunal, the claimed balances may not represent efficient forward-looking levels, as they reflect investment choices which may never have been representative of efficient decisions or no longer represent efficient choices. Accordingly, the ACCC considers that CCA values assigned to the cost pools will overstate TSLRIC+.

317 Telstra has submitted that the class of asset categories that might more obviously include unnecessary assets is small. The ACCC agrees with this. However it notes that even for the CAN asset categories, the asset balances largely consist of allocated rather than direct costs. Telstra also submits that there is no evidence that its cost claim includes cost categories that are inefficient, unnecessary to the supply of the ULLS, or relate to downstream or other services.²²¹ Telstra asserts that its allocations are made in accordance with the RAF. As noted in the ACCC's pricing principles report, the ACCC does not accept that making allocations in accordance with the RAF will lead to CCA data providing a TSLRIC+ measure.

318 Lastly, the ACCC noted to the parties in its supplementary consultation paper that there is the potential for claimed costs to be recovered in other charges, and that any such costs that are recovered in other charges should be excluded from the cost pool to be recovered from ULLS monthly charges. The ACCC identified Telstra Exchange Building Access (TEBA) charges, and cable interconnection charges as possible examples of other charges that recover in part the claimed costs. The ACCC notes Telstra's submission that, regarding "TEBA and cable interconnection charges", costs are allocated in according with Regulatory Accounting Rules, the CCA allocates a positive amount of accommodation and property costs to facilities access that CAN assets and costs are not allocated to facilities access services and TEBA and cable interconnection charges do not seek to recover CAN costs.²²² However, as noted above the ACCC does not accept that making allocations in accordance with the RAF will lead to CCA data providing a TSLRIC+ measure.

Assessment of the use of Telstra's model and PIE II/specific cost model against subsection 152CR(1) matters and pricing principles

319 Given the above analysis, and after having regard to the subsection 152CR(1) matters as discussed below, the ACCC has decided not to use Telstra's model and has decided to utilise the models it proposed to the parties in its consultation paper for calculating ULLS costs. The ACCC considers that using its specific cost model and a PIE II model with

²²¹ Telstra, *op cit*, p. 11.

²²² Telstra, *op cit*, pp. 11-12.

appropriate inputs will better lead to costs that reflect the section 152CR(1) matters.

Paragraph 152CR(1)(a)

- 320 In terms of applying the subsection 152CR(1) criteria, the first criterion concerns the long term interests of end-users (paragraph 152CR(1)(a)). This calls for consideration of a number of factors identified in section 152AB, namely the objective of promoting competition, the objective of achieving any-to-any connectivity, the objective of encouraging the economically efficient use of and the economically efficient investment in infrastructure and subsidiary matters (paragraphs 152AB(2)(c)-(e), sub-section 152AB(4), paragraphs 152AB(6)(a)-(c) and subsection 152 AB(7A)).
- 321 As discussed previously, the ACCC considers that access charges that represent the forward-looking costs of an efficient provider best promote competition. The ACCC's pricing principles make this clear in the adoption of a TSLRIC+ methodology. This is because, over the long run, forward-looking efficient costs lead to conditions which allow the access provider and access seekers to compete in downstream markets on their relative merits. The ACCC considers that its preferred models are more consistent with this outcome, and so would better promote competition. The ACCC does not consider that CCA balances reflect forward-looking costs as they reflect past investment decisions that are not assessed for relevance or adjusted for efficiency.
- 322 An efficient access provider would incur certain costs of the type Telstra has claimed; the question is whether the level of costs are those of an efficient operator of the ULLS. The ACCC considers that Telstra's original cost claim for the ULLS, that Telstra prepared using bottom-up TSLRIC+ models and which were used in proposing the DFD, lead to more appropriate estimates of the efficiently incurred costs of the ULLS. Although there is the potential for some inefficiencies to occur in these models, the use of a TSLRIC+ bottom-up methodology and the comparative level of sophistication in modelling techniques would likely result in costs closer to efficient levels.
- 323 Comparatively, the ACCC is not satisfied that the level of costs claimed in the Telstra alternative model are an efficient forward-looking level of costs, nor that all the expense and asset categories are relevant to provision of the ULLS.
- 324 Accordingly, the ACCC considers that its proposed approach would better promote competition.
- 325 The ACCC considers that the choice of models used would not affect any-to-any connectivity.
- 326 The ACCC considers that its models will better lead to efficient investment decisions. By setting prices that better reflect forward-looking efficient costs, the ACCC considers that parties will make more appropriate build/buy decisions and better promote efficient investment. By providing for a risk-adjusted rate of return, the ACCC has regard to the risks involved in investing.
- 327 The ACCC considers that accepting Telstra's model is unnecessary to meet Telstra's legitimate commercial or business interests, including its interest in recovering its direct

costs of supplying the ULLS or exploiting economies of scale or scope in the provision of ULLS and CAN-based services. The ACCC considers its proposed approach is sufficient to meet these interests, as the level of costs that Telstra incurs in supplying the ULLS is less than those claimed in its model. The ACCC's proposed approach accounts for all of the costs that are likely to be incurred in the provision of the ULLS.

Paragraph 152CR(1)(b)

- 328 This criterion concerns the legitimate business interests of the provider and its investment in facilities used to provide the ULLS (paragraph 152CR(1)(b)). This criterion is discussed as part of the first criterion. The ACCC considers that its approach is consistent with Telstra realising its legitimate business interests, such as recovering its costs of providing access and a normal, risk-adjusted return on its investment.

Paragraph 152CR(1)(c)

- 329 This criterion concerns the interests of all persons with rights to use the ULLS (paragraph 152CR(1)(c)). The access seekers' interests lie in being able to compete on their relative merits. The ACCC considers its approach best meets this criterion, as access seekers pay access charges based on the efficient forward-looking cost of supplying the ULLS. Telstra's proposed approach would not, as it would tend to inflate ULLS access seekers' cost base above TSLRIC+ and relative to Telstra's cost base. This would be detrimental to access seeker' interest and impede their ability to enter markets and supply downstream services.

Paragraph 152CR(1)(d)

- 330 This criterion concerns the direct costs of providing access to the ULLS (paragraph 152CR(1)(d)). It is concerned with ensuring that Telstra will be able to recover its costs of providing access, to itself or others. As noted above, the ACCC considers that its approach of using the PIE II and specific cost models will be sufficient to meet the direct costs of the ULLS. The ACCC's proposed approach accounts for all the costs that are likely to be incurred in the provision of the ULLS.

Paragraphs 152CR(1)(e) & (f)

- 331 The cost of extensions to Telstra's ordering systems necessary to supply the ULLS (and equivalent services) are taken into account within the ACCC's specific cost model. The ACCC does not consider that the 'operational and technical requirements' criterion materially contributes to this decision.

Paragraph 152CR(1)(g)

- 332 The ACCC has also considered the objective of enabling a carriage service, telecommunications network or facility to be operated efficiently. The criterion in paragraph 152CR(1)(g) calls for consideration to be given, in this instance, to services, networks and facilities associated with the ULLS and downstream voice and DSL services, of the access provider, the access seeker, and any other downstream service providers. The ACCC considers that its proposed approach strikes the best balance. It will

lead to conditions that make competition in downstream DSL services more likely, which will in turn encourage efficiencies in markets for those services.

333 Turning to the ULLS pricing principles, the ACCC considers that its approach best meets these principles. Although Telstra considers its alternative model can approximate the TSLRIC+ of providing the ULLS, as noted above, the ACCC considers that Telstra's approach will significantly overstate TSLRIC+ of the ULLS. It notes the conclusions of its pricing principles report in that regard.²²³ Further, Telstra's approach appears inconsistent with the requirement in the pricing principles, to have express regard to LSS and ULLS specific costs, and the equivalent costs of internal supply of these inputs.

n/e/r/a

334 Telstra has advocated the use of the ACCC's n/e/r/a model, while PowerTel and Request submitted that no regard should be had to the model. Telstra asked for access to the model a number of times during the course of the arbitrations (2 March, 19 March, and 19 October). In its initial submission in response to the DFDs Telstra submitted that the ACCC had an obligation to update and adjust the n/e/r/a model.

335 In its response to Telstra in the course of this arbitration, the ACCC stated that it considered that using a model based on what are now outdated data and modelling techniques would not be appropriate for the purposes of resolving this access disputes. The ACCC noted that it was not proposing to use the model in setting prices in the course of the arbitration and has not used the model in its regulatory price-setting or price-assessing roles since 2002. Accordingly the ACCC considered that there was no need to have access to the model.

336 The ACCC maintains the view that the n/e/r/a model is not relevant in this arbitration, to decisions on ULLS costs or to setting monthly prices in the final determination. The ACCC notes that the Tribunal reached the following conclusion about the use of the n/e/r/a model:²²⁴

The Commission contended that the adjusted NERA model no longer reflected best practice and was significantly out of date as it had not been updated since 2000/2001. In a submission to the Commission dated 25 July 2004, Telstra accepted that the NERA model was significantly out of date and no longer provided any meaningful insight into the cost of its network.

In the light of this acknowledgement by Telstra, we are not satisfied that the NERA model adequately models the current ULLS network costs or that the model provides a reasonable estimate of the efficient network costs associated with providing the ULLS for the periods covered by the undertakings.

337 The ACCC considers that, in light of its and the Tribunal's views on the n/e/r/a model, that the ACCC should not have regard to the model in setting ULLS prices. As discussed earlier in these reasons, the ACCC considers that an adjusted PIE II model can be used to

²²³ ACCC, above n 5, p. 11.

²²⁴ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [376].

provide a reliable measure of the TSLRIC+ of the ULLS in the bands that are the subject of the final determination. Accordingly, the ACCC does not need to develop another model to do this. The ACCC does not consider that it is under any obligation to update and adjust the n/e/r/a model in these circumstances. The n/e/r/a model would not lead to prices that accord with the relevant statutory matters in section 152CR of the TPA.

International benchmarks

- 338 Finally, Telstra submits that regard should be had to international benchmark prices for the ULLS, adjusted for population density and purchasing power parity. Access seekers oppose this.
- 339 The ACCC notes that it is valid to have regard to international examples and that this can in certain circumstances provide useful information. However, the ACCC noted the following in its ULLS pricing principles report about using international benchmarks to directly assess prices between jurisdictions:²²⁵

In general, the ACCC considers that international benchmarking should be used cautiously in informing regulatory pricing decisions. In particular, before international benchmarks might be useful, the ACCC would need to be satisfied that, notwithstanding differences between Australia and the relevant international jurisdictions, the international benchmarks are reasonable comparators. Relevant differences may include matters such as the definition of the regulated service, the applicable regulatory framework, the geographic price structure, the cost of capital, the prescribed cost standard (if any) and population concentration and distribution (as opposed to population density). Accordingly, the ACCC considers that international benchmarks are often of limited informative value.

- 340 The ACCC considers that its conclusion in its pricing principles report is equally valid in the current context. In particular, the ACCC notes that Telstra adjusts prices for population density only. However, the ACCC considers that population concentration and distribution are particularly relevant to the Australian context.
- 341 Having regard to these views, the ACCC does not propose to use international benchmarks in setting monthly prices in these access disputes.

TEA model

- 342 The ACCC notes Telstra's letter of 17 December 2007 that the ACCC should have regard to Telstra's TEA model. While the ACCC welcomes the development of the TEA model by Telstra, it does not consider that it would be appropriate to delay the final determinations to assess the model in the context of these arbitrations.
- 343 The ACCC considers that its experience with modelling using models such as PIE II and the n/e/r/a model has shown that network cost modelling can take a significant time to resolve. The ACCC notes that the TEA model is as yet untested, that the extent of the

²²⁵ ACCC, above n 5, p. 11.

model is not known and that the model has not been the subject of any comprehensive review by parties external to Telstra. Accordingly, the ACCC considers that resolving issues with the implementation of the new TEA model could take considerable time and would be likely to continue significantly beyond the currently planned expiry date of the final determinations. Accordingly, the ACCC anticipates that there would be significant delay in the making of final determinations in the disputes were the ACCC to defer the making of final determinations. In that regard, the ACCC notes that section 152CLA requires the ACCC to have regard to the desirability of access disputes being resolved in a timely manner.

344 The ACCC notes that Telstra is prepared to reinstate and maintain pricing in interim determinations until the ACCC makes final determinations. Telstra has submitted that this will prevent any prejudice to access seekers. However the ACCC notes that access seekers also have a significant interest in the regulatory certainty afforded by a final determination. In that respect, the ACCC notes that a number of the access disputes have been running for a significant length of time, in some cases over two years.

345 In light of:

- the very late introduction of the TEA model into the arbitration process
- The need to resolve the access disputes in a timely manner
- The fact that the TEA model has not been the subject of any external review and the likelihood that such review will take a considerable amount of time
- The benefits of regulatory certainty

the ACCC considers that it will not have regard to the TEA model for the purposes of the current arbitrations.

4.1.8 Network costs

Introduction

346 Network costs are one of the two cost components recovered in ULLS monthly charges. Network costs refer to the capital, operational and maintenance, and indirect costs of Telstra's fixed line network. In particular, for the ULLS, the relevant efficient network costs are the efficient costs attributable to the copper lines between the end-user and the exchange.

347 In prior regulatory proceedings, a number of separate issues that influence (to varying degrees) the measurement of ULLS network costs have been raised for consideration. The ACCC's views on these matters are discussed below.

348 As noted above, and consistent with the ACCC's preparedness to accept alternate methods for an access provider to put forward material about its efficient costs, the ACCC considers that it is appropriate to use the PIE II model, with appropriate inputs, to

estimate network costs for the purpose of setting ULLS monthly prices.

349 The PIE II network cost model was first submitted by Telstra to the ACCC in January 2003 in support of Telstra's undertakings for PSTN originating and terminating access and ULLS. Since that time, the ACCC has attempted to work with Telstra to overcome concerns about:

- the model's lack of transparency
- users' inability to manipulate the model
- the model's overestimation of network costs in regional and rural areas (particularly in Band 4)
- Telstra's unwillingness to change the model as a result of the ACCC's and industry's concerns.

350 As noted in the consultation paper, the ACCC most recently set out those concerns in its August 2006 final decision on Telstra's ULLS monthly charge undertaking from December 2005.²²⁶ The ACCC also expressed particular concerns in that report about issues such as network provisioning, operational and maintenance factors, network planning costs, trench sharing, network design parameters and the annualisation of capital costs.

351 The ACCC notes that Telstra has recently been conducting further modelling work that may seek to address the ACCC's concerns. However, despite attempts to work with Telstra on modelling issues, a number of ACCC concerns with PIE II have not to date been addressed by Telstra.

352 The ACCC can make changes to some inputs to the PIE II model - such as the Weighted Average Cost of Capital (WACC) inputs - that address significant concerns. Further, although the ACCC has commissioned a fixed network cost model that it anticipates will be available in mid 2008, the ACCC is yet to develop an alternative cost model in preference to the PIE II model. Similarly, various access seeker parties submitted on the lack of transparency and usability of the PIE II model, although Telstra submitted that these concerns about transparency were unfounded.²²⁷ The ACCC continues to hold concerns about the transparency of the model. However, given the need to resolve this disputes in a timely and efficient manner, the ACCC considers that it would not be appropriate to wait until an alternative cost model is available and tested.

353 Accordingly the ACCC has used the PIE II model with the ACCC's preferred inputs to set prices for the final determinations, despite its concerns. The ACCC considers that this is a conservative position likely to lead to an estimate of efficient network costs that is higher than if all the ACCC's concerns were fully addressed.

²²⁶ ACCC, above n 32, Appendix B.

²²⁷ Telstra, above n 42, p. 82, Annexure 13.

354 In assessing particular modelling assumptions the ACCC must have regard to the section 152CR matters. The ACCC considers that this will be achieved by considering whether cost assumptions and inputs better lead to an estimate of the efficient forward-looking network costs of the ULLS. The ACCC considers that such assumptions and inputs resulting in efficient forward-looking network costs will:

- better promote the LTIE, as they will better promote competition and encourage the economically efficient use of and investment in infrastructure. The ACCC considers that efficient cost-reflective prices will allow access seekers and Telstra to compete on the basis of their relative efficiencies, and allow for appropriate build/buy decisions
- allow Telstra to recover amounts necessary to protect its legitimate business interests, but not more than necessary. The ACCC also considers that efficient cost-reflective prices will allow Telstra to exploit the economies of scale and scope inherent in its network
- allows access seekers to compete on their merits
- reflect the direct costs of providing the ULLS
- allow the recovery of sufficient costs to ensure the safe and reliable operation of the network.

355 The ACCC does not consider that the matter in paragraph 152CR(1)(e) is likely to be a material considerations in the consideration of network costs.

356 As discussed below, the parties have made submissions on various aspects of the use of the PIE II model, appropriate inputs and possible adjustments to the model's costs. Telstra has also submitted with its initial submissions a revised version of the model that seeks to address several criticisms of the model made by the Tribunal about the years modelled by PIE II. The ACCC considers these issues in turn below.

Years modelled by PIE II and the need for “roll-forward”

357 Telstra's PIE II model was originally designed to provision a network and calculate network costs for the period 2001-02 to 2004-05. Accordingly, the model as provided to the ACCC at the time of the DFDs was incapable of modelling a network for the years relevant to the access disputes. Accordingly, to calculate costs for 2005-06, 2006-07 and 2007-08, which are the years relevant to the access disputes, a procedure was required to take costs from years up to and including 2004-05 and extrapolate them to 2005-06 and beyond.

358 In submissions supporting its December 2005 ULLS undertakings, Telstra provided a Microsoft Excel spreadsheet that it had used to calculate network costs for the years of its undertakings (2005-06 to 2007-08).²²⁸ Telstra's approach was to estimate a model for the 2004-05 financial year, and then alter the prices for that 2004-05 network by use of the

²²⁸ Telstra, “PIE II Rollforward new ULLS.xls” model, as submitted to the ACCC on 14 March 2006

“Scenario costing” page in the PIE II model.²²⁹

359 The Tribunal raised two primary concerns with the approach used by Telstra:²³⁰

- the PIE II model uses a distribution of addresses as at October 2000
- the Telstra approach assumes that the aggregate number of SIOs remains at 2004/2005 levels.

360 The Tribunal accordingly criticised the model on the basis that it was “not satisfied that the PIE II model depicted the dimensions of Telstra’s CAN or its ULLS network for any of the years to which the undertakings relate”.

361 Informed by the Tribunal’s comments, the ACCC’s preliminary view was that Telstra’s approach from its undertaking submissions was not the most appropriate method to calculating network costs for 2005-06 onwards. In particular, Telstra’s approach assumed a static network – ie. that the number of lines remains the same as that in 2004-05.

362 The ACCC considers that it would be more appropriate to assume that the size of the network is changing, in accordance with observed and forecast trends. However it did not have access to a version of the model that could run for 2005-06, 2006-07 and 2007-08, nor was it in a position to update the model to do so, given the well-documented issues with the transparency and manipulability of the model.

363 Accordingly the ACCC’s preliminary view, as set out in its consultation paper, was that a better approach to estimating costs for 2005-06 and onwards would be to:

- estimate networks for 2002-03, 2003-04 and 2004-05
- calculate costs for those networks using appropriate WACC assumptions
- calculate costs for subsequent years by extrapolating the trend in ULLS prices from the three years estimated.

364 The ACCC considered that this approach better reflected the trend in SIOs in Telstra’s network over time. The ACCC’s preliminary approach was designed to reflect trends in both prices **and** demand, as opposed to Telstra’s approach which only reflected trends in prices.

365 The ACCC noted that its proposed approach would not directly address the Tribunal’s concerns about population growth patterns and the distribution of lines in the network. In its consultation paper, the ACCC sought submissions from the parties on this particular issue as well as on its proposed approach generally.

²²⁹ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [341] to [348].

²³⁰ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [356].

366 The ACCC also did not adjust SIO, call and minutes of use (“MOU”) demand figures in the model on the basis that there was a lack of apparent data on which the changes could be made, that call costs would have minimal effect on ULLS costs and that it may be inconsistent to only adjust SIO figures while not changing call data.

Submissions from parties

367 The parties’ views on particular inputs are discussed separately. The following discussion deals with views on the issue of the years for which prices are set in the final determination.

368 Optus considered that the ACCC’s proposed approach was a reasonable and pragmatic one and accepted the ACCC’s position on demand.²³¹ PowerTel/Request also accepted the ACCC’s proposed approach.²³² Chime, Primus and Macquarie did not specifically address this point.

369 Telstra objected to the ACCC’s approach.²³³ Despite not having previously indicated to the ACCC that the PIE II model could be updated in such a way as to more directly address the Tribunal’s concerns, or presenting an updated model in the course of the ACCC’s previous undertaking process, Telstra criticised the ACCC’s failure to make adjustments to the underlying data in the model. Telstra criticised the fact that the ACCC had used customer locations from 2001, SIO distributions from 2001, SIOs, MOUs and call volumes from 2002, an old US\$ exchange rate, old exchange service area (“ESA”) banding and old ULLS demand proportions.²³⁴

370 In response to these criticisms, Telstra updated data in the underlying databases in the PIE II model and submitted that the ACCC could not rely on PIE II without making such adjustments.²³⁵ Telstra’s amendments involved overwriting various underlying databases in the model with updated information from 2006 and 2007—customer locations, SIO distribution per ESA, banding of exchanges, starting asset prices and forecasts of SIOs, MOUs and call volumes—as well as amending input variables in the model such as the US\$ exchange rate, ULLS target demand proportions, price trends and WACC.²³⁶

371 PowerTel/Request in their reply submissions noted Telstra’s adjustments but maintained that the PIE II model was “fundamentally defective and unreliable”.²³⁷ It is unclear whether PowerTel/Request were objecting to the approach used by Telstra or to particular parameters.

ACCC’s view

²³¹ Optus, above n 49, pp. 15-16.

²³² PowerTel and Request, above n 49, p. 11.

²³³ Telstra, above n 42, p. 29.

²³⁴ Telstra, *op cit*, pp. 29-30.

²³⁵ Telstra, *op cit*, p. 30; Annexure 21.

²³⁶ *Ibid*.

²³⁷ PowerTel and Request, above n 49, p. 39.

- 372 The ACCC deals with certain of Telstra's contentions and suggested changes separately below. However it considers it appropriate to firstly consider Telstra's updated version of the PIE II model to the procedure proposed by the ACCC in the DFDs.
- 373 The ACCC notes that its DFD approach suffers from some inherent limitations, such as being based on customer locations from 2001 and relying on an extrapolation of prices from 2002-03, 2003-04 and 2004-05, rather than modelling the years of the undertaking. In that respect, the ACCC considers that its DFD approach was the best approach available at that time.
- 374 However, in light of Telstra updating PIE II to contain information more applicable to the periods relevant to the arbitrations, the ACCC considers that it is preferable to use Telstra's proposed model (subject to the views contained below on the appropriate inputs). The ACCC considers that the use of customer, SIO and usage data more proximate to the time of the arbitrations will better lead to estimation of the forward-looking cost of the network for the periods of the final determinations.
- 375 The ACCC notes that access seekers in their initial submissions generally supported the ACCC's proposed approach in its consultation paper. However at that stage parties did not have access to the updated PIE II provided by Telstra. Access seekers have generally not objected to the approach of using the updated model.
- 376 Accordingly the ACCC considers that it will use the updated PIE II model submitted by Telstra, but populated with the ACCC's preferred inputs as discussed below, in preference to the use of a roll-forward mechanism in its calculations of ULLS network costs. The ACCC notes that it generally considers it appropriate to use information available at around the time of the commencement of the dispute, but in the present case considers that the revised PIE II model's advantages over the roll-forward approach mean that it should use the revised model.

Weighted average cost of capital inputs

- 377 The weighted average cost of capital (WACC) is used to calculate a normal return on capital employed. There are a number of inputs relevant to deriving a WACC. The ACCC in its consultation paper proposed using a 'post-tax vanilla' WACC ranging from around 8.5 per cent to 9.5 per cent for each relevant year. These rates and inputs were based on analysis and evidence discussed in the ACCC's assessment of WACC as part of its consideration of Telstra's ULLS monthly charges access undertaking.²³⁸ The ACCC sought the parties' views in its consultation paper.
- 378 The matters that the ACCC particularly drew the parties' attention to were:

²³⁸ ACCC, above n 31, Appendix D.

- whether the asset beta, and WACC inputs generally, should be the asset beta and inputs observed for a business supplying PSTN services, or some other business – the ACCC’s preliminary view was that it should be the former²³⁹
- whether the risk free rate should be based upon a five year or ten year bond –the ACCC’s preliminary view was to follow its current practice of using the yield on Commonwealth 10 year bonds and to take a 10 day average leading up to the relevant date
- the date upon which the relevant observations of the risk free rate should be made for the financial years subsequent to the time to which the final determination is to be backdated – the ACCC’s preliminary view was that it is appropriate to use forward looking risk-free rate data from around the time that the dispute began, consistent with the approach outlined in the ACCC’s letter of 5 April 2007²⁴⁰
- whether there was an asymmetry in social consequences from setting the WACC too low that should be accounted for by setting a WACC uplifted by one standard deviation – the ACCC’s preliminary view was that it was not clear that there is any asymmetry in outcomes and that no uplift should be incorporated into the WACC.²⁴¹

379 The ACCC’s preliminary views on the first and fourth of these points were informed by the conclusions of the Tribunal in its consideration of the WACC in Telstra’s ULLS monthly charge undertakings.²⁴²

380 The ACCC used certain WACC inputs that reflected conclusions drawn in its August 2006 final decision on Telstra’s ULLS undertaking about debt premium and debt issuance costs. It proposed using the statutory tax rate as a pragmatic solution.

Submissions from parties

381 Telstra submits that the estimation of the WACC should be based on the approach as described in its submission, and in particular on the reports of Professor Bowman attached to its submission.²⁴³

382 Telstra submits that the ACCC is applying a WACC developed in the context of PSTN OTA. Telstra submits that the ULLS has greater riskiness to PSTN OTA as services supplied over it, such as broadband, have a more discretionary element than traditional

²³⁹ ACCC, above n 31, p. 101.

²⁴⁰ The ACCC used for the years 2006-07 and 2007-08 a rate of 5.82 per cent, which is an average for the 10 days leading up until 30 June 2006. The ACCC considers that, as a forward-looking estimate from 2005-06 (the year of negotiations and notification of disputes), it would be appropriate to use this rate for 2006-07 and 2007-08.

²⁴¹ ACCC, above n 31, p. 127.

²⁴² *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [428] to [429], [449].

²⁴³ Telstra, above n 42, p. 116, Annexure 18.

telephone services and that accordingly a higher WACC would be appropriate.²⁴⁴ Telstra also submits on various values and parameters to be used in quantifying the WACC.²⁴⁵

- the ACCC should apply a 10 year bond rate, but the risk free rate should not be averaged, should be observed on the previous trading day to each of 1 July 2005, 1 July 2006 and 1 July 2007 and should be applied to asset valuations on or close to those dates
- a Telstra-wide debt risk premium DRP should be preferred rather than a benchmark DRP, and as with the risk free rate should be measured on the trading days prior to 1 July 2005, 1 July 2006 and 1 July 2007 and that these values be applied to the asset valuations on or close to those dates
- debt issuance costs of around 15 basis points should be allowed based on results from US studies
- the market risk premium (“MRP”) should be 7.0 per cent and not 6 per cent as adopted by the ACCC in the past
- a corporate tax rate is to be preferred
- an imputation factor of 0 per cent should be used to reflect emerging international opinion about the marginal investor
- an asset beta of 0.75 is more appropriate to pricing ULLS services in recognition of higher systematic risk
- equity issuance costs should be included in the WACC rather than cash flows
- gearing should be [**c-i-c**] per cent or [**c-i-c**] per cent rather than the ACCC’s preferred 40 per cent.

383 Telstra also raises, as it has in other regulatory proceedings, what might be termed the ‘welfare asymmetry’ argument; that the social consequences of under-estimating the WACC are greater than the consequences of over-estimating it.²⁴⁶ Telstra submits that to address this welfare asymmetry that the WACC should be set at ‘a somewhat above normal rate-of-return’.

384 Optus submits that the ACCC’s asset beta should be adjusted to reflect the fact that operation of a CAN is lower than that of an operator of a PSTN.²⁴⁷ It also submits that the risk-free rate should be averaged but that the ACCC should reconsider its use of a 10 year rate in favour of a five year rate that better accorded to the regulatory period. It submitted that using a risk-free rate from around the period of the dispute was reasonable. It

²⁴⁴ Telstra, *op cit*, p. 40, Annexure 18.

²⁴⁵ Ibid.

²⁴⁶ Telstra, *op cit*, Annexure 19.

²⁴⁷ Optus, above n 49, p. 13.

submitted that there was no evidence of an asymmetry in social consequences and that an effective tax rate should be applied.

385 In its response submission, Telstra responded to Optus' submissions.²⁴⁸ Telstra submitted that the asset betas for gas and electricity are irrelevant and provide minimal assistance except as an inappropriate floor on a possible asset beta. It also submitted that a ten year maturity was appropriate, in that there was no notable regulatory cycle and that other conditions for matching the risk-free investment maturity to regulatory cycle were not in any case met. Telstra also submitted again that the risk-free rate should not be averaged, or calculated at around the time of the access dispute. Finally, Telstra contends that the effective tax rate is not appropriate.

386 PowerTel and Request accepted the manner in which the ACCC had calculated the WACC.²⁴⁹

ACCC's views

387 Three principal issues were addressed by the parties regarding the estimation of the WACC:

- the appropriateness of applying the WACC of the PSTN to CAN services such as the ULLS (which principally affects the estimation of the Asset Beta)
- whether to provide for an 'above normal' WACC value on the basis of Telstra's 'welfare asymmetry argument'
- when to observe particular CAPM inputs.

