Australian
Competition &
Consumer
Commission

Unconditioned Local Loop Service (ULLS)

Final pricing principles

November 2007

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1. Introduction

The unconditioned local loop service (ULLS) is a service for access to unconditioned cable, usually a copper wire pair, between an end user and a telephone exchange. The ULLS essentially gives an access seeker the use of the copper pair without any dial tone or carriage service. This allows the access seeker to use its own equipment in an exchange to provide a range of services, including traditional voice services and high speed internet access, to end-users connected to that exchange.

On 28 July 2006, the ACCC issued a final decision to "declare", or continue the regulation of, the ULLS as part of its fixed services review.[1]

The ACCC is required by s.152AQA of the *Trade Practices Act 1974* (TPA) to determine, in writing, principles relating to the price of access to declared services.

Chapter 7 of the ACCC's ULLS declaration decision contained draft pricing principles for the ULLS.[2] The ACCC sought submissions on the draft pricing principles from interested parties. Those draft ULLS pricing principles considered that, consistent with the ACCC's past approach, it was appropriate to maintain the use of a Total Service Long Run Incremental Cost (TSLRIC+) pricing principle for the ULLS.[3] A TSLRIC+ pricing principle was considered by the ACCC in its July 1997 access pricing principles paper.[4]

The draft pricing principles also noted that the ACCC has in the past adopted a geographically de-averaged approach to ULLS pricing, where charges are set by reference to the costs in different geographic areas.[5]

The ACCC received submissions from three parties in August and September 2006 in response to the draft ULLS pricing principles.[6] However, it did not finalise the ULLS pricing principles at that time given that there were a number of ULLS pricing issues being considered in undertakings and subsequently on appeal to the Australian Competition Tribunal.

Given the lapse of time since the ACCC's previous consultation, it was considered appropriate to allow parties to make a submission or further submission on the draft ULLS pricing principles.[7] The ACCC received a further six submissions in response to this additional consultation.

This document sets out the ACCC's pricing principles for the ULLS. These finalised pricing principles take into account all submissions received in both consultation periods.

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1 ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS—final decision*, July 2006.
2 ibid, p. 54.
3 ibid, p. 56.
4 ACCC, *Access Pricing Principles – Telecommunications – a guide*, 1997.
5 ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS—final decision*, July 2006, p. 55.
6 Public versions of the submissions are available on the ACCC's website at http://www.accc.gov.au/content/index.phtml?itemId=719844
7 ACCC, *Fixed services review—further consultation on draft ULLS pricing principles*, Oct 07.

2. Regulatory framework

This section sets out the relevant legislative background to the making of pricing principles and the legislative matters to which the ACCC has particularly had regard to in making the ULLS pricing principles.

2.1 Part XIC access regime

The ULLS was first declared under Part XIC of the TPA in August 1999 and then declared again in July 2006 for a further three years.[8]

Once a service is declared, carriers and carriage service providers supplying the declared service to themselves or others are subject to the standard access obligations (SAOs). These obligations constrain the manner in which those carriers and carriage service providers can conduct themselves in supplying the declared service.

Section 152AR of the TPA sets out the SAOs applying to carriers and carriage service providers supplying the declared service to themselves or others. In summary,[9] if requested by a service provider,[10] the carrier/carriage service provider must:

- supply the declared service
- take all reasonable steps to ensure that the declared service supplied to the service provider is of equivalent technical and operational quality as that which the carrier/carriage service provider is supplying to itself
- take all reasonable steps to ensure that the fault detection, handling and rectification which the service provider receives in relation to the declared service is of equivalent technical and operational quality as that provided by the carrier/carriage service provider to itself
- permit interconnection of its facilities with those of the service provider
- provide particular billing information to the service provider.

The ACCC is also required by s.152AQA of the TPA to determine, in writing, principles relating to the price of access to declared services. The ACCC is required to publish a draft pricing principles determination, invite submissions on the draft and consider any submissions received, before it finalises the pricing principles.

The pricing principles may also "contain price-related terms and conditions". This means that the ACCC can specify indicative prices for a declared service.[11]

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

9 There are some exceptions to these obligations. These are set out in s152AR, and in any exemption issued under s152AS or s152AT of the TPA.

10 A service provider is a carriage or content service provider within the meaning of the *Telecommunications Act 1997*.

11 In *Vodafone Australia Ltd v ACCC* [2005] FCA 1294 (16 September 2005), the Federal Court held that pricing principles may specify a price.

The terms and conditions on which a carrier/carriage service provider is to comply with the SAOs are as agreed between the parties. If they cannot agree, one of them can notify the ACCC of an access dispute under s152CM of the TPA. Once notified, the ACCC can arbitrate and make a determination which resolves the dispute. The ACCC's determination can deal with any matter relating to access by the access seeker to the declared service.[12]

Section 152AQA(6) of the TPA states that, once the ACCC has made a pricing principle determination, it must have regard to the pricing principle determination if it is required to arbitrate an access dispute. The ACCC considers that pricing principles will guide commercial negotiation of access by providing greater certainty as to the ACCC's views on access pricing.

The TPA also enables a carrier/carriage service provider to resolve potentially contentious issues with the ACCC outside the arbitral process. It can do this by giving the ACCC an access undertaking under s152BS of the TPA, setting out the terms and conditions on which it proposes to comply with particular SAOs.

If an undertaking is accepted by the ACCC, the undertaking becomes binding on the carrier/carriage service provider and the ACCC must not make an arbitral determination that is inconsistent with the undertaking.[13]

2.2 Process for making pricing principles

The TPA does not set out the matters to which the ACCC must have regard to in making pricing principles. However, the ACCC considers that, in making pricing principles, it should have regard to legislative matters that it must consider in making pricing decisions under the TPA.

In particular, section 152AQA(6) of the TPA requires the ACCC to have regard to its pricing principles determination in arbitrating an access dispute. Section 152CR of the TPA further requires the ACCC to, in making a final determination in access disputes, have regard to a number of relevant legislative matters:

- whether the terms and conditions promote the long-term interests of end-users (LTIE) which requires consideration of:
  - the objective of promoting competition
  - the objective of any-to-any connectivity
  - the objective of encouraging the economically efficient use of, and the economically efficient investment in, infrastructure
- the legitimate business interests of the access provider, and their investment in facilities used to supply the declared service

[12] TPA ss. 152CP(2).
[13] ibid, ss. 152CQ(5).

- the interests of access seekers
- the direct costs of providing access to the declared service
- the value to a party of extensions or enhancement of capability where the cost is borne by someone else
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, telecommunications network or facility and
- the economically efficient operation of a carriage service, telecommunications network or facility.[14]

The ACCC may also have regard to other matters.[15]

The ACCC must have regard to similar matters in determining whether the terms and conditions in an undertaking are reasonable.[16] An undertaking assessment is the other context in which the ACCC will typically assess the price of a declared service.

The ACCC considers that, when it is making pricing principles for a declared service, it is appropriate to have regard to the matters set out above, given that it must have regard to them in making pricing decisions. A more detailed discussion of these legislative matters and their application in determining access pricing principles can be found in the ACCC's *Access Pricing Principles – Telecommunications – a guide*.[17]

14 ibid, section 152CR(1)
15 ibid, section 152CR(2).
16 ibid, section 152AH.
17 ACCC, *Access pricing principles – Telecommunications – a guide*, July 1997.

