ACCOUNTING SEPARATION OF TELSTRA:

IMPUTATION TESTING AND NON-PRICE TERMS AND CONDITIONS REPORT FOR THE SEPTEMBER QUARTER 2012

December 2012

CONTENTS

GLOSSARY AND ACRONYMS

ADSL	Asymmetric digital subscriber line is a digital technology that supports high speed services over conventional copper telephone lines. It is a high bandwidth downstream service (toward the customer) with a lower bandwidth upstream service.
FTM	Fixed to mobile
ISDN	The integrated services digital network is a network that has evolved from the PSTN. ISDN services enable end users to send and receive information at faster speeds and with greater reliability than is possible using the standard PSTN service.
KPI	Key performance indicator
LCS	The local carriage service is a service for local call resale. That is, the carriage of telephone calls from customer equipment at an end-user's premises to separately located customer equipment of an end-user in the same standard zone.
PSTN	The public switched telephone network is the standard fixed-line telephone network, used primarily for the supply of long-distance, fixed-to-mobile and mobile-to-fixed calls to end-users in Australia.
PSTN-O	PSTN originating access service
PSTN-T	PSTN terminating access service
RAF	Telecommunications industry regulatory accounting framework
RKR	Record-keeping rules are rules issued by the ACCC under s. 151BU of the *Competition and Consumer Act 2010* (formerly the *Trade Practices Act 1974*) that require carriers or carriage service providers to keep and retain records and to give any or all of the reports to the ACCC as required.
SIO	Services in operation
ULLS	The unconditioned local loop service involves the use of unconditioned lines (typically copper) between end-users and a telephone exchange, where the line terminates. This service enables the supply of advanced, high-speed data services to customers as well as local and long-distance voice services.
WACC	Weighted average cost of capital
WLR	Wholesale line rental

SUMMARY

The imputation and non-price terms and conditions reports are produced in accordance with a direction issued by the Minister for Communications, Information Technology and the Arts on 19 June 2003.

The reports are intended to provide greater transparency of Telstra's operations and to assist the ACCC to monitor whether Telstra is unfairly discriminating between access seekers using its network and its own retail operations.

In March 2012, the ACCC accepted Telstra's structural separation undertaking (SSU), which contains interim equivalence and transparency arrangements that are applied to Telstra's supply of regulated services to its wholesale customers and its business units. These arrangements surpass those contained within the accounting separation regime. Therefore, this may be the last imputation and non-price terms report should the Minister choose to revoke the Direction requiring the ACCC to implement accounting separation.

IMPUTATION TESTING

Telstra is required under the *Imputation Testing Record Keeping Rule* (Imputation RKR) to undertake quarterly imputation testing. Imputation testing adds up the costs of buying a wholesale service and transforming it into a retail service, and compares that figure with the retail price charged by Telstra. Telstra is determined to have passed the imputation test if the retail price is sufficiently high so as to provide a margin between it and the combined wholesale and transformation costs.

The primary objective of imputation testing is to examine whether an equally efficient access seeker can compete with Telstra in retail telecommunications markets. This provides preliminary indications of whether Telstra is engaging in systematic price-squeeze behaviour in relation to its core telecommunications services.

A negative imputation margin could indicate Telstra is engaging in anti-competitive behaviour (e.g. a price squeeze) against its retail competitors. However, a negative margin, on its own, is not sufficient to determine whether anti-competitive behaviour is occurring. There may be other reasons why Telstra fails an imputation test that are not related to anti-competitive behaviour. For example, an increase in competition that drives down retail prices could cause a negative result for an imputation margin. There may also be reasonable explanations for increases in costs that could contribute to a negative result.

Imputation testing has been undertaken for the following retail services: local calls and line rental, domestic and international long-distance calls, fixed-to-mobile calls and ADSL services (both stand-alone and bundled). Imputation testing concerns the retail services supplied using certain regulated access services: unconditioned local loop services (ULLS), public switched telephone network originating and terminating access services (PSTN OTA) and local carriage services (LCS).

Key results for the September 2012 quarter are:

- Telstra passed 11 out of 15 imputation tests for the September 2012 quarter
- Since the June 2012 quarter, margins increased for seven, declined for three and remained the same for five out of 15 imputation tests
- Telstra failed the imputation tests for:
    - local call and line rental for business and residential customers. The margins for both groups remained stagnant since the June 2012 quarter.
    - ADSL services for residential customers. However, the margins for these services for both customer groups improved since last quarter.
    - the bundle of ADSL and fixed voice services for residential customers.

NON-PRICE TERMS AND CONDITIONS KEY PERFORMANCE INDICATORS

The non-price terms and conditions section of this report measures Telstra's relative performance in provisioning services, fixing faults, and keeping appointments for retail and wholesale basic access and ADSL customers. Performance is assessed against the Customer Service Guarantee standards or similar measures.

The overall results do not provide any evidence of systemic discrimination by Telstra against access seekers in respect of performance.

In relation to business services, Telstra provided better service to its wholesale customers for six out of the 11 performance metrics. For Metrics 1 to 3, which relate to various types of provisioning services, the percentage of occasions in which Telstra met the performance standard was at least 10 percentage points higher for wholesale customers than it was for retail customers. Telstra performed relatively the strongest in relation to its retail customers in relation to Metric 5, where it repaired basic faults within the timeframes at a rate that was 4.61 percentage points higher for retail customers than wholesale customers.

In relation to residential services, Telstra provided better service to its wholesale customers for eight out of the 11 performance metrics. For Metric 3, which relates to the percentage of basic access orders provisioned (new service requiring additional cable or network capacity), Telstra met the performance standard at a rate that was 19.55 percentage points higher for wholesale customers than retail customers. Again, Metric 5 was the metric in which Telstra provided its relatively strongest performance in relation to retail customers.

1. INTRODUCTION

On 19 June 2003, the Minister for Communications, Information Technology and the Arts directed the ACCC to use its record keeping rule (RKR) making powers under the *Trade Practices Act 1974*, (now the *Competition and Consumer Act 2010* (the Act)) to introduce enhanced accounting separation of Telstra.

In accordance with this direction, the ACCC issued RKRs requiring Telstra to provide the ACCC with reports on:

- regulatory accounting statements that have been prepared on a current cost basis, in addition to reports prepared on a historical cost basis, under the Telecommunications Industry Regulatory Accounting Framework (RAF) for core services (CCA reports)
- imputation analysis comparing Telstra's retail prices and the costs faced by access seekers in purchasing core services from Telstra to supply competing retail services (imputation reports)
- key performance indicators on non-price terms and conditions that compare Telstra's customer service performance between specified retail and wholesale supplied services (NPTC reports).

The direction also requires that the ACCC publish the reports and a commentary which discusses the accuracy of the reports and the extent to which the reports comply with:

- the regulatory accounting framework (for the imputation report only)
- any other relevant record-keeping rules made by the ACCC
- any direction given by the ACCC for Telstra to make public information contained in the reports.

The comments are to include any qualifications that the ACCC considers necessary. The ACCC must also summarise the results of the imputation analysis.

1.1 PURPOSE OF THE REPORTS

The purpose in establishing the enhanced accounting separation framework for Telstra is to provide the ACCC, access seekers and the public with greater transparency with respect to Telstra's wholesale and retail costs.[1]

This is intended to assist the ACCC in investigating conduct that may breach Part IV (restrictive trade practices) or Part XIB (the telecommunications industry: anti-competitive conduct and record-keeping rules) of the Act. This would include conduct such as predatory pricing, margin squeezing, cross-subsidisation and vertical cost shifting.[2] In such investigations, it is important to be able to carefully distinguish between wholesale costs and retail costs.

1.2 LIMITATIONS OF THE REPORTS

It should be noted that there are limitations associated with the information published in this report. In particular, the information captured under these arrangements is highly aggregated and can hide specific instances of anti-competitive behaviour. Further, accounting separation requires only a notional allocation of costs across wholesale and retail operations, and therefore does not contribute greatly to detecting and remedying specific occurrences of anti-competitive conduct. As a result, it does not completely remove

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[1] Department of Communications, Information Technology and the Arts, *Draft Direction on Telstra's accounting separation issued for public comment*, media release, 19 March 2003.

[2] See ACCC, *Current cost methodology for Telstra's subsequent reports under the accounting separation regime*, *framework document*, January 2004, pp. 8–9.

incentives for Telstra to favour its retail operations. It does not compel Telstra to ensure that it consistently applies equivalent treatment of its wholesale and retail customers in the normal course of business.

2. IMPUTATION REPORT

2.1 INTRODUCTION TO THE IMPUTATION RKR

This section presents the analysis of the imputation results of Telstra for the following residential and business services: local call and line rental; domestic and international long distance; fixed-to-mobile; the total bundle of fixed voice services; ADSL; and the total bundle of fixed voice and ADSL services. The imputation tests are conducted in accordance with an ACCC record keeping rule issued in September 2004.[3]

Imputation results based upon both historical and current cost are presented in the report. However, the analysis in the report focuses on the historical cost results. There is generally little difference between the imputation results based on historical cost and current cost measures.

The primary objective of the reports provided under the imputation RKR is to indicate whether Telstra is engaging in systematic price squeeze behaviour in relation to core telecommunications services.[4]

2.2 BACKGROUND

2.2.1 VERTICAL PRICE SQUEEZING

Telstra is a vertically integrated carrier that owns the delivery platform from which its services are supplied. Telstra supplies retail telecommunications services to end-users and wholesale access services to competing retail suppliers. For many telephony services, Telstra's retail competitors rely on wholesale supply from Telstra, such as access to the 'local loop' (such as origination and termination on the PSTN). The competitors then add network services (e.g. long-distance transmission for long-distance calls) and additional services to transform the core input into the retail service (e.g. billing or call centre support).

A vertical price squeeze may occur if Telstra reduces the margin between its price for a retail service, and the wholesale access price it charges for an essential input to that retail service. Telstra could reduce the margin by lowering the retail price for the service, raising the wholesale access price for the essential input, or doing both.