388 The subsequent approach to individual CAPM inputs has a lesser influence to the WACC measure.

389 In assessing the various approaches to these issues, the ACCC has had regard to the ULLS pricing principles and the subsection 152CR(1) criteria.

– Appropriate asset beta

390 The ACCC maintains its position that the appropriate WACC for the ULLS is one based on a business of providing access to a fixed-line customer access network, either to itself or to other service providers.

391 Consistent with previous decisions, the ACCC notes that direct observations are unavailable for different services supplied on the CAN, such as the ULLS. In part, this is a result of factors such as vertical integration and expansion of fixed network service providers into additional services such as mobile telephony. Consequently, the ACCC's approach has been to use the observed asset beta of a business of supplying voice services

²⁴⁸ Telstra, above n 11, pp. 8-19.

²⁴⁹ PowerTel and Request, above n 49, p. 29.

on a fixed-line CAN, before the relevant business diversified into other services, such as mobiles.²⁵⁰

392 Similarly, the ACCC rejects the submission that the asset beta, and other CAPM inputs, should be adjusted in an attempt to more precisely estimate the WACC for a business of only providing the ULLS. Consistent with previous decisions, the ACCC considers that the relevant consideration is the WACC (and hence asset beta) for a carrier who operates the PSTN. Such an operator will make the decision whether to operate the PSTN on the aggregate cash flows generated by the PSTN asset, whether or not the cash flows are generated from the supply of the ULLS, broadband, traditional voice or other services.²⁵¹ The ACCC does not consider that it is necessary or realistic to consider an operator of just ULLS services.

393 Furthermore, and at the conceptual level, the ACCC reaffirms its position that if a higher asset beta was to be allocated to a specific set of assets, then, in principle, this would require a compensating reduction in the WACC that is applied to other fixed-line services. Telstra discusses the desirability of applying different asset betas to different assets. However, based on the material provided and assessed, the ACCC does not consider that compensating adjustments to other assets necessary to ensure that the WACC for the CAN as a whole remains constant, or how these could be reliably estimated.

394 Finally, the ACCC again raises the important practical consideration that in considering adjustments of this type to reflect the relative riskiness of different services the potential exists to introduce many sources of error. As such any change would need to be supported by robust and extensive data. The ACCC does not consider that such data are available, and the submissions made to the ACCC do not attempt to make such a measure of the relative riskiness of different services. In that respect, the ACCC notes the views of the Tribunal that, while “it is arguable that different WACC values can be validly determined for each asset group. However the leap from theoretical possibility to practical reality can be a large one”.²⁵²

395 Following from these considerations, and consistent with its previous views, the ACCC has applied the same WACCs to both network and specific costs.

– Welfare asymmetry

396 The ACCC has considered Telstra’s arguments previously, and has not accepted that there is a welfare asymmetry in the social consequences of over-estimating or under-estimating the WACC.²⁵³ The Tribunal has also considered a possible asymmetry and relevantly considered that:²⁵⁴

We accept that it is possible that there may be asymmetric consequences associated with setting a WACC too high or too low. However, it is not clear to us

²⁵⁰ ACCC, above n 31, p. 110-115.

²⁵¹ ACCC, *op cit*, p. 101.

²⁵² *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [428] to [429].

²⁵³ ACCC, above n 31, p. 125.

²⁵⁴ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [449].

that the asymmetry would always imply that overestimation of the WACC led to a lesser social cost than underestimation of the WACC. The nature of the asymmetric consequences of incorrectly setting a WACC is likely to depend on the circumstances of a given matter.

- 397 The ACCC remains of the view that an unbiased estimate of the WACC that allows for a normal rate of return on capital is appropriate given the regulatory criteria to which it must have regard.
- 398 Telstra presents a description of the potential cause and effects of any welfare asymmetry.²⁵⁵ Telstra contends that the consumer gains from consumption of a service are substantial and that if the WACC is set too low these gains will not be realised insofar as the necessary investment is not undertaken. Conversely, Telstra states that if the WACC is set above the normal level, the investment will always be undertaken and that the consumption gains will be realised. However, Telstra acknowledges that there will be a ‘second-order’ welfare effect from overpricing of these services. Essentially, Telstra contends that the ‘second-order’ effects from overpricing will be less adverse to welfare than the consumption effects of the investment not occurring in the first instance.
- 399 An important assumption underlying Telstra’s submission is that investment decisions are effectively ‘all-or-nothing’: either the WACC is sufficient and all investors would consider undertaking the investment, or the WACC is collectively adjudged to be too low and no investor will consider undertaking the investment. Telstra states that this decision will be common to all investors as typically they will require external financing for major projects and, it can be inferred, that capital markets tend to hold a collective view of the expected viability of different investments.
- 400 The conceptual argument presented by Telstra obviously does not allow for heterogeneity in terms of risk profiles, or requirements as to returns among investors or participants in capital markets. Telstra’s assumption is that all investors – and by extension financiers in capital markets – share a common view as to an appropriate WACC for an investment project. This implies that *all* investors have similar expected marginal costs and revenues (as this impacts the margin necessary for the project to be considered viable). In addition, it assumes that all potential investors have a homogenous risk profile.
- 401 In the ACCC’s view these assumptions are unlikely to reflect how investment decisions are actually made in practice. More generally, in the ACCC’s view, the decision as to whether or not to invest in a specific project can differ among different groups of investors, and over time is dependant on factors such as the relative risk aversion and the expected returns required on different investments. In this respect, the ACCC notes the views of the Tribunal:²⁵⁶

Telstra assumed that setting a WACC that was too low would deter investors. However, different investors will inevitably have different attitudes to risk. Setting the WACC below the true value may deter some investors and therefore result in less investment taking place in the short run, but it will not be likely to cause all

²⁵⁵ Telstra, above n 42, Annexure 19.

²⁵⁶ Telstra, *op cit*, Annexure 19.

investors to cease providing funds.

402 As risk aversion and expected returns are likely to differ among different investors and institutions, it is unlikely that there will always be a common view among investors and capital markets as to appropriateness of a particular return on capital. Rather investors will have different risk and return profiles for investment projects, and it is precisely the possibility to take advantage of these differences which arguably drive capital markets. For this reason, it is possible to observe in practice a combination of both high risk investments being undertaken at high rates of return, and at the same time, relatively low risk investments with correspondingly lower rates of return.

403 A separate argument raised in Telstra's submission to these proceedings is that the WACC employed by the ACCC may, in fact, be part of a 'strategy by the regulator of leaning toward low rates of return' or that the ACCC might offer a rate of return designed to ignore certain costs.²⁵⁷ Telstra submits that, as a consequence, the WACC should be increased to address this. This suggestion raises different issues to those discussed in prior regulatory decisions, where Telstra's position could be inferred to be one of accepting that the WACC estimate was properly estimated, but that the uncertainty regarding the estimation process suggested that it was prudent to allow for an above normal return.

404 The ACCC has not been provided with, nor is it aware of, any evidence that it has followed a strategy of leaning towards low rates of return in the estimation of the WACC or ignored relevant costs in setting the WACC. In the ACCC's view, suggestions that the ACCC has acted in this way, and the WACC should be adjusted to address this, are unfounded.

– Other CAPM inputs

405 The ACCC's views on the other CAPM inputs are as follows:

Risk-free rate: For this decision, 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 a point estimate. The ACCC has not chosen a shorter maturity bond. Averaging is done to lessen volatility.

The observations should be taken on an ex ante basis for financial years commencing after the date from which these determinations will have effect. In this case, the average value for the period leading up to 30 June 2006 has been applied to 2006-07, and the following year, reflecting the ACCC's decision as to when the ULLS monthly charge terms should apply. The ACCC considers that this approach better replicates what would have occurred in an effectively competitive market for the ULLS, where prices would be set proximate to when access was sought, having regard to unbiased forecasts for future periods. The ACCC outlined this approach in a letter to the parties dated 5 April 2007. The risk free rates are sourced from the Reserve Bank of Australia.²⁵⁸

²⁵⁷ Ibid.

²⁵⁸ RBA, *Interest rates and yields: Money market and Commonwealth government securities*, viewed 7 December 2007, <http://www.rba.gov.au/Statistics/HistoricalInterestRatesYields/1993_to_2007.xls>.

MRP: The ACCC has noted previously that there is a large amount of conflicting evidence about the MRP.²⁵⁹ The ACCC estimates a forward-looking market risk premium by adjusting historically observed values. Adjustments are made to reflect that markets are becoming more integrated and efficient. The ACCC chose a value of six per cent, which is at the lower end of the range of historically observed values. This value is generally consistent with past and current regulatory practice and market participant survey results.²⁶⁰

Debt ratio: The ACCC has used a target debt ratio of 40 per cent. It considers that this is reflective of the target debt ratio for a company that provides services over the PSTN and CAN to itself and others. The 40 per cent rate is in accordance with the Telstra-wide historic book value and overseas fixed line regulation.²⁶¹

Asset beta: The asset beta used is 0.5, which is leveraged to provide an equity beta of around 0.83. The basis for these values is discussed above. The ACCC does not consider that it is necessary to consider the betas for electricity and gas companies.

Debt premium: Reflecting its previous ULLS decisions,²⁶² the ACCC has used a debt premium of 1.02 per cent, reflecting a benchmark debt premium for a company that provides services over the PSTN and CAN to itself and others.

Issuance cost: Reflecting its previous ULLS decisions,²⁶³ the ACCC has used a value of 0.083 per cent for debt issuance, reflecting the benchmark debt issuance costs appropriate for a company that provides services over the PSTN and CAN to itself and others and finances an amount the value of Telstra's CAN. Equity issuance costs are not included in the WACC. Should such costs be relevant, they can be considered for inclusion within the efficient cost pool as an operating-type expense.

Gamma: The possible values range from 0 to 1. The ACCC notes Telstra's views but has adopted a value of 0.5, the midpoint of the range. The final WACC value is not materially sensitive to the value chosen.

Tax rate: Reflecting its previous ULLS decisions,²⁶⁴ the ACCC prefers an effective tax rate. However it notes that a reliable estimate of the effective tax rate may not be possible. The ACCC has used a corporate tax rate in its calculations below. This does not have a significant effect on cost estimates.

– Resulting WACC values

²⁵⁹ ACCC, above n 31, p.115-118.

²⁶⁰ *ibid*, p. 117-8.

²⁶¹ *ibid*, p. 103.

²⁶² ACCC, *op cit*, p.106-7.

²⁶³ ACCC, *op cit*, p.107-10.

²⁶⁴ ACCC, *op cit*, p.120.

406 The following WACC values result from the ACCC's above analysis. The 2005-06, 2006-07 and 2007-08 WACCs are entered into the PIE II model. The earlier WACCs are relevant to the ACCC's consideration of specific costs, discussed below.

| | 2000-01 | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
|------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| D/V ratio | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| E/V ratio | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 |
| Risk-free (rf) | 0.0623 | 0.0587 | 0.0590 | 0.0483 | 0.0582 | 0.0515 | 0.0582 | 0.0582 |
| Risk premium | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 |
| Asset beta | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Equity beta | 0.8299 | 0.8301 | 0.8301 | 0.8305 | 0.8301 | 0.8304 | 0.8301 | 0.8301 |
| Tax rate (e) | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| Debt premium | 0.0102 | 0.0102 | 0.0102 | 0.0102 | 0.0102 | 0.0102 | 0.0102 | 0.0102 |
| Issuance cost | 0.0008 | 0.0008 | 0.0008 | 0.0008 | 0.0008 | 0.0008 | 0.0008 | 0.0008 |
| Gamma | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Return on equity | 0.1121 | 0.1085 | 0.1088 | 0.0982 | 0.1080 | 0.1013 | 0.1080 | 0.1080 |
| Return on debt | 0.0733 | 0.0697 | 0.0701 | 0.0594 | 0.0692 | 0.0625 | 0.0692 | 0.0692 |

| | | | | | | | | |
|--|--------|--------|--------|-------|--------|-------|--------|--------|
| WACC (post-tax vanilla) | 9.66% | 9.30% | 9.33% | 8.26% | 9.25% | 8.58% | 9.25% | 9.25% |
| WACC (pre-tax exclusive of imputation) | 10.85% | 10.45% | 10.48% | 9.30% | 10.39% | 9.65% | 10.39% | 10.39% |

Price trends and tilted annuities

- 407 The PIE II model allows a user to enter a number of price trends that reflect changes in the prices for inputs into the network. The price trends serve two purposes. Firstly, they are used to update asset prices from year to year (e.g. to reflect increase or decrease in asset prices from 2005-06 to 2006-07 to 2007-08). Secondly, the price trends are used in calculating the tilted annuity that is used to annualise capital costs in the model.
- 408 These two uses have different effects on the ultimate price to be derived from the model. When an asset price is increasing over time, the asset price in the model will be higher year on year. However the tilted annuity will mean that some cost recovery is deferred until later years. Similarly, when an asset price is decreasing over time, the asset price in the model will be lower year on year. However the tilted annuity will mean that cost recovery is brought forward to earlier years.
- 409 The ACCC's preliminary position set out in its consultation paper was to update previously estimated Telstra price trends related to main cable, main conduit and trenching, distribution cable and distribution conduit and trenching, and to accept Telstra's previous estimates of 0 per cent price trends for network lands and buildings and indirects. Telstra has previously given evidence that the cable and conduit assets represent [c-i-c a significant percentage] of the value of the total network assets used in supplying the ULLS. Accordingly, the ACCC considered that the price trend in other variables could be expected to have little effect on ULLS costs and that it was not evident on what basis those trends could be changed. Accordingly it did not propose to update these other price trends.

Submissions from parties

- 410 Telstra submitted that updating only the asset prices for cable and conduits was inappropriate.²⁶⁵ It referred to the views of the Tribunal about selectively updating only certain asset price trends.²⁶⁶ Telstra provided updated price trends for all of its assets in Telstra's "Depreciation, O&M, indirect and price trend values for asset classes" worksheet in PIE II that affect the ULLS access prices. The calculation of those price trends was set out in a statement of Telstra employee Geoff Sims, derived using publicly available information such as Australian Bureau of Statistics (ABS) data.
- 411 Telstra uses the calculated Sims price trends for two purposes. Firstly, it updates the asset prices in its element cost tables to 2004-05 values in order to generate a base version of its updated PIE II model. Secondly, it also uses 13 of the 21 calculated price trends in the PIE II "Scenario costing" sheet in order to advance asset values to the appropriate year.²⁶⁷ It does not enter those price trends into the price trend category for asset classes for the 28 assets in its "Depreciation, O&M, indirect and price trend values for asset classes" sheet. This is because of its submissions on tilted annuities (which is discussed below).

²⁶⁵ Telstra, above n 42, Annexure 17, p. 112.

²⁶⁶ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [347] to [348], [366].

²⁶⁷ The USO asset category is given a 0 per cent price trend.

Accordingly, eight asset price trends are not used in the model to update costs year on year. However, Telstra submits that the asset classes for which it updates prices account for assets which represent [c-i-c a significant majority] of CAN costs.²⁶⁸

412 Optus submits that it is appropriate to have regard to the price trend in assets in the way proposed by the ACCC.²⁶⁹ However, Optus also submits that the large increase in copper prices over recent periods might mean that alternative technologies would be more viable compared to copper.²⁷⁰ Optus submits that this could be seen as a defect in the model, but noted that it would be difficult to adjust for this.

413 Telstra submits that a tilted annuity should not be used in the model.²⁷¹ Rather it submitted that using the tilted annuity suffers from the ‘year 1 problem’. Telstra describes the problem as follows:²⁷²

Whenever capital charges vary over time, as is the case with a tilted annuity (whenever the tilt value is non-zero), the TSLRIC methodology which assumes that a new optimised network is installed each year, will result in the infrastructure owner receiving revenue to compensate for year 1 capital charges. Where capital charges are front-loaded, this will result in the owner of the assets being over-compensated for the cost of the assets, as it will receive revenues consistent with the year 1 capital charge every year. Conversely, if the capital charges are back-loaded, this will result in under-compensation.

In Telstra’s PIE II model, the tilt applied for the majority of CAN assets is positive. That is, the replacement cost of CAN assets is generally increasing over time so that the tilted annuity results in a back-loaded profile of capital charges. However, the only capital charge that is ever used from PIE II is the year 1 capital charge, the lowest value over the entire life of the assets.

414 Telstra accordingly submits that it only ever recovers the lower year 1 capital charge and that it under-recovers over time. It considers that it would be appropriate to set the tilt factor for assets to zero in the annuity.²⁷³ Telstra submits that this would allow it to recover an even amount of depreciation in each year and that this would be a more appropriate cost recovery profile. Telstra submits that the ACCC “should take a more balanced approach and also adjust for errors that move costs [downwards].”²⁷⁴

415 As noted above Telstra considers that asset values should continue to be scaled up year on year.

²⁶⁸ Telstra, above n 42, p. 112, Annexure 17.

²⁶⁹ Optus, above n 49, p. 15.

²⁷⁰ Optus, *op cit*, p. 12.

²⁷¹ Telstra, above n 42, p. 163, Annexure 20.

²⁷² Telstra, *op cit*, p. 163.

²⁷³ Telstra, *op cit*, p. 164, Annexure 20.

²⁷⁴ *Ibid*.

416 Optus, in its reply submission, submits that it would be inappropriate to accept Telstra's submission.²⁷⁵ Optus submits that a tilted annuity is common in access pricing models that revalue the asset base at shorter than the life of the assets, based on an optimised replacement cost of the asset base. Optus submits that this is in order to allow "regulators to replicate the cost recovery conditions that would be faced by a firm in a competitive market".²⁷⁶ Optus submits that the rationale for the tilt is:²⁷⁷

(a) when input prices are falling, the incumbent operators will know that a new entrant in the future will have a lower cost base. As a result, incumbent operators will only invest in the market today if they can recover more of their capital in the early periods, because they know they will face a lower cost entrant in the future; or alternatively

(b) when input prices are rising, the incumbent operators will know that a new entrant in the future will have a high cost base, therefore their future return will be 'protected', they are[sic] can therefore afford to invest and compete price down today in the knowledge they will not face a new entrant with a lower cost base in the future.

417 Optus submits that the annuity formula accounts for future price movements by revaluing the asset base each time the tilted annuity is applied (ie. when the next year is priced), and that accordingly the year 1 problem does not exist. It submits that Telstra will recover 'year 2' in the next period of the arbitration.

418 Telstra, in its third submission, agrees with Optus that a tilted annuity will recover the initial price of the asset and no more.²⁷⁸ However, it contends that the ACCC's approach to ULLS prices has not been consistent and that a tilted annuity would compound problems with cost recovery. It submits that, as the ACCC has reduced its estimates of network costs since 2002, the cost profile over time has actually been declining, in contradiction to the expected profile under a tilted annuity. It also submits that, in any case, a tilted annuity should not be applied when asset prices are increasing and depreciation is accordingly backloaded.²⁷⁹

ACCC's views

419 The ACCC firstly considers that, in general, Telstra's estimated price trends are appropriate. As the trends are based on publicly available ABS data, they are verifiable, and the proposed approach to the calculation of the price trends accords with the ACCC's approach in the DFDs. No party opposed the calculated price trends. Those price trends are:

²⁷⁵ Optus, above n 194, p. 15.

²⁷⁶ Optus, *op cit*, pp. 15-16.

²⁷⁷ Optus, *op cit*, p. 16.

²⁷⁸ Telstra, above n 45, p. 13.

²⁷⁹ Telstra, *Telstra's confidential response to the Commission's draft decision on Telstra's ULLS monthly charge undertakings dated 23 December 2005*, 7 August 2006, p. 14.

| Asset category | Description | Price trend (5 year CAGR) |
|----------------|-----------------------------|---------------------------|
| BD | Radio transmission | 0.98% |
| BDS | Radio spectrum | 0.98% |
| BO | Optical fibre | -7.01% |
| Ind | Indirect assets (Fleet, IT) | -1.52% |
| LI | Lead-ins | 4.13% |
| NM | Network management | -18.28% |
| Prp | Land & Buildings | 1.49% |
| SD | SDH transmission | -7.01% |
| SDS | SDH software | -5.14% |
| SL | Local switching | -7.01% |
| SLS | LAS software | -5.14% |
| SP | Signalling transfer point | -7.01% |
| ST | Transit switching | -7.01% |
| STS | TNS software | -5.14% |
| XC | Main conduit | 5.02% |
| XD | Distribution cable | 4.13% |
| XN | Distribution conduit | 5.11% |
| XP | Pair gain systems | -3.14% |
| XR | Customer radio | -3.65% |
| XU | Main cable | 4.46% |
| ZT | Miscellaneous transmission | 0.98% |

420 In regard to Telstra's submissions on whether a tilted annuity should be used, the ACCC considers that the 'year 1' problem does not exist, given the approach to pricing that is taken by the ACCC. This is because, in addition to the tilted annuity being applied, the asset prices for later years are increased by the estimated change in prices. Accordingly, while Telstra is only paid for the first year of a tilted annuity, in each subsequent period the actual value of the payment increases in line with the estimated price trends. This results in a cost recovery profile that mirrors the profile under a tilted annuity over time.

421 Conversely, Telstra has submitted that it should be permitted to recover its assets by use of a flat annuity, while increasing asset costs each year. This approach would result in an over-recovery by Telstra of the value of its network assets. A flat annuity would not lead to over-recovery if Telstra received the same amount each year. However Telstra also submits that asset prices should be increased each year. This would result in a significant overpayment from access seekers. For example, over the life of an asset of 10 years and a WACC of 10 per cent, with capital costs increasing by 4 per cent a year, Telstra's proposed approach would lead to an over-recovery in the order of 16.44 per cent in each year of the asset's life.

422 Accordingly, the ACCC considers that taking the approach submitted by Telstra would lead to ULLS network costs higher than a cost-reflective level. Having regard to the ACCC's ULLS pricing principles, the ACCC considers that Telstra's approach would not reflect TSLRIC+, but would rather overstate it.

423 The ACCC also notes that Telstra submits that a flat annuity is appropriate due to what it characterises as inconsistencies in the ACCC's pricing approach to ULLS in that ULLS prices have not consistently increased over time. The ACCC rejects this contention. Firstly, the ACCC notes that prices set in the final determinations will be set for a known

and consistent period of time. Secondly, the ACCC's pricing approach to ULLS network costs over time has been consistent and has evolved with improved modelling techniques. In that respect, the ACCC notes its previous conclusions, expressed earlier in these reasons, about the applicability and appropriateness of the n/e/r/a model used for price setting. Accordingly, the ACCC considers that the evidence presented by Telstra would equally suggest that the network cost profile provided by Telstra demonstrates significant over-recovery by Telstra in early periods.

424 The ACCC also does not consider that it would be appropriate to only apply a tilted annuity when costs are declining overall. The ACCC considers that there are valid economic reasons for applying the tilted annuity consistently regardless of the direction of the tilt. It notes Optus' submission in that regard. In particular, a tilted annuity when prices are rising reflects the fact that costs can be recovered in higher prices in later periods, when any entrant will face the higher level of costs, rather than the current period where costs are relatively low. This is consistent with the outcome likely to occur in a competitive market. The ACCC considers that applying the tilt only when it resulted in a price increase would be inconsistent.

425 Having regard to the subsection 152CR(1) matters, the first criterion concerns the LTIE (paragraph 152CR(1)(a)). This calls for consideration of a number of factors identified in section 152AB, being the objective of promoting competition, the objective of achieving any-to-any connectivity, the objective of encouraging the economically efficient use of and the economically efficient investment in infrastructure, and subsidiary matters. (paragraphs 152AB(2)(c)-(e), subsection 152AB(4), paragraphs 152AB(6)(a)-(c), and subsection 152AB(7A)).

The ACCC considers that access charges that reflect forward-looking efficient costs will better promote competition, as they will allow the access provider and access seeker to compete in downstream markets on their relative merits. The ACCC considers that adopting Telstra's submitted approach would inflate costs for access seekers and inhibit competition on the merits. The ACCC considers that its proposed approach is more consistent with outcomes in a competitive market.

426 The ACCC does not consider that the approach adopted on this issue affects the objective of achieving any-to-any connectivity. Nor are the matters identified in paragraph 152AB(6)(a) affected by this decision.

427 Turning to the objective of encouraging economic efficiency in use or investment (paragraph 152AB(2)(e)), the ACCC considers that its approach will better encourage efficiencies. The ACCC considers that its approach will better lead to investment and efficient use of infrastructure related to the provision of downstream DSL and voice services. This is because a cost-reflective price, more consistent with the outcomes in a competitive market for the ULLS, will encourage competition in downstream services and encourage efficiencies in markets for these services. The ACCC considers that the pricing approach will also lead to more efficient build/buy decisions as the ULLS prices will reflect the efficient cost of the CAN.

428 The next criterion is the legitimate business interests of the provider and its investment in the CAN which is used to provide the ULLS (paragraph 152CR(1)(b)). This is related closely to the matters in section 152AB(6)(b). The ACCC considers that its tilted annuity

approach will lead to Telstra recovering an amount commensurate with its legitimate commercial or business interests, including its recovery of direct costs. This is because the increased asset base in each subsequent period will lead to a cost profile that reflects the cost to Telstra of its network assets. Telstra can continue to generate economies of scale and scope over its CAN. Conversely, Telstra's submitted approach would lead to it recovering more than necessary to meet its legitimate business interests.

- 429 The next criterion is the interests of all persons with rights to use the ULLS (paragraph 152CR(1)(c)). The ACCC similarly considers that the tilted annuity approach will best meet the interests of access seekers in being able to compete on their merits. The ACCC considers that Telstra's proposed approach would lead to an inflated ULLS network cost, giving Telstra a significant cost advantage, and preventing access seekers from competing with Telstra on their merits.
- 430 The next criterion is the direct costs of providing access to the ULLS (paragraph 152CR(1)(d)). It is concerned with ensuring that Telstra will be able to recover its costs in providing access, either to itself or to ULLS access seekers. In this context, the criterion involves consideration of whether Telstra will be able to recover its network costs inclusive of a normal risk-adjusted return on its capital employed. As noted above in the ACCC's consideration of paragraph 152CR(1)(b), the ACCC considers that the use of a tilted annuity will allow Telstra to recover its network costs.
- 431 The ACCC does not consider that the matters in paragraph 152CR(1)(e) and (f) materially contribute to consideration of the price path approach. In relation to paragraph 152CR(1)(g), the ACCC has considered efficiency incentives in its consideration of the LTIE above.
- 432 Therefore the ACCC will use Telstra's calculated price trends and will continue to apply a tilted annuity as it considers it is appropriate in accordance with both the pricing principles and the subsection 152CR(1) matters.

4.1.9 Particular model inputs

- 433 Parties have made submissions in relation to various particular inputs used in the PIE II model. These same inputs are used in the updated version of PIE II provided by Telstra as are used in the previous version of the model.

Trench sharing

- 434 The ACCC noted in its consultation paper that trench sharing reduces the cost of trenches in the provision of fixed line network services. Telstra has traditionally stated that the appropriate level of trench sharing in the PIE II model would be 1 per cent, reflecting the proportion of open trenches available over one year.²⁸⁰ Comparatively, the ACCC has stated that a value in the order of 13 per cent, reflecting historical cumulative trench

²⁸⁰ Telstra, *op cit*, Annexure A.

sharing, would be more appropriate.²⁸¹ The ACCC noted that the 13 per cent figure might now itself understate historical trench sharing.

435 The use of a higher trench sharing value will tend to decrease estimates of network costs. In setting prices for the DFDs, the ACCC's preliminary approach was to use a 13 per cent trench sharing figure, reflecting the ACCC's past views.

Submission from parties

436 Telstra submits that a 1 per cent trench sharing figure is still appropriate.²⁸² Telstra submits that an efficient network operator deploying a network today would only be able to use free trenches to the extent there are new SIOs in new estates in one year. It also submits that the PIE II model inherently underestimates the cost of trenches due to the manner in which it accounts for new estates. Telstra presents a number of reasons which it submits support a lower trench sharing figure, including:²⁸³

- new estates being laid with fibre
- the PIE II model being forward-looking and historical trench sharing being irrelevant
- the need to recover holding capital
- Telstra having limited ability to share trenches with other utilities.

437 Optus submits that the Tribunal's ULLS decision supports the inclusion of historical cumulative trench sharing.²⁸⁴ It submits that, in the long run, a new entrant would have available to it all inputs of production, including the availability of open trenches in new estates. However, Optus submits that the ACCC has in fact understated the level of trench sharing as it has used a static figure. Optus submits that the amount of trench sharing used in the model should increase from year to year to represent new estates. Optus' reply submission submits that the use of a historical trench sharing measure is supported by analyst reports.²⁸⁵ Optus also submits that the PIE II model is not entirely forward-looking given that it is a scorched node model and that a proper application of a scorched node model would reflect historical trench sharing.

438 In its response submission, Telstra contends that Optus's submissions are inconsistent and should be rejected.²⁸⁶

439 PowerTel and Request cite a report by MJAEI that had been provided in the course of the ACCC's 2006 undertaking assessment.²⁸⁷ The MJAEI report considers that trench

²⁸¹ ACCC, above n 31, pp. 55-6.

²⁸² Telstra, above n 42, p. 109, Annexure 16.

²⁸³ Telstra, *op cit*, p. 110, Annexure 16.

²⁸⁴ Optus, above n 49, p. 10.

²⁸⁵ Optus, above n 194, p. 19.

²⁸⁶ Telstra, above n 40, p. 6.

sharing in new estates should reflect a cumulative, historical trench sharing measure.

440 Chime submits that the ACCC should make an allowance for the fact that a 13 per cent trench sharing figure may understate historical trench sharing.²⁸⁸ Primus makes an equivalent submission.²⁸⁹

ACCC's view

441 Telstra's contentions in support of its 1 per cent figure are based on the argument that the PIE II model and the TSLRIC concept assumes that the network which is to be costed is rebuilt in each year priced. Accordingly, Telstra submits that given that only 1 per cent of trenches are available in new estates each year, it is inappropriate to have regard to Telstra's historical trench sharing figures.