3. Pricing principles

The price charged for a service has a significant impact on the promotion of competition and the encouragement of efficient investment in and use of infrastructure. Declaration of a service will not of itself necessarily promote the LTIE if the price charged by an access provider is inappropriate. Accordingly the ACCC considers that pricing principles (and, when issued, indicative prices) are an important aspect of a declaration decision. Indicative prices, in particular, can provide valuable certainty to industry about the appropriate level of charges for a service.

This chapter sets out the ACCC's final pricing principles for the ULLS. As required by section 152AQA(4) of the TPA, the ACCC published draft ULLS pricing principles in August 2006 with the final ULLS declaration decision.[18] The ACCC consulted on the draft pricing principles at that time and again in October 2007.[19]

The ACCC has not chosen to specify indicative prices at this time. However, the ACCC may consult on indicative prices at a later time.

A discussion of the ACCC's 2002 ULLS pricing principles, and events since those pricing principles, is set out in Appendix A to this paper.

3.1 Appropriate pricing principles

Possible pricing principles

A fundamental question in considering the pricing of a declared service is the general type of pricing principle to apply. The ACCC's access pricing principles for telecommunications guide concludes that a forward-looking cost-based pricing approach (typically the ACCC uses the total service long-run incremental cost plus an allocation of indirect overhead costs (TSLRIC+) methodology) would usually be the most appropriate methodology for determining access prices.[20] However the ACCC has employed other pricing approaches, such as benchmarking or retail minus retail cost (RMRC), for pricing telecommunications services. Other possible options include the use of historic or current cost accounting information.

In its March 2002 ULLS pricing principles, the ACCC considered that TSLRIC+ would be the most appropriate pricing principle for the ULLS.[21]

The TSLRIC+ approach can be best considered by breaking the concept into components:

- "Total service" refers to the cost of production of an entire service, not to the cost of a particular unit. However, the cost is usually expressed on a per-unit basis by dividing by the number of units supplied.

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18 ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS—final determination*, July 2006.
19 ACCC, *Fixed services review—further consultation on draft ULLS pricing principles*, Oct 07.
20 ACCC, *Access pricing principles – Telecommunications – a guide*, July 1997.
21 ACCC, *Pricing of unconditioned local loop services (ULLS)*, March 2002, p. 18.

- "Long run" means that the concept refers to a period where all factors of production can be varied, as opposed to the short run, where the amount of at least one factor of production is fixed.

- "Incremental cost" means that the concept refers to the additional costs of supplying the service over and above the situation where the service was not supplied, assuming the scale of all other production activities remains unchanged. Strictly speaking, the concept refers to only those costs that can be attributed to the production of the service. In practice, the strict TSLRIC concept is often expanded to include a contribution for indirect and overhead costs (TSLRIC+).

The RMRC approach has been used by the ACCC to price the local carriage service and wholesale line rental service. The approach takes the retail prices paid for the declared service and deducts the avoidable costs of retailing the service to end-users to calculate an access price. However, it is necessary for there to be a readily referable retail service equivalent to the declared service to apply this principle. For a service such as ULLS, where the transformed retail service can vary quite significantly, this approach may not be appropriate.

Historic cost accounting (HCA) or current cost accounting (CCA) information approaches take the costs for a service allocated in accounting documentation, possibly with adjustments, to estimate the cost of the declared service. The ACCC has not used these pricing approaches to price any declared services. A lack of reliable accounting data, and the risk of including unrelated costs in the cost base, can be a significant barrier to using these approaches. Furthermore, unadjusted accounting data will not reflect possible productivity improvements that will be achievable in the future. This may be a particular issue for pricing of telecommunications services, where rapid technological change can drive productivity gains.

Submissions

Submissions in response to the ACCC's draft pricing principles mostly support the use of a TSLRIC+ pricing principle.

iiNet, Agile, Amcom and Adam state that the use of forward-looking cost approaches such as the TSLRIC+ approach are "preferable because they better reflect the workings of competitive markets and are therefore more likely to promote competition than historical cost models".[22] They submit that TSLRIC+ is appropriate given that Telstra's Customer Access Network (CAN) is well-developed, necessary for competition in dependent markets and that the forces of competition work poorly in constraining prices. They also submit that the ACCC should consider the costs of efficient forward-looking technology rather than actual technology in use, as this would provide stronger incentives for efficient investment decisions.[23]

AAPT and PowerTel consider that TSLRIC+ prices are consistent with the prices that would apply if an access provider faced effective competition and that such prices are

[22] iiNet, Agile, Amcom and Adam Internet, *Fixed services review—further consultation on draft ULLS pricing principles*, 8 November 2007, p. 1.

[23] ibid, p. 2.

generally considered to best promote the LTIE.[24] They submit that there are no circumstances to justify a divergence from a TSLRIC+ approach.[25]

The Competitive Carriers' Coalition submits that ULLS prices should reflect a TSLRIC+ methodology.[26]

Optus' 2006 submission also supports the maintenance of a TSLRIC+ pricing approach.[27] However Optus' 2007 submission submits that TSLRIC+ places too much emphasis on the efficiency incentives associated with new entry.[28] Optus submits that the ULLS pricing methodology should not seek to recover costs that exceed costs actually incurred historically. It also submits that the use of a TSLRIC+ estimate of the network in each year in which the prices are set also opens the regulatory process up to gaming opportunities.[29]

Telstra's 2006 submission argues that CCA would best ensure that the relevant legislative matters in section 152AH are adequately balanced, encourage efficient investment and recognise the constraints under which service provision occurs.[30] It argues in favour of a pricing approach where an initial opening asset base is determined and then rolled forward by including new assets and depreciating old assets. This approach is used in regulation of industries such as electricity and gas.[31]

Telstra's 2007 submission states that it agrees that TSLRIC+, properly applied, may be an appropriate pricing principle for the ULLS.[32] However, it submits that there may be potential errors in bottom-up TSLRIC+ cost modelling when there is a lack of reliable data. It instead argues that it may be appropriate in such circumstances to use a top-down TSLRIC+ cost model which relies upon the actual cost of a service, and to have regard to international benchmarks.[33]

ACCC's view

The ACCC has historically been of the view that a TSLRIC+ approach is consistent with the price that would prevail if an access provider faced effective competition, and that it usually best promotes the long-term interests of end-users.[34]

Further, the ACCC has historically been of the view that a TSLRIC+ pricing approach is consistent with the legislative matters discussed above at 2.2.[35]

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24 AAPT/PowerTel, *Submission by AAPT and PowerTel to the ACCC in response to Fixed Services review—further consultation on draft ULLS pricing principles*, October 2007, p. 2.

25 ibid, p. 3.

26 Competitive Carriers Coalition, *Submission on ULLS draft pricing principles*, 2 Nov 07, p. 1.

27 Optus, *Optus' comments on the ACCC's proposed indicative prices for fixed line services*, August 2006, 1 Sep 06, p. 4.

28 Optus, *Further consultation on draft ULLS pricing principles*, 8 Nov 07, p. 2.

29 ibid, p. 2.

30 Telstra, *Addressing the pricing principles for the ULLS, PSTN OTA, LCS and WLR services and the draft price related terms and conditions for the PSTN OTA, LCS and WLR services*, 11 September 2006, p. 5-6.

31 For example, see ACCC, *Statement of principles for the regulation of electricity transmission revenues—background paper*, 8 Dec 04.

32 Telstra, *Telstra response to "Fixed services review: further consultation on draft ULLS pricing principles" of October 2007*, November 2007, p. 2.

33 ibid, p. 3.