If the difference between the retail price and the wholesale access price is not sufficient to cover Telstra's network transformation and retail costs of supply, competitors who are equally efficient as Telstra in the supply of the retail services may not be able to remain in the market, as their profit margins would be negative. Imputation can therefore be used as a first step in detecting possible price squeezes in the retail market.

2.2.2 WHAT ARE THE ELEMENTS OF AN IMPUTATION TEST?

An imputation test compares:

- the price charged by Telstra for a particular retail service it supplies, and by other retail service providers who wish to supply the same retail service using Telstra's network.

[3] An earlier made RKR was revoked at this time as the data that was available to Telstra did not allow it to be fully implemented.

[4] Senator Richard Alston, *Government boost to telecommunications competition*, media release, 24 September 2002.

- the wholesale price charged by Telstra for access to its network, plus the additional costs incurred by Telstra, in transforming the essential input into the retail service.

Where the retail price is less than the sum of the wholesale access price and additional costs, the imputed margin is negative, which may indicate potential anti-competitive behaviour by Telstra.

2.2.3 LIMITATIONS OF IMPUTATION TEST RESULTS

The objective of imputation testing is to indicate whether Telstra is engaging in systemic price squeeze behaviour in relation to core telecommunications services.[5] However, a 'fail' result for an imputation test does not exclusively determine that Telstra has engaged in such behaviour.

There are a number of limitations of the imputation testing including:

- the imputation tests require allocations of common costs across wholesale and retail operations and across services. These can be arbitrary in nature.
- the costs of transformation reported under imputation testing are those of Telstra. A more efficient access seeker may be able to make a profit in providing a service even where the imputation margin is negative.
- for most Telstra services, the costs of transformation are higher than the access costs. Whether an access seeker can successfully compete with Telstra in the supply of these services is more likely dependent on its own efficiency as well as service quality and differentiation rather than the access price charged by Telstra.
- the data is highly aggregated and may not identify particular examples of price squeeze behaviour. The aggregated data may also hide that some access seekers may only target certain high value customers or may operate in lower cost areas.
- the imputation RKR uses average total cost in calculating the retail price as well as the cost of transforming Telstra's core service into a retail service. A retailer targeting niche services or customers may be able to make a profit in providing a service even where the imputation margin is negative.
- the bundles of fixed voice and fixed voice and ADSL services are notional bundles which are derived from the fixed-voice and ADSL data. These bundles may not accurately represent the bundles bought by consumers.
- there are certain data limitations. For example, imputation testing is conducted using cost data from the last available half-year Regulatory Accounting Framework report. This means that in the results for this September quarter 2012 imputation report, the unit cost data was obtained from the RAF data for the period January to June 2012. Further limitations of the data are examined in sections 2.6 and 2.7.

However, despite these limitations, the ACCC considers that the principles on which these imputation tests are based are sound. The ACCC believes that this imputation testing provides a useful indicator of whether Telstra is engaging in this price squeeze behaviour but it should not be solely relied upon.

2.3 THE IMPUTATION TESTS IN THIS RKR

In this report, imputation testing is conducted on the following retail services that use Telstra's core telecommunications services as inputs:

- local calls and line rental, which use the local carriage service (LCS)
- domestic long-distance calls, which use the public switched telephone network originating/terminating access (PSTN-O/T) services

[5] Senator Richard Alston, *Government boost to telecommunications competition*, media release, 24 September 2002.

- outgoing international calls, which use the public switched telephone network originating access (PSTN-O) services
- fixed-to-mobile calls, which use the PSTN-O services
- ADSL services, which use the unbundled local loop service (ULLS).

There are three main variables in an imputation test:

- the 'retail price' - the average retail price of each retail service, calculated by using the total revenue and volume data provided by Telstra
- the 'access price' - the volume-weighted average of the prices Telstra charges its access seekers for the underlying core service in relation to the retail service, and
- the 'unit cost' - the average total cost of transforming the core service into the relevant retail service.

The imputation RKR details how each variable is calculated. The results are presented in Tables 2.1 to 2.6 of this report.

Costs are derived from Telstra's reports under the RAF, which requires the allocation of direct and common costs across Telstra's services.

The costs attributed to 'retail services' in the RAF are the 'retail costs' used for the imputation tests. However, there are further costs incurred in transforming a core service to a retail service, such as the transmission costs. These are included under 'other costs' in the imputation results. The tests also separate out the cost of capital (i.e. the cost of holding the capital assets necessary to transform the core services) and ancillary charges (e.g. charges for access to Telstra's exchange).

The sum of the 'retail costs', 'other costs', 'ancillary charges' and 'cost of capital' per unit of retail service is the 'unit cost'.

The imputation RKR requires Telstra to provide data calculated on both a historical cost accounting basis and a current cost accounting basis.[6]

The ACCC and Telstra have agreed to certain procedures for addressing methodological issues about costs, as outlined in section 2.7.

The imputed margin for each retail service can then be calculated as follows:

- The 'imputed margin' is calculated by subtracting the 'access price' and 'unit cost' from the 'retail price' for each retail service. This 'imputed margin' (in dollar terms) represents the profit margin that could be available to Telstra's competitors in the retail markets, who are equally efficient as Telstra, if they supply the retail service to their customers using Telstra's core service.[7]
- The 'imputed margin' is further expressed as a percentage of the retail price.

2.4 RESULTS SUBMITTED BY TELSTRA

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[6] Under current cost accounting reporting, assets and liabilities are valued based on replacement costs, which are the present-day costs of acquiring an identical or substantially similar asset that could provide equivalent services and capacity as the existing asset. Replacement costs are based on current market values and current technology.

[7] As noted above, this margin is calculated after a contribution is made to 'common costs', that is, costs that are shared among multiple services.

2.4.1 CURRENT QUARTER RESULTS

In accordance with the ACCC's imputation testing RKRs, Telstra has submitted imputation reports in relation to the September 2012 quarter for both fixed-line voice telephony services and ADSL services. These reports are shown in the following Tables 2.1 to 2.6. Separate reports are presented based on historical accounting costs and current accounting costs.

TABLE 2.1 FIXED TELEPHONY REPORT FOR SEPTEMBER 2012 QUARTER ON HISTORIC COST BASIS

	Local carriage service		Domestic PSTN originating and terminating access services		Domestic PSTN originating access service				Total Bundle of Fixed Voice Products		
	Local calls and Line rental		Domestic long distance		International long distance		Fixed to mobile		Bundle		
	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Total
Revenues											
retail	203,506,331	391,829,700	21,978,320	75,451,231	2,761,699	17,835,763	59,934,030	113,567,989	288,180,379	598,684,683	886,865,062
other	0	0	0	0	0	0	0	0	0	0	0
total	203,506,331	391,829,700	21,978,320	75,451,231	2,761,699	17,835,763	59,934,030	113,567,989	288,180,379	598,684,683	886,865,062
Retail Costs											
organisation	20,845,951	48,945,838	1,461,086	5,474,212	299,157	2,856,026	4,044,396	6,505,162	26,650,590	63,781,238	90,431,828
product and consumer	21,497,977	50,193,856	2,059,522	7,716,357	762,565	7,280,134	18,970,846	30,513,442	43,290,910	95,703,789	138,994,699
total	42,343,927	99,139,694	3,520,607	13,190,569	1,061,723	10,136,159	23,015,242	37,018,604	69,941,500	159,485,027	229,426,527
Other Costs											
organisation	0	0	415,999	1,558,615	19,172	183,036	-96,500	-155,214	338,672	1,586,436	1,925,108
product and consumer	0	0	36,452	136,574	3,820	36,470	-16,540	-26,604	23,732	146,440	170,172
network expenses	0	0	1,079,587	4,044,860	43,436	414,679	-239,497	-385,216	883,526	4,074,323	4,957,849
total	0	0	1,532,038	5,740,049	66,428	634,186	-352,538	-567,035	1,245,929	5,807,200	7,053,129
Ancillary*	N/A	N/A	246,746	924,476	5,551	52,991	146,254	235,240	398,550	1,212,707	1,611,258
Cost of Capital	8,223,284	19,285,535	1,409,743	5,281,847	177,555	1,695,096	1,897,011	3,051,226	11,707,593	29,313,704	41,021,297
Retail Volume*	2,023,885	4,883,588	201,014,227	753,134,853	9,043,711	86,339,403	238,294,813	383,282,581			
Retail price	$100.552	$80.234	$0.109	$0.100	$0.3054	$0.2066	$0.2515	$0.2963	$142.3897	$122.5912	$128.3921
Access price	$83.805	$71.847	$0.019	$0.019	$0.0094	$0.0093	$0.0099	$0.0097	$86.9176	$75.6674	$78.9637
Unit cost	$24.985	$24.250	$0.033	$0.033	$0.1450	$0.1450	$0.1037	$0.1037	$41.1553	$40.0973	$40.4073
Imputed margin	-$8.238	-$15.863	$0.057	$0.048	$0.1509	$0.0523	$0.1379	$0.1830	$14.3168	$6.8264	$9.0211
Imputed margin %	-8.19%	-19.77%	51.97%	47.94%	49.43%	25.29%	54.83%	61.75%	10.05%	5.57%	7.03%