442 The ACCC notes Telstra's submissions that, under a forward-looking network, historical sharing should be ignored. The ACCC considers that the concept of a forward-looking network needs to be related to realities of deployment of the network. The ACCC considers that, in the real world, construction of a network would be planned a significant time in advance with other operators and utilities, and would allow a new entrant to progressively make use of open trenches in new estates at no cost. Accordingly, the best available proxy for trench sharing in new estates is the cumulative (or historical) trench sharing measure.

443 The ACCC notes that Telstra considers that its ability to share trenches with other utilities might be limited. However the ACCC considers that, given that the 13 per cent figure relates only to sharing in new estates, this is likely to be of limited concern. Infrastructure deployment in new estates is planned simultaneously and can take account of matters such as separation requirements. The 13 per cent figure does not account for further trench sharing with other infrastructure owners outside new estates, nor for increasing the level of sharing between the IEN and CAN.

444 In relation to submissions about holding capital, the ACCC considers that matters of depreciation and holding capital are adequately dealt with in the general depreciation and WACC calculations already accounted for in the PIE II model.

445 The ACCC acknowledges the submissions of access seeker parties that 13 per cent may understate historical trench sharing. However, it considers that the 13 per cent figure has been the subject of significant previous analysis by the ACCC²⁹⁰ and industry and would be the appropriate figure to use in this case. The ACCC notes that additional small changes to trench sharing have marginal changes on the network cost estimates produced by the PIE II model.

²⁸⁷ PowerTel and Request, above n 49, p. 18.

²⁸⁸ Chime, above n 200, p. 2.

²⁸⁹ Primus, above n 202, p. 2.

²⁹⁰ ACCC, above n 31

- 446 Having regard to the subsection 152CR(1) matters, the first criterion concerns the LTIE (paragraph 152CR(1)(a)). This calls for consideration of a number of factors identified in section 152AB, being the objective of promoting competition, the objective of achieving any-to-any connectivity, the objective of encouraging the economically efficient use of and the economically efficient investment in infrastructure, and subsidiary matters. (paragraphs 152AB(2)(c)-(e), subsection 152AB(4), paragraphs 152AB(6)(a)-(c), and subsection 152AB(7A)).
- 447 The ACCC considers that using a 13 per cent trench sharing figure rather than a 1 per cent trench sharing figure will better reflect the amount of trench sharing available to an infrastructure owner deploying the CAN. Accordingly, this will better reflect the efficient forward-looking cost of Telstra's ULLS and better promote competition. A 13% trench sharing figure will allow the access provider and access seeker to compete in downstream markets on their relative merits. The ACCC considers that adopting Telstra's submitted approach would inflate costs for access seekers and inhibit competition on the merits.
- 448 The ACCC does not consider that the approach adopted on this issue affects the objective of achieving any-to-any connectivity. Nor are the matters identified in paragraph 152AB(6)(a) affected by this decision.
- 449 Turning to the objective of encouraging economic efficiency in use or investment (paragraph 152AB(2)(e)), the ACCC considers that a 13% trench sharing figure will better encourage efficiencies. The ACCC considers that its approach will better lead to investment and efficient use of infrastructure related to the provision of downstream DSL and voice services. This is because a cost-reflective price, more consistent with the outcomes in a competitive market for the ULLS, will encourage competition in downstream services and encourage efficiencies in markets for these services. The ACCC considers that the pricing approach will also lead to more efficient build/buy decisions as the ULLS prices will reflect the efficient cost of the CAN.
- 450 The next criterion is the legitimate business interests of the provider and its investment in the CAN which is used to provide the ULLS (paragraph 152CR(1)(b)). This is related closely to the matters in section 152AB(6)(b). As the 13% figure reflects the amount of trench sharing available to Telstra historically and the level of sharing available to an future provider of the ULLS, and hence reductions in cost achievable, it will allow a level of cost recovery necessary to meet Telstra's legitimate business interests.
- 451 The next criterion is the interests of all persons with rights to use the ULLS (paragraph 152CR(1)(c)). The ACCC similarly considers that the tilted annuity approach will best meet the interests of access seekers in being able to compete on their merits. Using a 1% trench sharing figure would lead to an inflated ULLS network cost, preventing access seekers from competing with Telstra on their merits.
- 452 The next criterion is the direct costs of providing access to the ULLS (paragraph 152CR(1)(d)). It is concerned with ensuring that Telstra will be able to recover its costs in providing access, either to itself or to ULLS access seekers. In this context, the criterion involves consideration of whether Telstra will be able to recover its network costs inclusive of a normal risk-adjusted return on its capital employed. As noted above in the ACCC's consideration of paragraph 152CR(1)(b), as the 13% figure reflects the amount of trench sharing available to Telstra historically, and the level of sharing available to an

future provider of the ULLS, and hence reductions in cost achievable. Accordingly the ACCC considers that the 13% trench sharing figure allows the recovery of direct costs.

- 453 The ACCC does not consider that the matters in paragraph 152CR(1)(e) and (f) materially contribute to consideration of the appropriate trench sharing figure. In relation to paragraph 152CR(1)(g), the ACCC has considered efficiency incentives in its consideration of the LTIE above.
- 454 Therefore the ACCC will use a 13% trench sharing figure as it considers it is appropriate given the TSLRIC+ pricing principles and the subsection 152CR(1) matters.

Asset lives

- 455 As noted above, capital costs in the PIE II model are annualised using a tilted annuity. The key inputs into the tilted annuity formula are price trends and asset lives. The ACCC has previously expressed concerns that the asset lives used appeared to be based on accounting measures that may not represent economic asset life. The ACCC considered that this might be a particular issue for the life of copper cables in the model.²⁹¹
- 456 Asset lives used in a cost model are based on economic lives of assets rather than accounting values. This reflects the useful life of the asset and the appropriate period of cost recovery for the asset. The ACCC proposed in its consultation paper to accept the asset lives entered by Telstra into its PIE II model but noted that this approach may lead to increased estimates of network costs.

Submissions from parties

- 457 Telstra in its initial submission submitted that the asset lives in the PIE II model were appropriate and cited reports prepared by Ernst and Young (“EY”) and PriceWaterhouseCoopers (“PWC”), as well as its own staff.²⁹²
- 458 Optus criticised the [c-i-c] year asset life for main cable in the PIE II model, contending it would lead to over-recovery by Telstra.²⁹³ Optus submitted that a 15 year asset life was a reasonable estimate of the economic life of the asset. Optus submitted that 15 years was consistent with results from an Ofcom study.
- 459 Chime submitted that the asset lives in the model appeared to be based on accounting measures rather than economic asset life.²⁹⁴
- 460 Primus submitted that the [c-i-c] year main cable asset life was inconsistent with the practical technical lifetime of this asset, based on advice of its consultants Gibson Quai – AAS.²⁹⁵ Primus submits that a 25 year lifetime would be more appropriate for main cable.

²⁹¹ ACCC, above n 31, p. 65

²⁹² Telstra, above n 42, p. 106, Annexure 15.

²⁹³ Optus, above n 49, p. 12.

²⁹⁴ Chime, above n 49, p. 2.

- 461 In its reply submission, Telstra maintains that the [c-i-c] year main asset life is appropriate.²⁹⁶ It also submits that copper main cable is likely to be replaced within [c-i-c] years in any case given the likelihood of a fibre-to-the-node deployment in the near future.
- 462 Optus' reply submission contends that 15 years was reasonable.²⁹⁷ Optus submits that its analysis of Telstra's PWC and EY studies, as well as UK and Canadian examples and a MJA report,²⁹⁸ suggest that 15 years was more appropriate. Optus submits that this was true whether or not a FTTN network could be expected to be deployed.²⁹⁹
- 463 Telstra's third submission submits that Optus' comments fail to recognise that the reports cited often refer to all cabling, and that the PIE II model deals with main and distribution cabling separately.³⁰⁰ It submits that the [c-i-c] year main asset cable life is appropriate given the [c-i-c] year distribution cable life in the model.

ACCC's views

- 464 The ACCC considers that the asset lives used in the PIE II model should reflect the economic lives of the assets. The asset life used directly affects the depreciation schedule of the assets and will therefore affect the network cost estimates. A too short asset life will increase network cost estimates, as cost recovery will be spread over a shorter period, and will tend to inhibit competition and lead to the recovery of more than the direct costs of the ULLS. Equivalently, a too long asset life would tend to unduly favour access seekers and adversely affect the legitimate business or commercial interests of the access provider. As noted above, the ACCC has expressed concern in the past about the appropriate asset lives for use in the PIE II model, with particular reference to main cable life.³⁰¹
- 465 The evidence submitted to the ACCC is conflicting. Many reports submitted or cited by the parties did not distinguish between main cable and distribution cable in the manner of the PIE II model. Further, while the EY study indicates that distribution cable typically had a longer asset life than main cable, the PWC study indicates that the part of the network in which copper was deployed did not generally appear to make a difference to the economic life. In some cases the submissions are unclear as to whether accounting lives or economic lives are being discussed. The ACCC also notes that the information available to it does not demonstrate the basis of the "default" asset lives that Telstra has used in the model.

²⁹⁵ Primus, above n 202, p. 3.

²⁹⁶ Telstra, above n 40, p. 6.

²⁹⁷ Optus, above n 194, p. 20.

²⁹⁸ MJA, *Comments on discussion paper—Telstra's undertaking in relation to the Unconditioned Local Loop Services, report for the Competitive Carriers' Coalition*, 4 May 2006, page 31.

²⁹⁹ Optus, *op cit*, p. 24.

³⁰⁰ Telstra, above n 45, p. 12.

³⁰¹ ACCC, above n 31, p. 65

466 The ACCC considers that Telstra's submissions about pending FTTN deployments are not compelling. The deployment of FTTN largely represents a strategic decision rather than providing guidance about the economic lives of the assets. If Telstra's submission was to be accepted as valid, it would tend to suggest that an asset life of closer to two or three years would be appropriate. However this in turn raises issues about the appropriate technologies that should be deployed in the model and whether the PIE II model can be considered forward-looking. In any case, the ACCC considers that deployment of FTTN in any significant way is unlikely during the period covered by the final determination.

467 The evidence presented by both Telstra and the access seekers suggests that a main cable life of [c-i-c] years is shorter than typically used elsewhere. EY and PWC's reports both imply a main cable life of around 15 years. Similarly, the OfCom, CRTC and MJA reports suggested a cable life of 18 years, 20 years and 20 years respectively. This evidence supports the submissions made by Optus and Primus.

468 However, while access seekers were critical of the main cable asset life, there were no submissions that the distribution cable asset life of [c-i-c] years appeared too long. This appeared equally plausible on evidence presented. In particular, the average lives of cable assets presented by PWC, OfCom, CRTC and MJA all suggested that a period of around 20 years would be a more appropriate cable life.

469 In light of the submissions from the parties, the ACCC considers that the most appropriate approach would be to increase main cable life from [c-i-c] to 12 years while decreasing the distribution cable life from [c-i-c] to 20 years. The ACCC considers that this approach better reflects the information available to it about both the average cable lives and the difference in cable lives between main and distribution cable.

470 The ACCC considers that it cannot be definitive on the appropriate asset lives to be used. However, the ACCC considers that adopting these asset lives better reflects the appropriate economic lives of the cable assets used in the PIE II model. This would be more likely to lead to efficient, forward-looking asset prices

471 Having regard to the subsection 152CR(1) matters, the first criterion concerns the LTIE (paragraph 152CR(1)(a)). This calls for consideration of a number of factors identified in section 152AB, being the objective of promoting competition, the objective of achieving any-to-any connectivity, the objective of encouraging the economically efficient use of and the economically efficient investment in infrastructure, and subsidiary matters. (paragraphs 152AB(2)(c)-(e), subsection 152AB(4), paragraphs 152AB(6)(a)-(c), and subsection 152AB(7A)).

472 The ACCC considers that using asset lives that better reflect the appropriate economic life of the cable assets used in the CAN will better reflect the efficient forward-looking cost of Telstra's CAN and ULLS and better promote competition. Appropriate asset lives will allow the access provider and access seeker to compete in downstream markets on their relative merits. The ACCC considers that adopting the previously used asset life for main cable would inflate costs for access seekers and inhibit competition on the merits. Similarly, the previously used asset life for distribution cable may have inhibited Telstra's ability to compete as it may have lead to cost under-recovery.

- 473 The ACCC does not consider that the approach adopted on this issue affects the objective of achieving any-to-any connectivity. Nor are the matters identified in paragraph 152AB(6)(a) affected by this decision.
- 474 Turning to the objective of encouraging economic efficiency in use or investment (paragraph 152AB(2)(e)), the ACCC considers that the asset lives used will better encourage efficiencies. The ACCC considers that its approach will better lead to investment and efficient use of infrastructure related to the provision of downstream DSL and voice services. This is because a cost-reflective price, more consistent with the outcomes in a competitive market for the ULLS, will encourage competition in downstream services and encourage efficiencies in markets for these services. The ACCC considers that the pricing approach will also lead to more efficient build/buy decisions as the ULLS prices will reflect the efficient cost of the CAN, as the appropriate asset lives would have been used to price the network.
- 475 The next criterion is the legitimate business interests of the provider and its investment in the CAN which is used to provide the ULLS (paragraph 152CR(1)(b)). This is related closely to the matters in section 152AB(6)(b). As the asset lives better reflect the asset lives of the CAN, they will allow a better estimate of the cost of the CAN and will allow a level of cost recovery necessary to meet Telstra's legitimate business interests. A too-long distribution cable life may have impacted negatively on Telstra's legitimate business interests, while a too-short main distribution cable life may have recovered more than necessary for Telstra's legitimate business interests.
- 476 The next criterion is the interests of all persons with rights to use the ULLS (paragraph 152CR(1)(c)). The ACCC similarly considers that the asset lives used will best meet the interests of access seekers in being able to compete on their merits. The asset lives used would lead to an efficient forward-looking ULLS network cost, allowing access seekers from competing with Telstra on their merits.
- 477 The next criterion is the direct costs of providing access to the ULLS (paragraph 152CR(1)(d)). It is concerned with ensuring that Telstra will be able to recover its costs in providing access, either to itself or to ULLS access seekers. In this context, the criterion involves consideration of whether Telstra will be able to recover its network costs inclusive of a normal risk-adjusted return on its capital employed. As noted above in the ACCC's consideration of paragraph 152CR(1)(b), the asset lives used will better estimate the costs of the CAN. Accordingly the ACCC considers that the asset lives used allow the recovery of direct costs.
- 478 The ACCC does not consider that the matters in paragraph 152CR(1)(e) and (f) materially contribute to consideration of the appropriate asset lives. In relation to paragraph 152CR(1)(g), the ACCC has considered efficiency incentives in its consideration of the LTIE above.
- 479 Therefore the ACCC will use the asset lives of 12 years for main cable and 20 years for distribution cable as it considers these are appropriate given the TSLRIC+ pricing principles and the subsection 152CR(1) matters.

Network provisioning, O&M factors, network planning and network design

- 480 In its consultation paper, the ACCC noted a number of specific concerns it had raised about the PIE II model assumptions and inputs. These concerns relate to network provisioning, operating and maintenance (O&M) factors, network planning costs and network design algorithms. These concerns apply equally to the updated version of PIE II provided by Telstra, as the underlying model architecture has not been changed.
- 481 In relation to network provisioning, the ACCC has in past undertaking assessments disagreed with Telstra on how the costs of provisioning for future demand should be recovered.³⁰² In those assessments, Analysys and MJAEI also considered that, while modelling spare capacity is common for future provisioning, the cost implications in the PIE II model seemed to be overestimated.³⁰³
- 482 In relation to operational and maintenance factors, the ACCC has in the past expressed concerns about the manner in which O&M costs are calculated within the PIE II model. The PIE II model uses either the actual O&M costs directly (for copper cable and conduits) or uses the actual O&M costs to calculate a ratio of O&M costs to assets. In particular the ACCC had considered that it is unclear whether the historic O&M costs that are used in the model reflect efficient costs.³⁰⁴
- 483 In relation to network planning costs, the ACCC had historically been concerned that Telstra may be over-recovering network planning costs.³⁰⁵ These concerns relate to whether the costs in the PIE II model were recovering an alternative hypothetical network, and as to whether ongoing network planning costs should be already recovered in O&M costs. However, Telstra had provided submissions that it was only recovering normal ongoing planning costs and that these costs were not already recovered.³⁰⁶
- 484 In relation to network design parameters, the ACCC noted in its assessment of Telstra's most recent ULLS undertaking three particular concerns about three network design parameters in the PIE II model:³⁰⁷
- the lack of clustering algorithms
 - use of rectilinear distance estimation
 - use of minimum spanning trees.
- 485 The ACCC expressed concerns that these characteristics of the PIE II network cost model may lead it to overstate the required lengths of cable and conduits in the network.

³⁰² ACCC, *op cit*, p. 48

³⁰³ ACCC, *op cit*, p. 46-7.

³⁰⁴ ACCC, *op cit*, p.51.

³⁰⁵ ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings—final decision (public version)*, December 2005, pp. 99-100.

³⁰⁶ ACCC, *op cit*, p. 100; Telstra, above n 279, p. 52.

³⁰⁷ ACCC, above n 31, p. 56-63.

486 The ACCC noted in its consultation paper that a number of its specific concerns with the PIE II model increased in importance as population density within a given exchange area diminished, reflecting public concerns of the ACCC.³⁰⁸ However, as it is not estimating costs for Band 4, the ACCC considers that some of its concerns about using the PIE II model to estimate costs in rural and regional areas are not in issue in these arbitrations.

487 Despite the concerns listed above, the ACCC adopted a preliminary position in its consultation paper for the DFDs of accepting Telstra's approach to provisioning, O&M, network planning and network design. The ACCC considered that the preliminary positions it had taken were conservative positions that would tend to result in a higher estimate of network costs than would otherwise be the case.

Submissions from parties

488 Telstra submits that the engineering rules used by the PIE II model are appropriate.³⁰⁹ It also submits that the approach to O&M costs, as well as network planning, was appropriate and set out its approach taken to calculate those ratios.³¹⁰ Telstra further submits that the approach to provisioning for future demand and network planning was appropriate.³¹¹

489 Optus notes that it is difficult to adjust the PIE II model for issues such as network provisioning or network design parameters, although it submits that it has concerns about such parameters in the model.³¹² It contends that it would be appropriate to adjust network planning costs based on international benchmarks.

490 PowerTel and Request note previously expressed concerns with the PIE II model, such as O&M factors and network planning costs.³¹³ Similarly, Chime notes previously expressed concerns that were discussed in the ACCC's consultation paper.³¹⁴

491 Primus also notes the concerns listed in the ACCC's consultation paper.³¹⁵ It also raises particular concerns about provisioning in the model, submitting that the PIE II model appears to provision up to two pairs per SIO and that this is excessive.

492 Telstra's reply submission responds to these concerns of the access seekers.³¹⁶ Telstra submits that the PIE II model's provisioning is not excessive, given the potential for future growth and demand, and the fact that such growth is uneven. It submits that the network planning costs are appropriate and that in any case Optus's concerns about the

³⁰⁸ ACCC, *op cit*, p. 78.

³⁰⁹ Telstra, above n 42, p. 84, Annexure 13, p. 100, Annexure 15.

³¹⁰ Telstra, *op cit*, p. 100, Annexure 15 and Annexure 14.

³¹¹ Telstra, *op cit*, pp. 98-9, Annexure 15.

³¹² Optus, above n 49, pp. 9, 11.

³¹³ PowerTel and Request, above n 49, pp. 16-7.

³¹⁴ Chime, above n 200, p. 2.

³¹⁵ Primus, above n 202, p. 2.

³¹⁶ Telstra, above n 40, p. 5.

size of indirect O&M costs and network planning costs are incorrect.

ACCC's views

- 493 The ACCC notes the access seeker parties' views regarding the potential concerns about the PIE II model, and notes that Telstra has responded on those concerns. The ACCC further notes that it is difficult or impossible to adjust the PIE II model for some of these concerns. In particular, the provisioning and network design approaches in the model cannot be changed, and it would be difficult to make an exogenous adjustment to the model's outputs to account for them. The ACCC considers that it will accept Telstra's position that network planning costs are not over-recovered in the PIE II model, noting Telstra's submissions in that regard. However, the ACCC notes that the situation with respect to O&M costs is unclear, as the relationship of the costs to efficient costs cannot be assessed.
- 494 The ACCC retains concerns about each of these aspects of the PIE II model and notes that it could be considered that adopting Telstra's proposed inputs is conservative and tends to result in higher costs. The ACCC's conservative position does not indicate that it accepts Telstra's methodology or estimation approaches, or that the ACCC no longer holds previously expressed concerns. However, it considers that, for the purpose of final determinations, it will accept Telstra's submissions as an appropriate and pragmatic approach, given the difficulty or impossibility of adjusting for them.

Exogenous adjustments to PIE II's network cost estimates

- 495 In the context of assessing Telstra's ULLS monthly charge access undertaking from December 2005, Telstra submitted that exogenous adjustments should be made to the PIE II model's estimates of network costs. It submitted that these were necessary to account for the following factors:
- lead-in costs
 - trenching cost uplifts
 - a cable distance uplift to account for gradients
 - a cable distance uplift to account for obstacles.
- 496 The ACCC was not satisfied that the exogenous adjustments were reasonable. Telstra again raised exogenous adjustments as an issue in the consultation on interim determinations in these disputes. It submitted that the ACCC should take these exogenous adjustments into account when setting prices.
- 497 In reviewing Telstra's access undertaking, the Tribunal concluded in regard to Telstra's claimed exogenous adjustments that:³¹⁷

³¹⁷ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [373].

...having assessed the evidence provided by Telstra in support of the exogenous adjustments, we are not satisfied that Telstra has provided sufficient evidence to support its contention that the exogenous adjustments should be made to the cost estimates produced by the PIE II model. Although there was extensive material tendered by Telstra, the material that was put before us was little more than a technical recitation of the manner in which each of the adjustments had been calculated. The material did not support the reasonableness of the adjustments nor did it satisfy us that the adjustments were necessary to correct deficiencies in the model.

498 However, the Tribunal also held the view that, if these costs were legitimate and were not recovered, then they should be accounted for. It was not relevant whether the cost was made endogenously or exogenously to the PIE II model.³¹⁸

499 Reflecting its view from its undertaking assessment, the ACCC's preliminary position as outlined in its consultation paper on the exogenous adjustments proposed by Telstra in its undertaking submissions were that it did not consider that the adjustments should be allowed.

500 The ACCC considers each of Telstra's claimed exogenous adjustments below.

Lead-in costs

501 Telstra contended in its submission to the ACCC's draft decision on Telstra's December 2005 draft undertakings that the ACCC should add an exogenous lead-in cost to ULLS network costs as calculated by the PIE II model.³¹⁹ This represented a departure from Telstra's previous position that the cost of lead-ins is recovered through the amounts charged for connections.³²⁰

502 In setting prices for the DFDs, the ACCC's preliminary position outlined in its consultation paper was that it should not add an allowance for lead-ins to the network costs as calculated in the PIE II model This was because:

- the ACCC considers that lead-in costs, being once-off costs associated with connecting a service, would more appropriately be recovered through connection charges
- the ACCC cannot be satisfied that the cost of lead-ins are not already fully or partially recovered by connection charges charged by Telstra³²¹

³¹⁸ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [371] to [372].

³¹⁹ Telstra, above n 279, pp. 22-3.

³²⁰ Telstra, *Telstra's detailed submission in support of its undertakings dated 9 January 2003*, 31 July 2003, p. 31.

³²¹ Telstra, *Our Customer Terms, Basic telephone service section, Part A – General, 31 August 2007*, accessed on 6 December 2007 at <http://www.telstra.com.au/customerterms/docs/fixed_general.pdf>, p. 7.

- lead-in costs may be already recovered in O&M costs
- the methodology which Telstra used to support its claimed exogenous estimate of lead-in costs, in the undertaking assessment,³²² is insufficiently detailed on information such as price trends or discount rates
- the PIE II model already has an asset cost category for lead-ins, and altering inputs (such as price trends) for that category would appear to already affect ULLS prices.

503 The consultation paper sought parties' views on this position.

Submissions from parties

504 Telstra submits that a \$[c-i-c], \$[c-i-c] and \$[c-i-c] exogenous lead-in cost should be added to the PIE II model network costs in 2005/06, 2006/07 and 2007/08 respectively.³²³ That amount represents an annualised recovery over [c-i-c] years of \$[c-i-c], \$[c-i-c] and \$[c-i-c] in the same three years. The amounts are calculated by multiplying a wage rate by an estimate of time taken to install a lead-in.

505 Telstra submits that it is reasonable and necessary that the ULLS network costs estimated by the PIE II model be increased in its proposed way to account for these costs because:³²⁴

- lead-ins are part of the forward-looking costs of providing ULLS
- it would be inappropriate to expense the costs or recover them in connection charges
- the costs are not included in ULLS cost estimates in the model.

506 Telstra also submits that the ACCC's concern that the cost of lead-ins are already fully or partially recovered by connection charges is unfounded because:³²⁵

- revenues from the past are not a relevant consideration to forward-looking costs
- the connection fees for connection work depend on the work required to connect the service and do not contribute to ongoing costs of the lead-ins
- historical connection revenues have not recovered lead-in costs.

507 Optus' initial submission states that it accepts the ACCC's preliminary view not to make any exogenous adjustment for lead-ins.³²⁶ Primus states that its agrees with the ACCC's

³²² Briggs, Andrew, *Supplementary statement of Andrew Harvey Briggs*, 11 August 2006, p. 3.

³²³ Telstra, above n 42, p. 32.

³²⁴ Telstra, *op cit*, p. 33.

³²⁵ *ibid*, p. 33.

preliminary approach to lead-in costs and states that it considers that Telstra has miscalculated in its calculations, as lead-in costs are generally incurred by developers and that lead-in costs should not be based on all SIOs.³²⁷ Telstra in response states that only trenching costs are incurred by developers and that it is appropriate to recover the costs associated with all SIOs in a forward-looking cost exercise.³²⁸ PowerTel/Request reference the Tribunal's rejection of the exogenous adjustments and state that they support the ACCC's position to treat lead-in costs as already being recovered.³²⁹ Telstra stated in its third submission that, if these costs were to be treated as already recovered in connection charges, the ACCC must add them into ULLS connection charges.³³⁰

ACCC's view

- 508 The ACCC notes firstly that lead-in costs are a legitimate expense and that those costs should be recovered. However, the ACCC considers that those costs should not be recovered in ULLS monthly charges.
- 509 The ACCC notes that the Telstra's lead-in cost adjustment is based on a once-off cost of around \$[c-i-c] to perform wiring of the lead-in. The ACCC considers that this cost is already recovered by Telstra separately in its connection charges.
- 510 In particular, Telstra charges a \$299 fee for every service that is connected at premises where a telephone service has not been connected previously, or where the connection requires a technician to visit and undertake cabling work. This compares to a \$125 fee where a previous service existed and a technician must visit, but no cabling is required. The ACCC considers that the \$174 difference in the fees represents the cost of undertaking cabling work at the customer premises and accordingly allows recovery of the cost of lead-ins. As such a fee has been charged at least once for all connections made, the ACCC considers that the cost of lead-ins is adequately recovered. The ACCC considers that, as a once-off cost, it is more appropriate that lead-in costs be treated as a once-off charge in the way they currently are.
- 511 The ACCC further considers that Telstra's submissions that in a forward-looking model past fees should be ignored as a new network would have to be built and lead-ins deployed misapprehends the forward-looking concept. The forward-looking concept does not extend to recovering costs that are already recovered through separate connection charges.
- 512 The ACCC also considers that Telstra's submissions about lead-in costs failing to contribute to ongoing costs to be mistaken. The recovery of a cost over time does not mean that the cost is contributing to ongoing costs. Rather it is a once-off charge that is recovered over a number of years.

³²⁶ Optus, above n 49, p. 13.

³²⁷ Primus, above n 202, p. 13.

³²⁸ Telstra, above n 42, p. 6.

³²⁹ PowerTel and Request, above n 49, pp. 7, 41.

³³⁰ Telstra, above n 42, p. 20.

513 Accordingly, the ACCC considers that including Telstra's claimed lead-in costs uplift would lead to Telstra recovering more than its efficient costs of provision of the ULLS. This would lead to reduced competition and send inefficient signals for investment. The ACCC further considers that this would lead to Telstra recovering more than required to serve its legitimate business interests and recover direct costs. The ACCC further considers that including these costs would adversely affect the interests of access seekers in competing with Telstra on their relative merits.

Trenching cost uplifts

514 Telstra also contended in its submission to the ACCC's draft decision on Telstra's December 2005 draft undertakings that the ACCC should add an exogenous trenching cost of around [c-i-c] to [c-i-c] per month (depending on geographic band) to ULLS network costs as calculated by the PIE II model.³³¹ Telstra submitted that this was to account for having to bore trenches under driveways or concrete pathways, and/or for the costs of backfilling with soil and re-turfing.

515 In setting prices for the DFDs, the ACCC's preliminary position outlined in its consultation paper was to not add an amount to the PIE II model's network costs to account for trenching cost uplifts. This was because:

- the costs of backfilling with soil and reinstating with turf would appear to already be included in the PIE II model, based on previous advice by Telstra in 2003 and the content of the model³³²
- Telstra had not previously provided sufficient detail about how these claimed uplifts were derived and applied to the PIE II estimates of network costs
- it was unclear whether the exogenous uplifts can be sufficiently related to estimates arising from the PIE II model.

