

## **A guide to Telstra's price-related interim equivalence and transparency obligations – 5 September 2011**

The structural separation undertaking imposes several price-related obligations on Telstra, which are discussed in this guide. In summary, the framework addresses several concerns of industry and the ACCC:

- It makes the reference prices charged by Telstra transparent to industry and the ACCC;
- It ensures that efficient wholesale customers would earn a protected return, with efficient profit incentives to expand into regional and rural areas;
- Wholesale ADSL2+ customers will be able to replicate increases in Telstra's usage caps, since higher retail customer usage will convert into lower wholesale prices;
- The reference prices for wholesale ADSL2+ are "future proofed" by built-in review mechanisms including a six-monthly update of the calculation, a material retail price change mechanism and updates to account for increases in Telstra's retail end-user usage;
- When changes to the wholesale ADSL2+ reference price are required as a result of a Telstra retail price change, the wholesale price change must be implemented and notified to the ACCC before the retail price change is implemented;
- The reference prices are "walk in" prices and are available without volume or term type commitments (however, they are conditional on Telstra's standard contract terms and conditions) and are the first time Telstra has published such prices;
- Wholesale customers have a choice to take the reference prices which will be incorporated in future contracts or negotiate even better rates with Telstra; and
- People will be able to compare the unit internal wholesale prices that would be paid by Telstra's retail business units if they consumed the same wholesale inputs, to the external wholesale prices paid by wholesale customers, for those same services.

The rest of this guide describes in more detail the two price-related components of Telstra's structural separation undertaking.

### **Wholesale rate card and reference prices**

Telstra is required to publish a rate card with reference prices for key regulated wholesale services in areas that are not exempt from regulation as well as for wholesale ADSL2+ (covering connection, port and usage charges). However, in the interests of transparency, the table below sets out Telstra's expectations of where the reference prices will turn out.

Telstra will publish the first formal rate card of reference prices within 3 months of the commencement date of the SSU. From this point, as soon as their existing contracts expire, wholesale customers will be able to acquire these services from Telstra at the prices listed on the rate card and updated from time to time. However, the rate card prices are not intended to be the only prices that are available to wholesale customers. It is recognised that, particularly for wholesale ADSL2+, many wholesale customers have commercially negotiated different and in some cases lower price points.

For example, some customers prefer geographically averaged over de-averaged prices. It is expected that wholesale customers will continue to negotiate price points that are better than the rate card given the different characteristics of their end users and the value that these wholesale customers bring to negotiations. The rate card prices are, therefore, “reference” prices and are available without volume or term type commitments (however, they are conditional to supply on Telstra’s standard contract terms and conditions). The reference prices for wholesale ADSL2+, taken together, act as a ceiling for commercial negotiations. Notwithstanding, Telstra has forecast that its wholesale revenues from wholesale ADSL2+ will fall as a result of this reference offer. Therefore, while some wholesale customers might already face lower prices than the reference offer, on average wholesale customers’ prices will fall.

For declared services, the rate card will list the wholesale prices as determined by the ACCC in the most recent interim access determination (IAD), final access determination (FAD) or binding rule of conduct (BRoC). If the ACCC varies an IAD, FAD or BRoC with different prices, then the rate card will be updated to reflect those changes.

For wholesale ADSL2+, there is no regulated rate. Instead, reference prices for zone 1 and zone 2/3 will be set equal to Telstra’s retail price minus its avoidable retail cost. This ensures that wholesale customers would earn a protected return.

The formulas used to calculate an aggregate reference price for ADSL2+ are as follows:

ADSL2+ Wholesale Reference Price (Zone 1)  
= National Average Retail Price  
– Short Run Marginal Avoidable Retail Cost  
– Fixed Avoidable Retail Cost Allocated to Zone 1

and

ADSL2+ Wholesale Reference Price (Zone 2)  
= National Average Retail Price  
– Short Run Marginal Avoidable Retail Cost  
– Fixed Avoidable Retail Cost Allocated to Zone 2

The calculation used to update the wholesale ADSL2+ reference price will be set up front, and agreed to by the ACCC. While the mechanism can be reviewed after three years, the calculation will be locked down to avoid the ongoing regulatory dispute and uncertainty that was a feature of the retail minus approach to pricing Wholesale Line Rental.