TABLE 2.2: FIXED TELEPHONY REPORT FOR SEPTEMBER 2012 QUARTER ON CURRENT COST BASIS

	Local carriage service		Domestic PSTN originating and terminating access services		Domestic PSTN originating access service				Total Bundle of Fixed Voice Products		
	Local calls and Line rental		Domestic long distance		International long distance		Fixed to mobile		Bundle		
	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Total
Revenues											
retail	203,506,331	391,829,700	21,978,320	75,451,231	2,761,699	17,835,763	59,934,030	113,567,989	288,180,379	598,684,683	886,865,062
other	0	0	0	0	0	0	0	0	0	0	0
total	203,506,331	391,829,700	21,978,320	75,451,231	2,761,699	17,835,763	59,934,030	113,567,989	288,180,379	598,684,683	886,865,062
Retail Costs											
organisation	20,592,630	48,350,786	1,441,839	5,402,101	296,234	2,828,113	3,994,363	6,424,687	26,325,065	63,005,687	89,330,752
product and consumer	21,492,883	50,181,891	2,059,135	7,714,907	762,506	7,279,572	18,969,840	30,511,824	43,284,364	95,688,194	138,972,558
total	42,085,513	98,532,677	3,500,974	13,117,008	1,058,740	10,107,685	22,964,203	36,936,511	69,609,430	158,693,881	228,303,311
Other Costs											
organisation	0	0	384,905	1,442,114	18,006	171,903	-94,059	-151,289	308,852	1,462,729	1,771,580
product and consumer	0	0	35,827	134,231	3,797	36,247	-16,491	-26,525	23,132	143,953	167,085
network expenses	0	0	1,079,587	4,044,860	43,436	414,679	-239,497	-385,216	883,526	4,074,323	4,957,849
total	0	0	1,500,319	5,621,206	65,239	622,829	-350,048	-563,030	1,215,510	5,681,005	6,896,515
Ancillary*	N/A	N/A	246,746	924,476	5,551	52,991	146,254	235,240	398,550	1,212,707	1,611,258
Cost of Capital	8,167,804	19,155,211	1,429,464	5,355,735	177,587	1,695,408	1,861,981	2,994,882	11,636,835	29,201,236	40,838,071
Retail Volume*	2,023,885	4,883,588	201,014,227	753,134,853	9,043,711	86,339,403	238,294,813	383,282,581			
Retail price	$100.552	$80.234	$0.109	$0.100	$0.3054	$0.2066	$0.2515	$0.2963	$142.3897	$122.5912	$128.3921
Access price	$83.805	$71.847	$0.019	$0.019	$0.0094	$0.0093	$0.0099	$0.0097	$86.9176	$75.6674	$78.9637
Unit cost	$24.830	$24.099	$0.033	$0.033	$0.1445	$0.1445	$0.1033	$0.1033	$40.9412	$39.8864	$40.1955
Imputed margin	-$8.083	-$15.712	$0.057	$0.048	$0.1514	$0.0527	$0.1383	$0.1833	$14.5308	$7.0373	$9.2329
Imputed margin %	-8.04%	-19.58%	52.11%	48.09%	49.5776%	25.5162%	54.9694%	61.8647%	10.2050%	5.7405%	7.1912%

Notes to Tables 2.1 and 2.2

* All retail volumes are reported in minutes with the exception of the local carriage service where volumes are in SIOs.

TABLE 2.3 ULLS REPORT FOR SEPTEMBER 2012 QUARTER ON HISTORIC COST BASIS

	Unconditioned Local Loop Service		Unconditioned Local Loop Service	
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and fixed to mobile	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service + 1 x Voice Lines
Revenues				
retail	65,829,561	262,845,061	217,733,184	475,208,252
other	0	0	0	0
total	65,829,561	262,845,061	217,733,184	475,208,252
Retail Costs				
organisation	4,264,045	27,695,701	18,311,917	50,319,944
product and consumer	5,438,738	35,325,535	28,257,940	69,273,224
total	9,702,784	63,021,236	46,569,857	119,593,168
Other Costs				
organisation	6,737,706	43,762,549	9,037,144	49,852,742
product and consumer	639,066	4,150,840	6,183,473	12,572,223
network expenses	14,496,560	94,157,633	43,332,228	142,806,583
total	21,873,332	142,071,022	58,552,846	205,231,548
Ancillary Charges (TEBA)	1,516,248	9,848,292	1,568,769	10,278,459
Cost of Capital	6,499,527	42,215,537	38,366,273	95,578,757
Retail Volume	266,704	1,732,288	266,704	1,732,288
Retail price	$246.8263	$151.7329	$816.3851	$274.3240
Access price	$51.3208	$51.3208	$67.4744	$56.7237
Unit cost	$148.4488	$148.4488	$543.8904	$248.6203
Imputed margin	$47.0567	-$48.0367	$205.0203	-$31.0200
Imputed margin %	19.0647%	-31.6587%	25.1132%	-11.3078%

TABLE 2.4 ULLS REPORT FOR SEPTEMBER 2012 QUARTER ON CURRENT COST BASIS

	Unconditioned Local Loop Service		Unconditioned Local Loop Service	
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and fixed to mobile	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service + 1 x Voice Lines
Revenues				
retail	65,829,561	262,845,061	217,733,184	475,208,252
other	0	0	0	0
total	65,829,561	262,845,061	217,733,184	475,208,252
Retail Costs				
organisation	4,210,067	27,345,105	18,086,351	49,694,246
product and consumer	5,437,696	35,318,761	28,253,447	69,260,919
total	9,647,763	62,663,866	46,339,798	118,955,166
Other Costs				
organisation	6,911,213	44,889,507	10,341,607	52,616,451
product and consumer	642,554	4,173,501	6,209,703	12,627,795
network expenses	14,496,560	94,157,633	43,332,228	142,806,583
total	22,050,328	143,220,641	59,883,539	208,050,829
Ancillary Charges (TEBA)	1,516,248	9,848,292	1,568,769	10,278,459
Cost of Capital	1,764,580	11,461,248	54,234,534	99,806,228
Retail Volume	266,704	1,732,288	266,704	1,732,288
Retail price	$246.8263	$151.7329	$816.3851	$274.3240
Access price	$51.3208	$51.3208	$67.4744	$56.7237
Unit cost	$131.1526	$131.1526	$607.5148	$252.3199
Imputed margin	$64.3529	-$30.7405	$141.3959	-$34.7195
Imputed margin %	26.0721%	-20.2596%	17.3198%	-12.6564%

Notes to Tables 2.3 and 2.4

* As per instructions from the ACCC, ancillary charges are calculated as TEBA revenues per ULL service that are reasonably expected in a mature market. This is calculated as the TEBA revenue for the September quarter divided by the adjusted number of installed tie cable pairs. The adjustment factor set by the ACCC is 66%.

**Retail volumes are reported in terms of SIOs.

TABLE 2.5 ADJUSTED ULLS REPORT FOR SEPTEMBER 2012 QUARTER ON HISTORIC COST BASIS

	Unconditioned Local Loop Service		Unconditioned Local Loop Service	
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and fixed to mobile	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service + 1 x Voice Lines
Revenues				
retail	65,829,561	262,845,061	217,733,184	475,208,252
other	0	0	0	0
total	65,829,561	262,845,061	217,733,184	475,208,252
Retail Costs				
organisation	4,264,045	27,695,701	18,311,917	50,319,944
product and consumer	5,438,738	35,325,535	28,257,940	69,273,224
total	9,702,784	63,021,236	46,569,857	119,593,168
Other Costs				
organisation	6,737,706	43,762,549	9,037,144	49,852,742
product and consumer	639,066	4,150,840	6,183,473	12,572,223
network expenses	14,496,560	94,157,633	43,332,228	142,806,583
total	21,873,332	142,071,022	58,552,846	205,231,548
Ancillary Charges (TEBA)	1,516,248	9,848,292	1,568,769	10,278,459
Cost of Capital	6,499,527	42,215,537	38,366,273	95,578,757
Retail Volume	266,704	1,732,288	266,704	1,732,288
Retail price	$246.8263	$151.7329	$816.3851	$274.3240
Access price	$51.3208	$51.3208	$64.8355	$55.6469
Unit cost	$148.4488	$148.4488	$543.8904	$248.6203
Imputed margin	$47.0567	-$48.0367	$207.6592	-$29.9431
Imputed margin %	19.0647%	-31.6587%	25.4364%	-10.9152%

TABLE 2.6: ADJUSTED ULLS REPORT FOR SEPTEMBER 2012 QUARTER ON CURRENT COST BASIS

	Unconditioned Local Loop Service		Unconditioned Local Loop Service	
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and fixed to mobile	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service + 1 x Voice Lines
Revenues				
retail	65,829,561	262,845,061	217,733,184	475,208,252
other	0	0	0	0
total	65,829,561	262,845,061	217,733,184	475,208,252
Retail Costs				
organisation	4,210,067	27,345,105	18,086,351	49,694,246
product and consumer	5,437,696	35,318,761	28,253,447	69,260,919
total	9,647,763	62,663,866	46,339,798	118,955,166
Other Costs				
organisation	6,911,213	44,889,507	10,341,607	52,616,451
product and consumer	642,554	4,173,501	6,209,703	12,627,795
network expenses	14,496,560	94,157,633	43,332,228	142,806,583
total	22,050,328	143,220,641	59,883,539	208,050,829
Ancillary Charges (TEBA)	1,516,248	9,848,292	1,568,769	10,278,459
Cost of Capital	1,764,580	11,461,248	54,234,534	99,806,228
Retail Volume	266,704	1,732,288	266,704	1,732,288
Retail price	$246.8263	$151.7329	$816.3851	$274.3240
Access price	$51.3208	$51.3208	$64.8355	$55.6469
Unit cost	$131.1526	$131.1526	$607.5148	$252.3199
Imputed margin	$64.3529	-$30.7405	$144.0348	-$33.6427
Imputed margin %	26.0721%	-20.2596%	17.6430%	-12.2639%

Notes to Tables 2.5 and 2.6

* As per instructions from the ACCC, ancillary charges are calculated as TEBA revenues per ULL service that are reasonably expected in a mature market. This is calculated as the TEBA revenue for the December quarter divided by the adjusted number of installed tie cable pairs. The adjustment factor set by the ACCC is 66%.

**Retail volumes are reported in terms of SIOs

2.5 SUMMARY OF RESULTS

2.5.1 OVERVIEW

RESULTS FOR THE QUARTER

Table 2.1 provides a summary of the imputation test results (on a historic cost basis) for Telstra for the September 2012 quarter. A discussion of results in relation to the specific retail services is provided in sections 2.5.2 to 2.5.8.