516 The consultation paper sought parties' views on this position.

Submissions from parties

517 Telstra submits that it is necessary to allow a trench uplift to allow for the fact that trenches must cross driveways or be laid under concrete pathways.³³³ The uplifts proposed are based on the cost of trenching in turfed areas compared to trenching in paved areas where pavement must be broken up and re-laid, and to trenching where underground boring must be used under driveways. Telstra submits, based on its contractor rates, that trenching in paved areas costs \$[c-i-c] per metre, that trenching in turfed areas and boring under driveways costs \$[c-i-c] per metre and that trenching in

³³¹ Telstra, above n 279, pp. 23-6.

³³² The "Non_PRM_Data" table in 'Costing.mdb' in the PIE II model contains items for the laying of turf and reinstatement of soil.

³³³ Telstra, above n 42, p. 34.

completely turfed areas costs \$[c-i-c].³³⁴

518 Telstra then applies these rates depending on the proportion of paved kerb found in each of the capital city ESAs, and applies the uplifts to the trenching assets in the PIE II model. Telstra submits that the uplift was necessary because the PIE II model does not have cost categories for driveways and concrete pathways, nor for soil and turf reinstatement for main cable and IEN cable. Telstra submits that these are legitimate costs.

519 Optus' initial submission states that it accepts the ACCC's preliminary view not to make any exogenous adjustment for trench uplifts.³³⁵ Primus questions whether historical costs or quotes would take into account factors Telstra has claimed are not accounted for.³³⁶ Telstra in its reply submission responds that those items are not listed in PIE II and provides a table listing trenching costs.³³⁷ PowerTel and Request reference the Tribunal's rejection of the exogenous adjustments.³³⁸

520 Access seeker parties did not make submissions on Telstra's late submitted trenching cost uplifts spreadsheet that was provided to them in December 2007.

ACCC's views

521 The ACCC considers that trenching costs are a real and significant cost of the ULLS. It also notes that, to the extent any particular efficient cost of deploying the network is not recovered, not including that cost would not allow the recovery of direct costs and would not meet the legitimate business interests of the access provider.

522 The ACCC notes that Telstra's submissions about not recovering soil and turf costs for main and IEN cable directly contradicts previous advice to the ACCC from Telstra in 2003 that it had included these costs into PIE II.³³⁹

523 However, the ACCC considers that, more fundamentally, and as noted in its consultation paper, any exogenous adjustment must be sufficiently related to the costs in the PIE II model. In that regard, the ACCC notes that Telstra has stated that uplifts must be applied to all network elements which make up trenching, including conduit, duct, pits and manholes.

524 Telstra has stated that the appropriate markups should be based on the proportional costs of laying distribution pipe in a paved area or area with driveways, compared to the cost of laying distribution pipe in a completely turfed area. The ACCC's concern with this approach is that this markup is then applied to all trenching assets. However, trenching in the PIE II model is costed on a variety of different prices, depending on the type of trench laid and the location. The ACCC considers that it is not appropriate to simply apply a

³³⁴ Telstra, *op cit*, p. 198, Annexure 23.

³³⁵ Optus, above n 49, p. 13.

³³⁶ Optus, *op cit*, p. 3.

³³⁷ Telstra, above n 40, p. 7.

³³⁸ PowerTel and Request, above n 49, p. 41.

³³⁹ Telstra, *Telstra's response to the Australian Competition and Consumer Commission's Section 152BT information request*, 20 May 2003, p. 7.

ratio of distribution trenching costs to all trenching assets in the network.

- 525 The fact that there are no explicit items in the model for laying concrete or boring is not a sufficient reason to add an uplift. It is necessary to consider the actual costs listed in the model and the proportion of assets for which an uplift would therefore be relevant or appropriate.
- 526 In particular, in most exchange areas there is a significant percentage of distribution cable that shares trenching with main cable.³⁴⁰ This trenching is already costed at significantly higher rates than the distribution cable only trenching within the PIE II model.³⁴¹ The ACCC does not consider, therefore, that it would not be appropriate to uplift this cost by the ratio of distribution cable trenching costs. The proportions of distribution and main cabling sharing is higher in CBD and metropolitan areas, which are the areas Telstra identifies as requiring the largest trenching uplift. Similarly, there are significant areas of new estate trenches for which the uplifts would not be appropriate.
- 527 The ACCC accordingly considers that Telstra's proposed uplifts are inappropriate, as they seek to apply distribution cabling ratios to all trenching assets. The ACCC considers that the trenching costs in the model take into account Telstra's concerns. In areas with higher proportions of pavement, the large proportions of distribution-main cable sharing, which is priced at significantly higher trenching costs, should address Telstra's concerns.
- 528 In light of the above analysis, the ACCC considers that including the trenching uplift would tend to lead to costs higher than the costs of an efficient forward-looking network. This would tend to discourage competition and give incorrect signals for efficient investment in infrastructure. The ACCC also considers that including the uplift would lead Telstra to recover more than necessary to meet its legitimate business interests, including in recovering its direct costs. The ACCC considers that including the uplift would adversely affect the interests of access seekers in competing with Telstra on their merits.

Gradient and obstacle multiplier

- 529 Telstra has also asserted in the past that conservative elements of the PIE II model relating to gradient multipliers and obstacle uplifts needed to be accounted for.³⁴² Telstra previously submitted that:

- a 1 per cent uplift in cable and trench distance should be added to account for the

³⁴⁰ The Costing module of the PIE II model contains tables titled "Trenching resources" "Trenching types conversion" "trench sharing reductions" and "PRM mapping table" that deal with the amount of trenching of particular types, the trenching costs and the cost items included in the trenching costs. A summary of the proportions of distribution only trenching, distribution shares with main trenching and distribution shares with main and IEN trenching can be observed in the PIE II model's trenching and ploughing report.

³⁴¹ In Metropolitan areas the trenching cost for distribution cable only is priced at \$52.32 per metre, whereas the trenching cost where distribution cable and main cable is shared is priced at \$180.03 per metre. There are also additional costs for soil and turf, as well as a small allocation for road crossings.

³⁴² Telstra, above n 279, p. 26.

existence of a gradient in the real world

- a 2 per cent uplift to cable and trench distances should be added to account for obstacle factors such as the fact that trenches are not always laid in straight lines.

530 In setting prices for the DFDs, the ACCC's preliminary position outlined in its consultation paper was to not add to the PIE II model's network costs to account for these claimed costs. This was because:

- Telstra had not presented any evidence about how the claimed uplifts were calculated
- Telstra had not provided any indication of how these claimed uplifts would be applied to the PIE II model's estimates of network costs (even if such changes were to be considered appropriate), or of the resulting changes in costs that it considered would be appropriate
- it was unclear that a blanket allowance for gradient and obstacles would be appropriate without knowing how the PIE II model designs a network in particular geographic locations that would warrant an allowance for gradients and/or obstacles.

531 The consultation paper sought parties' views on this position.

Submissions from parties

532 Telstra submits that the cost of trenches needed to be uplifted to reflect the fact that the PIE II model is flat and also that the PIE II model assumes that all trenches can be constructed in straight lines.³⁴³ Telstra submits that this was appropriate based on international experience, citing a report by its consultant Bridger Mitchell.³⁴⁴ Telstra submits that uplifts of between [c-i-c] and [c-i-c] (for 2006-07, depending on band) would be appropriate.

533 Optus' initial submission states that it accepts the ACCC's preliminary view not to make any exogenous adjustment for gradients and obstacles uplifts.³⁴⁵ PowerTel and Request reference the Tribunal's rejection of the exogenous adjustments.³⁴⁶

ACCC's view

534 The ACCC notes that Telstra has not explained exactly how it has derived the calculated uplifts claimed in its submissions. Accordingly there is some doubt about the amounts claimed. However, the ACCC notes that it is still relevant to consider whether it is necessary to allow uplifts for gradients and obstacles if those are not appropriately dealt with in the PIE II model.

³⁴³ Telstra, n 42, p. 36.

³⁴⁴ Mitchell, *ULLS supplementary commentary*, 14 August 2006.

³⁴⁵ Optus, above n 49, p. 13.

³⁴⁶ PowerTel and Request, above n 49, pp. 7, 41.

- 535 Therefore the ACCC has closely examined the Mitchell commentary cited by Telstra as supporting its case for the addition of gradient and obstacle uplifts. Mitchell examines two US models. Mitchell observes that the Hybrid Cost Proxy Model (HCPM) allows for uplifts in cable distances where certain maximum or minimum slope characteristics are met in a particular area. Mitchell also notes that both the HCPM and HAI models allow for adjustments for road factors or uplifts that allow for the adjustment of difficult soil conditions.
- 536 Relevantly, however, Mitchell notes that the HCPM model only uses a road factor distance multiplier of greater than 1 for Cartesian distances. The uplift for rectilinear distances ranges 0.95 and 1.05. Similarly, the HAI model sets the distance uplift parameter to 1 and then increases the trenching and placement costs to account for difficult soil.
- 537 Based on Mitchell's analysis, the ACCC is satisfied that there is no evidence that a case can be made out that an uplift should be included for obstacle factors. The PIE II model accounts for different soil conditions in its different trenching costs, and uses rectilinear distances. Accordingly, the ACCC considers that there is no evidence that a case can be made out for an obstacle uplift based on international experience, as posited by Telstra. The ACCC considers that an obstacle uplift would lead to network cost estimates in excess of efficient forward-looking costs. This would lead to negative effects on competition and efficient investment decisions, and would negatively affect access seekers' interests in competing on their merits. It would also lead to Telstra recovering more than the direct costs of provisioning of the service, and more than needed to meet its legitimate business interests.
- 538 The ACCC notes that the HCPM model does allow for an adjustment for gradient uplift and that this is not accounted for by the PIE II. model While the HCPM model allows for an area-specific uplift, the ACCC notes that there clearly will be gradient in actual Australian conditions. Accordingly real world cable lengths would be increased from those modelled by PIE II. Accordingly, the ACCC considers that some uplift for gradient would be appropriate. This would lead to an amount that would better allow Telstra to recover the direct costs of provisioning of the ULLS, and an amount to meet its legitimate business interests.
- 539 With respect to the amount of gradient uplift that should be allowed, the ACCC notes that the uplift submitted by Telstra is not transparent. However, given the small scale of the uplift sought by Telstra and in the absence of a robust method to assess gradient in each ESA, the ACCC accepts Telstra's banded uplifts, scaled by the ratio of Telstra's network cost estimates to the ACCC's network cost estimates.

Overall conclusion on network costs

- 540 In assessing particular modelling assumptions the ACCC has had regard to the matters listed in section 152CR. The ACCC's view is that proper consideration of these matters is best achieved by taking into account whether cost assumptions and inputs better lead to an estimate of the efficient forward-looking network costs of the ULLS. In reaching its above conclusions, the ACCC considers that assumptions and inputs better resulting in efficient forward-looking network costs will:

- better promote the LTIE, as they will better promote competition and encourage the economically efficient use of and investment in infrastructure. The ACCC considers that efficient cost-reflective prices will allow access seekers and Telstra to compete on the basis of their relative efficiencies, and allow for appropriate build/buy decisions
- allow Telstra to recover amounts necessary to protect its legitimate business interests, but not more than necessary. The ACCC also considers that efficient cost-reflective prices will allow Telstra to exploit the economies of scale and scope inherent in its network
- allow access seekers to compete on their merits
- reflect the direct costs of providing the ULLS
- allow the recovery of sufficient costs to ensure the safe and reliable operation of the network.

541 The ACCC considers that the matters in paragraph 152CR(1)(e) are not likely to be material considerations to consideration of network costs. The ACCC considers that efficient forward-looking network costs will better lead to costs which match the TSLRIC+ pricing set out in the ULLS pricing principles. In certain cases, such as the ACCC’s acceptance of the network design algorithms in the PIE II model, the ACCC has had regard to its limited ability to amend underlying code in the model and to the requirement in subsection 152CLA(1) of the TPA to the desirability of resolving access disputes in a timely manner.

542 The ACCC’s views on the issues discussed above, namely:

- whether to use the updated PIE II model with the ACCC’s preferred inputs
- the WACC
- the price trends and the use of a tilted annuity
- the particular model inputs—trench sharing, asset lives, network planning, network provisioning, O&M factors and network design
- the possible exogenous uplifts to the PIE II model’s costs

will better lead to an efficient forward-looking estimate of network costs and satisfy the relevant provisions of the TPA.

543 The network costs resulting from the ACCC’s consideration of these issues are:

PIE II outputs

| | 2005-06 | 2006-07 | 2007-08 |
|--------|--------------|--------------|--------------|
| Band 1 | \$ [c-i-c] | \$ [c-i-c] | \$ [c-i-c] |

| | | | |
|--------|-------------|-------------|-------------|
| Band 2 | \$[c-i-c] | \$ [c-i-c] | \$ [c-i-c] |
| Band 3 | \$ [c-i-c] | \$[c-i-c] | \$[c-i-c] |

Gradient uplift

| | 2005-06 | 2006-07 | 2007-08 |
|--------|------------|------------|------------|
| Band 1 | \$[c-i-c] | \$[c-i-c] | \$[c-i-c] |
| Band 2 | \$[c-i-c] | \$[c-i-c] | \$[c-i-c] |
| Band 3 | \$[c-i-c] | \$[c-i-c] | \$[c-i-c] |

Total network costs

| | 2005-06 | 2006-07 | 2007-08 |
|--------|----------|----------|----------|
| Band 1 | \$ 3.13 | \$ 3.48 | \$ 3.67 |
| Band 2 | \$ 9.81 | \$ 11.19 | \$ 11.76 |
| Band 3 | \$ 22.54 | \$ 24.77 | \$ 25.98 |

544 These network costs differ from the network costs proposed in the DFDs due to:

- the use of the updated PIE II model provided by Telstra and the ACCC's abandonment of the roll-forward approach, which increased network cost estimates relative to the DFD prices
- the addition of a gradient uplift as submitted by Telstra, which increased network cost estimates relative to the DFD prices
- the five year reduction in distribution cable asset life, which increased network cost estimates relative to the DFD prices
- the two year increase in main cable life, which decreased network cost estimates relative to the DFD prices.

545 The effect of these changes has been to increase the estimate of network costs in Band 1, but decrease the estimate of network costs in Bands 2 and 3.

4.1.10 'Specific costs'

546 The term 'specific costs', in respect of the ULLS, refers to the incremental cost of providing the ULLS, and includes the costs associated with ordering, provisioning and qualifying a ULLS. Relevant cost categories could include IT system development and operational costs; connection costs; wholesale management costs; and indirect costs.³⁴⁷

547 Some of these cost categories are recovered through ULLS connection charges, or other charges that Telstra imposes. Accordingly, it is not appropriate to recover these charges through ULLS monthly charges.

³⁴⁷ ACCC, above n 5, p. 12.

548 As per the ULLS pricing principles, ULLS prices should be cost based using a TSLRIC+ methodology.³⁴⁸ The ULLS pricing principles provide additional guidance on the implementation of a TSLRIC+ methodology in relation to specific costs.

549 A number of matters have been identified as influencing the measurement of ‘specific-costs’ and the calculation of the access charge. The Commission had regard to the section 152CR(1) criteria, and the ULLS pricing principles as required by subsection 152AQA(6) of the Act, in considering the approach to take on these matters. These issues were raised with the parties in the ACCC’s consultation paper and are discussed in turn below.

Cost allocation

550 The ACCC proposed to the parties in its consultation paper the following approach to cost allocation:

- firstly, to pool:
 - ‘specific costs’ associated with the ULLS
 - ‘specific costs’ associated with the LSS
- Telstra’s own internal costs of a nature equivalent to the specific costs of the LSS and ULLS, and
- secondly, allocate this pool to a demand base including all downstream ADSL services.

551 Under this approach, the costs to pool and allocate are limited to the like-for-like incremental costs associated with:

- a Telstra internal request for line sharing (when a retail or wholesale ADSL service is requested); or
- a request for line sharing, or access to the full spectrum on the line, from an external service provider (LSS or ULLS).

552 Costs associated with the conversion of line sharing into a downstream service are not included in the cost pool to be allocated.

553 This approach is consistent with the previous views of the ACCC.³⁴⁹ It is also consistent with the views of the Tribunal as expressed in regard to both LSS monthly charges and ULLS monthly charges:³⁵⁰

We do not accept Telstra’s submission that the specific costs incurred by it in providing the ULLS should only be allocated to, and recovered from, the ULLS and

³⁴⁸ ACCC, *op cit*, pp. 9-11.

³⁴⁹ ACCC, above n 126, pp. 45-62, Appendix A; ACCC, above n 31, pp. 132-145, Appendix E.

³⁵⁰ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [387] to [413].

should not be allocated across a broader range of services, such as all active or potentially active xDSL lines.

554 The ACCC considers that the Tribunal's guidance in its decision on ULLS monthly charges means that the ACCC must pool like-for-like specific costs related to ULLS, LSS and internal ADSL provisioning.

555 The ACCC considers that Telstra implicitly supplies the ULLS to itself (ie. it uses the copper pair) as an input into downstream Telstra retail fixed-line services.

Submissions from parties

556 Telstra opposes pooling, advocating that costs should be allocated only to the ULLS.³⁵¹

557 Telstra submits that pooling is inconsistent with the direct cost criterion. In Telstra's view, this criterion requires that the specific costs of the ULLS should be recovered solely from ULLS access charges, while the pooling approach does not measure or estimate costs in such a way to permit this.³⁵²

558 Telstra claims that the ACCC's impetus for adopting the pooling approach is to reduce costs faced by competitors. Telstra submits that while this would promote entry of competitors, this is not the same as promoting competition. In order to promote competition, access seekers should pay for costs of resources consumed in respect of the service.³⁵³

559 Telstra considers that the pooling approach will reduce incentives for efficient use of and investment in infrastructure. Telstra submits that the pooling approach denies Telstra the ability to exploit economies of scale and scope.³⁵⁴ Telstra submits that the pooling approach would distort investment in Telstra's own ADSL services, as it would require Telstra to share scale economies of those services. Telstra also submits that the use of the pooling approach would deter all potential facilities investors from seeking economies in alternative infrastructure.³⁵⁵

560 Telstra also considers the pooling method is inconsistent with its legitimate business interests, including its interest in exploiting economies of scale and scope to compete in downstream markets.³⁵⁶ It submits that its interests include but are not limited to recovering its legitimate costs. Telstra also contends that the pooling approach does not properly consider the interests of access seekers, and that this interest should not include subsidising or artificially advantaging such users.³⁵⁷

³⁵¹ Telstra, above n 42, pp. 43-7, Annexure 24.

³⁵² Telstra, *op cit*, pp. 43-4, Annexure 24, pp. 203-5.

³⁵³ Telstra, *op cit*, pp. 43-4, Annexure 24, pp. 205-7.

³⁵⁴ Telstra, *op cit*, p. 208, Annexure 24.

³⁵⁵ Telstra, *op cit*, p. 208, Annexure 24.

³⁵⁶ Telstra, *op cit*, p. 209, Annexure 24.

³⁵⁷ Telstra, *op cit*, p. 211, Annexure 241.

- 561 Telstra also submits that the pooling approach is inconsistent with the TSLRIC+ approach in the ACCC's ULLS pricing principles. It submits that the principles require that ULLS charges be set at the TSLRIC+ of the ULLS alone. Telstra considers the pooling approach would not result in such a measure being derived.³⁵⁸
- 562 Telstra acknowledges that its views conflict with the Tribunal's decisions on this issue.³⁵⁹ Telstra however submits that there are two fundamental errors in the Tribunal's analysis. Firstly, it submits that the Tribunal only allowed Telstra to exploit economies of scale and scope up to the point of access, when it should be allowed to exploit all economies. Telstra also states that the Tribunal was wrong to assert that Telstra could impose higher costs on access seekers compared to its own costs as the ACCC would ensure that only efficient costs were recovered.
- 563 In its response to the ACCC's supplementary consultation paper, Telstra repeats and relies on its previous submission that specific costs should be recovered from ULLS users only. Telstra notes that in the context of the current arbitration, Telstra has not claimed a number of specific costs that it typically has in the past. Telstra further contends that the ACCC has failed to take into account some specific costs categories which should be included in calculating the specific costs component. In particular, Telstra submits that the ACCC has failed to follow its own TSLRIC+ approach by failing to include a contribution to indirect capital costs in its calculation of service specific costs for the ULLS.³⁶⁰
- 564 Optus submits that the appropriate demand base to allocate costs over is larger than just all ADSL services.³⁶¹ Optus submits that the impact of ULLS prices is not restricted to ADSL services but may also affect voice services. It submits that accordingly the spread of costs should be across all CAN lines. It submits that distributing costs only to ADSL providers would not allow a level playing field for competition for voice customers. It submits that a wider distribution base would more closely approach competitive neutrality. It also submits that ULLS specific costs are caused by declaration of the service and that the beneficiary of such declaration is all end users of the CAN.³⁶²
- 565 In its submission to the ACCC's supplementary consultation paper, Optus repeats and relies on its previous submissions that it is appropriate for the ACCC to allocate ULLS specific costs across all potentially active DSL lines, or call lines – a broader allocation that proposed in the ULLS pricing principles.³⁶³
- 566 PowerTel and Request submit that there is a strong argument for adopting a broader basis on which to allocate ULLS specific costs.³⁶⁴ Powertel and Request submit that this is because the ULLS leads to lower consumer prices and increased quality of all telephone services and not just broadband. They also submit that Telstra has attempted to place all

³⁵⁸ Telstra, *op cit*, p. 46.

³⁵⁹ Ibid.

³⁶⁰ Telstra, above n 16, pp. 6-7.

³⁶¹ Optus, above n 49, p. 20.

³⁶² Optus, *op cit*, p. 21.

³⁶³ Optus, above n 21, p. 2.

³⁶⁴ PowerTel and Request, above n 49, p. 20.

costs and uncertainties onto access seekers by using a ULLS lines only allocation. They submit that any alternative approach would give supernormal profits to Telstra.³⁶⁵ PowerTel and Request also submit that a broad recovery base would promote competition and efficient investment in infrastructure, allow Telstra to recover its legitimate costs and meet the interests of access seekers. They submit that all possible pooling approaches allow the recovery of direct costs. These submissions are referred to and repeated in their submission on the ACCC's supplementary consultation paper.³⁶⁶

567 Chime submits that the pooled recovery base should be across all copper lines, because the ULLS can be used to provide both ADSL and telephony, and therefore all customers accessing the CAN will benefit from ULLS price competition.³⁶⁷ It also submits that Telstra's legitimate commercial interests will be fully met under a wider recovery base. Primus makes equivalent submissions.³⁶⁸

568 Macquarie agrees with the ACCC's analysis of cost allocation in the ULLS pricing principles and submits the ACCC should adopt the allocation of costs across a broader range of services, consistent with the pricing principles, than those advocated by Telstra.³⁶⁹

569 In response to the submissions of access seekers, Telstra submits that the benefits of competition do not imply that one competitor must subsidise another.³⁷⁰ It submits that competition does not require rival firms to all have the same costs, but rather that competitive neutrality only requires that where firms use the common infrastructure, the costs are allocated to each firm on an equal basis. However it submits that specific costs are not 'common to all firms'.³⁷¹ Telstra also restates its views around economies of scale and efficient investment. It also submits that Chime and Primus are incorrect to say that Telstra will recover its costs under any allocation method. It further submits that profitability is irrelevant to allocation and would discourage investment in products that are likely to be successful.³⁷² Telstra also rejects PowerTel and Request's submissions about the efficiency of Telstra's systems.

ACCC's views

570 The 'pooling approach' the ACCC proposed has been adopted previously for both the ULLS and the LSS.³⁷³ The pooling approach is also adopted in the ACCC's pricing principles for the ULLS.³⁷⁴

³⁶⁵ PowerTel and Request, *op cit*, p. 24.

³⁶⁶ PowerTel and Request, above n 21, p. 3.

³⁶⁷ Chime, above n 200, p. 3.

³⁶⁸ Primus, above n 202, p. 4.

³⁶⁹ Macquarie, above n 21, p. 2.

³⁷⁰ Telstra, above n 42, p. 23.

³⁷¹ *Ibid.*

³⁷² Telstra, *op cit*, p. 24.

³⁷³ ACCC, above n 126, pp. 45-62, Appendix A; ACCC, above n 31, pp 132-145, Appendix E.

³⁷⁴ ACCC, above n 5, p. 16.

571 It is also consistent with the reasoning of the Tribunal on both LSS monthly charges and ULLS monthly charges. In finding that Telstra's then proposed approach to cost allocation was not reasonable (under section 152AH of the TPA), the Tribunal adopted a pooling approach as the comparator. In discussing the likely effect on competition of these two approaches to cost allocation, the Tribunal stated that:³⁷⁵

...it is helpful in the present analysis to note that spreading the LSS specific costs over a broader range of services would be more likely to promote competition between providers of those services, subject to those costs being pooled with other specific costs relevant to the provision of DSL services in downstream markets (eg Telstra's own internal costs of a nature similar to those of providing the LSS and ULLS specific costs). This will ensure that all providers of DSL services using Telstra's CAN would face the same non retailing costs of providing their services.

572 The Tribunal concluded that costs should be pooled, although it was not necessary for the Tribunal to express a concluded view on the demand base over which these costs should be spread. In its view, the demand base comprised at least downstream DSL services.

573 As noted above, the Tribunal also considered this issue in the context of ULLS monthly charges. The Tribunal again concluded that the pooling approach should be adopted, and that Telstra's proposed approach to specific costs was unreasonable.³⁷⁶

574 The ACCC concurs with the reasoning of the Tribunal on this issue, and does not agree with Telstra's claims that the Tribunal was in fundamental error in twice reaching the view that the pooling approach should be adopted.

575 Adopting Telstra's position on this issue (i.e. that 'ULLS specific costs' should be recovered only from ULLS lines) would lead to a higher access charge than what was proposed, and which results from the pooling approach. Telstra claims that it is this result that provides the impetus for the ACCC's preference for the pooling approach. However, this is not the case. The ACCC's preference for the pooling approach results from its detailed consideration of the alternative approaches against the subsection 152CR(1) criteria and the ULLS pricing principles. In this regard, the ACCC considers that the higher charges that results from Telstra's approach cannot be supported by those criteria and principles. Adopting the access seeker's favoured approach of allocating the specific costs over all lines would reduce the ULLS monthly charge.

576 The ACCC has considered the views the parties have advanced, but remains of the view that the approach it proposed is to be preferred having regard to the subsection 152CR(1) matters and ULLS pricing principles. It follows that the ACCC does not accept Telstra's view that the approach Telstra has advocated better meets the subsection 152CR(1) criteria or the ULLS pricing principles.

Consideration against subsection 152CR(1) criteria

³⁷⁵ *Telstra Corporation Limited (ACN 051 775 556)* [2006] ACompT 4 (2 June 2006) at [150].

³⁷⁶ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [387] to [413].

Paragraph 152CR(1)(a)

- 577 The first criterion concerns the promotion of the LTIE (paragraph 152CR(1)(a)). This calls for consideration of a number of factors identified in section 152AB, being the objective of promoting competition, the objective of achieving any-to-any connectivity, the objective of encouraging the economically efficient use of and the economically efficient investment in infrastructure, and subsidiary matters. (paragraphs 152AB(2)(c)-(e), subsection 152AB(4), paragraphs 152AB(6)(a)-(c), and subsection 152AB(7A)).
- 578 The ACCC considers that its proposed approach, as compared to the Telstra approach, better promotes competition, by better enabling ULLS (and LSS) based service providers to compete on an equal footing with Telstra's wholesale and retail DSL services. The ACCC considers that ULLS and LSS-based supply has to date brought benefits to end-users in relevant service areas, in particular, by supporting higher quality, ADSL2+, services. This has encouraged competition in downstream DSL markets in particular. An unequal footing between Telstra and access seekers would tend to lessen competition in those markets and also the associated fixed voice market.
- 579 This does not mean that Telstra and access seekers will face equivalent costs across all stages of production, as Telstra and ULLS access seekers will each separately transform the ULLS into downstream services, and in doing so will make investments and incur significant additional costs. It does mean, however, that for those cost categories that are within the control of Telstra, ULLS access seekers will face the same level of costs. The ACCC does not accept that the access regime removes these cost categories from Telstra's control.
- 580 The ACCC does not agree with Telstra's view that the pooling approach underestimates TSLRIC+, and hence will not promote competition, due to a potential for entry by inefficient firms. The ACCC considers that the pooling approach measures the TSLRIC+ of (the specific costs of) the ULLS, and that this measure is appropriate for use in deriving the ULLS monthly charges. Hence, the ACCC does not accept that the pooling approach will subsidise inefficient entry, or otherwise will not promote competition. The ACCC considers that the pooling approach will lead to competition between parties on their merits, rather than subsidising inefficient entry. However, not implementing the pooling approach would mean Telstra would have less incentive to obtain efficiencies.
- 581 It can be noted however that Telstra does not object to pooling per se, given that it also puts forward a ULLS cost estimate based on CCA data primarily consisting of allocations made from higher level cost pools, rather than allocated directly to the ULLS. What is in issue here is the type of 'pooling' and transparency with which the 'pooling' is undertaken.
- 582 Further, in its submissions in these proceedings, Telstra accepts that allocating costs associated with common infrastructure on an equivalent basis would promote competition. Telstra concludes, however, that allocating specific costs on such a basis would not promote competition.
- 583 It is not disputed that it is Telstra's ordering and provisioning systems and common associated infrastructure and processes that are used to provide the relevant functionality

to support each of the LSS, ULLS, and the internal equivalent inputs used by Telstra's retail and wholesale divisions. That is, it is Telstra's systems that are used to receive customer orders, qualify the requested services and to arrange the necessary exchange based work etc. Further, for certain products such as the LSS and wholesale ADSL, the exact same systems are used for each such step including the client interface ("LOLO") that is used to submit orders.³⁷⁷

- 584 The ACCC considers conducting this assessment at a lower level, and considering each program that is run on Telstra's computer systems in providing this common functionality, is unnecessary. What is important is that common systems are used to provide common functionality, and that each of these is under the control of Telstra.
- 585 It is possible that the access seekers' advocated all CAN lines approach could further promote competition, should it lead to conditions that were more conducive to competitive entry by LSS and ULLS based suppliers in both DSL and voice markets. However, the ACCC considers that the ULLS is currently being used to a limited extent to provide only downstream voice services.
- 586 The ACCC does not consider that the approach adopted on this issue affects the objective of achieving any-to-any connectivity. Nor are the matters identified in paragraph 152AB(6)(a) affected by this decision.
- 587 Turning to the objective of encouraging economic efficiency in use or investment (paragraph 152AB(2)(e)), the ACCC considers that the different level of unit costs that would likely be allocated to Telstra and access seekers, respectively, under Telstra's submitted approach would not represent the relative efficiency of Telstra compared to ULLS (and LSS) access seekers. As noted already, the incremental costs are those of internal Telstra systems, which are passed through to access seekers, and do not reflect decisions or practices of access seekers. The ACCC notes the views of the Tribunal in this regard, where it stated that "it is important to recognise in this context that access seekers such as Optus and the other intervenors have no control over, or say in, the development of the ULLS specific costs".³⁷⁸
- 588 The ACCC considers that Telstra's approach would tend towards encouraging less efficient use of and investment in the infrastructure used in providing common ordering and provisioning functionality for LSS, ULLS, and DSL services. While the pooling approach ensures that access seekers and Telstra each face their share of the cost for this functionality, there is no assurance that Telstra's approach would achieve this. Under Telstra's approach, there is a likelihood that differentiated unit costs for this common functionality would be allocated to the LSS, ULLS and Telstra's DSL services. Further, as associated costs would only be met from access seekers, Telstra would have less incentive to ensure that investments that it could subsequently attribute to external supply of the ULLS were necessary and implemented at efficient cost levels. Higher resulting unit costs for external access seekers would discourage use of LSS and ULLS below efficient levels. These inefficiencies would flow through to downstream services and discourage the efficient investment in infrastructure used to supply downstream DSL

³⁷⁷ Telstra, above n 40, p. 25.