34 ACCC, *Access pricing principles – Telecommunications – a guide*, July 1997, p. 29.

The Australian Competition Tribunal has also expressed its general agreement with the TSLRIC+ pricing methodology and the approach taken by the ACCC. The Tribunal has stated in the context of a review of anticipatory exemption orders that:[36]

> In our view, there are some basic pricing principles that should be observed in applying the LTIE test. In considering these principles, we are in general agreement with the approach established by the Commission in its guide to Access Pricing Principles – Telecommunications (as published in July 1997).
>
> This version of cost-based pricing is known as 'total service long run incremental cost' ("TSLRIC"). It includes operating and maintenance costs, a normal commercial return (moderated by the risk involved) and a contribution to common costs. In our view, in the general case where access prices need to be regulated, unless pricing is on a TSLRIC basis, efficient investment is unlikely to be encouraged. This, in turn, would fail to promote competition in the long-term, as end-users would not be able to benefit from new investment (thereby also missing out on more efficient and diverse product offerings).

The Tribunal went on to state that:[37]

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

As noted above, there is a general consensus in submissions by interested parties that, properly applied, TSLRIC+ is an appropriate pricing principle for the ULLS.

In relation to CCA, which Telstra's older submission suggests may be appropriate, the ACCC has noted in the past that the use of accounting data can be problematic:[38]

> Accounting costs are largely a record of previously incurred or embedded costs which do not necessarily represent the forward-looking or ongoing costs of providing the service using the most efficient means commercially available. Furthermore, it can be difficult in an accounting framework to identify the source of many costs and allocate them to a particular service.

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

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35 ibid, pp. 29-31.

36 Australian Competition Tribunal, *Seven Network Limited (No 4)* [2004] ACompT 11 at [135] to [136].

37 ibid, at [137].

38 ACCC, *Access pricing principles—telecommunications—a guide*, July 1997, p. 31.

The ACCC also notes the data limitations of accounting data, as discussed above. While Telstra's Regulatory Accounting Framework (RAF) data is provided in accordance with the reporting requirements set out in the RAF, the relevant Record Keeping Rules (RKRs) do not set out in detail how costs relating to a particular service should be allocated.[39] Rather, the RKRs provide general principles and 'high level' allocation methods which telecommunications carriers can apply in a number of different ways. The ACCC does not accept or reject a particular carrier's cost allocation method or assess the efficiency of the resulting cost allocation, it merely raises issues where there is non-compliance with the high-level principles set out in the RKRs. Accordingly, there may be an absence of reliable accounting cost data attributed to particular services on which to base a CCA approach, even if total cost amounts were appropriate.

Given these considerations, the ACCC considers that CCA is not a desirable pricing principle for the ULLS. CCA information might provide some indication of a possible upper bound of access prices, but is not an appropriate pricing principle for the ULLS.

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

Given the ACCC's previous views, the Tribunal's guidance and the submissions made by the parties, the ACCC will continue to apply a TSLRIC+ pricing principle to the ULLS. The ACCC considers that a TSLRIC+ pricing principle best accords with the relevant legislative matters.

3.2 Implementation of the pricing principles

The choice of the broad pricing principle is only the first step in making the pricing principles for a declared service such as the ULLS. The particular implementation of the pricing principles is also significant.

It is necessary to consider both ULLS monthly charges and connection charges.

There are two cost components in the monthly provision of a ULLS. These are:

- the specific costs of providing the ULLS
- the costs of the line which constitutes the ULLS.

[39] ACCC, *Telecommunications industry regulatory accounting framework (Record-keeping rules)*, October 2003.

The inclusion of both these cost components is relatively non-controversial. However, the measurement and appropriate recovery of the costs has been the subject of significant debate.

The connection charges for the ULLS relate to the costs of technicians performing jumpering work inside Telstra exchanges, travel and vehicle costs for the technicians, back-of-house costs and materials costs.

Specific costs

The specific costs of providing the ULLS are the costs incurred by Telstra to allow for supply of the declared ULLS. The costs typically claimed by Telstra are:

- IT system development and operational costs
- connection group costs
- wholesale product management costs
- indirect costs.

It is important to consider that an access provider can use copper loops itself, or can provide access for another service provider to use them. Further, copper loops can be used to provide a single service (typically a single voice service), or can be 'shared' so as to provide a combination of voice and broadband services.

An access provider will face the above categories of cost when:

(i) supplying the ULLS (or LSS) to another service provider or

(ii) when providing line sharing to itself – that is, when it uses a copper loop to supply both voice and data services (either retail or wholesale) on the line.

Accordingly, in addition to incurring specific costs to allow for the supply of the ULLS, Telstra also incurs equivalent specific costs to allow for the supply of the declared LSS, or when supplying line sharing to itself to provide ADSL services over the line. Telstra would also arguably incur such costs in provisioning a voice service to an end-user.[40]

Telstra has previously provided detailed documentation and models about the amount of costs it incurs in providing the ULLS.[41] The ACCC has noted in the past that the amount of specific costs claimed by Telstra may be overstated.[42]

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40 The ACCC has noted previously that an appropriate number of services could be as wide as all active CAN lines. ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 132.

41 see, e.g. Telstra, *Telstra's submission in support of the ULLS monthly charge undertakings dated 13 December 2004*, March 2005, Annexure C; Telstra, *Telstra's submission in support of the ULLS monthly charge undertakings dated 23 December 2005*, 23 December 2005, p. 15.

42 ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings - final decision*, December 2005, pp. 57-62. The discussion deals with both ULLS and LSS specific costs.

However, an issue that has been more controversial and has a significant bearing on the level of ULLS monthly charges is the method of recovery of the specific costs and the range of services over which the specific costs should be recovered.

The ACCC has expressed the view that 'ULLS-specific costs' should not, under the legislative matters, be allocated to ULLS lines alone. Rather, the ACCC considered that 'ULLS-specific costs' should be combined with, at the least, 'LSS-specific costs' and Telstra's internal equivalent costs for ADSL, and then allocated across a broader range of services.[43] In other words, all *equivalent* costs should be measured and allocated across a broader demand base. The ACCC's position on, and analysis of, 'ULLS-specific costs' is consistent with its position on, and analysis of, 'LSS-specific costs'.

It is important to note that, under the ACCC's preferred approach, the costs to pool and allocate are limited to the like-for-like or equivalent incremental costs associated with:

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

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

Given that the ULLS is also a service relevant to the provision of voice services, it could also be argued that the like-for-like or equivalent incremental costs associated with Telstra's own internal request for a voice service, and distribution over the total number of voice services in the network, could be appropriate.[44] The ACCC notes that, at a minimum, the like-for-like costs associated with Telstra's internal requests for line sharing for ADSL should be included.

Contrary to the ACCC's position, Telstra has contended that 'ULLS-specific costs' should be recovered from ULLS lines alone.[45]

Submissions

Telstra's 2007 submission reiterates its position that "ULLS-specific costs" should be recovered from ULLS users only.[46] Telstra submits that any other allocation of costs

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43 ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings - final decision*, December 2005. pp. 39-41, 45-62; ACCC, *Assessment of Telstra's ULLS monthly charge undertaking - final decision*, August 2006, p. 132-160.

44 ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 132.

45 Telstra, *Public version of Telstra's confidential response to the Commission's draft decision on Telstra's ULLS monthly charges undertakings dated 23 December 2005*, 7 August 2006, pp. 37-42.