TABLE 2.7: TELSTRA IMPUTATION TESTING RESULTS (ON A HISTORICAL COST BASIS)

Retail service	Core service(s)		Sep 11	Dec 11	Mar 12	Jun 12	Sep 12	
Local calls and line rental	**LCS**	Business	-25%	-16%	-9%	-8%	-8%	Fail
		Residential	-21%	-14%	-20%	-20%	-20%	Fail
Domestic long-distance	**PSTN–O/T**	Business	52%	58%	55%	52%	52%	Pass
		Residential	51%	55%	53%	50%	48%	Pass
International long-distance	**PSTN–O**	Business	51%	48%	54%	54%	50%	Pass
		Residential	25%	21%	37%	35%	26%	Pass
Fixed-to-mobile	**PSTN–O**	Business	43%	44%	42%	46%	55%	Pass
		Residential	56%	57%	53%	57%	62%	Pass
Bundle of fixed voice services #	**LCS and PSTN–O/T**	Business	-2%	3%	8%	8%	10%	Pass
		Residential	6%	11%	7%	6%	6%	Pass
		Total	4%	9%	7%	7%	7%	Pass
ADSL	**ULLS**	Business	3%	4%	11%	12%	19%	Pass
		Residential	-54%	-52%	-44%	-41%	-32%	Fail
Bundle of ADSL and fixed voice services *	**ULLS and PSTN–T**	Business	15%	18%	20%	21%	25%	Pass
		Residential	-20%	-18%	-17%	-17%	-11%	Fail

The bundle of fixed voice services comprises local calls and line rental, domestic and international long-distance and fixed-to-mobile calls.

* The bundle for business customers is assumed to contain one ADSL service and four fixed-voice services, while the bundle for residential customers is assumed to consist of one ADSL service and one fixed-voice service.

Key findings for the September 2012 quarter are:

- Overall, the results are largely consistent with the previous quarter’s results.
- Telstra passed 11 out of 15 imputation tests.
- Margins increased for seven out of 15 imputation tests and margins remained at the same level for five out of 15 tests since the June 2012 quarter.
- Margins for local calls and line rental services for both residential and business customers remain negative.
- Telstra continued to fail the imputation test for standalone ADSL services for residential customers; however, margins improved moderately for both residential and business customer groups.
- Telstra continued to fail the test for a bundle of ADSL and fixed voice services for residential customers, although the margins improved since the last quarter.
- Telstra continued to pass the test for bundled fixed voice services for both customer groups with improved margins for business customers since the June quarter.

ACCESS PRICES OVER FOUR QUARTERS

Retail, access prices, and the costs of transformation (unit costs) are reported in the imputation tests on an average per unit basis. As such, changes in these prices can be due to changes in underlying revenues and/or volumes (e.g. the number of local calls per service in operation), the access price or the costs of transformation.

Telstra's estimates of the average access prices for the core services in relation to imputation testing are represented in Figures 2.1 and 2.2 below.

Figure 2.1 shows that the access price for local calls and line rentals has increased slightly in the September 2012 quarter. However, the overall trend since December 2010 is negative. The decline in the access price for the previous quarters followed the access price cuts for wholesale line rental (WLR) and the local carriage service (LCS) announced by the ACCC in its interim access determination in March 2011. The ACCC then issued its final access determination for these services in July 2011.

FIGURE 2.1: AVERAGE ACCESS PRICES FOR CORE SERVICES USED IN LOCAL CALLS/LINE RENTAL AND FIXED VOICE BUNDLED SERVICES

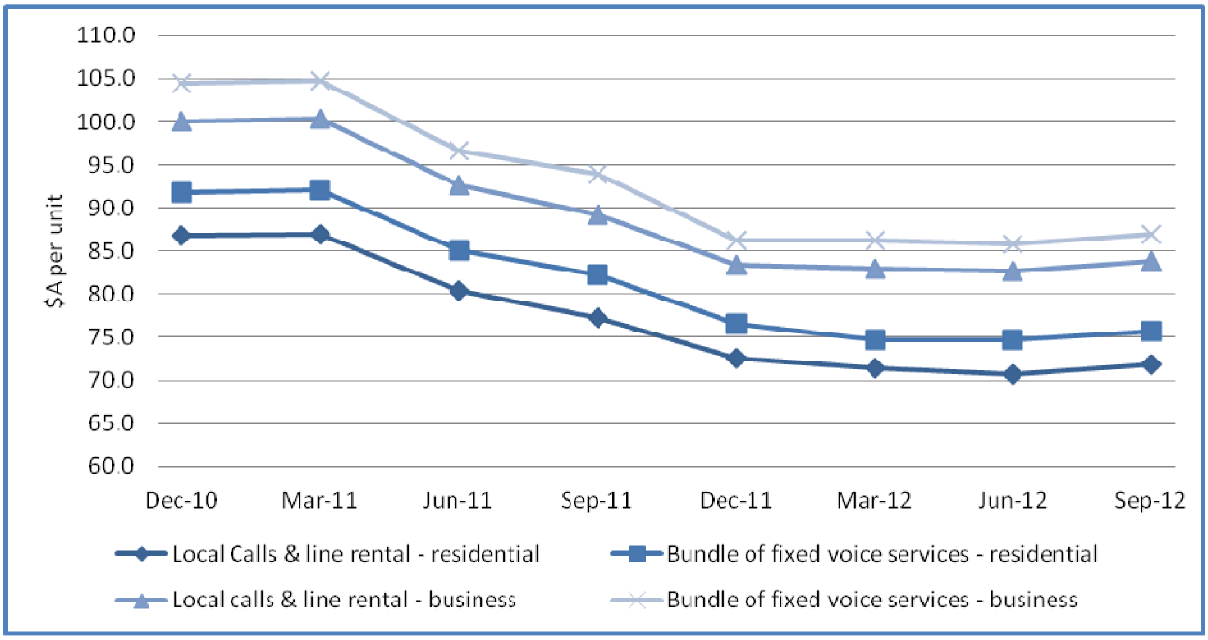
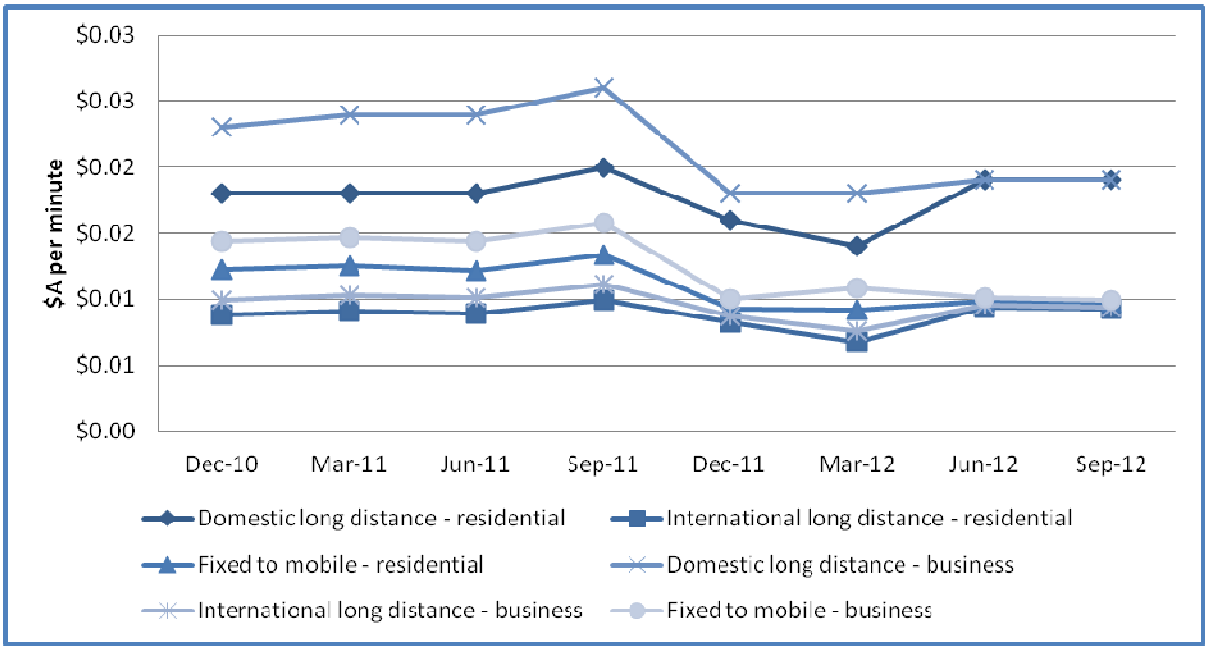


Figure 2.2 shows movements in average access prices for long distance call and fixed-to-mobile call services. Average access prices remained stable in the September 2012 quarter.

FIGURE 2.2: AVERAGE ACCESS PRICES FOR CORE SERVICES USED IN SUPPLYING DOMESTIC & INTERNATIONAL LONG-DISTANCE AND FTM CALL SERVICES



The PSTN originating/terminating services are the underlying core services for the services shown in Figure 2.2. Average PSTN originating and terminating prices are dependent upon call hold times and the geographic area in which calls are supplied. Changes in reported PSTN-O/T prices can therefore be caused by changes in traffic characteristics as well as changes in the underlying rates/prices for PSTN-O/T services.

2.5.2 LINE RENTAL AND LOCAL CALLS

Telstra has reported negative imputed margins for the supply of local calls and line rental for both residential and business customer groups in the September 2012 quarter. Telstra has failed the imputation test for the local call and line rental services since reporting commenced.

In the September 2012 quarter, the imputed margin for both business and residential customers remained at the same level as in the June 2012 quarter.

2.5.3 DOMESTIC AND INTERNATIONAL LONG-DISTANCE AND FIXED-TO-MOBILE CALLS

For domestic long-distance calls, international long-distance calls and fixed-to-mobile calls, Telstra again passed the imputation test for the September 2012 quarter with big positive margins.

In relation to margins for fixed-to-mobile services, it is assumed that Telstra's fixed-to-mobile calls are terminated off-net, that is, on a mobile network other than Telstra's own mobile network. The ACCC estimates that the cost Telstra incurs to terminate a fixed-to-mobile call on its own network is less than that currently charged by other mobile network operators for the mobile terminating access service. To the extent that access seekers can terminate calls on their own networks, the margins available to access seekers may be understated. This qualification is also relevant to the bundles that include fixed-to-mobile calls.

2.5.4 BUNDLE OF FIXED VOICE SERVICES

Imputation testing has also been undertaken for a notional bundle of fixed-line voice services, consisting of line rental and local, domestic and international long-distance and fixed-to-mobile calls.