³⁷⁸ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [401].

services.

- 589 The ACCC does not accept that the pooling approach amounts to basing cost allocations on profitability, and hence does not accept that the pooling approach would thereby reduce incentives to invest in successful products.
- 590 Nor does the ACCC accept that one or other of the approaches would be likely to promote efficient investment in access network infrastructure. The ACCC considers that Telstra has strong incentives to invest in its CAN given the excess of revenues to cost Telstra reports in its RAF returns for products supplied over the CAN. The ACCC does not consider that ULLS access seekers would be likely to invest in a duplicative CAN as a result of the approach to this issue.
- 591 Telstra contends that the pooling approach is contrary to its legitimate commercial interests, as it would prevent Telstra from fully exploiting economies of scale and scope that would otherwise be open to it. Telstra considers that the pooling approach means that Telstra is required to share a portion of the economies it realises in providing access. Telstra's contention focuses on the exploitation of some of the economies that are realised in providing access, and ignores the other economies potentially available in transforming this access into downstream services.
- 592 The ACCC considers that Telstra's ability to exploit economies of scale and scope over all stages of production involved in supplying services to end-users would be greater under the ACCC's approach. This is because the pooling approach will expand demand for downstream services, as well as access, as by promoting competition it leads to the supply of downstream services that are of higher quality, of greater variety and/or more competitively priced. This increase in demand will generate strong economies of scale and scope, due to the presence of fixed costs. These economies of scale and scope will be, as the Tribunal has found, open to Telstra to exploit.³⁷⁹
- 593 The ACCC has discussed investment incentives above. The ACCC considers that the pooling approach provides incentives to Telstra and LSS access seekers to each invest in infrastructure by which downstream DSL services are supplied. By providing for a normal, risk-adjusted return on investment, the ACCC has had regard for risks in making this investment.

Paragraph 152CR(1)(b)

- 594 The next criterion is the legitimate business interests of the provider and its investment in facilities used to provide the ULLS (paragraph 152CR(1)(b)). Telstra's legitimate business interests are discussed in considering legitimate commercial interests under the first criterion. In this context, the criterion involves consideration of whether Telstra will be able to recover its costs, including the direct costs associated with the ULLS, and a normal risk-adjusted return on its capital employed. These matters are discussed under the criterion in paragraph 152CR(1)(d). The ACCC considers that Telstra's legitimate business interests will be satisfied under the ACCC's 'pooling' approach.

³⁷⁹ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [409] and [410].

595 Telstra submits that the pooling approach is inconsistent with the ‘direct costs criterion’, on the basis that it does not lead to specific costs being recovered only from charges paid by ULLS access seekers. This submission was considered by the Tribunal in reaching its view that the pooling approach would satisfy this criterion. As the Tribunal has noted, there may be a variety of allocation methods that would enable Telstra to recover its direct costs. Provided that Telstra is able to recover its direct costs under the cost allocation method, then the criterion is satisfied.³⁸⁰ The ACCC agrees that the pooling approach will permit the recovery of direct costs, as Telstra will be able to include the equivalent increment in charges for all LSS, ULLS and downstream services.

Paragraph 152CR(1)(c)

596 The next criterion is the interests of all persons with rights to use the ULLS (paragraph 152CR(1)(c)). The access seekers’ interest lies in being able to enter markets and compete on their relative merits. The ACCC considers that in this context it is access seekers’ ability to enter downstream DSL and voice markets that should be assessed. The ACCC considers that its approach satisfies these interests. Telstra’s proposed approach would not, as it would necessarily inflate ULLS access seekers’ cost base above TSLRIC+ and relative to Telstra’s cost base. This would be detrimental to access seekers’ interests and impede their ability to enter markets and supply downstream services.

Paragraph 152CR(1)(d)

597 The next criterion is the direct costs of providing access to the ULLS (paragraph 152CR(1)(d)). It is concerned with ensuring that Telstra will be able to recover its costs in providing access, either to itself or to ULLS access seekers. In this context, the criterion involves consideration of whether Telstra will be able to recover its ‘ULLS specific costs’ inclusive of a normal risk-adjusted return on its capital employed.

598 The pooling of costs associated with the external supply of the ULLS and its internal provisioning could not compromise Telstra’s ability to recover its direct costs of providing access to the ULLS. What is involved here is ensuring that each instance of ULLS provision is considered in deriving the associated unit cost.

599 Further, as discussed above, the inclusion of “LSS-specific costs” in determining the “ULLS-specific” costs is appropriate given the commonality in underlying functionality and the use of Telstra systems involved in each case.

Paragraphs 152CR(1)(e) & (f)

600 The cost of extensions to Telstra’s ordering systems necessary to supply the LSS or ULLS have been taken into account (paragraph 152CR(1)(e)). The Commission does not consider that the ‘operational and technical requirements’ criterion materially contributes to this decision (paragraph 152CR(1)(f)).

³⁸⁰ *Telstra Corporation Limited (ACN 051 775 556) [2006] ACompT 4 (2 June 2006) at [139].*

Paragraph 152CR(1)(g)

- 601 The ACCC has considered which approach should be favoured in terms of enabling a carriage service, telecommunications network or facility to be operated efficiently. The criterion calls for consideration to be given, in this instance, to services, networks and facilities associated with the ULLS, LSS and downstream DSL services, of the access provider, the access seeker, and any other downstream service providers.
- 602 The ACCC considers that its proposed approach strikes the best balance. It will promote competition in downstream services, which will in turn encourage efficiencies in markets for these services. The Tribunal has stated that it is possible that that allocative efficiency in the upstream supply of ULLS or LSS would be reduced to a small extent, but that the resulting efficiencies in the downstream DSL markets would far outweigh this.
- 603 Turning to the ULLS pricing principles, the parties accept that TSLRIC+ is the appropriate cost methodology to use. Telstra takes issue with the manner of the ACCC's implementation of the TSLRIC+ methodology, and in particular the adoption and application of the pooling approach. Telstra considers that the ULLS pricing principles should not be applied insofar as they require the adoption of the pooling approach and, if they are applied, all relevant cost categories should be included in ULLS specific costs.
- 604 The ACCC considers that its pooling approach is consistent with the current ULLS pricing principles and that these pricing principles should be applied. The ACCC considers that the pooling approach is also consistent with the previous pricing principles on which parties were initially consulted. This is because the pooling approach better ensures that all common Telstra infrastructure and associated services are considered in measuring the TSLRIC+ of the ULLS. Further, the ACCC considers that its pooling approach is the most consistent with the ULLS pricing principles of all approaches that have been proposed.

Summary

- 605 In summary, the ACCC considers that incremental costs should be pooled and allocated over downstream DSL services. The ACCC considers that this approach is supported by the subsection 152CR(1) criteria and the ULLS pricing principles, and, as compared to Telstra's approach and the access seekers' approach, better meets these considerations.
- 606 The ACCC notes the access seeker parties' submissions that an all lines allocation should be used to recover specific costs. The ACCC notes that the ULLS can be used to provide just voice and has noted the potential for an all lines allocation in the past.³⁸¹ However, a key consideration has been the services that are typically supplied by means of the LSS and ULLS. The ACCC has not adopted an 'all-lines' allocation as it understands that, currently, the LSS and ULLS are used mainly where the end-user requires a DSL service, and that LSS and ULLS based supply is driving competition in DSL services. The ACCC understands that the use of ULLS to provide only voice is not likely to be widespread.

³⁸¹ ACCC, above n 31, Appendix E.

Weighted average cost of capital ('WACC')

607 The ACCC notes its conclusions in relation to WACC in its analysis of network costs. As noted in that section, the ACCC considers that one single WACC should be used for all assets supplied over the PSTN. Accordingly the conclusions drawn by the ACCC and discussed earlier in this statement of reasons in relation to the WACC and network costs apply equally to specific costs.

Levelisation period

Introduction

608 Levelisation refers to setting a 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 ACCC proposed that a levelisation period should be adopted commencing on 1 July 2000 and ending on 30 June 2008.

Submissions from parties

609 Telstra's initial submission makes no comment on levelisation.³⁸² PowerTel and Request accept the ACCC's approach to levelisation.³⁸³

610 Primus questions whether a levelisation period ending on 30 June 2008 is sufficient. It considers that it would not expect that the market for the ULLS and LSS would be fully matured by this stage, and requests that the ACCC consider extending the levelisation period.³⁸⁴ Chime submits that there is a lengthy period for access seekers to deploy the ULLS, on a site by site basis and requests that the ACCC consider extending the levelisation period to 30 June 2011.³⁸⁵ In response, Telstra advises that it opposes the levelisation period extending to 30 June 2011, submitting that it would impose substantial risk on Telstra due to demand uncertainty.³⁸⁶

ACCC's views

611 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 timeframe over which to levelise costs can have a significant bearing on the per unit cost estimate.

³⁸² Telstra, above n 42, p. 49.

³⁸³ PowerTel and Request, above n 49, p. 29.

³⁸⁴ Primus, above n 202, p. 5.

³⁸⁵ Chime, above n 200, pp. 3-5.

³⁸⁶ Telstra, above n 40, p. 20.

612 This issue was considered by the Tribunal, which concluded that a levelisation period of four years for the LSS was too short.³⁸⁷ The ACCC concurs with the Tribunal's reasoning on this issue and considers that it is equally applicable to the current context.

613 Adopting Primus' and Chime's position would likely tend towards a lower access charge, but the amount of any reduction is not known as implementing this approach would require more data.

614 The ACCC remains of the view that it is appropriate to levelise over the period from 1 July 2000 to 30 June 2008. A number of factors inform this approach:

- it draws upon the available data (as forecasts are available for the prospective period);
- the access charge is reflective of charges expected in a reasonably mature market for the ULLS and internal and external line sharing, as a longer period is allowed for demand to mature; and,
- it better ensures that costs can be recovered – for instance, if a previously proposed levelisation period of five years was adopted for incremental costs, it is possible that Telstra may not have recovered its costs due to lower than expected demand materialising.

615 While the demand for the ULLS itself may not mature for some time after 30 June 2008, the approach to cost allocation that has been adopted means that it is total demand for LSS, ULLS and downstream DSL services that informs incremental unit costs. While this total demand base is likely to continue to grow beyond 30 June 2008, these services as a whole have reached a significant level of penetration, and it is likely that the rate of growth in this total demand base will reduce. In these circumstances, there would be less reason to continue to levelise costs over multiple years.

616 As a result, a single ULLS specific cost has been specified for the entire period of the final determination (including any backdated operation).

Efficient costs (including efficient indirect capital costs), and tilting of annuity

617 The ACCC noted that Telstra's claimed ULLS 'specific costs' and 'LSS specific costs' (which are both taken into account in deriving the pooled specific costs) are actual incurred costs that have not been demonstrated to be efficient costs. However, the ACCC proposed in its consultation paper to adopt Telstra's claimed costs as being efficiently incurred costs for the purpose of the arbitrations. It was noted that this assumption might lead to a higher TSLRIC+ estimate of the pooled specific costs than would otherwise result.

Submissions from parties

³⁸⁷ *Telstra Corporation Limited (ACN 051 775 556) [2006] ACompT 4 (2 June 2006) at [120].*

- 618 Telstra submits that its costs are efficient, but submits that actual costs should be had regard to even if inefficient.³⁸⁸ Telstra submits that the ACCC's estimates of costs should also include common costs of IT core systems, and an allocation of indirect capital costs.³⁸⁹
- 619 Telstra did not comment on the staff cost allowances or IT O&M (other than its submissions about IT core systems), but submits that if the tilt factor was removed from the model then the specific costs would be reduced by 1 cent.³⁹⁰
- 620 In its supplementary submission, Telstra submits that the ACCC has omitted indirect capital costs *inter alia* from the ACCC's cost model and contends that a contribution to indirect capital costs is consistent with the statutory criteria and the ACCC's own TSLRIC+ calculation of the ULLS. Telstra further submits that the ACCC has failed to address Telstra's previous submissions on this claimed deficiency.³⁹¹
- 621 Optus raises concerns with the significant increase in IT O&M costs in 2005-06 and submits that the ACCC should adjust the costs down.³⁹² PowerTel and Request submit that the ACCC's proposed approach is a conservative one.³⁹³ Chime questions the ACCC's proposed approach, given concerns expressed in the ACCC's undertaking assessment processes.³⁹⁴ Primus raises similar concerns.³⁹⁵ Telstra in response to these submissions reiterates that it considers its costs to be efficient.³⁹⁶

ACCC's views

- 622 Telstra has submitted that the ACCC should have regard to Telstra's actual costs as well as TSLRIC+ measures. The ACCC does not consider that ULLS charges should be set by reference to actual costs, consistent with the pricing principles and the long-held position of the ACCC and as endorsed by the Tribunal.
- 623 The ACCC accepts that an efficient provider of the ULLS would incur costs such as staff costs and IT O&M costs.
- 624 In relation to IT O&M costs, the ACCC notes that Optus submits that the costs should be decreased, while Telstra states that the costs should be increased. The ACCC notes that Telstra has previously stated that the increase in claimed IT O&M costs for 2005-06 onwards represented a greater proportion of ULLS transactions performed on common computer systems compared to other transaction types.³⁹⁷ Accordingly, the ACCC

³⁸⁸ Telstra, above n 42, p. 49.

³⁸⁹ Telstra, *op cit*, pp. 41-3.

³⁹⁰ Telstra, *op cit*, p. 49.

³⁹¹ Telstra, above n 16, pp. 6-7.

³⁹² Optus, above n 49, p. 20.

³⁹³ PowerTel and Request, above n 49, p. 30.

³⁹⁴ Chime, above n 200, p. 5.

³⁹⁵ Primus, above n 202, p. 5.

³⁹⁶ Telstra, above n 42, p. 20.

³⁹⁷ ACCC, above n 31, p. 156, Appendix E.

considers that Telstra's concerns about understating the costs of IT are not founded as the increases in IT O&M costs account exactly for these increased costs. The ACCC notes that it applies these higher ULLS O&M costs to all ULLS, LSS and ADSL SIOs and that this is a conservative approach. The ACCC does not intend to increase IT costs as it considers that would be likely to overstate costs above an efficient forward-looking cost level.

- 625 The ACCC notes Optus' submission that IT O&M costs should be reduced. However the ACCC does not consider that this is practicably open to it without a basis for assessing the reduction in costs. As there is no basis for assessing the reduction, the ACCC considers that it will accept Telstra's claimed IT O&M costs.
- 626 In relation to a need to account for Telstra's claimed indirect capital costs, the ACCC notes that Telstra has suggested either adopting indirect capital ratios from the PIE II model or from wholesale transmission assets. Indirect capital may be a justifiable cost item, if the indirect capital items can be considered referable to the direct capital and the efficient forward-looking costs of the ULLS. As noted above in the analysis of Telstra's CCA model, there are a number of organisational asset items that could be considered to not be referable to supply of the ULLS. Furthermore Telstra proposes amortising such assets over [c-i-c] years in its Telstra CCA model, which would reduce the annualised level of costs claimed.
- 627 In reference to adopting an indirect capital ratio from the PIE II model, the ACCC notes that indirect capital calculations in the PIE II model are based on general ledger accounts and that ratios are dependent on asset type.³⁹⁸ Telstra has not suggested a particular ratio to adopt from the numerous ratios in the PIE II model, although it elsewhere suggests using a 6 per cent uplift. The ACCC notes that software assets, which would be most comparable assets to the specific costs assets and hence the most appropriate ratio to apply, have an indirect capital uplift of 0 per cent in the PIE II model. Applying this ratio would obviously not affect the costs in the specific cost model. Other assets (which the ACCC considers are less referable to the specific costs) have between [c-i-c] per cent and [c-i-c] per cent allocated to them. The evidence from the PIE II model suggests an uplift in the order of 1 to 3 per cent would be appropriate. Even applying such an uplift to the specific cost assets would have a very small effect on the specific cost estimates (around 1 to 2c), which would be subsumed in the rounding of charges adopted by the ACCC.
- 628 In light of the above discussion the ACCC does not consider that the effect of including indirect capital in the specific cost model is material.
- 629 The possibility remains in the ACCC's proposed approach of accepting Telstra's claimed costs that inefficient costs will remain in the cost base. However, the ACCC considers that the extent to which this would occur is relatively limited, given the small scale of the costs involved and the TSLRIC+ approach involved. Accordingly for the purpose of this arbitration, and while the claimed costs have not been proven to be efficient, the ACCC has accepted in full Telstra's cost claims from August 2006.

³⁹⁸ Telstra, above n 42, p. 94, Annexure 14.

630 The ACCC notes that Telstra advocates not tilting the annuity in the specific cost model. However, the effect of tilting or not tilting the annuity is marginal and does not affect the rounded ULLS monthly charge. This can be observed by inputting ‘0’ into relevant cells at row 3, of worksheet ‘General data’, in the ULLS monthly charges cost model that the ACCC provided to the parties with its consultation paper.

Telstra’s internal equivalent costs

631 The ACCC noted to the parties in its consultation paper that Telstra has not made a cost claim for its internal equivalent costs, and invited Telstra to make such a claim. The ACCC proposed that if Telstra was unable to provide information regarding its internal equivalent costs, these would be estimated based upon the data that had been provided in respect of the ULLS. In particular, the ACCC proposed to estimate these costs on the basis that:

- the efficient internal equivalent operating (“opex”) costs per line that Telstra incurs are the same as those that Telstra has claimed for the ULLS
- the efficient internal equivalent capital costs that Telstra incurs are double the capital costs that Telstra has claimed for the ULLS, and incurred at the same time as the ULLS capital costs.

Submissions from parties

632 Telstra refers to previously supplied ADSL costs drawn from its accounting systems, and did not provide any data relating to its internal equivalent costs of line sharing.³⁹⁹ Telstra considers that the proposed allowance is arbitrary.

633 Optus submits that there is insufficient justification for the ACCC to take the position that the efficient internal equivalent capital costs are twice the actual ULLS capital costs and submits that it should assume they are equal to the actual ULLS capital costs.⁴⁰⁰ PowerTel and Request accept the ACCC’s proposed approach.⁴⁰¹

634 Chime submits that the allowance for Telstra’s internal equivalent capital and operating costs is too high. Chime acknowledges that there could be greater complexity in internal line sharing, as there will be a need to interface with Telstra retail and Telstra wholesale ordering systems, but considers that it would not expect this to result in a build cost double that of the ULLS system.⁴⁰² Primus makes equivalent submissions.⁴⁰³

635 In response, Telstra rejects Chime’s and Primus’ submissions on the basis that no evidence is adduced in support of their contentions. Telstra states that it has led evidence concerning its internal equivalent costs, and restates its contention that if there is

³⁹⁹ Telstra, *op cit*, p. 41.

⁴⁰⁰ Optus, above n 49, p. 19.

⁴⁰¹ PowerTel and Request, above n 49, p. 32.

⁴⁰² Chime, above n 200, p. 7.

⁴⁰³ Primus, above n 202, p. 7.

insufficient evidence, the ACCC should investigate the matter further.⁴⁰⁴

ACCC's views

- 636 Telstra would incur equivalent costs to ULLS and LSS specific costs when it provisions a line or a line sharing for its own use. These costs relate to qualifying the line, processing requests, and arranging for exchange-based work necessary to establish the provision of voice and/or DSL on the line. The question is what allowance would be reasonable.
- 637 The ACCC considers that its proposed allowance is appropriate, having regard to the section 152CR(1) criteria and the ULLS pricing principles, and taking a conservative approach to estimating the efficient forward-looking level of these costs. The ACCC considers that this is preferable to the approaches advocated by Telstra and the access seekers, respectively, to increase or decrease the allowance.
- 638 In this regard, the ACCC's allowance is calculated so as to permit Telstra to build two additional ordering and provisioning systems, of the same type and functionality that Telstra built for the ULLS, to process Telstra retail and Telstra wholesale orders for internal line sharing and perform associated tasks.
- 639 The ACCC considers that this allowance would tend towards overstating the efficient forward-looking cost of systems that provide the functionality necessary to establish internal line sharing. Should the costs of implementing the same functionality for internal line sharing, as provided by the ULLS system in respect of service qualification and provisioning, was more than double the actual costs that Telstra incurred in developing the ULLS system, those costs would not be efficiently incurred. Further, this assumes that the actual amount that Telstra spent in developing this functionality for ULLS was at an efficient level, such that it could be used as an efficient benchmark for equivalent functionality concerning internal line sharing.
- 640 The 'ADSL costs' that are claimed by Telstra are not the internal equivalent costs of line sharing. ADSL is the supply of a managed service over a shared line. The LSS and ULLS are services of a lower layer involving access to spectrum on copper wire. Different cost categories and elements are associated with 'unbundled' line sharing, and managed services.
- 641 Telstra has previously accepted that ADSL costs are not the same as the relevant internal equivalent costs in proceedings before the Tribunal.⁴⁰⁵
- 642 Nor does the ACCC accept Telstra's claim that the cost of downstream ADSL services would be close to that of providing internal access or internal line sharing, given the additional technical and operational complexity of converting access to spectrum on a copper wire into an end-to-end voice and/or ADSL service.

⁴⁰⁴ Telstra, above n 40, p. 19.

⁴⁰⁵ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [399].

- 643 Further support for this view is provided from the terms of the xDSL profit and loss statement on which Telstra relies, which indicates that the retail xDSL capital expenditure data is inclusive of network expenditure, in addition to systems development. This, together with the additional functions that are required of retail systems, can be expected to explain the significant variation between reported retail ADSL and wholesale ADSL capital expenditure.
- 644 That said, the ACCC does not consider that it is appropriate to reduce the capital allowance for internal line sharing as the access seekers propose. Doing so would run the risk that the allowance may prove insufficient to recover efficient forward-looking costs, and at a practical level, it is unclear what lesser allowance than that proposed would still ensure that efficient costs were recovered.
- 645 The ACCC notes Telstra's submission that the ACCC should further investigate this issue before making this determination. However, the ACCC considers that the available information is sufficient for it to form a view on the costs that would be efficiently incurred in the provisioning of internal line sharing, and that the ACCC should proceed to make the final determination on the basis advised to the parties in the June 2007 consultation paper.
- 646 Further, the ACCC notes that Telstra was invited in this arbitration hearing to provide a submission on its internal equivalent costs (as distinct to its downstream costs) should it wish to do so, but did not make such a submission.

Consideration against subsection 152CR(1) criteria

Paragraph 152CR(1)(a)

- 647 In terms of applying the subsection 152CR(1) criteria, the first criterion concerns the LTIE. (paragraph 152CR(1)(a)). This calls for consideration of a number of factors identified in section 152AB, being the objective of promoting competition, the objective of achieving any-to-any connectivity, the objective of encouraging the economically efficient use of and the economically efficient investment in infrastructure, and subsidiary matters. (paragraphs 152AB(2)(c)-(e), subsection 152AB(4), paragraphs 152AB(6)(a)-(c), and subsection 152AB(7A)).
- 648 As discussed previously, the ACCC considers that access charges that represent the forward-looking costs of an efficient provider best promote competition. This is because over the long run they lead to conditions which allow the access provider and access seekers to compete in downstream markets on their relative merits. The ACCC considers that its option is more consistent with this outcome than the parties' respective approaches, and so would better promote competition.
- 649 Adopting the approach Telstra implies would require LSS and ULLS-based service providers to contribute to the capital costs of Telstra's supply of competing higher layer, managed services. This outcome would lessen competition.
- 650 The ACCC does not consider that this decision affects the objective of achieving any-to-

any connectivity, or that the matters identified in paragraph 152AB(6)(a) are relevant.

- 651 The ACCC considers that its approach satisfies Telstra's legitimate commercial or business interests, including its interest in recovering its direct costs and exploiting economies of scale and scope. This is because an allowance is made for Telstra's capital and operating costs when supplying the ULLS or line sharing to itself or access seekers.
- 652 Hence, Telstra will be able to recover its costs, including a normal return on investment, from its supply of LSS, ULLS and wholesale and retail services downstream from internal line-sharing. An additional allowance for ADSL level costs is not necessary in LSS and ULLS charges, as Telstra will be able to recover these costs in ADSL charges. Similarly, access seekers will be required to meet their ADSL level costs from their charges for ADSL services.
- 653 Further, by adopting an approach that promotes competition and dynamic efficiencies, demand for ADSL and voice services, and cost savings, will be encouraged, and this will further drive economies of scale and scope, given the present of fixed costs. Telstra will remain able to generate economies of scale and scope over all stages of production involved in supplying services to end-users. In this regard, the ACCC's approach will promote competition and dynamic efficiencies, which in turn will stimulate demand for downstream services.
- 654 Further, in respect of operating costs, the ACCC assumes that unit costs will remain approximate to those estimated for the ULLS, when much greater demand is brought to account, when there seems the potential for economies of scale and scope. Telstra will be able to get the benefit of those economies of scale and scope under the ACCC's approach.
- 655 Adopting the ACCC's approach will promote incentives for investment in infrastructure, such as DSLAM/MSAN networks and ordering systems. There is the potential for the ACCC's approach to provide too great an allowance for capital costs, and this could reduce investment in DSLAM/MSAN networks and ordering systems. However, Telstra's approach would have a far greater detrimental effect on investment incentives, as it would further increase the capital allowance above the likely efficient level. The risks associated with investment are taken into account by allowing for a risk-adjusted rate of return.

Paragraph 152CR(1)(b)

- 656 The next criterion is the legitimate business interests of the provider and its investment in facilities used to provide the ULLS (paragraph 152CR(1)(b)). This criterion is discussed as part of the first criterion. The ACCC considers that its approach is consistent with Telstra realising its legitimate business interests, such as recovering its costs of providing access and a normal, risk-adjusted return on its investment.

Paragraph 152CR(1)(c)

- 657 The next criterion is the interests of all persons with rights to use the ULLS (paragraph 152CR(1)(c)). The access seekers' interests lie in being able to compete on their relative merits. The ACCC considers its approach best meets this criterion, in the present circumstances where information is limited. Telstra's approach would necessarily lead to

Telstra gaining a significant cost advantage over access seekers, as access seekers would be required to contribute to Telstra's costs of transforming line sharing into downstream services as well as funding their own transformation costs. This would be contrary to access seekers' interests.

Paragraph 152CR(1)(d)

658 The next criterion is the direct costs of providing access to the ULLS (paragraph 152CR(1)(d)). It is concerned with ensuring that Telstra will be able to recover its costs in providing access, to itself or others.

659 Under the ACCC approach, Telstra will be able to recover its costs of providing access to the ULLS, including a normal return on investment, from its supply of LSS, ULLS and the services that it supplies that use the ULLS or LSS as an input (wholesale and retail ADSL services).

660 The additional ADSL level costs that Telstra has claimed are not the direct costs of providing access to the ULLS, as they include additional expenditures incurred in supplying managed end-to-end ADSL services. Nor is an allowance for these additional ADSL level costs in ULLS charges necessary to allow their recovery. Telstra will be able to recover these costs in ADSL charges. Similarly, access seekers will be required to recover their ADSL level costs from their charges for ADSL services.

Paragraphs 152CR(1)(e) & (f)

661 The cost of extensions to Telstra's ordering systems necessary to supply the LSS or ULLS have been taken into account.⁴⁰⁶ The ACCC does not consider that the 'operational and technical requirements' matter materially contributes to this decision.

Paragraph 152CR(1)(g)

662 The ACCC has considered which approach should be favoured in terms of enabling a carriage service, telecommunications network or facility to be operated efficiently.⁴⁰⁷ The criterion calls for consideration to be given, in this instance, to services, networks and facilities associated with the ULLS, LSS and downstream DSL services, of the access provider, the access seeker, and any other downstream service providers. The ACCC considers that its proposed approach strikes the best balance. It will lead to conditions that make competition in downstream DSL services more likely, which will in turn encourage efficiencies in markets for those services.

663 Turning to the ULLS pricing principles, the principles expressly require that Telstra's internal equivalent costs should be considered. The ACCC's proposed approach is consistent with this. Telstra's approach is contrary to these principles, as it seeks to incorporate a broader cost base.