To avoid another cause of dispute experienced with the Wholesale Line Rental retail minus pricing approach, the Retail Price input will be based on the weighted average retail prices over all plans Telstra sells, including when supplied as part of a bundle, rather than a stand-alone price for a single plan. Avoidable retail costs will be sourced from Telstra’s internal management accounts (TEM). TEM records the real costs Telstra faces from its company accounts, not hypothetical or modelled costs. Avoidable retail costs include the costs that Telstra would avoid if, instead of supplying its retail ADSL services through retail channels, it supplied those services through the wholesale channel. Some examples of such costs are retail sales and marketing costs and call centre costs. The avoidable retail costs are divided into short-run marginal and fixed costs, and allocated between zones 1 and

2/3. A greater share of fixed costs are expected to be allocated to zone 1, so that the wholesale reference price is lower in zone 1 than zone 2/3.

The wholesale ADSL2+ reference prices in both zones will be disaggregated into the connection, AGVC and port price components. One input into this disaggregation will be the forecast average customer usage of Telstra's retail ADSL2+ customers (metered + unmetered). Increases in retail customer usage mean that more data needs to be transported from its sources to end users and, to replicate the offers made by Telstra's retail business units, wholesale customers would need to purchase more AGVC transmission. Therefore, the AGVC price component will need to fall as Telstra's retail customer usage increases. To prevent unwanted variability in the wholesale price over time and to avoid double counting, the usage input will be a forecast of Telstra's average retail usage over time and it will not include any usage that otherwise recovers the cost for its own transmission (e.g. in the future, some paid-for movies or applications might recover the cost of their own transmission requirements). All usage associated with content that does not recover the cost of its own transmission will be included in the average retail usage calculation. The average usage will be updated periodically, as the usage of Telstra's retail customers increases.

The wholesale ADSL2+ reference price calculation will be updated every six months (if the update requires a reference price change of 3% or more since the last update) or when there is a material retail price change (of 5% or more). If a change to the wholesale ADSL2+ reference price is required after a 6 monthly update to the calculation, then Telstra must implement that change within 10 business days of the completion of the calculation. If a change to the wholesale ADSL2+ reference price is required as a result of a material retail price change, then Telstra must implement that wholesale price change and notify the ACCC before the retail price initiative is implemented.

As indicated above, Telstra will publish the first formal rate card of reference prices within 3 months of the commencement date. However, in the interests of transparency, the table below sets out Telstra's expectations of where the reference prices will turn out.

Wholesale Services		Reference Price	Source
Wholesale Line Rental (WLR)	In-Place Connection (\$/connection)	From \$53.64 to \$204.55, depending on the work required	www.telstra.com.au/home-phone/plans-rates-connections/index.htm
	New Connection (\$/connection)	From \$271.82 to \$362.73, depending on the work required	
	Rental (\$/SIO)	\$22.84	
Local Calls	Usage (\$/call)	\$0.089	Sch. 3, FAD for fixed line services, 20 July 2011
PSTN OTA	Usage (\$/end-min)	\$0.0095	Sch. 4, sch.5, FAD for fixed line services, 20 July 2011
Wholesale ADSL	In-Place Connection (\$/connection)	\$80	Sch. 8.2, SSU
	New Connection (\$/connection)	\$80	
	AGVC (\$/mbps)	\$65	
	Port - Zone 1 (\$/SIO)	\$31	
	Port - Zone 2/3 (\$/SIO)	\$38	
Unbundled Local Loop Service (ULLS)	Connection (\$/connection)	\$52.67 (band 1) \$55.49 (band 2) \$60.29 (band 3)	Sch. 6, FAD for fixed line services, 20 July 2011
	Port (\$/SIO)	\$16.21 (band 1-3) \$48.19 (band 4)	
Line Sharing Service (LSS)	Connection (\$/connection)	\$45.04	Sch. 2, FAD for fixed line services, 20 July 2011
	Port (\$/SIO)	\$1.80	
MTAS	Usage (\$/end-min)	[TBA]	[FAD expected in Dec 2012]
DTCS	Service (\$/service)	[Refer to ACCC IAD]	Sch. 2, IAD for DTCS, 18 April 2011