46 Telstra, *Telstra response to "Fixed Services Review: Further Consultation on draft ULLS pricing principles" of October 2007"*, November 2007, p. 8.

is contrary to the ACCC's consideration of the direct costs of the ULLS. Optus considers that ULLS specific costs should be allocated across all CAN lines.[47]

ACCC's view

The ACCC's most recent public assessment of the approach to recovery of specific costs was in its August 2006 decision on Telstra's ULLS undertaking. In that assessment, the ACCC considered the merits of Telstra's approach to the recovery of specific costs against the legislative reasonableness matters discussed above. Significant ACCC conclusions were that:

- a broader cost recovery basis "leads to an outcome which more closely approaches a competitive outcome" and better leads to competitive neutrality than Telstra's narrower approach[48]

- a broader cost recovery basis will give Telstra stronger incentives to invest in efficient technology and will better promote efficient access seeker investment in alternative infrastructure, compared to Telstra's narrower approach[49]

- Telstra's legitimate business interests will be met under either approach, but Telstra's narrower approach will go beyond what is needed to protect those legitimate business interests[50]

- a broader cost recovery basis better allows access seekers to compete for end-users on their merits, provides a more stable price and provides greater certainty, and thus better allows for the interests of access seekers than Telstra's narrower approach[51]

- either approach could be considered commensurate with the recovery of the direct costs of providing access to the declared service, but the fact that the costs are caused by declaration, rather than end-users alone, supports a wider cost recovery base[52]

- a broad recovery base for specific costs will better lead to the promotion of productive and allocative efficiency.[53]

Accordingly, the ACCC considered that a broader recovery base better accords with the matters to which the ACCC typically has regard when considering pricing. The ACCC has drawn similar conclusions in relation to LSS specific costs,[54] and has applied the principle in setting a $2.50 monthly price in recent final determinations in

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47 Optus, *Further consultation on draft ULLS pricing principles,* 8 Nov 07, p. 3.
48 ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision,* August 2006, p. 136.
49 ibid, p. 139.
50 ibid.
51 ibid, p. 140.
52 ibid, p. 143.
53 ibid, p. 145.
54 ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings—final decision,* December 2005, pp. 49-57.

Chime-Telstra and Request-Telstra LSS access disputes.[55] The ACCC also applied the principle in making recent pricing principles for the LSS. Much of the following analysis and conclusions reflects analysis and conclusions from that assessment.[56]

Telstra has appealed the issue of the recovery of specific costs on two occasions. It appealed to the Australian Competition Tribunal both the ACCC's December 2005 decision to reject Telstra's LSS monthly charge undertaking and the ACCC's August 2006 decision to reject Telstra's ULLS monthly charge undertaking. Both ACCC decisions took the same position on specific costs.

The Tribunal affirmed the ACCC's position to reject the undertakings on both appeals, and agreed with the ACCC that the broader recovery base was the appropriate approach to specific costs. In the LSS decision, the Tribunal concluded, after assessing Telstra's proposed approach against the reasonableness matters, that:[57]

> As we noted in respect of the levelisation issue, it is no part of our task to decide whether one form of cost allocation is more reasonable than another form of cost allocation. Our task is to determine whether the manner in which Telstra has determined its monthly per unit costs is reasonable having regard to the statutory matters to which we have referred. We have reached the conclusion that it is not so reasonable. However, it follows from our analysis that a reasonable approach to cost allocation should go beyond allocating the costs of providing the LSS to LSS lines alone, and that any method should allocate costs at least over active DSL lines. We leave open for later consideration whether cost allocation should be over all active or potentially active DSL lines. However, we note that, at the least, the cost allocation should be over all active DSL lines.
>
> On balance, we do not consider that allocating costs across only LSS lines is likely to give rise to a per unit cost estimate for providing the LSS (and a charge determined in reliance upon this cost estimate) that is reasonable.

Equivalently, the Tribunal made the following statement about specific costs in the context of the ULLS decision:[58]

> We do not accept Telstra's submission that the specific costs incurred by it in providing the ULLS should only be allocated to, and recovered from, the ULLS and should not be allocated across a broader range of services, such as all active or potentially active xDSL lines.

Given the ACCC's views on the recovery of specific costs in two previous undertaking assessments, and the Australian Competition Tribunal's endorsement of those views on two occasions, the ACCC considers that 'ULLS-specific costs' should not be recovered from ULLS lines alone. Telstra's proposed approach does not accord with the relevant legislative matters that the ACCC must have regard to when making pricing decisions. No submissions made in response to the draft ULLS pricing principles present any substantive arguments suggesting that the views of the ACCC and the Tribunal are in error.

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55 See, e.g., ACCC, *Access dispute between Chime Communications and Telstra—LSS—publication of final determination and associated statement of reasons*, June 07, published 8 August 07, available at http://www.accc.gov.au/content/index.phtml?itemId=793060

56 ACCC, *Review of the line sharing service declaration—final decision*, October 2007, p. 71-110.

57 Australian Competition Tribunal, *Telstra Corporation Ltd (ACN 051 775 556)* [2006] ACompT 4 at [161].

58 Australian Competition Tribunal, *Telstra Corporation Ltd (No. 3)* [2007] ACompT 3 at [396].

The ACCC noted in the making of its LSS pricing principles that the broad recovery base was not inconsistent with the legislative matter in section 152CR(1)(d) of the TPA.[59] This is contrary to Telstra's submissions in both this process and the LSS pricing principles process.

Section 152CR(1)(d) requires the ACCC to take account of the direct costs of the service. The ACCC has taken account of those costs in making this and previous decisions about specific costs. It considers that the appropriate way for those costs to be recovered, having regard to all the legislative matters, is by using a broad recovery base. The ACCC further notes the Tribunal's views on this point in its decision on Telstra's LSS undertaking, as endorsed by the Tribunal in its assessment of Telstra's ULLS undertaking.[60] In its decisions, the Tribunal considered that the relevant inquiry, when considering the direct costs of providing access to a declared service, is whether Telstra would be able to recover its direct costs of providing access to the LSS (or ULLS). The Tribunal considered in the LSS decision that there are a number of cost allocation methods, other than the recovery of LSS specific costs solely from LSS charges, that would enable Telstra to recover its direct costs of the LSS.[61] The Tribunal specifically identified the ACCC's use of a broad recovery base as one of those methods.

The ACCC considers that its approach is entirely consistent with the requirements of section 152CR(1)(d) of the TPA. The ACCC is satisfied that Telstra will recover its ULLS specific costs under the broad recovery base approach.

Telstra has further submitted in other regulatory contexts that the ACCC's approach does not allow it to exploit economies of scale and scope in the provisioning of its retail services. However, the ACCC considers that such an argument is misconceived as it fails to realise that the ACCC's approach to specific costs also drives economies of scale and scope by encouraging the uptake of DSL, LSS and ULLS services and generating efficiencies.

Accordingly, it is the ACCC's pricing principle that 'ULLS-specific costs' should be combined with 'LSS-specific costs' and 'Telstra's internal equivalent costs when providing internal line-sharing', and then allocated across the active number of ULLS, LSS and ADSL lines.

The ACCC notes that, arguably, the costs could be allocated over a greater number of lines.[62] Optus makes such a submission in response to the ACCC's draft pricing principles.[63] However, the ACCC considers that, at the present time, the ULLS and LSS would be likely mainly used where an end-user seeks a DSL service (either with or without voice) and that ULLS and LSS based supply is driving competition in DSL services. Accordingly, the ACCC considers that, while its proposed approach is conservative, using the active number of ULLS, LSS and ADSL lines is an

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59 ACCC, *Review of the line sharing service declaration—final decision*, October 2007, p. 71-110.

60 Australian Competition Tribunal, *Telstra Corporation Ltd (No. 3)* [2007] ACompT 3 at [400].

61 Australian Competition Tribunal, *Telstra Corporation Ltd (ACN 051 775 556)* [2006] ACompT 4 at [130].

62 ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings—final decision*, December 2005, Appendices A and F; ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, Appendix E.