Telstra passed the imputation test for both business and residential customers in the September 2012 quarter. Margins for business customers improved by two percentage points while the margin for residential customers remained the same.

2.5.5 ADSL

The margins for ADSL standalone services for both residential and business customers improved compared to the previous quarter. The margin for residential customers remained significantly negative (i.e.-32 per cent), but increased by nine percentage points from the June 2012 quarter. The margin for business customers was 19 per cent, up by seven percentage points from the previous quarter.

In assessing the reported cost, it should be noted that the test excludes costs associated with the installation, removal or connection of equipment to/from customer premises.

In considering the difference in results between customer groups, the following factors should also be considered:

- the customer groups are now being determined based on the basic-access product code for the line on which the ADSL service is supplied.[8]
- the revenues for BigPond services are averaged across customer groups. Consequently costs and revenues are not allocated to each group. For example, if one class of customers generally subscribes to higher-priced BigPond plans, the reported results would understate the revenues earned from that customer group and overstate the revenues received from other customer groups.
- as the RAF does not disaggregate costs between customer groups, the costs are averaged over each customer group's demand for the service.

In considering whether the reported imputation results for the ULLS provide an accurate indication of market conditions faced by ULLS access seekers, the factors outlined in 2.2.3 should be considered as well as:

- that the test focuses on the use of ULLS to supply ADSL, but other retail services can be supplied in conjunction with ULLS (e.g. local and long-distance calls) that may yield significantly higher retail revenues.
- on the other hand, the reported imputation tests exclude connection costs and revenues—should access seekers subsidise connections to acquire customers, their actual margins would be less (i.e. more negative) than those reported.

Despite the qualifications above, the results suggest that any business model involving the use of ULLS to supply only ADSL to residential customers is unlikely to be sustainable. The tests that combine ADSL and voice services may therefore more accurately reflect current market conditions.

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[8] Initially, these groups were populated on the basis of unaudited survey data collected by Telstra when the customer first connects the ADSL service. The ACCC considers the current method to be more robust than that previously used. For the June quarter 2006 report and future reports, Telstra made further corrections to its procedure in allocating retail revenues to its business and residential customers to fully align the procedure with Telstra's Regulatory Procedure Manual for imputation testing.

It should also be remembered that other wholesale inputs in addition to the ULLS, including wholesale ADSL services, would be available to service providers that wish to supply retail ADSL. That said, the attributes of these other wholesale inputs will differ.

2.5.6 BUNDLE OF ADSL AND FIXED VOICE SERVICES

Imputation tests have been undertaken on two types of notional bundles of ADSL and fixed voice services (comprising local calls, line rental, domestic and international long-distance calls and fixed-to-mobile calls).

The first bundle is the bundle of ADSL and fixed voice services for residential customers, which comprises one ADSL service and one voice service. Telstra failed the imputation test for this bundle, with a negative 11 per cent margin.

The second bundle is the bundle of ADSL and fixed voice services for business customers, which comprises one ADSL service and four voice services. Telstra passed the imputation test for this bundle with the imputed margin increasing from 21 per cent to 25 per cent in the September 2012 quarter.

Given the bundle of ADSL and fixed voice services is made up of the ADSL service and voice services, the reasons outlined for failing the stand-alone ADSL imputation test (as discussed in 2.2.3 and 2.5.5) are also relevant for Telstra failing the bundle of ADSL and fixed voice service for residential customers. Likewise the assumption that in the calculation of imputation margins, all fixed-to-mobile calls are terminated off-net, as outlined in section 2.5.3, is not necessarily the case. This means that the profit available to access seekers for this service is likely to be understated.

Also, the imputation test assumes that the costs of supply of the voice services in this bundle would be in line with costs of supply of voice services over the PSTN. Service providers wishing to supply voice services and broadband services over the PSTN could choose to do so by using voice over broadband, data or Internet protocol (IP) alternatives. This may result in significantly lower costs than those reported in the current tests.

The ACCC again notes that these tests focus on the use of ULLS to supply ADSL and voice services, but that other wholesale inputs may be used. Additionally, use of the ULLS core service enables a wide range of retail services, not limited to just ADSL and the aforementioned voice services, to be supplied.

However, the results indicate that, in the absence of market developments, the use of the ULLS to supply competitive services will likely be limited to areas in which costs of supply are lower. The services are able to be directed to customers who yield higher revenues per service supplied, as compared with the average revenue and cost estimates used in these tests.

Market developments that could expand the scope of services that could reasonably be expected to be supplied would include the supply of other services over the ULLS. These include pay TV, IPTV, higher speed/quality DSL services, other multi-media services or reductions in access prices or other cost inputs.

The results of these imputation tests indicate that it is not simply the access price of the ULLS that is likely to be driving the imputation test results. This is because the costs incurred in transforming the ULLS into ADSL are much higher than the access price.

Telstra has provided additional imputation results for the ULLS/ADSL and voice services bundle that are prepared on the basis that certain geographically averaged transformation costs are replaced by costs specific to the geographic areas where ULLS is currently being supplied.[9]

The transformation costs that have been substituted concern the costs of termination of local calls that originate on an access seeker's ULLS. Table 2.8 sets out the unadjusted and adjusted results.

TABLE 2.8: SUMMARY OF IMPUTED MARGINS WHEN LOCAL CALL TERMINATION CHARGES ARE ESTIMATED ON A GEOGRAPHIC-SPECIFIC BASIS, SEPTEMBER QUARTER 2012

	ULLS Test	Business: 1 ADSL + 4 voice lines	Residential: 1 ADSL + 1 voice line
Historic Cost Basis	Unadjusted	25.11%	-11.31%
	Adjusted	25.44%	-10.92%
Current Cost Basis	Unadjusted	17.32%	-12.66%
	Adjusted	17.64%	-12.26%

While some of the assumptions on which these additional results have been derived could bear closer scrutiny, it is likely that the reported results are broadly indicative of the effect of using geographically specific local call termination costs instead of fully distributed average termination costs in these imputation tests.

2.6 RECONCILING IMPUTATION RKR DATA WITH THE RAF

Telstra prepares its imputation reports each quarter. In doing so, for each of the retail services subject to imputation testing, Telstra uses revenue and volume data for the quarter to obtain the average retail price and average access price, and uses RAF data to obtain average unit costs.

Ideally, the imputation test results would be based on retail price, access price and unit cost figures appropriate to the quarter. Telstra is able to obtain retail price and access price data from its management systems on a quarterly basis. However, the RAF report is published twice a year only (i.e. for the January–June and July–December reporting periods) and is not available until after the imputation testing results must be submitted to the ACCC. Imputation testing is therefore conducted using cost data from the last available half-year RAF report. For example, for this September 2012 quarter imputation report, the unit cost data was obtained from the RAF data for the period January to June 2012.

Reconciliation reports are prepared every six months to check whether the accuracy of the imputed margins disclosed in the quarterly reports is affected by the use of lagged RAF cost data and current-quarter revenue and volume data. These reconciliation reports compare the results shown in the quarterly reports (which use management system and lagged RAF data) to results obtained using revenue, volume and cost data from the RAF appropriate to the test period.

Telstra has provided the ACCC with a reconciliation report for the January to June 2012 period.

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[9] The ULLS is predominantly supplied in urban areas (bands 1 and 2) with few services supplied outside those areas (bands 3 and 4). Telstra advised that as at 31 June 2012 around four per cent of ULLS were supplied in band 1, and 94 per cent in band 2. Source: Telstra CAN RKR Data June 2012.

2.6.1 SUMMARY OF RECONCILIATION RESULTS

Telstra's latest reconciliation report shows that imputed margins for individual fixed voice services vary slightly when using the matching RAF data compared to using the lagged RAF data. However, the use of June 2012 RAF data to calculate the imputation margins for the January to June half 2012 shows that the previously reported total margin for fixed-voice services was only overstated by 2.85 percentage points (Table 2.11). This suggests that although the use of lagged data appears to under or overestimates the imputation margins of individual fixed voice services, when an overall imputation margin is calculated for fixed voice services these overestimations and underestimations in margins nearly cancel each other out.

Significant difference occurred with the Fixed to Mobile service. When imputation margins for this service were calculated using the June 2012 RAF data, the business sector margin was 8.62 percentage points higher and the residential sector margin was 6.97 percentage points higher compared with the margins calculated using the December 2011 RAF data.

TABLE 2.9: TELSTRA'S IMPUTED HISTORIC COST HALF YEAR MARGINS (BUSINESS) APPLYING THE DECEMBER 2011 AND JUNE 2012 RAF

	Access Rental & Local Calls	Domestic Long-Distance	International Long-Distance	Fixed to Mobile	Bundle of Access Rental and all call services
Business (June 2012 RAF)	-6.49%	51.65%	47.21%	52.65%	11.15%
Business (December 2011 RAF)	-8.74%	53.17%	54.08%	44.03%	7.93%
Difference	**2.25%**	**-1.52%**	**-6.87%**	**8.62%**	**3.22%**

TABLE 2.10: TELSTRA'S IMPUTED HISTORIC COST HALF YEAR MARGINS (RESIDENTIAL) APPLYING THE DECEMBER 2011 AND JUNE 2012 RAF

	Access Rental & Local Calls	Domestic Long-Distance	International Long-Distance	Fixed to Mobile	Bundle of Access Rental and all call services
Residential (June 2012 RAF)	-17.48%	50.05%	26.61%	61.96%	8.85%
Residential (December 2011 RAF)	-20.23%	51.70%	36.20%	54.99%	6.17%
Difference	**2.75%**	**-1.65%**	**-9.59%**	**6.97%**	**2.68%**

TABLE 2.11: TELSTRA'S IMPUTED HISTORIC COST HALF YEAR MARGINS (TOTAL) APPLYING THE DECEMBER 2011 AND JUNE 2012 RAF

	Total Imputation Margins
Total Imputation Margin (June 2012 RAF)	9.58%
Total Imputation Margin (December 2011 RAF)	6.73%
Difference	**2.85%**

TABLE 2.12: TELSTRA'S IMPUTED HISTORIC COST HALF YEAR MARGINS APPLYING THE DECEMBER 2011 AND JUNE 2012 RAF – ADSL AND BUNDLE OF ADSL AND VOICE SERVICES