**Notes:**

- All reference prices are GST exclusive (and other taxes that may apply over time)
- reference prices for declared products apply in areas that are not exempt from regulation
- Wholesale AGVC price is the same for customers who use WATM or TWE backhaul
- Conditional on Telstra's standard contract terms and conditions

## TEM Reporting and Internal and External Wholesale Prices

Telstra will be required to provide to the ACCC detailed quarterly financial reports taken from its internal management accounts (TEM). The TEM Reports are reconciled to Telstra's audited statutory accounts. Each TEM report will set out the fully allocated costs, revenues, demand, EBIT, EBITDA and Economic Return (which includes a rate of return) associated with each of Telstra's regulated products and related retail products.

Telstra will ensure that all costs and revenues are allocated on an equivalent basis in the TEM, including between wholesale and retail products. Telstra will provide documentation of the TEM reporting including allocation principles, to the ACCC each year. Telstra will also have an independent auditor confirm in a report for the ACCC each year that Telstra has complied with the relevant processes when preparing its TEM Reports.

Based on the data in the TEM Reports, Telstra will be required to report its internal and external wholesale prices for equivalent services. This reporting will be undertaken on a six monthly basis for publication, consistent with the statutory reporting timeframes applying to Telstra's financial reporting. Internal and external wholesale prices will be determined for the services and bundles set out in the table below.

<b>Wholesale Services</b>		
Wholesale Line Rental (WLR)	In-Place Connection	per connection
	New Connection	per connection
	Rental	per SIO
Local Calls	Usage	per call
PSTN OTA	Usage	Per end min
<b>VOICE BUNDLE</b>		<b>Per SIO</b>
Wholesale ADSL	In-Place Connection	per connection
	New Connection	per connection
	AGVC	per Mbps
	Port Zone 1	Per SIO
	Port Zone 2	Per SIO
<b>VOICE AND ADSL BUNDLE</b>		<b>Per SIO</b>
Unbundled Local Loop Service (ULLS)	Connection	per connection
	Port	Per SIO
Line Sharing Service (LSS)	Connection	per connection
	Port	Per SIO
<b>TOTAL BUNDLE OF FIXED WHOLESALE SERVICES</b>		<b>Per SIO</b>
MTAS	Usage	

Comparisons between retail services and wholesale services have always been complicated because Telstra's retail business units do not necessarily use the same cost elements, in the same quantities, in the same geographic areas and for the same end-users as wholesale customers. However, the TEM reporting will provide for equivalence in three respects:

- (a) Telstra will provide the ACCC with its allocation principles for the TEM Reports which will demonstrate that the same type of costs are allocated equivalently as between retail and wholesale services.
- (b) The TEM reports will allow people to compare the unit internal wholesale prices that would be paid by Telstra's retail business units to the external wholesale prices paid by wholesale customers, assuming Telstra's retail business units use the same cost elements as wholesale customers.
- (c) If there is a variation greater than 5% between these internal and external wholesale prices for any bundle of wholesale services, then Telstra must provide a substantiation report to the ACCC explaining the variation. That report will then contribute to any subsequent ACCC regulated pricing process, where a decision by the ACCC in that process could be used to align the internal and external wholesale prices for that bundle.