63 Optus, *Further consultation on draft ULLS pricing principles*, 8 Nov 07, p. 3.

appropriate measure. The ACCC has used this recovery base in setting the $2.50 monthly charge to recover specific costs in recent final determinations in Chime-Telstra and Request-Telstra LSS access disputes[64] and its final LSS pricing principles and accompanying indicative prices.[65]

Network costs models, assumptions and inputs

The relevant amount of network costs for the ULLS has been a subject of considerable debate. As noted in Appendix A, the issue of network costs has been a subject of debate in assessments of ULLS undertakings. In particular, the appropriate model for determining network costs, and the appropriate inputs for any such model, has been particularly controversial.[66]

Submissions

Optus submits that the PIE II model as presented by Telstra is not an appropriate model for determining access prices for the ULLS.[67] Optus submits that, should it be used to set prices, the PIE II model must be subject to adjustment. Optus also submits on cost of capital inputs and the appropriateness of tilted annuities.

Telstra submits that, in setting ULLS prices, it will be necessary to consider the technical limits of the ULLS.[68] Telstra in particular submits that the ULLS requires the use of copper, and that pricing should reflect this.

ACCC's view

The ACCC notes the various submissions made by Optus and Telstra. The ACCC considers that these specific matters are more relevant to applying the pricing principles in making regulatory pricing decisions. The ACCC does not consider that pricing principles are a relevant place to consider these issues further.

Averaging or de-averaging

ULLS prices were based on a geographic de-averaged price structure since the declaration of the service in 1999. This pricing structure was adopted by Telstra and the ACCC to reflect significant cost differentials between four different geographic regions—CBD, metropolitan, regional and rural areas. However, following the Government's decision to require Telstra to offer a basic line rental product

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

65 ACCC, *Review of the Line sharing service declaration—final decision*, October 2007, p. 89-91.

66 See, for example, in relation to the n/e/r/a model, ACCC, *Pricing of unconditioned local loop services (ULLS)—final report*, March 2002; in relation to the PIE II model, ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, Appendix B.

67 Optus, *Further consultation on draft ULLS pricing principles*, 8 Nov 07, p. 3.

68 Telstra, *Addressing the pricing principles for the ULLS, PSTN OTA, LCS and WLR services and the draft price related terms and conditions for the PSTN OTA, LCS and WLR services*, 11 September 2006, p. 8; Telstra, *Telstra response to "Fixed Services Review: Further Consultation on draft ULLS pricing principles" of October 2007"*, November 2007, p. 7.

(HomeLine Part and BusinessLine Part) at the same price across the country,[69] Telstra now argues that ULLS prices should be geographically averaged.[70]

The geographic de-averaging of ULLS prices has been the subject of significant debate in recent years. In particular, Telstra's December 2005 ULLS monthly charge undertaking proposed a geographically averaged price of $30 per month in all geographic Bands. The ACCC rejected that undertaking, and considered that it could not be satisfied that Telstra's proposed averaged ULLS charge was reasonable.[71] The Australian Competition Tribunal upheld the ACCC's decision and also concluded that it could not be satisfied that Telstra's proposed averaged ULLS charges were reasonable. [72]

Submissions

iiNet, Agile, Amcom and Adam submit that geographic averaging would adversely affect competition and distort usage and investment decisions.[73] They submit that the differences between costs in the different bands are material such that competition would be materially distorted if prices were averaged. iiNet, Agile, Amcom and Adam submit that any issues relating to the Universal Service Fund should be addressed in a review of the Universal Service Regime rather than in ULLS pricing principles.[74] Finally, they submit on a possible price cap on regional ULLS charges

AAPT/PowerTel submit that prices should be de-averaged because averaged pricing necessarily means a shift away from the benefits of a TSLRIC+ approach.[75] It submits that "averaging will have serious negative impact on competition in the downstream markets for xDSL based broadband services and voice services".[76]

The Competitive Carriers' Coalition submits that ULLS prices should be geographically de-averaged.[77]

Austar submits that a "de-averaged approach to ULLS pricing is more directly cost reflective. It will be a more appropriate basis for build or buy decisions by prospective competitors than a fully averaged price."[78] Austar submits that fully averaged prices would make it impossible for alternative infrastructure-based providers to compete with Optus and Telstra.

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69 Minister for Communications, Information Technology and the Arts, *Explanatory statement—Telecommunications (Consumer protection and service standards) Act 1999—Telstra Carrier Charges – Price Control Arrangements, Notification and Disallowance Determination No. 1 of 2005*, (*Amendment No. 1 of 2006)*, 27 Feb 2006.

70 See, e.g., Telstra, *Telstra's submission in support of the ULLS monthly charge undertakings dated 23 December 2005*, 23 December 2005, p. 31.

71 ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 98.

72 Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [291]

73 iiNet, Agile, Amcom and Adam Internet, *Fixed services review—further consultation on draft ULLS pricing principles*, 8 November 2007, p. 2-5.

74 ibid, p. 4.

75 AAPT/PowerTel, *Submission by AAPT and PowerTel to the ACCC in response to Fixed Services review—further consultation on draft ULLS pricing principles*, October 2007, p. 4.

76 ibid.

77 Competitive Carriers Coalition, *Submission on ULLS draft pricing principles*, 2 Nov 07, p. 1.

78 Austar, *Response to Fixed services review (Further consultation on draft ULLS pricing principles)*, 6 Nov 07, p. 1.

Optus submits that ULLS prices should be geographically de-averaged. It submits that this is consistent with the findings of the Australian Competition Tribunal.[79]

Telstra argues that it incurs losses in supplying access services to high-cost rural areas, and that these losses are caused by the HomeLine/BusinessLine Part retail pricing parity obligation and an inadequacy in the Universal Service Fund.[80] Telstra accordingly argues in favour of geographic averaging to avoid these losses. Telstra also argues that geographic averaging of ULLS prices is consistent with:[81]

- the approach in other industries
- the views of the OECD
- Government policy
- overseas jurisdictions
- the relevant legislative matters in the TPA.

Telstra notes however that, should the Universal Service Fund provide it with adequate compensation for rural areas, then it would agree that ULLS prices should be de-averaged.[82]

ACCC's view

The ACCC conducted significant analysis on geographic averaging of ULLS prices in its decision to reject Telstra's December 2005 ULLS undertaking.[83] The Australian Competition Tribunal also discussed in some detail the merits of geographically averaged ULLS prices in its decision to uphold the ACCC's view on that undertaking.[84] The ACCC does not propose to revisit the entirety of those analyses here. However, it considers it appropriate to deal with the significant issues relating to geographic averaging.

The ACCC reached a view in its undertaking assessment that it was not satisfied that Telstra's proposed averaged ULLS charges were reasonable.[85] In particular, the ACCC considered that averaged pricing would adversely affect competition in the markets for basic telephony and broadband services, and distort usage and investment decisions, resulting in the inefficient use of, and investment in, telecommunications infrastructure.

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79 Optus, *Further consultation on draft ULLS pricing principles,* 8 Nov 07, p. 3.

80 Telstra, Telstra, *Telstra response to "Fixed Services Review: Further Consultation on draft ULLS pricing principles" of October 2007"*, November 2007, p. 6.

81 ibid. p. 6-7.

82 ibid. p. 7.

83 ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision,* August 2006, Appendix C.

84 Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [53] to [291]

85 ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 98.