⁴⁰⁶ Subsection 152CR(1)(e) of the TPA.

⁴⁰⁷ Subsection 152CR(1)(g) of the TPA.

Demand measures

Introduction

664 The ACCC proposed to adopt the demand measures that Telstra provided in prior regulatory proceedings which were compiled in around August 2006.⁴⁰⁸ The ACCC proposed to source ADSL demand for 2000-01 to 2004-05 from the ACCC's Snapshot of Broadband Deployment.⁴⁰⁹ The ACCC sought the parties' views in its June 2007 consultation paper.⁴¹⁰

Submissions from parties

665 Telstra submits that the most up-to-date demand data should be used, and supplies more recent demand data (actual and forecast) for the LSS and ULLS.⁴¹¹ Slightly higher demand for LSS is reported; while demand is revised down for ULLS. These data were compiled between December 2006 and February 2007. Revised data for ADSL services are not supplied.

666 Telstra considers use of most up to date data is consistent with the subsection 152CR(1) criteria, as use of earlier data would send incorrect price signals to access seekers, hinder Telstra in recovering its costs, would allow access seekers an artificial advantage and would inhibit the efficient supply of the ULLS and downstream services.⁴¹² Optus submits that the revised data presented by Telstra is not realistic and underestimate the likely demand for ULLS.⁴¹³

667 PowerTel and Request consider that the use of ex ante estimates of demand for future periods is the proper approach.⁴¹⁴

668 Chime suggests using ABS data for early period ADSL demand.⁴¹⁵ Primus makes equivalent submissions.⁴¹⁶

669 Telstra objects to basing early period demand for ADSL on ABS data.⁴¹⁷

ACCC's views

⁴⁰⁸ These were contained in the *Statement of Andrew Harvey Briggs*, 11 August 2006.

⁴⁰⁹ ACCC, Snapshot of Broadband Deployment as at 30 June 2005

⁴¹⁰ ACCC, *Draft Final Determination Consultation Paper*, 28 June 2007.

⁴¹¹ Telstra, above n 7, p. 47; *Statement of Peter John Car*, 3 May 2007.

⁴¹² Telstra, above n 7, p. 48.

⁴¹³ Optus, above n 194, p. 26.

⁴¹⁴ PowerTel and Request, above n 49, p. 31.

⁴¹⁵ Chime, above n 49, p. 6.

⁴¹⁶ Primus, above n 202, pp. 6-7.

⁴¹⁷ Telstra, above n 40, p. 21.

- 670 Adopting Telstra's revised demand data would tend towards a slightly higher access charge, as a fixed capital cost would be spread over lesser demand. However, adopting these data would only increase the capital unit cost marginally – in the order of 3 cents. This effect would largely be accounted for in the rounding of ULLS charges adopted by the ACCC. As the operating costs are largely variable, adopting Telstra's revised demand data would not be expected to influence unit operating costs. Similarly, adopting Primus and Chime's suggested approach of sourcing early ADSL demand data from ABS publications would be unlikely to change the rounded charge.
- 671 Consistent with its general approach to use ex ante TSLRIC+ modelling, the ACCC considers that the earlier compiled demand data should be used in preference to Telstra's more recent data. Here, the earlier compiled demand data are more complete than this alternative data set, as they contain DSL demand data. Demand data for DSL, LSS and ULLS are required to calculate the TSLRIC+ measure.
- 672 Importantly, Telstra's earlier compiled data were prepared at the same time as the corresponding cost data that has been used, and so there is consistency between the entire data set that has been used to derive the TSLRIC+ measure. That is, Telstra has previously calculated and provided the operating cost associated with the earlier compiled demand data. If the more recent demand data were to be adopted, these cost data would need to be revised accordingly.
- 673 The parties have not claimed that the methods used to prepare the earlier data set were flawed, and no such errors are apparent to the ACCC. The ACCC does not agree that using Telstra's own ex ante forecast data is contrary to Telstra's legitimate interests, or compromises its ability to recover its costs. Provided that Telstra is able, on average, to prepare unbiased forecasts, it will recover its costs regardless of the approach taken. For similar reasons, the ACCC does not consider that using ex ante forecasts would lead to access seekers obtaining an artificial advantage.
- 674 The earlier compiled demand data are also more consistent with the data that would have been available when the parties were negotiating ULLS monthly charges. This is because these data were prepared more proximate to the time of the negotiations. As it would be expected in a competitive market that the parties would have been able to agree on a price for access proximate to these negotiations, and the price would have been arrived at having regard to forecast data then to hand, use of forecast data is more likely to result in access charges that would have been agreed in a competitive market. This in turn will promote efficiency.
- 675 The ACCC has decided not to use the ABS data in this instance, as the dates at which the measures were made do not align with the other observation dates that have been used. Using ABS data, which is a more complete data set, would slightly reduce the costs charged.
- 676 A full analysis of the differences in approach against the section 152CR(1) criteria or the ULLS pricing principles is not provided here, as adopting one or other approach would not lead to a material change in the ULLS monthly charge in this instance.

Proposed specific cost model

Introduction

677 The ACCC provided to the parties with its consultation paper a cost model that implemented its preliminary views. The structure of the cost model generally reflects the discrete cost models that Telstra has developed in previous regulatory proceedings for (i) ‘LSS-specific costs’, and (ii) ‘ULLS-specific costs; but combines data from the two. The ACCC sought the parties’ views on use of this cost model in its consultation paper.

Submissions from parties

678 In addition to submissions already discussed above, Telstra submits that the ACCC should adjust its modelling to restate the capital values each year.⁴¹⁸ It submits that the ACCC’s proposed approach is inconsistent with modelling the costs of a new entrant and the ACCC’s approach to network costs.

679 PowerTel and Request support the ACCC’s model and submit that the results of the model are conservative.⁴¹⁹

ACCC’s views

680 The ACCC has considered the parties’ submissions and remains of the view that it should use the cost model that it circulated to the parties.

681 A cost model is a tool to convert assumptions and input values to a cost measure. The cost model structure proposed by the ACCC for specific costs works, is relatively well understood, and is transparent and flexible. It adopts the structure and formulae and same level of detail that Telstra developed in submitting TSLRIC+ models to the ACCC for consideration in prior regulatory proceedings, and which have subsequently been scrutinised during regulatory proceedings before the ACCC and the Tribunal.⁴²⁰

682 In contrast, Telstra’s alternative cost model adopts a model structure with less detail and transparency over input data and intermediate calculations. Telstra’s model does not allow separate estimation of specific and network costs. The result is that Telstra’s newly developed model cannot be readily modified to adopt other modelling approaches, including the approach which the ACCC advised the parties it was likely to adopt in these proceedings. The ACCC has reached the view that it should proceed to calculate the TSLRIC+ of the ULLS ‘specific costs’ in accordance with the approach outlined to the parties. As explained above, the ACCC has reached this view after considering the parties’ submissions and the section 152CR matters and the ULLS pricing principles.

683 Nor can Telstra’s cost model be readily adapted to reflect this approach. This would require the introduction of additional data, and additional formula, which would

⁴¹⁸ Telstra, above n 42, p. 41.

⁴¹⁹ PowerTel and Request, above n 49, p. 32.

⁴²⁰ ACCC above n 31, Appendix E; *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007)

essentially result in a new model. The development of this third model is unnecessary in these proceedings, as the model that the ACCC distributed to the parties is already configured in a way that allows the implementation of the approach that the ACCC has chosen to adopt.

684 While no party suggests that the model the ACCC proposed is incapable of deriving a proper measure of TSLRIC+, Telstra suggests an amendment to restate capital values for each year in the model. Telstra considers that would be more consistent with network cost estimates.

685 The ACCC has considered Telstra's submission, but does not consider that it is reasonably open to it to adopt Telstra's approach. Restating the capital base at the commencement of each regulatory period can assist in sending correct build-buy signals. However, in this instance, the ACCC's approach to levelisation of specific costs means there is a single regulatory period being considered, and it is therefore not appropriate or necessary to restate the capital values each year within that regulatory period. The levelisation approach allows Telstra to recover its costs over the regulatory period used. The ACCC does not consider that it is inconsistent to use this approach for specific costs as opposed to the approach for network costs. The ACCC also considers that in any case build-buy decisions are of more limited relevance to the assets constituting specific costs than to the assets constituting network costs.

Overall conclusions on specific costs

686 In assessing particular modelling assumptions the ACCC has had regard consideration to the matters listed in section 152CR. The ACCC's view is that proper consideration of these matters is best achieved by taking into account whether cost assumptions and inputs better lead to an estimate of the efficient specific costs of the ULLS. In reaching its above conclusions, the ACCC considers that assumptions and inputs resulting in efficient specific costs will:

- better promote the LTIE, as they will better promote competition and encourage the economically efficient use of and investment in infrastructure. The ACCC considers that efficient cost-reflective prices will allow access seekers and Telstra to compete on the basis of their relative efficiencies.
- allow Telstra to recover amounts necessary to protect its legitimate business interests, but not more than necessary. The ACCC also considers that efficient cost-reflective prices will allow Telstra to exploit the economies of scale and scope in all products.
- allow access seekers to compete on their merits
- reflect the direct costs of providing the ULLS and allow Telstra to recover those direct costs
- account for the value to a party of extensions or enhancement of capacity of the systems that has been incurred by Telstra

- allow the recovery of sufficient costs to ensure the safe and reliable operation of the network.

687 The ACCC further considers that an efficient forward-looking specific cost will better lead to costs which match the TSLRIC+ pricing set out in the ULLS pricing principles. The ACCC has noted above that certain assumptions and conclusions do not have a material effect on specific costs.

688 Telstra submits that adopting all of its preferences will result in a measure of specific costs of \$[c-i-c] per ULLS per month. This reflects Telstra's position on matters including allocation, restating of the asset base, flat annuities, updated demand, and indirect capital costs (although as noted, certain of these issues do not have a material effect on specific costs). These issues of principle have been discussed in detail earlier in this statement of reasons.

689 Adopting the access seekers' position would result in a lower measure. Chime and Primus have advocated a monthly specific cost of around \$2.27, which largely flows from reducing the allowance for Telstra's internal equivalent capital employed. Access seekers have made other submissions, as noted above, which might also reduce costs, although they have not quantified all those changes to costs. adopting an all-lines allocation would lead to a specific cost measure of around \$2 per month.

690 Adopting a mix of Telstra's contentions and those advanced by access seekers would result in an ULLS specific cost within the range of \$2 to \$[c-i-c] per service per month.

691 The ACCC considers that the overall cost measure that results from its approach is appropriate having regard to the subsection 152CR(1) criteria and the ULLS pricing principles. This is because this measure results from adopting the approach on each of the material issues that the ACCC considers appropriate, having regard to those criteria and principles.

692 Further, the overall TSLRIC+ measure of specific costs, and hence the access charge, which results from the ACCC's proposed approach falls within the range of measures that could result from adopting the alternative approaches that have been advanced by the parties.

693 The ACCC's cost model provides separate levelised cost estimates for efficient unit operating costs [c-i-c] and efficient capital charges [c-i-c], totalling to \$2.45, consistent with the specific costs proposed to the parties in the ACCC's consultation paper.

4.1.11 Overall level of ULLS monthly costs

694 Given the ACCC's above conclusions on network costs and specific costs, the ACCC's view is that appropriate ULLS monthly cost estimates are as follows for the financial years 2005-06, 2006-07 and 2007-08:

Final determination ULLS cost estimates

Network costs

| Band | 2005-06 | 2006-07 | 2007-08 |
|------|----------|----------|----------|
| 1 | \$ 3.13 | \$ 3.48 | \$ 3.67 |
| 2 | \$ 9.81 | \$ 11.19 | \$ 11.76 |
| 3 | \$ 22.54 | \$ 24.77 | \$ 25.98 |

Specific costs

| Band | 2005-06 | 2006-07 | 2007-08 |
|------|---------|---------|---------|
| 1 | \$ 2.45 | \$ 2.45 | \$ 2.45 |
| 2 | \$ 2.45 | \$ 2.45 | \$ 2.45 |
| 3 | \$ 2.45 | \$ 2.45 | \$ 2.45 |

Total estimated ULLS monthly costs

| Band | 2005-06 | 2006-07 | 2007-08 |
|------|----------|----------|----------|
| 1 | \$ 5.58 | \$ 5.93 | \$ 6.12 |
| 2 | \$ 12.26 | \$ 13.64 | \$ 14.21 |
| 3 | \$ 24.99 | \$ 27.22 | \$ 28.43 |

695 The ACCC has rounded the costs set out above up to the next 10 cents in order to obtain its ULLS monthly charges:

Final determination ULLS monthly charges

| Band | 2005-06 | 2006-07 | 2007-08 |
|------|----------|----------|----------|
| 1 | \$ 5.60 | \$ 6.00 | \$ 6.20 |
| 2 | \$ 12.30 | \$ 13.70 | \$ 14.30 |
| 3 | \$ 25.00 | \$ 27.30 | \$ 28.50 |

696 The ACCC notes that certain of the access seekers opposed the ACCC's rounding up of ULLS charges.⁴²¹ The ACCC has continued to round cost estimates used to derive access charges, noting that this is its usual approach and recognises that it is appropriate to allow for a margin for error in conducting modelling of this nature.

697 As stated in its letter of 5 April 2007, the ACCC does not propose to set ULLS prices for Band 4. The ACCC has reached this view in light of the following factors:

- the fact that no access seeker has sought a determination of ULLS prices in Band 4
- the role of the Universal Service Obligation and other funding arrangements for

⁴²¹ Chime, above n 200, p. 8; Primus, above n 202, p. 8.

the supply of services to Band 4

- the known technical limitations on the provision of xDSL services over the ULLS in regional and rural areas due to the length of copper loops, and the resulting small expected demand for the ULLS in Band 4
- the ACCC's concerns about the PIE II model's overestimation of network costs in regional and rural areas, and particularly in Band 4, as discussed earlier in these reasons.

698 Having considered the above factors, the ACCC's view is to not set prices for the ULLS in Band 4. The ACCC discusses the second and third of these points further below in relation to the structure of ULLS charges.

4.1.12 Structure of ULLS monthly charges

Introduction

699 As noted above at 4.1.1, the ACCC considers that there are effectively two broad issues in the consideration of ULLS monthly prices. The second of these is the appropriate structure of prices. In particular, the issue of geographic averaging of prices has been a point of significant debate since Telstra proposed a geographically averaged ULLS monthly charge in its submissions on its December 2005 undertaking.

700 Telstra submitted in support of its most recent set of undertakings that the price for the ULLS should be geographically averaged across Bands 1, 2, 3 and 4.⁴²² Telstra based this submission on a government retail pricing parity obligation (RPPO) and submitted that the effect of this obligation meant that it could not charge deaveraged ULLS prices.⁴²³ The ACCC considered that it was not satisfied that Telstra's proposed geographically ULLS charges were reasonable.⁴²⁴ The ACCC's view was that, in particular, averaged pricing would adversely affect competition and distort usage and investment decisions.

701 The Tribunal devoted a significant part of its decision on Telstra's ULLS undertakings to the issue of geographic averaging. The Tribunal's main findings were that averaging:⁴²⁵

- is not likely to achieve the promotion of competition
- is not likely to achieve the objective of encouraging the economically efficient use of infrastructure or encouraging economically efficient investment in infrastructure by access seekers

⁴²² For example, Telstra, *Telstra's confidential response to the Commission's Draft Decision on Telstra's ULLS monthly charges undertakings dated 23 December 2005*, 7 August 2006, p. 27-35.

⁴²³ The effect of the RPPO is discussed at *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [63].

⁴²⁴ ACCC, above n 31, pp. 98-99.

⁴²⁵ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [285] – [287].

- may, in principle, achieve the objective of encouraging economically efficient investment by Telstra
- is likely to ensure Telstra's legitimate business interests, provided the Universal Service Fund does not fully recover losses made by Telstra in providing retail line rental services in rural areas (significantly, the Tribunal was not satisfied that the Universal Service Fund did not fully compensate Telstra for any losses made by Telstra in providing retail line rental services in rural areas)
- is not in the interests of access seekers.
- should not, of itself, lead to the recovery of more than direct costs.

702 The Tribunal concluded that it could not be satisfied that Telstra's proposed averaged ULLS charges were reasonable.⁴²⁶

703 The ACCC's preliminary view, informed by the Tribunal's conclusions, and as outlined in its consultation paper, was that it continued to believe that it would not be appropriate to geographically average ULLS charges. The ACCC had also taken a preliminary position that, due partly to the concerns it had about the PIE II model's overestimation of network costs in regional and rural areas, and particularly in Band 4, that it would not set a price in Band 4 for the ULLS.

704 In light of the conclusions in its ULLS pricing principles report, the ACCC also reviewed Telstra's RAF reports for 2006-07 to examine whether the accounts demonstrated that Telstra had a current ability to recover its line costs. The ACCC presented parties in its November 2007 supplementary consultation paper with a comparison of the revenues and costs that Telstra had reported for those services which use the Telstra CAN as the access technology, and to which Telstra allocates line costs in its RAF reports.

705 The ACCC noted to the parties that on its review of the Telstra 2006-07 RAF returns, Telstra had reported revenues on these services in excess of allocated costs, including allocated CAN costs, and that the observed surpluses exceeded the small proportion of CAN cost that Telstra allocated to other RAF service classes. The ACCC suggested to the parties in the supplementary consultation paper that this indicated that Telstra was recovering its CAN costs and sought the parties views. The ACCC provided Telstra with the calculations that supported this analysis.

Submissions from parties

706 Access seekers' initial submissions did not address averaging in detail. Optus states it supports the ACCC's position to charge geographically de-averaged ULLS prices, based on the views of the Tribunal.⁴²⁷ PowerTel/Request also agree that prices should not be geographically averaged, and cite a MJA report that discusses the effects of averaging on

⁴²⁶ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [291].

⁴²⁷ Optus, above n 49, p. 21.

promotion of competition and on efficiency.⁴²⁸ Chime states that it agrees with the views of the ACCC and the Tribunal that geographic averaging would adversely affect competition and distort usage and investment decisions.⁴²⁹ Primus makes equivalent submissions.⁴³⁰

- 707 Telstra in its initial submission submits that the ACCC is following “an isolationist agenda to deaverage urban and rural prices in Australia”.⁴³¹ Telstra submits that deaveraged prices conflict with government policy and international experience. It submits that the ACCC’s approach will force higher prices in rural areas.
- 708 Telstra submits that it is in favour of either averaging or a high cost surcharge, given Telstra’s retail parity pricing obligations and the ACCC’s pricing for wholesale line rental.⁴³² It submits that the costs incurred in rural areas are crucial to setting the prices in the other three Bands. Telstra submits that either an averaged price could be obtained directly from the Telstra CCA-based model discussed above or through direct estimates of Band 4 prices using either the PIE II model, extrapolation of prices from Band 3 or a Productivity Commission cost model.⁴³³
- 709 Telstra submits that there are constraints on Telstra which require it to charge a uniform price for line rental across the country.⁴³⁴ It presented analysis which it submitted demonstrated that significant under-recovery would occur in Band 4 areas as a result of both the RPPO and the ACCC’s averaged wholesale line rental (WLR) prices.⁴³⁵ Telstra also submits that the Universal Service Fund (USF) is not sufficient to recover that potential under-recovery.⁴³⁶
- 710 Telstra submits that averaged prices promote competition.⁴³⁷ It submits that if ULLS prices were deaveraged then access seekers could reduce the price of line rental services in urban areas below the average uniform price that Telstra must charge. It submits that if Telstra responded by reducing its own line rental charges, it would be unable to increase its price of line rental services in rural areas because access seekers would undercut it through the use of the WLR. Telstra submits that, in contrast, averaged prices would mean that access seekers using ULLS in urban areas and ULLS/WLR in rural areas recover the same average costs in all areas.

⁴²⁸ PowerTel, above n 49, p. 32.

⁴²⁹ Chime, above n 49, p. 8.

⁴³⁰ Primus, above n 202, p. 8.

⁴³¹ Telstra, above n, 33p. 7.

⁴³² Telstra, above n 42, p. 1.

⁴³³ Telstra, *op cit*, pp. 1-2, Annexure 2, p. 8.

⁴³⁴ Telstra, *op cit*, p. 3.

⁴³⁵ Telstra, *op cit*, Annexure 1.

⁴³⁶ Telstra, *op cit*, Annexure 3.

⁴³⁷ Telstra, *op cit*, p. 2.

711 Telstra also submits that averaged ULLS prices open the door for ULLS-based competition in rural areas.⁴³⁸ Telstra submits that technical barriers to use of the ULLS in rural areas are limited and that there is significant potential for competition in rural areas.

712 Telstra disagrees with the Tribunal's view that Telstra's above normal profits from other services supplied over the CAN might be able to be used to set prices for line rental in urban areas below that of an access seeker using ULLS in urban areas.⁴³⁹ Telstra dismisses this concern for a number of reasons, namely:⁴⁴⁰

- its operational separation obligations
- the ability of access seekers to obtain access to other services
- it is inappropriate to consider profitability of services
- it would not be possible to calculate profitability ex post.

713 Telstra also points to analyst reports that say access seekers could well compete at a ULLS price of \$30.⁴⁴¹

714 Telstra also submits that averaging encourages the economically efficient use of and investment in infrastructure. It submits that if averaging is designed to recover no more than the overall costs of infrastructure, operating costs and a return on capital, then averaging will achieve economically efficient use of and investment in infrastructure. It submits that the Tribunal was incorrect to assume that averaging would cause allocative efficiency losses.⁴⁴² Telstra submits that averaging would not be likely to lead to allocative efficiency losses as WLR, wholesale ADSL and LSS are already geographically averaged and already generate allocative inefficiencies.

715 Telstra also submits that the Tribunal's conclusion that averaging will be unlikely to promote productive and dynamic efficiency is also wrong, as averaging will promote competition and therefore produce such efficiencies. It submits that dynamic efficiency would not be met without averaging, as Telstra would not be able to ensure a reasonable return on its assets in rural areas, at least not in the medium to long term.

716 Telstra submits that the possibility of inefficient bypass in urban areas under averaged ULLS prices is small in any case and that Telstra could commercially agree prices with access seekers to avoid inefficient bypass.⁴⁴³ It submits that there would be a much higher risk of inefficient entry under deaveraged prices. Telstra submits that deaveraged prices would generate an artificial cost advantage for access seekers, that price falls would be

⁴³⁸ Telstra, *op cit*, p. 5.

⁴³⁹ Telstra, *op cit*, p. 6.

⁴⁴⁰ Telstra, *op cit*, pp. 6-7.

⁴⁴¹ Telstra, *op cit*, pp. 7-8.

⁴⁴² Telstra, *op cit*, p. 9.

⁴⁴³ Telstra, *op cit*, p. 10.

rapid and that Telstra would suffer severe revenue consequences as a result.⁴⁴⁴

- 717 Telstra submits that it is inappropriate to consider WiMax services for supply in rural areas, as it submits that WiMax cannot supply voice, and VoIP cannot be considered a substitute.⁴⁴⁵
- 718 Telstra submits that, to the extent averaging may distort consumption choices, these distortions are already in place in light of the RPPO and of WLR pricing. Telstra submits that such distortions already existing need to be taken into account.
- 719 Telstra also submits that it is in its legitimate commercial interests to implement averaged prices in light of Government policy.⁴⁴⁶ Telstra also submits that the fact that the Government is conducting a review of the USO does not affect the ACCC's duty to enquire into and fully examine this issue, given any changes to the USF are unlikely to be implemented prior to 30 June 2008.⁴⁴⁷
- 720 Telstra notes that, with respect to its legitimate commercial interests, the Tribunal concluded that averaging would not allow Telstra to over-recover its costs so long as the USF does not fully compensate Telstra for any losses it may incur.⁴⁴⁸ Telstra refers to analysis that demonstrates it is not compensated for this under-recovery.⁴⁴⁹
- 721 Further on this issue, Telstra submits that the Tribunal's decision should not lead the ACCC to set deaveraged prices as there is evidence in this dispute that "clearly shows that the USF does not fully compensate Telstra" and that the ACCC's role in this arbitration can be clearly distinguished from its (and the Tribunal's) role in the undertaking context.⁴⁵⁰
- 722 Telstra submits that paragraph 152CR(1)(c) refers to all persons and not just access seekers, and submits that end users interests must also be taken into account.⁴⁵¹ It further submits that the Tribunal was wrong in considering that averaging would not be in the interests of access seekers. Telstra submits that an increase in urban prices would not be against access seekers' interests to the extent that they can still compete equally with Telstra. It also submits that the Tribunal's consideration to access seekers' investments is not consistent with the legislative criteria, and that the analysis was not complete.
- 723 Telstra contends that averaged prices better reflect the full direct cost of both production and the limits the RPPO places on Telstra's costs.⁴⁵² Telstra also contends that averaging is consistent with the operational and technical requirements necessary for the safe and

⁴⁴⁴ Telstra, *op cit*, p. 10.

⁴⁴⁵ Telstra, *op cit*, p. 11.

⁴⁴⁶ *Ibid*.

⁴⁴⁷ Telstra, above n 16, p. 7.

⁴⁴⁸ Telstra, above n 42, p. 12.

⁴⁴⁹ Telstra, *op cit*, Annexure 3.

⁴⁵⁰ Telstra, above n 16, p. 7.

⁴⁵¹ Telstra, above n 42, p. 15.

⁴⁵² Telstra, *op cit*, p. 16.

reliable operation of the CAN.⁴⁵³ It submits that considerations under paragraph 152CR(1)(g) are the same as those under paragraphs 152CR(1)(a) and 152AB(2)(c).

- 724 Telstra submits that the ACCC should have regard to the RPPO and to international precedent. In particular it points to a paper by the OECD and to an ACCC decision in reference to water, where postage stamp pricing was adopted.⁴⁵⁴
- 725 In respect of the OECD paper, Telstra rejects the ACCC's interpretation of the paper in the ULLS pricing principles. Telstra contends that "(t)he extract clearly states that the structure of access charges should reflect the structure of end-user charges, and that if the regulator wishes to preserve the geographically averaged structure of end-user prices it is "essential" to geographically average ULLS". Telstra further submits that the paper "does not say that prices should not be averaged because inefficient bypass can occur" but notes "that it is not desirable to regulate entry due to the fact that it is impossible to determine which parts of the local loop network are natural monopolies". Telstra submits that the implication drawn by the ACCC is therefore nonsensical and would render the entirety of the first paragraph of the extract nugatory.⁴⁵⁵
- 726 Telstra also later presented the ACCC with examples from US jurisdictions that it submit support Telstra's position that an averaged price is preferable under the legislative criteria.⁴⁵⁶
- 727 Telstra also submits that, if the ACCC did not enact an averaged ULLS price, it should calculate a high cost surcharge to be added to the ULLS prices in Bands 1, 2 and 3.⁴⁵⁷ Telstra states that a high cost surcharge would promote competition as it would ensure competitive neutrality and not allow access seekers to undercut Telstra in both urban and rural areas. It also submits that a high-cost surcharge would open the possibility of ULLS-based competition in rural areas.⁴⁵⁸
- 728 Telstra acknowledges that a high-cost surcharge may lead to some inefficient bypass but submits that Telstra would be likely to enter commercial negotiations to reduce inefficient bypass.⁴⁵⁹ As with averaging, Telstra submits that any inefficiency would in any case be smaller than the inefficiency stemming from deaveraged prices without a surcharge. Telstra also submits that, for reasons set out in reference to averaging, a high cost surcharge would more appropriately meet the matters in section 152CR.
- 729 Optus submits in its response submission that, at a broad level, the main question is whether losses or potential losses in rural areas are relevant to pricing access in urban

⁴⁵³ Ibid.

⁴⁵⁴ Telstra, *op cit*, p. 17.

⁴⁵⁵ Telstra, above n 16, p. 8.

⁴⁵⁶ Telstra, *Telecommunications Access Dispute between Chime Communications Pty Ltd, Optus Networks Pty Limited, XYZed Pty Limited, Primus Telecommunications Pty Ltd, PowerTel Ltd, Request Broadband Pty Ltd, Macquarie Telecom Pty Limited and Telstra Corporation Limited (Telstra) regarding Unconditioned Local Loop Service (ULLS)*, 31 October 2007.

⁴⁵⁷ Telstra, above n 42, p. 18.

⁴⁵⁸ Ibid.

⁴⁵⁹ Telstra, *op cit*, p. 19.

areas.⁴⁶⁰ Optus submits that the fundamental question is therefore whether the RPPO and WLR imposes a cost on Telstra, and that if the answer is no, claims about averaging can be dismissed. Optus submits that there is no evidence of any losses being imposed on Telstra by retail and wholesale pricing parity obligations.

730 Optus submits that Telstra actually over-recovers in Band 4 areas, as it states that Telstra's analysis:⁴⁶¹

- overestimates rural costs, as its PIE II model and alternative cost estimates are unreliable, and that the proper forward-looking cost of rural areas should be determined by reference to WiMax
- underestimates rural revenues, as line rentals should be higher, other profits should be taken into account and indirect benefits should also be considered
- underestimates the allowance for the USO, as it uses an incorrect technology mix.

731 Optus also submits that reasons put forward by Telstra for the supposed inadequacy of the USO are incorrect.

732 Optus submits that averaged ULLS prices will not promote competition. In making that submission, it submits that Telstra can recover its costs if prices are deaveraged, that 'cream-skimming' is not realistic, that some competition in rural areas is possible but limited, that it is appropriate to consider profitability and that Telstra has considerable excess profits on other services, that WLR in rural areas does not prevent Telstra from competing (especially in the short run) and that access seekers margins are not as high as submitted.⁴⁶²

733 Optus also submits there is a genuine risk of inefficient urban bypass under averaged ULLS prices and that Telstra would be unlikely to negotiate commercial agreements to avoid inefficient bypass.⁴⁶³ It also submits that Telstra is able to recover enough to meet its legitimate commercial interests.⁴⁶⁴ Optus further submits that, in considering the interests of access seekers, regard should be had to the asset life of DSLAMs as compared to the CAN.