	Standalone ADSL (Business)	Standalone ADSL (Residential)	Bundle of ADSL and voice services (Business)	Bundle of ADSL and voice services (Residential)
Total Imputation Margin (June 2012 RAF)	16.80%	-33.58%	24.51%	-10.78%
Total Imputation Margin (December 2011 RAF)	11.46%	-42.14%	20.61%	-16.64%
Difference	**5.34%**	**8.56%**	**3.90%**	**5.86%**

* Residential bundle is 1 ADSL service and 1 PSTN line, the Business bundle is 1 ADSL service and 4 PSTN lines

TABLE 2.13: FIXED TELEPHONY RECONCILIATION REPORT FOR JANUARY TO JUNE 2012 ON HISTORIC COST BASIS (APPLYING JUNE 2012 RAF)

	Local carriage service		Domestic PSTN originating and terminating access services		Domestic PSTN originating access service				Total Bundle of Fixed Voice Products		
	Local calls and Line rental		Domestic long distance		International long distance		Fixed to mobile		Bundle		
	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Total
Revenues											
retail	416,035,636	811,640,305	46,139,002	165,302,346	5,684,479	38,353,139	126,915,435	261,298,300	594,774,552	1,276,594,090	1,871,368,642
other	0	0	0	0	0	0	0	0	0	0	0
total	416,035,636	811,640,305	46,139,002	165,302,346	5,684,479	38,353,139	126,915,435	261,298,300	594,774,552	1,276,594,090	1,871,368,642
Retail Costs											
organisation	42,487,829	100,665,278	3,117,799	12,089,840	646,447	6,083,984	8,326,133	13,855,685	54,578,209	132,694,787	187,272,996
product and consumer	43,858,091	103,366,324	4,394,797	17,041,636	1,647,822	15,508,338	43,141,084	71,997,089	93,041,794	207,913,387	300,955,181
total	86,345,920	204,031,602	7,512,596	29,131,476	2,294,270	21,592,321	51,467,217	85,852,775	147,620,002	340,608,174	488,228,177
Other Costs											
organisation	0	0	887,698	3,442,212	41,429	389,908	-198,663	-330,599	730,464	3,501,521	4,231,985
product and consumer	0	0	77,785	301,625	8,255	77,690	-34,051	-56,665	51,988	322,650	374,638
network expenses	0	0	2,303,722	8,933,106	93,861	883,361	-493,049	-820,493	1,904,533	8,995,975	10,900,508
total	0	0	3,269,204	12,676,943	143,545	1,350,960	-725,763	-1,207,757	2,686,986	12,820,146	15,507,132
Ancillary*	N/A	N/A	512,641	1,983,974	11,684	109,795	293,235	487,158	817,559	2,580,927	3,398,486
Cost of Capital	16,763,839	39,674,625	3,008,239	11,665,000	383,677	3,610,940	3,905,347	6,498,966	24,061,101	61,449,531	85,510,632
Retail Volume*	2,052,917	4,990,736	428,942,650	1,663,304,240	19,542,498	183,922,537	490,573,724	816,373,589			
Retail price	$202.656	$162.629	$0.108	$0.099	$0.2909	$0.2085	$0.2587	$0.3201	$289.7216	$255.7927	$265.6815
Access price	$165.590	$142.227	$0.019	$0.016	$0.0086	$0.0081	$0.0105	$0.0095	$172.0834	$149.5128	$156.0911
Unit cost	$50.226	$48.832	$0.033	$0.033	$0.1450	$0.1450	$0.1120	$0.1122	$85.3350	$83.6467	$84.1388
Imputed margin	-$13.161	-$28.429	$0.056	$0.050	$0.1373	$0.0555	$0.1362	$0.1983	$32.3033	$22.6332	$25.4516
Imputed margin %	-6.4941%	-17.4811%	51.6486%	50.0499%	47.2097%	26.6132%	52.6492%	61.9595%	11.1498%	8.8483%	9.5797%

TABLE 2.14: FIXED TELEPHONY RECONCILIATION REPORT FOR JANUARY TO JUNE 2012 ON CURRENT COST BASIS (APPLYING JUNE 2012 RAF)

	Local carriage service		Domestic PSTN originating and terminating access services		Domestic PSTN originating access service				Total Bundle of Fixed Voice Products		
	Local calls and Line rental		Domestic long distance		International long distance		Fixed to mobile		Bundle		
	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Total
Revenues											
retail	416,035,636	811,640,305	46,139,002	165,302,346	5,684,479	38,353,139	126,915,435	261,298,300	594,774,552	1,276,594,090	1,871,368,642
other	0	0	0	0	0	0	0	0	0	0	0
total	416,035,636	811,640,305	46,139,002	165,302,346	5,684,479	38,353,139	126,915,435	261,298,300	594,774,552	1,276,594,090	1,871,368,642
Retail Costs											
organisation	41,971,555	99,441,579	3,076,729	11,930,582	640,129	6,024,522	8,223,130	13,684,276	53,911,543	131,080,960	184,992,502
product and consumer	43,847,709	103,341,718	4,393,971	17,038,434	1,647,695	15,507,142	43,139,013	71,993,643	93,028,388	207,880,936	300,909,325
total	85,819,264	202,783,297	7,470,700	28,969,016	2,287,825	21,531,664	51,362,143	85,677,919	146,939,931	338,961,896	485,901,827
Other Costs											
organisation	0	0	821,346	3,184,920	38,909	366,193	-193,639	-322,238	666,617	3,228,875	3,895,492
product and consumer	0	0	76,451	296,451	8,204	77,213	-33,950	-56,497	50,705	317,168	367,872
network expenses	0	0	2,303,722	8,933,106	93,861	883,361	-493,049	-820,493	1,904,533	8,995,975	10,900,508
total	0	0	3,201,518	12,414,477	140,974	1,326,768	-720,638	-1,199,228	2,621,855	12,542,017	15,163,872
Ancillary*	N/A	N/A	512,641	1,983,974	11,684	109,795	293,235	487,158	817,559	2,580,927	3,398,486
Cost of Capital	16,650,768	39,406,619	3,050,321	11,828,183	383,747	3,611,604	3,833,230	6,378,955	23,918,066	61,225,361	85,143,427
Retail Volume*	2,052,917	4,990,736	428,942,650	1,663,304,240	19,542,498	183,922,537	490,573,724	816,373,589			
Retail price	$202.656	$162.629	$0.108	$0.099	$0.2909	$0.2085	$0.2587	$0.3201	$289.7216	$255.7927	$265.6815
Access price	$165.590	$142.227	$0.019	$0.016	$0.0086	$0.0081	$0.0105	$0.0095	$172.0834	$149.5128	$156.0911
Unit cost	$49.914	$48.528	$0.033	$0.033	$0.1445	$0.1445	$0.1116	$0.1119	$84.9023	$83.2162	$83.7076
Imputed margin	-$12.849	-$28.126	$0.056	$0.050	$0.1378	$0.0560	$0.1366	$0.1987	$32.7360	$23.0637	$25.8828
Imputed margin %	-6.3403%	-17.2942%	51.7949%	50.2083%	47.3671%	26.8327%	52.7847%	62.0691%	11.2991%	9.0166%	9.7420%

Notes to Tables 2.13 and 2.14

* All retail volumes are reported in minutes with the exception of the local carriage service where volumes are in SIOs.

TABLE 2.15: ULLS RECONCILIATION REPORT FOR JANUARY TO JUNE 2012 ON HISTORIC COST BASIS (APPLYING JUNE 2012 RAF)

	Unconditioned Local Loop Service		Unconditioned Local Loop Service	
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and fixed to mobile	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service + 1 x Voice Lines
Revenues				
retail	132,604,900	505,259,024	454,160,502	939,302,966
other	0	0	0	0
total	132,604,900	505,259,024	454,160,502	939,302,966
Retail Costs				
organisation	8,871,799	54,270,052	38,377,431	99,389,730
product and consumer	11,315,873	69,220,800	61,636,364	139,879,318
total	20,187,672	123,490,851	100,013,795	239,269,048
Other Costs				
organisation	14,018,512	85,753,228	18,969,942	98,190,813
product and consumer	1,329,644	8,133,620	12,879,699	24,679,300
network expenses	30,161,633	184,502,987	90,571,664	281,084,973
total	45,509,790	278,389,835	122,421,305	403,955,086
Ancillary Charges (TEBA)	2,858,916	17,451,844	2,969,359	18,329,769
Cost of Capital	13,522,956	82,721,840	80,259,073	188,581,563
Retail Volume	277,453	1,697,219	277,453	1,697,219
Retail price	477.9364	297.6981	1636.8917	553.4364
Access price	101.8290	101.8477	134.0529	112.1819
Unit cost	295.8315	295.8100	1101.6768	500.8990
Imputed margin	80.2759	-99.9595	401.1619	-59.6445
Imputed margin %	16.7964%	-33.5775%	24.5075%	-10.7771%

TABLE 2.16: ULLS RECONCILIATION REPORT FOR JANUARY TO JUNE 2012 ON CURRENT COST BASIS (APPLYING JUNE 2012 RAF)

	Unconditioned Local Loop Service		Unconditioned Local Loop Service	
	ADSL Service		ADSL, local calls, line rental, domestic long distance, international and fixed to mobile	
	Business	Residential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service + 1 x Voice Lines
Revenues				
retail	132,604,900	505,259,024	454,160,502	939,302,966
other	0	0	0	0
total	132,604,900	505,259,024	454,160,502	939,302,966
Retail Costs				
organisation	8,759,492	53,583,054	37,904,716	98,153,990
product and consumer	11,313,703	69,207,527	61,626,947	139,855,011
total	20,073,195	122,790,581	99,531,664	238,009,001
Other Costs				
organisation	14,379,512	87,961,516	21,672,125	103,570,438
product and consumer	1,336,903	8,178,024	12,934,034	24,787,473
network expenses	30,161,633	184,502,987	90,571,665	281,084,973
total	45,878,049	280,642,527	125,177,823	409,442,884
Ancillary Charges (TEBA)	2,858,916	17,451,844	2,969,359	18,329,769
Cost of Capital	3,671,396	22,458,451	113,277,815	196,875,593
Retail Volume	277,453	1,697,219	277,453	1,697,219
Retail price	477.9364	297.6981	1636.8917	553.4364
Access price	101.8290	101.8477	134.0529	112.1819
Unit cost	261.2390	261.2175	1228.8808	508.2768
Imputed margin	114.8684	-65.3671	273.9579	-67.0223
Imputed margin %	24.0342%	-21.9575%	16.7365%	-12.1102%

Notes to Tables: 2.15 and 2.16* As per instructions from the ACCC, ancillary charges are calculated as TEBA revenues per ULL service that are reasonably expected in a mature market. This is calculated as the TEBA revenue for the September quarter divided by the adjusted number of installed tie cable pairs. The adjustment factor set by the ACCC is 66%.** Retail volumes are reported in terms of SIOs.