The ACCC noted that Telstra had a legitimate business interest in recovering its costs of complying with its retail parity obligation. However, it was not satisfied that Telstra would not be adequately compensated for those costs without averaged pricing due to the limited scope of the parity obligation and the role of the Universal Service Fund in compensating for retail parity.[86]

Telstra appealed the ACCC's decision to the Australian Competition Tribunal. The Tribunal made the findings that geographic averaging of ULLS prices:[87]

- is not likely to achieve the promotion of competition
- is not likely to achieve the objective of encouraging the economically efficient use of infrastructure or encouraging economically efficient investment in infrastructure by access seekers
- may, in principle, achieve the objective of encouraging economically efficient investment by Telstra
- is likely to ensure Telstra's legitimate business interests, provided the Universal Service Fund does not fully recover losses made by Telstra in providing retail line rental services in rural areas
- is not in the interests of access seekers.
- should not, of itself, lead to the recovery of more than direct costs.

The Tribunal concluded that it could not be satisfied that Telstra's proposed averaged ULLS charges were reasonable.[88] The ACCC considers that the Tribunal's guidance remains appropriate. However, the consideration of averaging requires a careful balancing of the various relevant legislative matters.

In relation to the particular points raised by Telstra about the consistency of averaging with other industries or jurisdictions, these examples need to be treated with caution. As noted above in the ACCC's consideration of the appropriate broad pricing principle, the differences between different regimes may significantly limit the comparability of overseas jurisdictions. Relevant differences include the definition of the regulated service, the applicable regulatory framework and government policy, the geographic price structure, the cost of capital, the prescribed cost standard (if any) and population concentration and distribution (as opposed to just population density).

Even more caution needs to be taken when comparing pricing approaches in industries other than communications, as there may be fundamental differences between industries. The nature of the product provided, the prospects for bypass and the regulatory regime may in particular be significantly different. For example, the ACCC noted in the Sydney Water decision cited by Telstra that the NSW government did not have a USO-style scheme in water provision.[89] The ACCC also noted in that report that sewerage prices are not geographically averaged across the whole of

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86 ibid.

87 Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [285]–[287]

88 Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [291]

89 ACCC, *Access dispute between Services Sydney Pty Ltd and Sydney Water Corporation—Arbitration report*, 19 July 2007, p. 44.

Australia.[90] In any case, the ACCC needs to have regard to the relevant matters in the TPA, rather than merely what might or might not happen in other industries.

The ACCC has previously considered that the OECD report quotation that Telstra includes in its submission is selective.[91] In particular, the full extract is:[92]

> In regard to geographic differentiation of prices, as before, if the scope for competition is to be maximised and if end-user charges are to be preserved, the structure of access charges should reflect the structure of the end-user charges. If end-user prices are geographically averaged, and ULL charges are based on actual costs, the entrants will have a strong incentive to only request unbundled local loops in low-cost areas, intensifying competition in those regions and driving down retail prices in those areas, raising prices in other areas. If geographic de-averaging of end-user prices is the objective (and this cannot be achieved directly by controlling end-user prices), it may in fact make sense to geographically de-average ULL charges. On the other hand, if the regulator wishes to preserve the geographically averaged structure of enduser prices, it is essential to geographically average ULL prices.
>
> Geographic averaging of ULL charges has the disadvantage that it may induce inefficient network duplication in low-cost areas. Entrants will have strong incentives to duplicate existing networks in regions where the incumbent's charges are above cost and little incentive to build duplicate networks (even when it is efficient to do so) in regions where the incumbent's charges are below cost. If it were known for sure what parts of the local loop network are a genuine natural monopoly (for which any duplication would be inefficient) these problems could be resolved through a simple ban on new local loop investment in the natural monopoly areas. But, in practice, it is not possible to determine in advance which parts of the network are a natural monopoly – this depends on demand patterns and technology that are continuously changing. For this reason, regulation of entry is considered undesirable.
>
> A preferable approach (explained further in the previous chapter) is to set the price for unbundled local loop equal to the "cost" of those loops, and to use taxes on the retail products of the incumbent and its rivals to recover any fixed costs or access deficit. In practice, this would likely imply the establishment of some form of universal service funding mechanism, which "taxed" the revenues of local loop providers in low-cost areas and used those funds to subsidise the activities of local loop providers in high-cost areas.

The ACCC considers that the full extract demonstrates that the OECD's support for averaged ULLS charges as a mechanism to combat the distortions from uniform retail prices is limited to situations where network bypass in natural monopoly areas is banned by the regulator. If this is not possible, the OECD advocates cost based access pricing and the use of a broad based retail tax to cover the deficit.

The ACCC has previously noted that the retail pricing parity obligation is limited only to the HomeLine Part and BusinessLine Part product.[93] Accordingly, the extent of the government's policy is limited to a very specific product that is not taken by a significant proportion of the population. However, the ACCC notes the Tribunal's view that the parity obligation would, "to some extent, constrain Telstra's pricing of bundled offerings that include the provision of line rental services".[94]

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90 ibid, p. 46.

91 ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 87.

92 OECD Competition Committee, Access Pricing in Telecommunications, Paris, 2004, pp 134-135

93 ACCC, *Assessment of Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 95.

94 Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [224]

A significant issue in the consideration of geographic averaging is the extent to which Telstra recovers sufficient money to compensate it for any losses it suffers as a result of the retail pricing obligation and any competition that materialises in urban areas. In particular, it is relevant to consider the extent to which the USF compensates Telstra for any losses. Telstra notes in its 2007 submission that, were it provided with adequate compensation from the Universal Service Fund, it would be appropriate that prices were de-averaged.[95]

The Tribunal, in its decision on Telstra's undertaking, was not satisfied that the Universal Service Fund did not fully compensate Telstra for any losses made by Telstra in providing retail line rental services in rural areas.[96] Furthermore, the Universal Service Obligation is currently the subject of a review by the Department of Communications, Information Technology and the Arts.[97] The outcome of this review is still uncertain.

The ACCC notes that it recently conducted an analysis of Telstra's recovery of its line costs using data from Telstra's RAF.[98] The ACCC examined the RAF accounts to which Telstra's allocates its CAN costs, which are fixed line voice and data services that use the CAN as the access technology. After comparing the revenues and costs for those services, the ACCC noted that the RAF data demonstrated that Telstra is currently recovering its line costs across the services to which it allocates these costs.[99] Accordingly, this analysis would demonstrate that, at this stage, competition in urban areas is not currently at a level that would lead to Telstra suffering losses as a result of the retail pricing parity obligation, as overall line costs are adequately being recovered.

Having regard to previous consideration by the ACCC and the Tribunal on the issue of geographic averaging of ULLS charges, and the analysis above, the ACCC considers that geographic averaging of ULLS charges would not be appropriate, having regard to the relevant legislative matters. Accordingly, the ACCC's pricing principle is that ULLS prices should be geographically de-averaged.

Connection charges and related issues

As noted above, the connection charges for the ULLS relate to the costs of technicians performing jumpering work inside Telstra exchanges, travel and vehicle costs for the technicians, costs of back-of-house management or assistance for technicians, materials costs and indirect costs. The ACCC has previously considered such charges in its assessment of Telstra's ULLS connection charge undertaking.[100] Telstra

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95 Telstra, *Addressing the pricing principles for the ULLS, PSTN OTA, LCS and WLR services and the draft price related terms and conditions for the PSTN OTA, LCS and WLR services*, 11 September 2006, p. 7-8; Telstra, *Telstra response to "Fixed Services Review: Further Consultation on draft ULLS pricing principles" of October 2007"*, November 2007, p. 7.