734 Finally, Optus rejects Telstra's reference to the OECD paper, and submits that a high cost surcharge should be rejected for the same reasons as averaging should be rejected.⁴⁶⁵

735 Optus further submits that the analysis put forward by the ACCC from Telstra's RAF reports prove conclusively "the falsehood of Telstra's repeated claims that a combination of geographically de-averaged ULLS prices and the retail pricing parity obligation will

⁴⁶⁰ Optus, above n 194, p. 2.

⁴⁶¹ Optus, *op cit*, Annexure A.

⁴⁶² Optus, *op cit*, pp. 3-10.

⁴⁶³ Optus, *op cit*, p. 10.

⁴⁶⁴ Optus, *op cit*, p. 12.

⁴⁶⁵ Optus, *op cit*, p. 14.

lead to a situation where it is unable to recover the costs of the CAN". Optus submits that this is consistent with analysis Optus has previously presented to the ACCC which demonstrates that Telstra earns supra-normal profits and does not incur losses for the provision of services in rural areas.⁴⁶⁶

736 PowerTel/Request in their reply submission generally adopt the views of the Tribunal on the issue of averaging.⁴⁶⁷ PowerTel/Request also contend that there is no risk of cream-skimming.⁴⁶⁸ They state that the RPPO is not relevant to ULLS prices and that the RPPO explicitly is drafted to allow Telstra to respond to new pricing packages or to respond to competition.⁴⁶⁹ They reject the alternative option of a high-cost surcharge.⁴⁷⁰

737 Chime contends that the appropriate forum to address any potential inadequacy in the USO is the appropriate forum of the current USO review.⁴⁷¹ It submits that averaging is only one of many possible approaches that could deal with the issue of urban and rural pricing. Primus makes similar submissions.⁴⁷² Macquarie submits that the access dispute is not the appropriate forum to address issues relating to the USO.⁴⁷³

738 In its third submission, Telstra rejects the access seekers' submissions with respect to averaging. In response to Optus, Telstra submits that Optus' analysis that Telstra overrecovers in Band 4 is inconsistent with other submissions it has made.⁴⁷⁴ Telstra also submits that the analysis is incorrect for a number of reasons, such as the use of WiMax costs, the use of EBITDA measures and other reasons.⁴⁷⁵ It also submits that it is incorrect to have regard to Telstra's profitability on other services.⁴⁷⁶ Telstra questions Optus' comments on the feasibility of competition in rural areas.⁴⁷⁷

739 In response to Chime, Telstra submits that the current USO review is not relevant to the present proceedings, as no outcome of the review will be heard before 30 June 2008, the expiry of the final determination.⁴⁷⁸ In response to PowerTel/Request, Telstra submits that PowerTel/Request misunderstand the purpose of the access regime in their submissions about averaging.

740 In relation to the ACCC's request for submissions on whether or not Telstra's RAF demonstrates that it is recovering its CAN costs in rural areas, Telstra submits that using HCA and CCA data is inconsistent with the ACCC's criticisms of using CCA data.

⁴⁶⁶ Optus, above n 21, p. 3.

⁴⁶⁷ PowerTel and Request, above n 170, p. 28.

⁴⁶⁸ PowerTel and Request, *op cit*, p. 31.

⁴⁶⁹ PowerTel and Request, *op cit*, p. 34.

⁴⁷⁰ PowerTel and Request, *op cit*, p. 35.

⁴⁷¹ Chime, above n 175, p. 1.

⁴⁷² Primus, above n 176, p. 1.

⁴⁷³ Macquarie, above n 173, p. 2.

⁴⁷⁴ Telstra, above n 45, p. 5.

⁴⁷⁵ Telstra, *op cit*, p. 7.

⁴⁷⁶ *Ibid.*

⁴⁷⁷ Telstra, *op cit*, p. 9.

⁴⁷⁸ Telstra, *op cit*, p. 17

741 Telstra also submits that, as the ACCC includes revenue from voice and data traffic, this would require all voice services supplied on the CAN to be priced such that they recover CAN costs regardless whether they are provided by Telstra or other providers. Telstra submits, though, that the ACCC does not allow Telstra to recover any CAN costs from voice or data services charged to access seekers. In this regard, Telstra notes CAN costs are not recovered by Telstra for PSTN OTA, LCS or LSS.⁴⁷⁹

742 Mirroring earlier submissions, Telstra submits that it is prevented from fully recovering CAN costs by the requirement for geographic deaveraging of ULLS prices, the availability of WLR to access seekers at geographically averaged prices and the inadequacy of the USF.⁴⁸⁰

743 Telstra submits this leaves only unrelated services or downstream retail voice and data services from which it can recover CAN costs. Telstra contends that recovering CAN costs from these services creates a material cost asymmetry between Telstra and its competitors that is contrary to the LTIE in two respects:

- it inhibits competition on the merits and
- disincentivises investment in facilities that could be “appropriated” by access seekers at prices that do not include the common costs of those facilities.

744 Telstra submits that if only revenues from end-user access, local calls and ULLS are included, then total costs will exceed revenue, using either the HCA or the CCA approach.⁴⁸¹

745 Telstra submits that the combined impact of deaveraged ULLS prices, the RPPO, averaged WLR prices and insufficient USF compensation would be that providers of retail voice and data services that do not have the obligation to provide rural ULLS would face a lower cost than Telstra for CAN-based inputs. Telstra states this would mean retail voice and data services supplied by Telstra would incur the full CAN costs and retail competition in these services would be distorted against Telstra.⁴⁸²

746 Chime and Primus each submit that Telstra’s RAF reports demonstrate that rather than suffering a loss, Telstra is recovering a significant profit from charges for services accessing the CAN. Further, Chime and Primus each submit that, given RAF reports are based on HCA or CCA data, it is likely the surplus would be greater than if the CAN costs were based upon a TSLRIC+ methodology. These parties submit that this contradicts Telstra’s claim that it incurs losses in supplying services to rural areas due to retail pricing parity and the claimed inadequacy of the USF. Chime and Primus submit that given Telstra is more than fully compensated for services accessing its CAN (regardless of the adequacy of the USF) it seems reasonable that Telstra’s submissions

⁴⁷⁹ Telstra, above n 16, p. 12.

⁴⁸⁰ Ibid.

⁴⁸¹ Telstra, *op cit*, p. 13.

⁴⁸² Ibid.

against de-averaging have been superseded by its own accounting data.⁴⁸³

747 Macquarie submits that it “strongly supports” the ACCC’s conclusions in its consultation papers and the ULLS pricing principles regarding the RAF reports and their relevance to geographic averaging of ULLS charges. Macquarie reiterates its strong support for the ACCC’s view that ULLS prices should be deaveraged and submits that as such, Telstra’s proposal of geographic averaging should be disregarded for the purposes of the final determination.⁴⁸⁴

748 PowerTel/Request cite the Tribunal decision that Telstra had not established that the USF does not adequately compensate it for losses in complying with the retailing pricing parity obligation in the provision of retail line rental services in rural areas. These parties submit that having regard to the Tribunal’s reasons and the material and observations of the ACCC in its supplementary consultation paper and the Final ULLS Pricing Principles Determination, the ACCC ought to disregard Telstra’s claims in relation to the relevance of Telstra’s RAF reports to the recovery of line costs and geographical averaging.

ACCC’s views

Introduction

749 The ACCC considered the parties’ extensive submissions made in regard to whether the ULLS price should be averaged for the period covered by this arbitration. For the reasons that follow, the ACCC considers that the ULLS price should not be geographically averaged for the period covered by this arbitration, having regard to the ULLS pricing principles and the subsection 152CR(1) matters.

750 This is consistent with the ACCC’s ULLS pricing principles, which state that the ULLS charges should be geographically de-averaged.⁴⁸⁵ The ACCC reached that view after a public inquiry and analysis of the relevant legislative matters in the TPA, in conjunction with the previous views of parties to the ACCC’s August 2006 undertaking decision and the Tribunal’s subsequent decision on the same undertaking.⁴⁸⁶ Those previous processes also inform the ACCC’s analysis below.

751 The ACCC noted at the time of making its ULLS pricing principles that a significant issue in the consideration of geographic averaging is the extent to which Telstra recovers sufficient money to compensate it for any losses it suffers as a result of the retail pricing obligation and any competition that materialises in urban areas. In particular, it is relevant to consider:

- the extent to which factors such as the RPPO or WLR pricing constrain Telstra in its pricing and ability to recover costs

⁴⁸³ Chime, above n 21, pp. 2-3; Primus, above n 21, pp. 2-3.

⁴⁸⁴ Macquarie, above n 21, p. 3.

⁴⁸⁵ ACCC, above n 5, p. 22.

⁴⁸⁶ ACCC, above n 31, pp. 98-99; *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007).

- the extent to which the USF compensates Telstra for any losses.

752 Telstra noted in its submission to the pricing principles inquiry that, were it provided with adequate compensation from the USF, it would be appropriate that prices were de-averaged.⁴⁸⁷

753 The Tribunal, in its decision on Telstra's undertaking, was not satisfied that the USF did not fully compensate Telstra for any losses made by Telstra in providing retail line rental services in rural areas.⁴⁸⁸ However, Telstra has submitted to this arbitration information that it states supports its submissions that it incurs losses in rural areas.

754 As noted by Chime and Primus, the USO and the USF is currently the subject of a review by the Department of Communications, Information Technology and the Arts (now the Department of Broadband, Communications and the Digital Economy).⁴⁸⁹ The outcome of this review is still unknown but as noted by Telstra has significant implications for the issue of averaging. The ACCC notes Telstra's submission that the outcome of this review would likely be handed down after the expiry of the final determination.

755 Having regard to these views, the ACCC considers it relevant to consider the effect of the RPPO, Telstra's ability to recover its line costs and the adequacy of the USO in the arbitration.

Effect of RPPO, ability of Telstra to meet line costs and adequacy of the USO

756 The ACCC considers that, as they are inherent to any consideration of the issue of averaging, it is directly relevant to consider the effect of the RPPO (and the ACCC's current interim approach to WLR pricing), the ability of Telstra to meet its line costs and the adequacy of the USO. The issue of averaging only arises from a possible Telstra under-recovery due to a possible combination of deaveraged ULLS prices with:

- pricing constraints from the RPPO
- increased urban competition, and
- inadequacy of the USF.

757 Telstra submits that the effect of the RPPO is that it must average retail line rental prices.⁴⁹⁰ The RPPO does not formally apply to line rental services other than HomeLine and BusinessLine Part, and these two service offerings are a very small subset of Telstra's overall offerings. Notably, they only provide a line rental and local call service.

⁴⁸⁷ Telstra, *Telstra response to "Fixed Services Review: further consultation on draft ULLS pricing principles:" of October 2007*, November 2007.

⁴⁸⁸ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [258].

⁴⁸⁹ DCITA, *Telecommunications Universal Service Obligation (USO) review issues paper*, August 2007.

⁴⁹⁰ Telstra, above n 42, p. 1, Annexure 1.

- 758 However, the ACCC notes the views of the Tribunal that the RPPO does “to some extent, constrain Telstra’s pricing of bundled offerings that include the provision of line rental services”.⁴⁹¹ The ACCC considers that the point to which prices might be raised is uncertain. Accordingly, the ACCC considers that Telstra is only partly correct. The RPPO will provide some constraint on Telstra’s other products, but the extent to which this is true is uncertain. The RPPO was specifically designed with the aim that “Telstra’s ability to respond to competition or to introduce new pricing packages is only limited in relation to its basic line rental services”.⁴⁹²
- 759 The ACCC has closely examined Telstra’s analysis of the extent to which the RPPO and current WLR pricing arrangements might impact on cost recovery, due to customers shifting to other carriers using WLR if Telstra sought to increase its line rental services towards costs.⁴⁹³ Telstra’s analysis attempts to quantify the extent of loss for three different factors—wholesale lines, HomeLine and BusinessLine customers and shifting retail customers. Telstra has based its analysis on three different Band 4 line costs – a cost proxied by WiMax prices, a cost from the ACCC’s model prices and a Telstra estimate based on the PIE II model.
- 760 The ACCC considers firstly that Telstra’s PIE II model based estimate at \$197 is unrealistic. Using more realistic inputs in its calculations of network costs above, the ACCC notes that it derived Band 4 network cost estimates from the PIE II model in the order of \$110-\$130. However the ACCC has significant concerns about the PIE II model’s ability to estimate realistic costs for Band 4 given certain of its modelling assumptions, particularly related to model design.⁴⁹⁴ Accordingly the ACCC considers that this would be likely to overstate costs. The ACCC considers that it is more relevant to consider that costs would be likely to approach the lower of the three costs used by Telstra—the cost based on WiMax values. The ACCC does not consider that Telstra’s extrapolation approach, or use of simple line density ratios, have sufficient sophistication to be relied upon as a cost estimate.⁴⁹⁵ These approaches do not give any consideration to the network that would be deployed.
- 761 Telstra has submitted that it is inappropriate to consider non-copper based technology when pricing the ULLS as the ULLS is inherently copper-based.⁴⁹⁶ The ACCC considers that this misconceives the reason for examining the cost of alternative technologies. In particular, alternative technologies are relevant not because they represent the price of copper deployment, but because they demonstrate whether forward-looking technology choices in a model are efficient. Similarly, Telstra submits that the ACCC should not have regard to WiMax as it may not have the necessary functionality to provide a comparable voice service.⁴⁹⁷ The ACCC notes firstly that this position directly contradicts

⁴⁹¹ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [224].

⁴⁹² *Explanatory Statement, Telstra Carrier Charges – Price Control Arrangements, Notification and Disallowance Determination No. 1 of 2005 (Amendment No.1 of 2006)*, 27 Feb 2006.

⁴⁹³ Telstra, above n 42, p. 2, Annexure 1.

⁴⁹⁴ ACCC, above n 31, p. 96.

⁴⁹⁵ Telstra, above n 42, Annexure 2.

⁴⁹⁶ Telstra, *op cit*, p. 83, Annexure 13.

⁴⁹⁷ Telstra, *op cit*, p. 11.

Telstra statements in other contexts about the competitive constraint provided by VoIP,⁴⁹⁸ but in any case does not consider that it can or needs to make a definitive decision on the viability of WiMax.

762 The ACCC similarly notes that the exact elasticity of end-users and the extent to which they would transfer from Telstra's bundled services is unclear. Telstra has provided analysis that is based on cross-price elasticity of end-users ranging from -0.1 to -0.9.⁴⁹⁹ The ACCC has noted in the past that there may be significant inertia present in the market for fixed voice services.⁵⁰⁰ Accordingly the ACCC would expect that the relevant elasticity would tend towards the lower values.

763 Accordingly, the ACCC considers that the possible under-recovery by Telstra as a result of the RPPO and/or WLR would err towards the lower estimates in Telstra's analysis – in the order of \$[c-i-c] - \$[c-i-c] loss rather than the \$[c-i-c] or so that Telstra hypotheses could be its Band 4 losses.

764 Similarly, the ACCC has paid close regard to Telstra's estimates of the inadequacy of the USO.⁵⁰¹ The ACCC notes that Telstra's analysis, premised on a loop cost of \$195.23, reaches the conclusion that its annual loss in Band 4 areas is \$[c-i-c] even after the USO is taken into account. Telstra submits that under-recovery will occur even if a \$52 estimate is used (in the order of \$[c-i-c] per annum).

765 The ACCC has also closely considered the submissions of Optus that Telstra over-recovers in Band 4.⁵⁰² Optus submits that regard should be had to WiMax costs, that all revenues need to be taken into account and that the proportion of the USO that Telstra allocates to the CAN is inadequate. The ACCC notes Optus' submission but considers that, as submitted by Telstra, Optus' use of EBITDA margins may mean that the value of the analysis is limited.

766 The ACCC notes the following three points about the analysis presented by Telstra on the recovery of its costs:

- the analysis relies on a 23 per cent allocation of costs from the USO
- the analysis assumes that there are no profits to be contributed from urban areas to offset losses in rural areas
- the analysis ignores any profits on other services provided over the CAN

⁴⁹⁸ See for example, Telstra, *Telstra's Local Carriage Service and Wholesale Line Rental Service exemption application,—supporting submissions*, July 2007, p. 26

⁴⁹⁹ Telstra, above n 42, p. 5, Annexure 1.

⁵⁰⁰ See for example, ACCC, *Local services review—final decision*, July 2006, p. 38.

⁵⁰¹ Telstra, above n 42, Annexure 3.

⁵⁰² Optus, above n 194, Appendix A.

767 With respect to the appropriateness of using the 23 per cent allocation from the USO, the ACCC has noted in the past the difficulty of using this measure applied to other estimates of costs, as the technology mix in the model is quite specific.⁵⁰³

768 In relation to the absence of any allocation of line cost recovery from urban areas, the ACCC notes that in the theoretical long run it would be expected that competition from deaveraged ULLS prices in urban areas would lead to a situation where prices were competed to zero. Telstra's analyses on both the effect of the RPPO and the adequacy of the USF rely on this outcome occurring. The ACCC considers that, while this outcome might be expected in the long run, it would not be realistic to assume that this would occur in any near time frame nor within the period of the final determination. In particular, the ACCC notes that ULLS rollout is limited to date. Further, parties must deploy significant infrastructure to provide DSL and voice services and other barriers to entry may also limit the effectiveness of competition in urban areas. Accordingly, urban areas may provide some contribution to line costs. In that respect, the ACCC notes that the number of lines in urban areas significantly outweighs the number of rural lines.

769 However, the ACCC considers that the major problem with Telstra's analysis is that it ignores the profits available to Telstra from the provision of other services that utilise the CAN. The Tribunal has said that it is relevant to consider, for example, in assessing the effect of averaging on competition, "whether Telstra makes sufficient above normal profits from the provision of services over its CAN, other than line rental, to balance any losses it may make from the provision of below-cost retail line rental services."⁵⁰⁴ Telstra's analyses do not account for any profits that may be received from other services. The ACCC notes that Telstra submits that it is inappropriate to have regard to Telstra's profitability on other services.⁵⁰⁵ However the ACCC considers that, as the relevant consideration is whether Telstra is prevented from recovering its line costs across its network, it is directly relevant to consider whether Telstra can recover its line costs from other services. There is no requirement that Telstra can only recover its line costs from line rental services – Telstra can allocate such costs to, and recover those costs from the revenues for, any services provided over the CAN.

770 Accordingly, and as noted above, the ACCC examined Telstra's RAF accounts to examine whether Telstra was currently recovering its line costs across the whole of the services supplied over the CAN. The ACCC noted significant surpluses in both Telstra's HCA and CCA reports. The surpluses observed from Telstra's HCA reports indicate that Telstra is recovering its actual CAN costs (although the ACCC does not consider that actual CAN costs are as relevant as efficient costs). Significantly, the surplus in Telstra's CCA reports indicate that Telstra would continue to recover its CAN costs in the event that Telstra was required to rebuild its CAN today without optimising the current deployed network or design. This is because, as noted above, the ACCC considers that CCA data is likely to overstate efficient forward-looking TSLRIC+ costs of the network because of this lack of optimisation. The ACCC does not consider that it is inappropriate to use CCA RAF data for this purpose as the data provides an upper bound on likely efficient costs. The analysis also incorporated a WACC from Telstra's returns that the

⁵⁰³ ACCC, above n 31, p. 166.

⁵⁰⁴ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [114].

⁵⁰⁵ Telstra, above n 45, p. 7.

ACCC considers is higher than an appropriate WACC.

- 771 The ACCC considers that its analysis better considers CAN cost recovery than the analyses of either Telstra or Optus. As the CCA RAF accounts, for reasons of the inherent inefficiency of CCA data, will be based on costs higher than the TSLRIC+ of the CAN, the results of the analysis represent a conservative estimate of the surplus of revenues over line costs. The results from the analysis demonstrate that, once the full range of services is taken into account, Telstra is currently recovering its line costs. Furthermore, were a TSLRIC+ estimate of CAN costs to be included, the observed surplus would be higher than that reported in the RAF accounts.
- 772 Telstra also submits that it may not be able to recover or to continue to recover line costs from revenues earned on all services that are supplied over the CAN, and submits that the ACCC should only have regard to the ULLS, end-user basic access and local calls to assess line cost recovery.⁵⁰⁶ It also submits that the ACCC's analysis introduces a significant retail cost disadvantage compared to Telstra's rivals, as above average profits on certain services, that Telstra submits are not directly referable to the CAN, would be used to service CAN costs.⁵⁰⁷ However the ACCC notes that its analysis of Telstra's RAF figures examines the retail and wholesale services to which Telstra itself allocates CAN costs in its RAF accounts, and that all of the services examined clearly utilise the CAN. The ACCC also notes that Telstra has the ability to rebalance its basic access and other charges. Accordingly the ACCC considers that the services included in its analysis are appropriate, in light of the Tribunal's guidance that above normal profits on services supplied over the CAN are relevant.
- 773 Furthermore, the amount by which Telstra's CAN-based service revenues exceed costs is significant, and overall revenues are steady over time. Should Telstra consider that fixed voice and data services may not be able to continue to contribute sufficiently to the recovery of line costs, or that costs should be directly allocated to basic access alone, it would be open to Telstra to increase line rental charges so that a greater proportion of line costs are recovered from these charges alone. Doing so would provide greater assurance that any decline in voice and data revenues that could possibly occur would not impede its ability to recover efficient, forward-looking line costs, or would provide assurance that basic access was directly recovering line costs.
- 774 The ACCC notes that Telstra is subject to retail price control arrangements on increasing its line rental charges (in addition to the RPPO on HomeLine and BusinessLine Part).⁵⁰⁸ Relevantly, under clause 13 of the arrangements, there is a cap on the average price for a basket of services including all line rental products and PSTN call products, and caps on Telstra's basic line rental products, HomeLine Part and BusinessLine Part.
- 775 The ACCC is of the view that these price control arrangements do not prevent Telstra from making material increases to its line rental charges. In this regard, the ACCC notes that the price cap over the basket that includes line rentals and PSTN calls does not

⁵⁰⁶ Telstra, above n 16, p. 13.

⁵⁰⁷ Ibid.

⁵⁰⁸ *Telstra Carrier Charges - Price Control Arrangements, Notification and Disallowance Determination No 1 of 2005* as amended

prevent the rebalancing of line rental and call charges, and so provides no direct constraint on the level of line rental charges. Furthermore, the ACCC notes that:

- the CPI price cap that applies to the HomeLine Part product (on which WLR prices are based) was set at a \$5 per month premium above its then price, which has allowed it to be priced above most other residential line rentals, and this price can be increased in real terms until it ‘catches up’ with the cap
- while there could be a degree of substitutability between the ‘Part’ products and other line rentals, it is unlikely that many customers on other line rentals would churn to the ‘Part’ products or to products using WLR unless the price of those other line rentals increased significantly. The HomeLine Part product was unpopular even when it was charged at a discount to other line rentals, and it has become slightly less popular since it has been priced at a premium to most other line rentals. Similarly, as noted above, there is considerable inertia in the market for fixed voice services.⁵⁰⁹

776 In summary, the ACCC considers that Telstra is able to recover its CAN costs, and will continue to be able to recover these costs in the foreseeable future.

777 In light of the ACCC’s conclusions about Telstra’s ability to recover the costs of the CAN across both urban and rural areas, the ACCC now considers geographic averaging against the legislative matters in section 152CR.

Consideration of averaging against the subsection 152CR(1) criteria

778 The first aspect of promoting the LTIE under paragraph 152CR(1)(a) of the TPA is to have regard to the promotion of competition.

779 In its decision on Telstra’s averaged ULLS monthly charge undertaking, the Tribunal considered that it could not be satisfied that averaging of ULLS charges would be likely to achieve the promotion of competition.⁵¹⁰ More specifically, the Tribunal considered that:

- averaging would be likely to neither promote nor prevent equally efficient access seekers from competing with Telstra in urban areas
- averaging may lead to reduced infrastructure based competition, although this may not necessarily be inefficient
- it could not be satisfied that averaging would be likely to promote competition in rural markets.

780 As noted above, the Tribunal also found that it was relevant to consider whether Telstra could use above normal profits from other services provided over the CAN that would

⁵⁰⁹ See for example, ACCC, *Local services review—final* decision, July 2006, p. 38.

⁵¹⁰ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [92] to [146].

allow it to subsidise urban line rental services.

781 Telstra has submitted that averaged ULLS prices will encourage competition on the basis that Telstra would be at a substantial competitive disadvantage compared to access seekers using ULLS in urban areas and WLR in rural areas. The Tribunal relevantly considered that efficient access seekers might still be able to compete with Telstra under an averaged price. However the ACCC considers that it is relevant to consider the guidance of the Tribunal on this matter.⁵¹¹

it is not clear whether Telstra needs to set above-cost prices for retail line rental services in urban areas in order to recover the losses it makes from setting below-cost prices for retail line rental in rural areas. The material before us does not enable us to determine whether Telstra makes sufficient above normal profits from the provision of services over its CAN, other than line rental, to balance any losses it may make from the provision of below-cost retail line rental services. If Telstra did earn such above normal profits from the provision of other services over its CAN, it might be able to reduce the price of retail line rental services in urban areas closer to its costs of production by using the above normal profits to cover the losses it might make from setting below-cost prices for retail line rental services in rural areas.

782 The ACCC considers that, as Telstra has significant above normal profits from other services, Telstra would be able under a deaveraged price structure to both set line rental prices close to cost in urban areas and set below-cost prices in rural areas to compete with HomeLine Part or WLR provision of services. Conversely, under an averaged price structure, Telstra would be able to use its above normal profits on other services to undercut access seekers in urban markets who would face an averaged ULLS charge. The ACCC notes the Tribunal's conclusion that "Telstra should have considerable freedom to respond to competition in urban areas through the use of unregulated service offerings".⁵¹² The ACCC considers that, in light of Telstra's available above normal profits, this would be likely to reduce competition in urban markets for ULLS-based services, particularly in the broadband market, as competition would not be on the merits.

783 Telstra presents a number of submissions in relation to the Tribunal's views on above normal profits. The ACCC considers that the Price Equivalence Framework has little real effect. In particular, the ACCC adopts the conclusions of the Tribunal in reference to Telstra's Informational Equivalence Strategy under operational separation.⁵¹³ The framework confers no rights on any person and cannot be taken as a representation that Telstra will act or refrain from acting in any particular way.⁵¹⁴ Similarly, the ACCC does not consider that possible ACCC regulation would compensate for establishing a price structure that discourages competition. Further, the ACCC does not consider that an access provider would stop seeking profits simply because those profits were relevant to averaging – the access provider would continue to seek the greatest profits available and would invest accordingly, as it would still keep the full amount of any profits. As noted,

⁵¹¹ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [114].

⁵¹² *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [124].

⁵¹³ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [316].

⁵¹⁴ *Telstra, Price equivalence framework strategy*, 30 June 2006, page 1.

the ACCC considers that the CCA RAF account presents a way to practicably account for profits, although the CCA results will understate actual productivity. The ACCC concedes that this analysis does not necessarily imply the same result for all time but notes the size of the surplus, the length of time of the determination and the current USO review are all relevant.

- 784 The ACCC notes that Telstra has submitted that there is significant competition feasible in rural areas.⁵¹⁵ The ACCC agrees that there are likely to be some Band 4 end-users for whom the provision of ULLS-based services is viable, and notes Telstra's information on current ADSL SIOs in that regard. However, the ACCC considers that competition in rural areas is still likely to be more limited, given that technical constraints do exist, that there are high capital costs of installing equipment in Band 4 because of the relative dispersion of end-users and the added disincentive of high backhaul costs (although Telstra should face a similar backhaul cost). The ACCC considers that any slight gain in competition in rural areas would be significantly smaller than the loss in competition in urban areas that would result from an averaged ULLS price. The ACCC also notes that such competition may not be economically efficient competition relative to alternative technologies.
- 785 Telstra also submits that having reference to above normal profits on other services could introduce a significant retail cost disadvantage relative to Telstra's rivals, leading to the result that "the playing field would be tilted against Telstra".⁵¹⁶ The ACCC agrees that in the long-term such an arrangement might in theory create such a disadvantage. However the ACCC notes again the rebalancing available to Telstra and considers that, given the size and persistence of Telstra's surplus in its provision of fixed line services using the CAN, any retail cost disadvantage compared to access seekers would be minimal over the period of the final determination. The ACCC does not consider that there would be longer term competition effects given the pending USO review.
- 786 In light of the above normal profits available to Telstra, the ACCC considers that an averaged ULLS price would tend to decrease competition in urban areas, and that any increase in competition in rural areas would by definition be significantly smaller than the loss of competition in urban areas.
- 787 The ACCC notes in general that it considers analyst reports may often be of limited value as they can be highly speculative. In relation to the particular reports cited by Telstra, the ACCC notes that Telstra has also submitted that regard should not be had to EBITDA.
- 788 Consistent with the views of the Tribunal, the ACCC does not consider that averaging or deaveraging ULLS charges will materially affect any-to-any connectivity.⁵¹⁷
- 789 In relation to the economically efficient use of and investment in infrastructure, the Tribunal considered that, if averaging were designed to recover no more than the overall costs of Telstra's infrastructure, operating costs and a normal return on capital, then averaging is likely to result in the economically efficient investment in Telstra's CAN and

⁵¹⁵ Telstra, above n 42, p. 5.

⁵¹⁶ Telstra, above n 16, p. 13.

⁵¹⁷ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [147].

its ULLS.⁵¹⁸ Telstra cites this conclusion as supporting averaging.⁵¹⁹ However, the ACCC notes that, based on the results from the PIE II model, Telstra's averaged charge of \$30 would not achieve this. In relation to the ACCC setting its own averaged charge, the ACCC does not consider that there is a reliable measure of Band 4 costs available with which to calculate an averaged charge.