2.7 EXTENT TO WHICH THE REPORTS COMPLY WITH THE RAF AND OTHER RKRS

The Ministerial Direction requires the ACCC to comment on the extent to which the reports comply with:

- the RAF;
- any other relevant record-keeping rules made by the ACCC (whether for the purposes of the Minister's Direction or otherwise); and
- any Direction given by the ACCC for Telstra to make public information contained in the reports.

This section discusses the extent to which the reports comply with the RAF.

2.7.1 RELATIONSHIP BETWEEN THE RAF AND THE IMPUTATION RKR

Telstra provides financial information to the ACCC in the RAF. Under the RAF, Telstra must provide capital-adjusted profit and loss statements for its retail services, internal wholesale services and external wholesale services. Telstra must also provide statements in relation to capital employed and fixed assets for those three service classifications.

The Ministerial Direction requires that Telstra provide the imputation RKR information to the ACCC each quarter. Telstra currently provides RAF information to the ACCC every six months. To address this time disparity, the ACCC requires Telstra to:

- obtain revenue information for core and retail services for the relevant quarter from Telstra's general ledger accounts
- obtain volume information for core and retail services for the relevant quarter from Telstra's management information systems
- obtain cost information for retail services each quarter by multiplying the volume data for the relevant quarter with the unit costs of the service derived from the RAF accounts for the six-month reporting period preceding that quarter.

The RAF records volume information for retail and core services. The imputation RKR requires Telstra to use volume data for retail services from the RAF for the previous six months to unitise cost information. It also requires that volume data for the relevant quarter be used, which can later be compared to the volume data that appears in the RAF.

The RAF does not disaggregate data between business and residential customer groups.

2.7.2 REVENUE DIFFERENCES BETWEEN THE IMPUTATION RKR AND THE RAF

The RAF allocates revenues across various retail services. The imputation RKR requires Telstra to allocate its retail revenues in a manner consistent with the RAF. This allows for the reports provided by Telstra to be reconciled with the RAF data in future periods.

That said, there are two material differences in the service descriptions that are used in the RAF and in the imputation test:

- The domestic long-distance service in the imputation RKR excludes revenues from operator-assisted calls, which are included in the corresponding RAF category. Therefore, the domestic long-distance revenues in the RKR will be lower than the RAF revenue for the national long-distance retail service.
- The RAF fixed-to-mobile service includes ISDN-originated calls.

As noted in section 2.6, differences between the imputation RKR and the RAF revenues also occur due to the effect of different accounting treatments. Differences also occur due to the inclusion of ADSL installation discounts and ULLS connection charges.

The revenues in the imputation RKR are otherwise consistent with the revenue items for these services in the RAF.

2.7.3 COST DIFFERENCES BETWEEN THE IMPUTATION RKR AND THE RAF

The RAF allocates common costs as well as direct costs to wholesale and retail services. The costs attributed to retail services in the RAF are appropriate for calculating 'retail costs' for the imputation test, but do not include all costs in the transformation of a core service to a retail service (such as transmission costs). Therefore, additional costs (listed separately as 'other costs') are included in Telstra's imputation testing results.

Telstra uses unitised cost information from the RAF reports from the preceding six-monthly reporting period, which is multiplied by the volume for the relevant quarter. This cost information is later reconciled with the RAF. In constructing the imputation test, Telstra raised implementation issues relating to the calculation of appropriate retail and other costs using the RAF data. Telstra and the ACCC agreed on ways to resolve these issues. This has resulted in some adjustments to the RAF figures in the imputation test. The adjustments relate to:

- the removal of installation costs from the cost of line rental and ADSL – as required by the imputation RKR
- the removal of modem costs from the cost of ADSL – implied from the definition of ADSL in the imputation RKR
- the use of a mobile termination methodology for costing fixed-to-mobile services
- avoiding the double-counting of ULLS and PSTN originating and terminating access service costs
- adjustment to call costs used in the bundle of ADSL and fixed-line voice products when services are provided over the ULLS
- ancillary costs.

The last four dot points are described in more detail below.

MOBILE TERMINATION METHODOLOGY FOR FIXED-TO-MOBILE SERVICES

As the imputation tests have been designed to show whether an efficient access seeker is able to compete with Telstra, the imputation test needed adjustment to account for Telstra's on-net fixed-to-mobile calls (i.e. voice calls that originate from Telstra fixed lines and terminate on Telstra's mobile network). The ACCC and Telstra agreed that Telstra impute the weighted average mobile termination charge that would apply to an access seeker which terminates fixed-to-mobile traffic on Telstra's mobile network.

DOUBLE-COUNTING ULLS AND PSTN ORIGINATING AND TERMINATING COSTS

To calculate the costs of transforming the PSTN and ULLS core services into the retail services specified in the imputation RKR, Telstra uses its Retail and Internal Wholesale accounts in the RAF. However, the Internal Wholesale accounts include costs of network elements and functions that are already captured in the access prices for the PSTN O/T and ULLS. For example, the Internal Wholesale costs recorded in the RAF allocate local switching and transmission costs to the domestic long-distance service, which are already factored into the PSTN access price.

To overcome this issue, Telstra deducts the common elements located in the External Wholesale accounts (which are used to calculate the access price) from the costs located in the Internal Wholesale accounts in the RAF. This adjustment is done at a relatively high level.

NON-ULLS CALL COSTS

For the bundled tests involving ADSL and fixed voice products, the costs for origination and termination for fixed telephony calls change when the underlying service is ULLS.

The ACCC and Telstra have agreed to a methodology that involves several steps. For local and domestic long-distance calls, the PSTN terminating access (TA) network costs are removed from the RAF and PSTN TA charges are added, using a similar method to that used to remove double-counted costs. For international long-distance calls, the international settlement payments are used for termination of such calls. For fixed-to-mobile calls, the methodology explained above for mobile termination is used.

ANCILLARY CHARGES

The imputation RKR requires Telstra to calculate ancillary charges for the PSTN (consisting of switchport charges) and ULLS (Telstra Exchange Building Access or TEBA charges). The imputation reports may double count some of the ancillary charges.

2.7.4 CONCLUSION ON THE EXTENT TO WHICH THE REPORTS COMPLY WITH THE RAF

Subject to the exceptions noted in sections 2.7.2 and 2.7.3 above, the revenue data for retail services and the cost data for retail services are likely to comply with the RAF. Other data involved in the imputation testing is not required to comply with the RAF.

2.8 ACCURACY OF THE IMPUTATION RKR REPORTS

The Ministerial Direction requires the ACCC to comment on the accuracy of the reports lodged by Telstra.

2.8.1 AUDIT PROCESS

Clause 13 of the imputation RKR addresses the audit requirements for the reports. The clause requires that a single audit be undertaken each year in respect of the reports that are prepared under the imputation RKR and an audit report be provided to the ACCC.

In August 2012, the ACCC granted Telstra an exemption from the auditing requirement of imputation report for 2011-12. This is because the ACCC considered the cost of auditing the reports would outweigh any potential benefits given the introduction of interim equivalence and transparency measures under Telstra's structural separation undertaking. The ACCC further considered that Telstra would have been operating on the basis that its reports would need to be audited and would have prepared as such.

2.8.2 ACCURACY OF REPORT

Given that the underlying Telstra reports used in the September 2012 quarter results has not been audited, the ACCC cannot conclusively state whether the reports provided by Telstra for the period comply in all respects with the Imputation RKR.

3. NON-PRICE TERMS AND CONDITIONS REPORT

3.1 OVERVIEW

3.1.1 WHAT DOES THIS REPORT DO?

This report presents various key performance indicators (KPIs) for the services that Telstra supplies to retail customers and wholesale customers. The data for these reports is compiled by Telstra and submitted to the ACCC.

The KPIs are on the ordering and provisioning (i.e. the connection of new services) and handling of faults for the basic access service and the ADSL service (see Table 3.1). The KPIs measure Telstra's basic access service levels against the standard specified in the customer service guarantee (CSG)[10] and Telstra's ADSL service levels against similar standards. Separate KPIs are presented for residential and business services.

TABLE 3.1: METRICS FOR WHICH PERFORMANCE IS ASSESSED

Metric 1	Basic access - Ordering and Provisioning - The percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard – previous service available for automatic connection
Metric 2	Basic access - Ordering and Provisioning - The percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard – new service with available cabling and capacity
Metric 3	Basic access - Ordering and Provisioning - The percentage of basic access orders provisioned in the quarter, on or by the performance standard – new service which requires additional cable or network capacity
Metric 4	Basic access - Ordering and Provisioning - The percentage of basic access order appointments that are met in the quarter
Metric 5	Basic access - Faults and Maintenance - The percentage of basic access faults that are rectified in the quarter, on or by the performance standard (Includes dial-up faults)
Metric 6	Basic access - Faults and Maintenance - The percentage of basic access fault appointments that are met in the quarter (includes dial-up faults)
Metric 7	Basic access - Faults and Maintenance - The percentage difference in recurring fault ratio
Metric 8	ADSL service activation - The percentage of services provisioned within performance standards – where the customer or end-user has an existing and functioning basis access service capable of supporting ADSL services
Metric 9	ADSL service activation - The percentage of services provisioned within performance standard – held orders
Metric 10	ADSL - Faults and Maintenance - The percentage of faults rectified within performance standards
Metric 11	ADSL - Faults and Maintenance - The percentage of appointments kept

The reporting of KPIs is intended to provide an initial indicator of whether or not Telstra is providing equivalent service levels, on average, to Telstra wholesale and Telstra retail customers.