96 Australian Competition Tribunal, *Telstra Corporation Ltd (No 3)* [2007] ACompT 3 at [258]

97 DCITA, *Telecommunications Universal Service Obligation (USO) review issues paper*, August 2007.

98 ACCC, *Review of the Line sharing service declaration—final decision*, October 2007, p. 89-91.

99 ibid.

100 ACCC, *Assessment of Telstra's ULLS and LSS undertakings relating to connection and disconnection charges—draft decision*, December 2005.

withdrew that undertaking after the ACCC released a draft decision. The ACCC is also considering ULLS connection charges in arbitrations currently before it.[101]

Submissions

Telstra submits that it does not object to the use of a TSLRIC+ pricing principles for determination of ULLS connection charges.[102] iiNet, Agile, Amcom and Adam do not submit on the pricing of connection charges but express frustration at the absence of a migration process between LSS and ULLS.[103]

ACCC's view

The ACCC considers that a TSLRIC+ pricing principle should be applied to connection charges in the same way as for monthly charges. The charges should be set to recover these costs that an efficient access provider will incur on a forward-looking basis.

In relation to the submission of iiNet, Agile, Amcom and Adam, the ACCC notes that it has recently considered the effects of the absence of a LSS-ULLS migration path.[104] The ACCC noted that the absence of a migration path may have implications for the substitutability of ULLS with other products. The ACCC does not consider that pricing principles are a relevant place to consider this issue further.

A number of practical issues arise in implementing a TSLRIC+ principle for ULLS connection charges. As the connection processes are similar for the LSS, a number of these issues are similar to the ACCC's consideration of connection charges for the LSS.[105] In particular, the ACCC would be minded to assess jumpering, travel, vehicle and tool costs based on charges paid by Telstra to third party contractors to perform jumpering work in Telstra exchanges.[106] This is because Telstra tenders out connections work to contractors on a competitive basis and a contractor performing the work would incur the costs associated with technician labour, vehicles, travel, tool and materials (copper wire). Accordingly the ACCC considers that contractor charges would be an appropriate basis upon which to assess the efficient, forward-looking level of these costs.

It would also be necessary to allow an appropriate recovery for efficient back-of-house activities through the use of a simple bottom-up cost model.[107] An allocation for indirect costs such as labour on-costs or contract management costs should also be

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101 A list of current arbitrations is available at: http://www.accc.gov.au/content/index.phtml?itemId=635059

102 Telstra, *Telstra response to "Fixed Services Review: Further Consultation on draft ULLS pricing principles" of October 2007"*, November 2007, p. 8.

103 iiNet, Agile, Amcom and Adam Internet, *Fixed services review—further consultation on draft ULLS pricing principles*, 8 November 2007, p. 5.

104 ACCC, *Review of the Line sharing service declaration—final decision*, October 2007, p. 54-55.

105 ibid, p. 99-102.

106 ACCC, *Assessment of Telstra's ULLS and LSS undertakings relating to connection and disconnection charges—draft decision*, December 2005, p. 29-40.

107 ibid, p. 40-45.

allowed. An allowance of around 10 per cent above contract rates is reasonable for contract management, based on Telstra's own modelling of supervision costs.[108]

Accordingly, it is the ACCC's pricing principle that connection charges should be set with reference to the amounts charged by third party contractors to Telstra for jumpering work in exchanges, indirect costs and back-of-house costs.

Investment levels and price setting where competitive infrastructure exists

Telstra also submits on the effect of ULLS pricing decisions on CAN investment.

Submissions

Telstra submits that the current level of pricing of regulated products such as ULLS and LSS is distorting build vs buy incentives in Australia.[109] It submits that investment in alternative end-to-end networks by competitors has been minimal. Telstra also presents arguments that investment in Australian telecommunications lags that in the USA and compared to other Australian industries.

Telstra concludes that this evidence means the ACCC should not set prices on a TSLRIC+ basis in areas there are alternative fixed-line networks.[110]

ACCC's view

The ACCC notes Telstra's submissions about the levels of investment in Australian telecommunications. However, the ACCC considers that there can be a number of explanations of investment levels in an industry and that telecommunications investment in particular can be significantly cyclical. Other data sources would also seem to indicate that investment in Australian telecommunications is relatively high on a world scale.[111] The ACCC notes that the relative size of the other Australian industries in Telstra's comparison is also a significant factor to be considered.

In respect of investment in alternative end-to-end networks by competitors, the ACCC considers that it will best provide signals for build vs. buy decisions by setting efficient cost-based prices. The TSLRIC+ pricing principle should allow access seekers to best assess the appropriate investments for use in various regions. The ACCC also notes that there may be reasons other than price why a ULLS might be used in conjunction with an alternative network, such as technical infeasibility for certain technology types. The ACCC notes that the relationship and constraint between alternative networks will be the subject of further consideration in its upcoming review of all declared fixed network services.[112]

The ACCC considers that it should not adopt the conclusion proposed by Telstra.

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108 ibid, p. 31; ACCC, *Assessment of Telstra's LSS undertaking relating to connection and disconnection charges—final decision*, April 2006, pp. 27-28.

109 Telstra, *Telstra response to "Fixed Services Review: Further Consultation on draft ULLS pricing principles" of October 2007"*, November 2007, p. 3.

110 ibid, p. 6.

111 See, e.g. OECD, *OECD Communications Outlook 2007*, p. 108, which places Australia fourth in the OECD for per capita telecommunications investment.

112 ACCC, *Fixed services review - a second position paper*, April 2007, p. 28.

3.3 Conclusion

In conclusion, the ACCC's final ULLS pricing principles are that:

- a TSLRIC+ pricing principle should be applied to the ULLS
- a specific cost component should be included in the ULLS monthly price, calculated by combining 'ULLS-specific costs' with 'LSS-specific costs' and Telstra's internal equivalent costs for ADSL, and allocating those costs across the number of active ULLS, LSS and ADSL lines
- the ULLS charges should be geographically de-averaged
- connection charges should be set with reference to the amounts charged by third party contractors to Telstra for jumpering work in exchanges, indirect costs and back-of-house costs.

Appendix A. Background

2002 pricing principles

The ACCC first declared the ULLS in July 1999,[113] and finalised pricing principles for the ULLS in March 2002.[114]

The notable conclusions in those principles were:[115]

- a TSLRIC+ pricing methodology was most appropriate for pricing the ULLS
- the ULLS price should be de-averaged
- no access deficit contribution should be included in ULLS access prices.

The ACCC concluded that the ULLS monthly charge should consist of two components:

- network costs, to recover the cost of the copper loops that constitute the ULLS,
- some form of incremental specific cost of providing the ULLS—essentially the capital expenditure and operating and maintenance costs of IT systems for ordering and provisioning ULLS, and operating costs associated with ULLS product management and front-of-house operations.

The ACCC also noted that other relevant charges would include service qualification charges and connection fees for the ULLS.[116]

Events since the 2002 pricing principles

Following the declaration of the ULLS in July 1999 and the ULLS pricing principles in August 2002, a number of events have occurred that are relevant to the future pricing of the ULLS:

- the ACCC issued model prices for the ULLS
- Telstra submitted four sets of undertakings about the price of the ULLS
- the ACCC re-declared the ULLS
- the Australian Competition Tribunal considered a Telstra ULLS undertaking
- the ACCC has arbitrated and continues to arbitrate a number of ULLS access disputes.

113 ACCC, *Declaration of Local Telecommunications Services*, July 1999.
114 ACCC, *Pricing of unconditioned local loop services (ULLS)—final report*, March 2002.
115 ibid, p. 15-26.
116 ibid, p. 28-29.