790 In any case, the Tribunal also considered that, in relation to efficient investment by access seekers, averaged ULLS prices would discourage allocative, productive and dynamic efficiency, largely due to averaging creating a disassociation between prices and costs.⁵²⁰ It is uncontroversial that a disassociation of price and cost would lead to allocative efficiency losses, as consumers and investors will not receive the correct signals from cost-based pricing.⁵²¹ However, Telstra submits that allocative efficiency already exists due to the impact of the other averaged products. The ACCC considers that this could be true to some extent. However, it does not consider that this means that allocative efficiency losses will not occur with an averaged ULLS price. In particular the ULLS provides a level of functionality and flexibility above all the services listed by Telstra that mean that allocative losses particular to the ULLS would arise.

791 In regard to productive and dynamic efficiency, Telstra submits that to the extent averaging promotes competition it will promote allocative and dynamic efficiency. As noted above, the ACCC considers that averaged charges will not promote competition and accordingly will not promote allocative and dynamic efficiency. Telstra submits that over the medium to long term its ability to gain sufficient returns over time will be diminished. The ACCC notes that, to the extent this may be true (despite the indications from the ACCC's analysis of RAF returns), it will not occur over the period of the determination and would also be dealt with in the pending USO review.

792 In relation to inefficient bypass, Telstra submits that the Tribunal considered that the risk of inefficient bypass was small.⁵²² The ACCC considers firstly that the Tribunal's comment in relation to the WACC cannot be directly applied to consideration of averaging, where the price changes and relativities are significantly greater. However in any case the ACCC considers that the Tribunal also noted there was evidence that some degree of bypass was already occurring but that it was difficult to tell the extent to which inefficient bypass might occur.⁵²³ The ACCC agrees with this assessment, and considers that averaging would certainly in no way encourage efficient investment, even if the risk of bypass might be small. In relation to the possibility of Telstra negotiating to avoid inefficient bypass, the ACCC considers that the number of ULLS access disputes that have been notified would suggest that Telstra would be unlikely to achieve widespread commercially negotiated outcomes for ULLS pricing.

793 The ACCC does not consider that deaveraged ULLS prices would lead to inefficient entry at the retail layer, since both Telstra and access seekers would be able to compete. To the

⁵¹⁸ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [165].

⁵¹⁹ Telstra, above n 42, p. 8.

⁵²⁰ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [172]-[175].

⁵²¹ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [173].

⁵²² Telstra, above n 42, p. 9.

⁵²³ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [168].

extent that there may be insufficient long term competition to drive prices to costs, or a transition period, the ACCC notes that this would hold under either averaged or deaveraged prices.

794 As noted above, the ACCC does not consider that the RPPO and deaveraged ULLS prices would be likely to affect Telstra's viability, given the ACCC's analysis of Telstra's RAF accounts. To the extent that this might occur in the long term, the ACCC notes again the size of the current surplus, the length of time of the determination and the current USO review.

795 In relation to Telstra's submissions about Government policy, the ACCC notes that Government policy, while a relevant consideration, will not mean that particular outcomes are economically efficient. In this respect, the ACCC concurs with the views of the Tribunal.⁵²⁴

796 In relation to the legitimate business interests of Telstra, the ACCC notes that the primary consideration in regard to averaging was not whether averaging was necessary to enable Telstra to recover its costs of and investment in the CAN but whether averaging is reasonable having regard to Telstra's legitimate interests.⁵²⁵ In that respect, and as submitted by Telstra, the Tribunal's major conclusions were that deaveraged ULLS prices had the potential to undermine Telstra's cross-subsidise rural and urban areas, and that averaged prices will not allow Telstra to over-recover its costs as long as the USF does not fully compensate Telstra for any losses it may incur. The Tribunal did not consider that above-average profits for other CAN services were relevant to consideration of this criterion, as it considered that averaging of itself would not lead to Telstra earning more revenues for these other services.⁵²⁶

797 Telstra pointed to its submitted analysis that it states demonstrate that it under-recovers from the USF.⁵²⁷ The ACCC has considered this analysis above, and considers that the claimed under-recovery in that analysis is larger than realistic. Furthermore, CCA RAF results (which include USO revenue) demonstrate that Telstra is not under-recovering its line costs as a result of the RPPO or WLR pricing. Accordingly, the ACCC considers that, applying the conclusion of the Tribunal, that averaging would lead to recovery of greater costs than necessary to meet Telstra's legitimate business interests and recovery of its investment in its CAN.

798 The ACCC does not consider it is necessary to draw a firm conclusion on the likelihood of inefficient bypass. However the ACCC considers that there is evidence that bypass has occurred.

799 In relation to the interests of access seekers, the ACCC has long considered that access seekers' interest is in being able to compete on their relative merits. In relation to Telstra's submission that the criteria in paragraph 152CR(1)(c) requires the consideration of end-users, the ACCC considers that those interests are already taken into account in

⁵²⁴ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [174].

⁵²⁵ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [187].

⁵²⁶ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [248].

⁵²⁷ Telstra, above n 42, p. 13.

paragraph 152CR(1)(a). The ACCC has already considered that rural competition is possible but likely to be limited.

800 The ACCC agrees with Telstra that the relevant question is not simply the cost that access seekers will pay. In relation to Telstra's submission about averaged charges being in the interests of access seekers, the ACCC has already considered that averaged charges will prevent competition on the merits. Accordingly, averaged charges will not be in the interests of access seekers.

801 In relation to Telstra's submissions on access seekers' investments, the ACCC does not agree that particular prices were imposed by the ACCC. The ACCC notes that Telstra itself put forward de-averaged ULLS charges in proposals to the ACCC. The ACCC considers that averaged prices could strand those assets to the access seekers' disadvantage.

802 The ACCC does not consider it needs to review operational data for all access seekers. To the extent access seekers are inefficient, they will be eliminated in the market. What is the relevant consideration is whether all firms, including Telstra, are competing on an even playing field. Averaging will not lead to such competition on the merits.

803 In regard to the direct costs of providing the ULLS, the ACCC endorses the view of the Tribunal that there are a number of cost recovery approaches, including averaging and deaveraging, that will allow the recovery of direct costs.⁵²⁸ The ACCC accordingly does not consider that consideration of this criterion materially affects the question of whether ULLS prices should be averaged.

804 The ACCC notes Telstra's submission that averaged ULLS prices better reflect the "full direct cost" to Telstra of supply of the ULLS, under the RPPO. The ACCC considers that, in light of its conclusions about the extent to which Telstra is bound by the RPPO, this submission is not relevant.

805 The ACCC similarly considers that deaveraged prices will be consistent with the operational and technical requirements necessary for the safe and reliable operation of the CAN and the ULLS, and that this consideration does not affect any decision on averaging of prices. The ACCC's views on the economically efficient operation of infrastructure are contained above in its consideration of allocative, dynamic and productive efficiency.

Other relevant matters

806 Telstra has submitted that the ACCC should have regard to international precedent, citing the OECD report and US cases, as well as other industries.⁵²⁹

807 In regard to other industries and other countries, the ACCC observes that there are fundamental differences between countries and industries that mean comparisons should be treated with caution. Relevant differences include the definition of the regulated

⁵²⁸ *Telstra Corporation Limited (No 3)* [2007] ACompT 3 (17 May 2007) at [270] to [274].

⁵²⁹ Telstra, above n 42, p. 17; Annexure 4.

service, the applicable regulatory framework and government policy, the geographic price structure, the cost of capital, the nature of the product provided, the potential for bypass, the cost of capital, the prescribed cost standard (if any) and population concentration and distribution (as opposed to just population density).

808 Telstra submits in particular that the ACCC should look at its own Sydney Water decision. As noted in the ACCC's pricing principles report, a difference noted by the ACCC in making that decision was that the NSW government did not have a USO-style scheme in relation to water provision.⁵³⁰ In relation to gas and electricity infrastructure, there is usually no reasonable prospect of wholesale bypass. As such, the need for price signals may not be as significant as in telecommunications. The ACCC notes the different access regime for those industries. In relation to the US examples provided by Telstra, the ACCC notes that there are differences relating to the implementation of universal service programs and the possibility of the deaveraging of retail prices.

809 In reference to the OECD report, the ACCC has on many occasions noted Telstra's selective quoting from that report.⁵³¹ In particular, the ACCC considers that a fuller extract demonstrates that the OECD advocates cost based access pricing and the use of a broad-based retail tax to cover the deficit.⁵³² Furthermore, the OECD notes that the use of averaged ULLS charges may induce inefficient network duplication in low-cost areas and that accordingly would best be limited to situations where network bypass in natural monopoly areas is banned. The ACCC notes Telstra's further submissions on this issue. However the ACCC remains of the view that this is an accurate interpretation of the OECD report.

810 In any case, the ACCC considers that examples from other jurisdictions cannot bear more heavily on a decision about averaging than the matters listed in subsection 152CR(1). In light of the ACCC's views on those matters, the ACCC considers that such examples cannot be considered at all determinative.

High cost surcharge

811 In light of the ACCC's conclusions above, the ACCC does not consider that a high cost surcharge would be appropriate having regard to the subsection 152CR(1) matters.

812 The ACCC reaches the same conclusions about a high cost surcharge as it does about geographic averaging of ULLS prices.

Overall conclusion on the structure of prices

813 The ACCC considers on the structure of prices that, having had regard to the ULLS pricing principles and the matters under section 152CR of the TPA, that prices should be geographically deaveraged between the geographic bands. Geographically deaveraged

⁵³⁰ ACCC, *Access dispute between Services Sydney Pty Ltd and Sydney Water Corporation—arbitration report*, 19 July 2007, p. 44.

⁵³¹ ACCC, above n 5, p. 21.

⁵³² OECD Competition Committee, *Access Pricing in Telecommunications*, 2004, pp. 134-135.

ULLS charges will:

- better promote competition
- better encourage the efficient use of and investment in infrastructure
- meet the legitimate business interests of Telstra
- better meet the interests of access seekers
- ensure the operational and technical requirements necessary for the safe and reliable operation of the CAN
- better lead to the economically efficient operation of the CAN.

814 Accordingly, the ACCC has decided to set de-averaged prices for the ULLS in Bands 1, 2 and 3. As previously noted, the ACCC has decided not to set a price for Band 4.

4.1.13 Investment in infrastructure by which carriage services are supplied

815 In its initial submissions, Telstra submits that the ACCC should have regard to the level of investment in Optus' HFC network and to investment levels generally, and in particular a Telstra submission titled "Lack of telecommunications investment in Australia and prices to be set in the Optus HFC footprint".⁵³³ Telstra also submits that the ACCC should have regard to a report by LECG on "Access regulation and infrastructure investment in the telecommunications sector".⁵³⁴ In its supplementary submission, Telstra again submits that the ACCC must not limit itself to the information put by Telstra (and presumably other parties) in relation to the ULLS pricing principles but must also consider Telstra's investment submission.⁵³⁵

Submissions from parties

816 Telstra submits that investment in fixed networks in Australia is at an all time low, with Optus "closing down" its HFC network in favour of ULLS.⁵³⁶ Telstra submits that in order to encourage investment by Optus in HFC and by access seekers in new networks more generally, the ACCC should set prices for ULLS in Optus' HFC network footprint at Telstra's commercially offered rates or at a rate that would encourage Optus to continue to invest in and expand its HFC network.

⁵³³ Telstra, above n 33, pp. 9-12.

⁵³⁴ Telstra, *Telecommunications Access Disputes between Chime Communications Pty Ltd ("Chime"), Optus networks Pty Limited ("Optus"), XYZed Pty Limited ("XYZed"), Primus Telecommunications Pty Ltd ("Primus"), PowerTel Ltd ("PowerTel"), Request Broadband Pty Ltd ("Request"), Macquarie Telecom Pty Limited ("Macquarie") and Telstra Corporation Limited ("Telstra") regarding Unconditioned Local Loop Service ("ULLS")*, 26 October 2007.

⁵³⁵ Telstra, above n 16, p. 8.

⁵³⁶ Telstra, above n 67, p.2.

- 817 Telstra presents a variety of overall industry investment figures that it submits demonstrates lagging growth in telecommunications infrastructure.⁵³⁷ It also submits that most investment has been by Telstra.⁵³⁸
- 818 Telstra submits that infrastructure investment by parties other than Telstra has not involved any comprehensive attempt to create newer and better communications systems, or invest in independent technologies. Instead, much of the investment has been on DSLAMs, while using “infrastructure owned by Telstra priced at below cost regulated prices.”⁵³⁹
- 819 Telstra refers to Optus' decreased investment in HFC as an example of ULLS take-up over further investment in own infrastructure. In particular, Telstra considers Optus has decreased its spending on its HFC network. Telstra provides examples of the US, Canada, and a number of European countries where cable networks have a healthy market share and are being further deployed and upgraded. It considers that these examples show that cable networks are capable of matching and even bettering the speeds offered by DSL technologies. Furthermore, cable deployment is continuing in jurisdictions where the ULLS is accessible at cost-based prices.
- 820 Telstra submits that the lack of investment in alternative infrastructure means that access prices to Telstra's fixed network are too low.⁵⁴⁰ Telstra considers that the ACCC should not “ignore the availability [of Optus's] HFC network when setting access prices.”⁵⁴¹ Telstra submits that correct pricing would also give Optus incentives to compete more aggressively with its HFC.
- 821 Telstra submits that current ULLS access prices and those proposed by the ACCC are inconsistent with the LTIE in that consumers lose out on important dynamic efficiency benefits that are greater under facilities-based competition and allows greater service innovation.⁵⁴² Telstra also contends that ULLS prices are below Optus' incremental cost of connecting a subset of customers, implying that prices are unlikely to be covering the TSLRIC of unbundled access to Telstra's customers, and therefore, Telstra contends, are not in Telstra's legitimate business interests.
- 822 Telstra also submits that the proposed pricing does not provide for the recoupment of the direct costs of providing the service, and thus is inconsistent with paragraph 152CR(1)(d) of the TPA. Telstra considers that Optus's refusal to 'in-fill' its network suggests that the ULLS price is below the relevant incremental cost to Optus of extending its network.
- 823 Telstra contends that given the deficit between the cost of providing ULLS and the proposed prices, the proposed prices would not lead to the economically efficient operation of a network.

⁵³⁷ Telstra, *op cit*, pp. 2-3.

⁵³⁸ Telstra, *op cit*, p. 3.

⁵³⁹ Telstra, *op cit*, p. 4.

⁵⁴⁰ Telstra, *op cit*, p. 6.

⁵⁴¹ Telstra, *op cit*, p. 7.

⁵⁴² Telstra, *op cit*, p.9.

824 Telstra submits that commercially agreed prices would not harm the interests of access seekers, as it would better lead to efficient pricing.⁵⁴³

825 In its submissions on the ULLS pricing principles, Telstra also submits that it needs clarification and explanations by the ACCC in relation to particular sentences in the ACCC's pricing principles report, namely:⁵⁴⁴

- the possible explanations of investment levels in the industry
- evidence of the length of investment cycles in the industry
- how the relative size of other Australian industries affects Telstra's comparison of the proportional growth of investment in various Australian industries compared with that of the telecommunications industry
- what "alternative network" might be used in conjunction with the ULLS.

826 Telstra also submits that due to cost diseconomies associated with Australian capex and the impact of exchange rates, no clear implications for the adequacy of communications capex is supported by the OECD report referred to by the ACCC in its final decision on the ULLS pricing principles.

827 Telstra also repeats its submissions regarding the ULLS price the ACCC has set being below the TSLRIC+ of supply and that the ACCC should set prices for the ULLS in Optus's HFC network footprint at commercially agreed rates.⁵⁴⁵

828 Finally, Telstra submits that in making the final determination, the ACCC should fully consider the issues at hand – including the issue of the adequacy of communications investment in Australia.⁵⁴⁶

829 Optus disputes Telstra's contention that it has not invested in its HFC network because it has been able to purchase low priced ULLS. Optus states that it has continued to invest in its HFC network over time. It also submits it has a business rule to not sell ULLS services where HFC is available.

830 Optus considers that it cannot be concluded that the lack of infill is related to ULLS price. Optus submits that, even in the absence of the ULLS, it may not be feasible for technical reasons and commercially viable for it to provide telephony services via the HFC to a given residential customer building (including single dwelling units (SDUs) and multi-dwelling units (MDUs)). It may not be feasible for SDUs, because in heritage areas, overhead access is denied and undergrounding is not feasible and the quality of voice telephony deteriorates once the distance is over 50m. For MDUs, reasons include the original network design not accommodating MDUs and difficulties in securing agreement

⁵⁴³ Telstra, *op cit*, p.12.

⁵⁴⁴ Telstra, above n 16, pp. 8-10.

⁵⁴⁵ Telstra, *op cit*, pp. 9-10.

⁵⁴⁶ Telstra, *op cit*, p. 10.

from body corporates. Also, viable access to MDUs has not been available via the ULLS due to a ULLS issue regarding MDUs. Optus refers to the ongoing access dispute between Optus and Telstra regarding provisioning of ULLS in MDUs.

- 831 Optus also submits that it also may not be commercially attractive for Optus to provide telephony services via its HFC network. Optus submits that even “*prior to the emergence of the ULLS*” as a viable alternative option, a business case could not be found for MDU access via the HFC. In inactive areas, activating these areas can cost up to \$[c-i-c] for each node. These inactive areas tend to be in low density areas, making it difficult to achieve economies of scale.
- 832 Optus also submits that it is incorrect for Telstra to assume that the incremental cost to Optus of providing telephony services via its HFC to particular residents within the network’s geographic footprint is an appropriate benchmark for the cost to Telstra of providing the ULLS. This is because Telstra’s submission assumes that ULLS costs may be benchmarked against HFC costs given they compete successfully against each other in other jurisdictions and the cost to Optus of infilling its HFC network is comparable with the typical costs of international HFC operators.
- 833 Optus states that its HFC’s lack of economies of scale means its costs are probably higher than international HFC operators’. Also, cable companies in other jurisdictions are often primarily pay TV operators, with voice telephony being a less significant business. Providing voice telephony to infill customers over the HFC requires substantial retrofitting, making it significantly more expensive than provision of pay TV services. Optus also notes that while the TSLRIC+ of the ULLS is likely to exceed that of serving the *average* HFC customer, it would not necessarily exceed those for *particularly difficult* customers, especially if HFC has more variable costs than the copper network. For example, customers located a significant distance from the road would receive weakened signals, necessitating additional repeaters, frequency boosters, etc. This problem does not occur with the copper network.
- 834 In its response to reply submissions, Telstra submits that Optus’ submissions that it does not sell ULLS where HFC is available should mean that Optus should not have any difficulty with Telstra’s proposition to not have ACCC-set prices in HFC areas.⁵⁴⁷ It also submits that technical complexities are inherent in all networks, that Optus was aware of the Australian legal regime when it deployed its network and that Optus’ submissions on growth in communications investment are misleading.⁵⁴⁸
- 835 On 19 December 2007, Telstra also submitted that the ACCC should have regard to Telstra’s submissions in support of an exemption application in Optus’ HFC network footprint. Telstra enclosed a submission dated 17 December 2007 relating to an application Telstra had made for an exemption from standard access obligations relating to the ULLS, and statements from Michael G Harris and Professor Martin Cave.

ACCC’s view

⁵⁴⁷ Telstra, above n 45, p. 10.

⁵⁴⁸ Telstra, *op cit*, pp. 10-12.

- 836 In terms of applying the subsection 152CR(1) criteria, the first criterion concerns the LTIE. (paragraph 152CR(1)(a)). This calls for consideration of a number of factors identified in section 152AB, being the objective of promoting competition, the objective of achieving any-to-any connectivity, the objective of encouraging the economically efficient use of the economically efficient investment in infrastructure, and subsidiary matters. (paragraphs 152AB(2)(c)-(e), subsection 152AB(4), paragraphs 152AB(6)(a)-(c), and subsection 152AB(7A)).
- 837 Telstra submits that competition with the Optus HFC network, if ULLS prices were set at the levels proposed by Telstra, could lead to greater competition caused by increased dynamic efficiency and service innovation. The ACCC does not, however, consider that the Optus HFC network has provided a strong competitive constraint on Telstra to date, and considers its decision in this ULLS final determination would be unlikely to promote the development of this possible source of competition. On the evidence presented to the ACCC, Optus uses the ULLS where it is not able to feasibly supply using HFC. As such, the terms of access to the ULLS will not have a direct influence on Optus's use of HFC.
- 838 Telstra submits that there is no technical reason why wholesale services could not be supplied over a HFC network (although vendor equipment does not yet exist to support access seeker control over the quality of those services). However, Optus does not currently supply a wholesale broadband service over the HFC network, and as cable broadband services are not declared under the Act, a service provider could not require Optus to do so. Even if in future Optus supplied a wholesale broadband service over the HFC network, the ACCC does not consider that such services would comprise a close substitute to existing ULLS-based DSL and voice services. In contrast to ULLS-based DSL services, the Optus HFC network does not pass the majority of end-user premises, not all premises within 'the footprint' are connected to the network, and different customer equipment is required when supplying cable broadband services. Upgrades to the Optus HFC network may also be necessary before an equivalent quality of service could be supplied over that network.
- 839 Even if improvements were made to the Optus HFC to allow delivery of the full suite of business and retail services to provide the potential for effective substitutability between the ULLS and the equivalent products on HFC, there would be a delay in implementing these improvements. The ACCC expects this implementation time to be longer than the duration of the final determination (which expires on 30 June 2008).
- 840 Accordingly, the ACCC considers that not setting access prices based on the presence of the HFC network would not have a significant encouraging effect on competition. However, not setting access prices in the HFC footprint would tend to inhibit competition by ULLS access seekers in downstream DSL and voice services markets, and inhibit access seekers' ability to provide differentiated service offerings such as ADSL2+.
- 841 Further, in those areas that can be serviced by the Optus HFC network, the ACCC considers that the presence of two vertically-integrated networks would not necessarily be sufficient to ameliorate the need for ex ante regulation, or support a different approach to setting terms of access within those areas. For instance, it can be noted that while Telstra retails higher quality, ADSL2+ services over its network, Telstra has not felt compelled to respond to the presence of the Optus HFC by providing a wholesale equivalent product.

- 842 Similarly, and in relation to Telstra's wider submissions about investment levels generally, while a number of fixed and mobile wireless networks are currently being deployed, these developments are still in their early stages. While it is an open question as to what extent services on these new networks will offer viable alternatives to those services provided via Telstra's copper CAN, the ACCC considers that these emerging networks will not provide strong competitive constraint over the period of the final determination.
- 843 The ACCC does not consider that the objective of achieving any-to-any connectivity affects its consideration of whether to set prices in the HFC footprint, or that the matters identified in paragraph 152AB(6)(a) are relevant.
- 844 In relation to Telstra's legitimate commercial and business interests, the ACCC considers that its final determination ULLS prices are sufficient to meet Telstra's interests in recovering the efficient costs associated with supplying ULLS. Accordingly setting prices in the HFC footprint would not affect these legitimate interests.
- 845 Telstra submits that ULLS prices influence investment by other service providers in alternative, stand-alone access networks. Telstra singles out the possible effect of lower ULLS prices on investment in the Optus HFC footprint, implying that such prices may deter Optus from investing in upgrades to the HFC network within its existing footprint.
- 846 In coming to a view on this issue, it is relevant to consider whether there a direct connection between the ULLS price and Optus' investment in its HFC network. That is, whether Optus would respond to a higher ULLS price by investing further in its HFC network; and importantly that this investment would be directed towards developing services that would compete with Telstra services.
- 847 The ACCC considers that there is little direct connection between ULLS prices and Optus' investment in its HFC network, given Optus does not supply wholesale broadband services over its HFC. While Optus acquires the ULLS, on the information available to the ACCC, this is not done to the detriment of servicing customers over HFC. The ACCC notes Optus' submissions in that regard.
- 848 Further, it is not apparent that the ACCC's regulatory approach to the ULLS inhibits investment in cable networks. Telstra has itself twice upgraded its HFC networks since the ACCC's decisions in December 2005 and August 2006 to reject Telstra's proposed prices for the ULLS. Similarly, Optus has announced upgrades to the speed of its HFC network.
- 849 In the longer term, it does not follow that the ACCC's approach to ULLS prices would tend to discourage, rather than encourage, other network operators to invest in their existing access networks. The resulting increase in competition provided by ULLS-based suppliers in downstream services could be expected to encourage Optus to upgrade the capability of its HFC network to match prevailing product offerings and service levels. The ACCC notes that there is evidence of this occurring already.⁵⁴⁹

⁵⁴⁹ Optus, *Optus cable network hits high speed*, 17 December 2007.

- 850 Further, the ACCC does not consider that the ULLS access seekers would be able to efficiently duplicate Telstra's access network at this time, and hence considers that pricing in the HFC footprint for the purpose of this final determination would not discourage the ULLS access seekers from making efficient investments in their own access network.
- 851 The next criterion is the legitimate business interests of the provider and its investment in facilities used to provide the ULLS (paragraph 152CR(1)(b)). This criterion is discussed as part of the first criterion. The ACCC considers that setting prices in the HFC footprint is consistent with Telstra realising its legitimate business interests, as the prices allow Telstra to recover its costs of providing ULLS access and a normal, risk-adjusted return on its investment.
- 852 The next criterion is the interests of all persons with rights to use the ULLS (paragraph 152CR(1)(c)). In relation to the interests of access seekers, the ACCC considers that Telstra's commercial rates greatly exceed efficient costs for the ULLS and that accordingly it would not be in the interests of access seekers to incur Telstra's commercial rates in the HFC footprint.
- 853 The next criterion is the direct costs of providing access to the ULLS (paragraph 152CR(1)(d)). It is concerned with ensuring that Telstra will be able to recover its costs in providing access, to itself or others. The ACCC considers that the final determination ULLS prices allow recovery of the direct costs of the ULLS.
- 854 In relation to the criterion in paragraph 152CR(1)(e), the cost of extensions to Telstra's ordering systems necessary to supply the LSS or ULLS have been taken into account in setting ULLS prices. These costs will be recovered if prices are set in the HFC footprint. The ACCC does not consider that the 'operational and technical requirements' matter in paragraph 152CR(1)(f) materially contributes to this decision.
- 855 The ACCC has considered which approach should be favoured in terms of enabling a carriage service, telecommunications network or facility to be operated efficiently, pursuant to subsection 152CR(1)(g). The ACCC's consideration is contained above in its assessment under section 152CR(1)(a).
- 856 The ACCC notes the LECG report that Telstra has submitted which seeks to demonstrate the relationship between European regulatory approaches and investment in alternative access networks. As the report relates to European jurisdictions, the ACCC considers that its applicability to the Australian jurisdiction is limited.
- 857 The ACCC notes Telstra's submission in its response on the ULLS pricing principles that it requires further information and an opportunity to respond on particular sentences in the ACCC's ULLS pricing principles. The ACCC does not consider that this is necessary, as the discussion in the pricing principles is clear and Telstra has, over the course of its submissions, provided submissions on all of the issues raised. As noted in the principles, the ACCC considers that it will best provide signals for build versus buy decisions by setting efficient cost-based prices. The ACCC disagrees with Telstra that its prices are inconsistent with efficient cost-based pricing.

858 In relation to Telstra's letter of 12 November 2007 concerning a reasonably willing seller and buyer, the ACCC considers, based on its considerations above, that a reasonably willing seller and buyer would not be achieved if the ACCC did not set prices in the HFC network footprint.

859 Finally, given the proposed timeframe for the final determination and the current commercial unavailability of necessary vendor equipment, the ACCC considers that the issues raised by Telstra in relation to its exemption application in respect of all declared services supplied in the Optus HFC footprint will be more appropriately considered within the ACCC's exemption processes.

860 Having had regard to the section 152CR matters and the ULLS pricing principles, the ACCC considers that it should set prices for the ULLS in the HFC footprint.

4.1.14 Utilities (Network Facilities Tax) Act 2006 (ACT)

861 As noted earlier in these reasons, the ACCC's ULLS prices do not include an allocation of costs to account for the Utilities (Network Facilities Tax) Act 2006 (ACT).

4.1.15 Band Definitions

862 Telstra submits that that the ACCC's proposed band definitions in the DFD would require Telstra to constantly monitor the number of SIOs in each ESA in order to ensure that Telstra complies with the final determination. Given that Telstra does not gather data in order to determine which ESAs would fall in the band classifications other than on a periodic basis; Telstra submits that this would place an onerous and costly burden on Telstra. Telstra has classified each ESA into the appropriate band according to the ACCC's proposed band definition.⁵⁵⁰ It recommends that the ACCC determine that these band classifications apply for the period of the determination.⁵⁵¹

ACCC's views

863 The ACCC considers that its proposed band definitions may place some administrative burden on Telstra. However the ACCC notes that its definitions were taken from Telstra's own documentation.

864 Telstra has provided a spreadsheet classifying each ESA into the appropriate band according to the ACCC's band definition, current as at 16 August 2007.⁵⁵² The ACCC considers that it is appropriate, in the interests of certainty, to identify each ESA in the band assigned to it in Telstra's spreadsheet.

865 Accordingly, the ACCC has decided to use the band definitions proposed in the DFD, applying information on band classifications of ESAs available on the date the final

⁵⁵⁰ Telstra, *UI:201 - ESA by ULL Band*, 16 August 2007.

⁵⁵¹ Telstra, above n 42, p. 55.

⁵⁵² Telstra, above n 334.

determination comes into effect, for the duration of the final determination.

866 As Telstra's spreadsheet is the most up-to-date information on the geographic classification of ESAs, the classifications in that spreadsheet will take effect from the date of the final determination and remain valid for the duration of the final determination.

4.1.16 Commencement date, expiry date and interest

867 As noted earlier in these reasons, the ACCC has backdated the ULLS monthly charge to the time the parties were first evidently in negotiations and has decided to apply prices until 30 June 2008. Interest is to be paid on resulting overpayments.