[10] The KPIs are not, however, directly comparable to those reported by the Australian Communications and Media Authority (ACMA) in the context of CSG reporting. This is because CSG reporting concerns only those customers with five lines or less.

The report is not intended to identify whether particular instances of anti-competitive behaviour by Telstra may have occurred. Rather, the results in this report serve as possible indicators. The ACCC will, therefore, continue to monitor any trends in Telstra's performance and respond to complaints of discrimination on their merits.

3.2 SUMMARY OF KPIS FOR THE FOUR QUARTERS ENDING 30 SEPTEMBER 2012

Table 3.2 presents Telstra's non-price KPI report for the four quarters up to 30 September 2012 as well as calculating an average for that period. By examining Telstra's performance over four quarters, the possibility of drawing conclusions regarding Telstra's performance based on a quarter affected by transient or seasonal factors is minimised.

For any performance metric, if the difference between the percentage of wholesale customers and retail customers for which Telstra has met the performance standard is positive, then Telstra has performed better in meeting the performance standard for its wholesale customers than its retail customers. Therefore, a positive performance metric indicates that Telstra is unlikely to be systematically discriminating in its own interests and against the interests of competitors in that area.

Conversely, for any performance metric, if the difference between the percentage of wholesale customers and retail customers for which Telstra has met the performance standard is negative, then Telstra has performed worse in meeting the performance standard for its wholesale customers than its retail customers. Where a performance metric is highly negative, it may provide an initial indicator that Telstra is favouring its own retail unit over its wholesale business unit.

TABLE 3.2: AVERAGE VARIANCES IN KPI METRICS - 12 MONTHS ENDING 30 SEPTEMBER 2012[11]

	Business services					**Residential services**				
Metric	**Difference in performance between wholesale and retail business customers (%)**					**Difference in performance between wholesale and retail business customers (%)**				
	Dec-11	**Mar-12**	**Jun-12**	**Sep-12**	**Ave.**	**Dec-11**	**Mar-12**	**Jun-12**	**Sep-12**	**Ave.**
1	2.31	1.98	6.27	**12.33**	3.52	3.86	4.28	4.73	**3.91**	4.20
2	6.00	6.30	10.60	**17.93**	7.63	4.32	5.34	8.96	**8.05**	6.67
3	-1.63	10.17	14.09	**16.79**	7.54	10.41	12.45	16.03	**19.55**	14.61
4	0.76	0.54	0.86	**0.63**	0.72	1.28	1.87	1.69	**2.28**	1.78
5	-0.81	-2.88	-6.49	**-4.61**	-3.39	-1.21	-1.90	-4.00	**-4.49**	-2.90
6	0.50	0.26	-0.37	**-0.13**	0.13	0.27	0.10	0.12	**-0.14**	0.09
7	-0.56	0.52	0.03	**-0.12**	0.00	0.94	0.74	1.06	**0.43**	0.79
8	0.76	-0.01	1.08	**0.97**	0.61	0.56	0.88	0.92	**0.49**	0.71
9	-1.90	0.00	-6.45	**-1.54**	-2.78	0.00	-2.59	-1.06	**0.43**	-0.81
10	2.92	3.40	3.36	**1.10**	3.23	-0.43	-0.36	-0.05	**0.42**	-0.11
11	-0.39	-0.21	-0.52	**-0.32**	-0.37	0.82	-0.21	-0.01	**-0.14**	0.12

Notes: A positive difference means that Telstra Wholesale has met the performance standard in a greater percentage of cases than Telstra Retail.

11 The performance standard used for all metrics is the same as that used for the Customer Service Guarantee, unless otherwise stated.

3.3 DISCUSSION OF PERFORMANCE

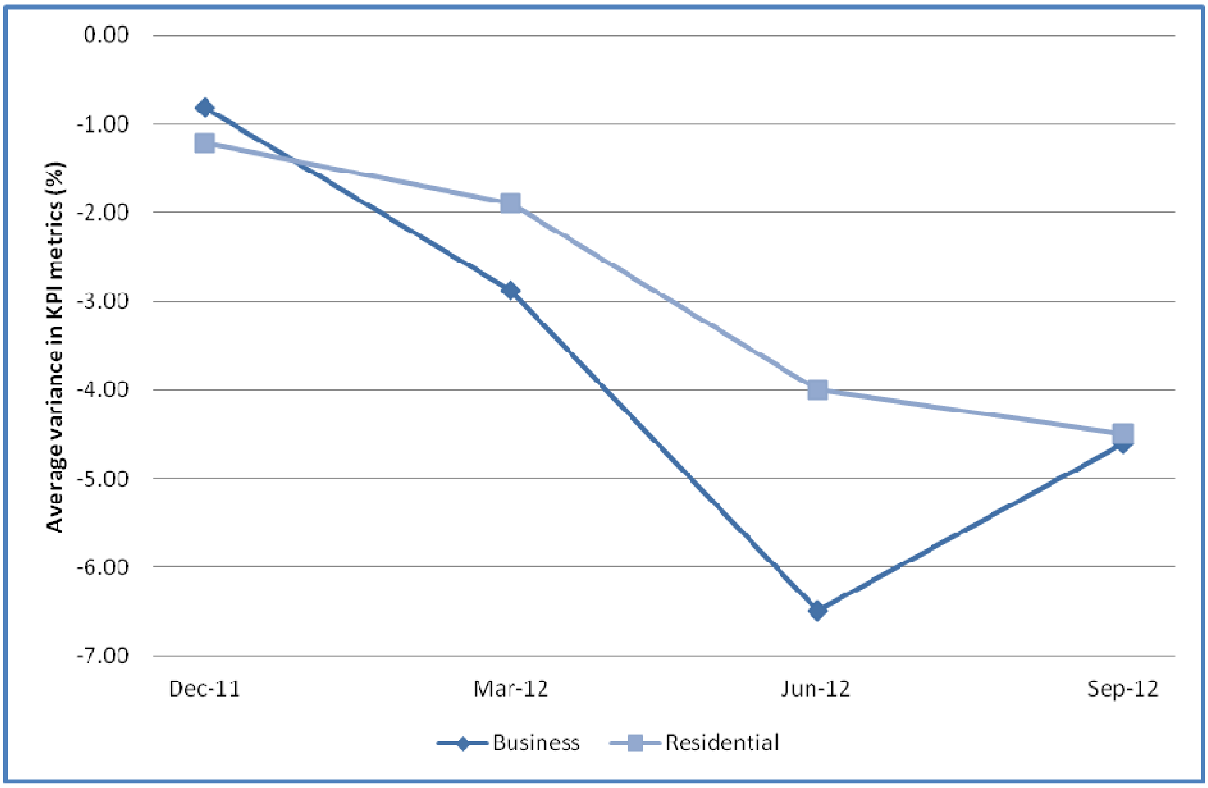
Table 3.2 shows that in relation to business services, Telstra provided better service to its wholesale customers for six out of the 11 performance metrics. For Metrics 1 to 3, the percentage of occasions in which Telstra met the performance standard was at least 10 percentage points higher for wholesale customers than it was for retail customers. Metric 5, the metric in which Telstra had its strongest performance in relation to retail customers, is discussed below.

In relation to residential services, Telstra provided better service to its wholesale customers for eight out of the 11 performance metrics. For Metric 3, which relates to the percentage of basic access orders provisioned (new service requiring additional cable or network capacity), Telstra met the performance standard at a rate that was 19.55 percentage points higher for wholesale customers than retail customers. Again, Metric 5 was the metric in which Telstra provided its relatively strongest performance in relation to retail customers.

Metric 5 relates to the percentage of basic access faults that are rectified in the quarter, on or by the performance standard. This metric had a variance of -4.61 per cent for business customers and -4.49 per cent for residential customers. This means that the performance for the retail business unit exceeded the wholesale business unit for both business and residential sectors.

Figure 3.1 presents the average variance in the KPI metrics over the last four quarters for Metric 5. The business services fell below -6 per cent in the June 2012 quarter but picked up in the September 2012 quarter. The residential services on the other hand, fell by over 2 percentage points to -4 per cent in June 2012 quarter and fell again slightly further in the September 2012 quarter.

FIGURE 3.1: RECENT CHANGES IN VARIANCE IN KPI METRIC 5 (BASIC FAULTS RECTIFIED WITHIN SPECIFIED TIMEFRAMES)



Telstra explained that it is still investigating the cause of this difference. According to Telstra, a contributing factor appears to be the incorrect allocation of increased severity levels by Telstra's call centre staff for a proportion of Telstra retail business services at a time when many wholesale business services were allocated standard priority levels. Telstra also stated that this was a consequence of an IT system change and also because the network was experiencing the effects of high workloads and inclement weather.

Despite the performance in relation to Metric 5, the overall results do not provide any evidence of systemic discrimination by Telstra against access seekers in respect of performance. This conclusion is based on Telstra generally performing better for its wholesale customers than retail customers. Even for metrics where Telstra performed better in relation to retail customers, the difference in performance was much smaller than for metrics where it performed better for wholesale customers. This suggests that there is no deliberate discrimination.

3.4 EXTENT TO WHICH TELSTRA'S REPORTS CONFORM WITH THE RKR REQUIREMENTS

The ACCC considers that the September quarter 2012 report conforms to the requirements of the RKR.

3.5 ACCURACY

Given that the underlying Telstra data used in the September 2012 quarter results has not been audited, the ACCC cannot conclusively state whether the reports provided by Telstra for the period comply in all respects with the *Non-price terms and conditions KPI RKR*. In August 2012, the ACCC granted Telstra an exemption from the auditing requirement of non-price terms and conditions report for 2011-12. This is because the ACCC considered the cost of auditing the reports would outweigh any potential benefits given the introduction of interim equivalence and transparency measures under Telstra's structural separation undertaking. The ACCC further considered that Telstra would have been operating on the basis that its reports would need to be audited and would have been prepared as such.