Model terms and conditions

In October 2003, the ACCC issued model price and non-price terms and conditions for the ULLS, LCS and PSTN OTA services in accordance with section 152AQB of the TPA. The ACCC stated that:[117]

> In this Final Determination [of model prices], the Commission considers it would be important to specify a single rate which would effectively form the upper bound in any future negotiations. This would also provide greater certainty about the Commission's position on any upper-bound level.

The ACCC's upper bound prices for the ULLS were $13, $22, $40 and $100 in Bands 1, 2, 3 and 4 respectively. Those prices were determined by reference to a specific cost amount of $10 per line.

Undertakings

In January 2003, Telstra submitted ULLS undertakings as part of a bundle of core undertakings for the PSTN OTA, LCS and ULLS core services. The January 2003 undertakings proposed a $20 a month charge for the ULLS in Band 1 and a $40 a month charge in Bands 2, 3 and 4.

Telstra then submitted replacement undertakings in November 2003, following the release of the ACCC's model terms and conditions. Those undertakings proposed prices of $13, $22, $40 and $100 in Bands 1, 2, 3 and 4 respectively. Following public consultation, the ACCC issued a draft decision rejecting the undertaking in October 2004.[118] The ACCC was of the view that Telstra's proposed adjustment mechanism—which took the above prices as price floors and increased prices if certain demand levels were not met—was not reasonable.[119] The ACCC also noted that it would not be appropriate to continue the recovery of ULLS–specific costs from ULLS lines alone in later regulatory periods.[120] Following the ACCC's draft decision, Telstra withdrew the access undertaking.

Telstra then submitted two sets of ULLS undertakings in December 2004, at the same time as submitting two sets of LSS undertakings. The December 2004 ULLS monthly charge undertakings proposed a ULLS monthly charge of $13, $22, $40 and $100 per month in Bands 1, 2, 3 and 4 respectively. The December 2004 ULLS connection charge undertakings proposed ULLS connection charges of $93, $98, $98 and $108 in Bands 1, 2, 3 and 4. Following its public consultation, the ACCC in December 2005 rejected the monthly charge undertakings and issued a draft decision to reject the connection charge undertakings.[121] Telstra withdrew the connection charge undertaking following the draft decision.

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117 ACCC, *Final determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003, p. 5.

118 ACCC, *Assessment of Telstra's undertakings for PSTN, ULLS and LCS—draft decision*, October 2004.

119 ibid, p. 72.

120 ibid, p. 64.

121 ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings—final decision*, December 2005; ACCC, *Assessment of Telstra's ULLS and LSS undertakings relating to connection and disconnection charges—draft decisions*, December 2005.

A significant factor in the ACCC's decision to reject the monthly charge undertakings in December 2005 was the ACCC's view that, under the legislative matters in the TPA, Telstra's proposed method of recovering the incremental cost categories that it incurs when supplying the ULLS was not reasonable. The ACCC considered that 'ULLS-specific costs' should be combined with 'LSS-specific costs' and 'Telstra's internal equivalent costs for ADSL', and then allocated across a broader range of services.[122] The ACCC also rejected Telstra's proposed IEN bypass charge,[123] rejected any need for an access deficit contribution,[124] and considered that Telstra's claimed network costs were unlikely to be reasonable.[125]

Telstra appealed the ACCC's decision on the LSS monthly charge undertaking, where the ACCC had reached the equivalent conclusion in relation to LSS-specific costs, to the Australian Competition Tribunal. It did not appeal the ULLS undertaking decision. Instead, Telstra proposed another ULLS monthly charge undertaking in December 2005. That undertaking proposed a geographically averaged charge of $30 per month in all bands.

Following a public consultation, the ACCC rejected the geographically averaged ULLS undertaking in August 2006. Among other conclusions, the ACCC considered that it could not be satisfied that Telstra's proposed geographically averaged charge for the ULLS would be reasonable, having regard to the relevant legislative matters.[126]

Re-declaration of the ULLS

The July 1999 declaration of the ULLS was specified to expire on 31 July 2006. Following a public inquiry, the ACCC considered that declaration of the ULLS would be in the long-term interests of end-users. Accordingly, the ULLS remained declared until 31 July 2009.[127]

Australian Competition Tribunal decisions

In June 2006, the Tribunal affirmed the ACCC's decision to reject the December 2004 LSS monthly charge undertakings.[128] In particular, the Tribunal considered that the allocation of 'LSS-specific' costs to LSS services alone would not be reasonable, and that any allocation method "should allocate costs at least over active DSL lines".[129] The Tribunal accordingly considered that it could not be satisfied that the terms and conditions of the LSS undertakings were reasonable.

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122 ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings—final decision*, December 2005. pp. 39-41, 45-62.
123 ibid. pp. 29-33, 80-95.
124 ibid. pp. 35-36, 63-76.
125 ibid. pp. 33-35, 96-106.
126 ACCC, *Assessment if Telstra's ULLS monthly charge undertaking—final decision*, August 2006, p. 81-99.
127 ACCC, *Declaration inquiry for the ULLS, PSTN OTA and CLLS—final determination*, July 2006, p. 27-40.
128 Australian Competition Tribunal, *Telstra Corporation Limited (ACN 051 755 556)*, [2006] ACompT 4.
129 ibid, at [161].

In May 2007, the Tribunal affirmed the ACCC's decision to reject the December 2005 ULLS geographically averaged monthly charge undertaking. [130] The Tribunal upheld its previous views about the allocation of specific costs.[131] In the course of that decision, the Tribunal relevantly found that it was "not satisfied that Telstra's allocation of its 'ULLS specific costs' across ULLS accessed [sic] or forecast accessed [sic] lines only is reasonable".[132]

The Tribunal also devoted a significant part of its decision on Telstra's ULLS undertakings to the issue of geographic averaging. [133] The Tribunal concluded that it could not be satisfied that Telstra's proposed geographically averaged ULLS charges were reasonable. [134]

Arbitration of ULLS access disputes

On 1 September 2006, the ACCC issued reasons supporting an interim determination made in August 2006 for a ULLS access dispute.[135] Those interim determinations set ULLS monthly charges of $7.20, $17.70 and $34.20 per month in Bands 1, 2 and 3 respectively. The ACCC's prices were set on a conservative basis as they accepted Telstra's claimed network costs and only partially adjusted Telstra's claimed specific costs with updated data.[136] The ACCC subsequently made a number of other ULLS interim determinations.[137] The ACCC has more recently issued draft final determinations in certain ULLS access disputes that specify lower prices than those set in the interim determinations.[138]

The ACCC continues to arbitrate thirteen price-related ULLS access disputes between various access seekers and Telstra.[139]

130 Australian Competition Tribunal, *Telstra Corporation Limited (No 3)* [2007] ACompT 3.
131 ibid, at [387] to [413].
132 ibid, at [411].
133 ibid, at [53] to [291].
134 ibid, at [291]
135 ACCC, *Access dispute between Chime Communications and Telstra—Unconditioned Local Loop Service—reasons for interim determination*, August 2006, published 1 Sep 06, available at http://www.accc.gov.au/content/index.phtml?itemId=760353
136 ibid, p. 3-7.
137 A list of the determinations made is available at http://www.accc.gov.au/content/index.phtml?itemId=768629
138 Telstra, *Annual report 2007*, September 2007, p. 189.
139 A list of current access disputes is available on the ACCC's website at: http://www.accc.gov.au/content/index.phtml/itemId/635059