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cc: Rebecca Mitchell
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By facsimile: 02 9261 8390

Dear Dr Warren

Telstra's Band 2 ULLS undertaking

I refer to your letter dated 17 February 2009. In that letter, you make a number of requests, including further clarification of:

- the issues raised in the appendix of your letter
- all issues raised in your letter dated 2 December 2008
- an explanation regarding the ACCC's use of Ovum's Weighted Average Cost of Capital (WACC).

I note that you are specifically concerned that Telstra may not be in a position to understand the ACCC's approach to various issues and, further, that you believe that the process may lack the transparency appropriate to the circumstances and may result in a denial of procedural fairness.

While I will address each of the specific issues that you raise later in your letter dated 2 December 2008, it should be noted that the ACCC is not obliged to provide answers to your particular requests, nor does it accept that there has been any lack of transparency in the current process. On the contrary, the ACCC has already exceeded its legislative obligations by releasing both a discussion paper and a draft decision, and calling for submissions on the draft decision.

Further, the ACCC does not believe, given the release of these documents, the issuing of formal requests for information dated 16 December 2008 and 23 January 2009, and our responses to your letters of 2 December 2008 and 17 February 2009, that the ACCC has or will deny Telstra procedural fairness in coming to its final decision. On the contrary, the ACCC is of the view that it has provided ample opportunities for

parties to make relevant submissions, and engaged in a full and robust consultation on relevant issues.

Your position that the consultation and draft decision phases are simply “further stages” in the TEA model development process fundamentally misapprehends that assessment process. As the ACCC has previously noted in correspondence with Telstra on 22 July 2008, any party who wishes to obtain a preliminary view or seek feedback prior to the lodgement of an undertaking may do so. However, once an undertaking is lodged, the ACCC is fully entitled to make a decision on the basis of material placed before it during the lodgement and consultation phases.¹ A party who fails to lodge the material on which they intend to rely at the earliest opportunity does so at their own risk. This was recognised by your own Senior Counsel in the recent Federal Court WLR/LCS appeal where he stated:

...if you put in a stark naked application for exemption without any supporting information at all, then one may not be surprised if the application were rejected, unless you had a Commission who was prepared to do all the work itself.²

Further, your own letters confirm that *you* are responsible for providing material to the ACCC which would satisfy the ACCC as to the reasonableness of the terms and conditions of the undertaking. This requires applicants (and other parties who make submissions) to provide the material on which they wish to rely at the earliest opportunity and within the specified timeframes. No party should consider the lodging of submissions (or models) as an iterative process, with multiple rounds of consultation and feedback. Accordingly, your position that,

If the ACCC waits until the final decision to provide answers to Telstra’s questions, then Telstra has no opportunity to place material before the ACCC to satisfy it in relation to the reasonableness of the TEA model and hence the price term of the Undertaking.

is simply untenable.

Further, the ACCC appropriately expects that all material is accurate and comprehensive *at the time of lodgement* – not when it has been refined as the result of competing submissions or the publication of preliminary views. Where errors are identified by a submitting party, these should be brought to the attention of the ACCC (and through it, the other submitters) as soon as they are identified. In this way, all parties may respond in an efficient manner. Where requested information is not provided in a timely manner, or errors are not corrected as soon as they are noticed, delays and waste will inevitably occur.

Where the ACCC identifies what it believes to be errors in submissions, as it has done previously in relation to the TEA model, it will draw the relevant party’s attention to the potential error and seek clarification as soon as practicable. However, this does not mean that the ACCC has the responsibility for checking the accuracy of the

¹ In the case of undertakings, there is no statutory obligation to issue a draft decision.

² NSD 30 of 2009, 23 February 2009, p. 29.

information or suggest improvements to submissions or models or terms and conditions in the undertaking. Nor does it mean that the ACCC must or will participate in an iterative process whereby submissions, evidence or terms and conditions are refined to a level where the ACCC will be satisfied of the matters set out in s 152BV(2).

Finally, I note your concern that the ACCC may not have given the relevant criteria proper, genuine and realistic consideration in the draft decision. While the ACCC disagrees with your assessment, your submission has been noted and will be taken into account when the ACCC makes its final decision.

Notwithstanding that the primary obligation to ensure the accuracy of submissions rests with the submitter and that the applicant has the responsibility of placing material before the decision maker to establish the reasonableness of the undertaking, the ACCC is open to clarifying its preliminary views where it is clear that some confusion has arisen or new information comes to light.

With this in mind, I have set out the Commission's specific responses to the questions posed in your letter of 2 December. However, the Commission will not be drawn into a general debate on whether or not its preliminary views as expressed in a draft decision are expressed with sufficient clarity. The preliminary views are exactly that – a ventilation of the relevant issue and an indication of current thinking at a particular point in time. They are intended to draw out further submissions from the parties rather than identify and deal with every potential issue that might arise. Accordingly, it can be expected that some views will be further refined upon the receipt of new submissions.

Issues raised in letter of 2 December 2008

1. Telstra ask that the ACCC provide clarification/explanation regarding which optimisations and efficiencies it would like included in the TEA model design

As noted above, the applicant has the responsibility of placing material before the decision maker to establish the reasonableness of the undertaking. Whilst it is not for the ACCC to recommend model developments, it considers that estimates based on replicating Telstra's network would not reflect efficient and forward looking costs. With this in mind, the ACCC notes that the TEA model does not contemplate the use of alternative technologies that would be deployed in the present day.

2. Does the ACCC believe the TEA model is based upon and reflects actual network costs?

As the ACCC considers that the hypothetical network operator is the access provider, the TEA model should be populated with Telstra's actual costs, where they can be shown to be efficient costs. However, the ACCC notes that for the purposes of assessing an undertaking, estimates produced by a cost model would also need to be shown to be efficient costs.

3. *If so, could the ACCC clarify/explain in what manner does the TEA model produce results which reflect actual network costs rather than forward looking efficient costs?*

Whilst the ACCC considers that the TEA model should be populated with Telstra's actual costs, if incurred in an efficient manner, the ACCC does not consider the estimates produced by the TEA model reflect efficient and forward looking costs. For example, as noted above, the TEA model replicates Telstra's existing network, despite the availability of alternative technologies in the present day.

4. *Could the ACCC clarify/explain whether it continues to hold its view expressed in the draft decision that the TEA model reflects Telstra's actual network given the recently lodged submission titled TEA Model Route Optimisation Process?*

The ACCC is still considering all submissions. For the purpose of preparing a submission, Telstra should assume that the ACCC does still hold this view.

5. *If not, could the ACCC clarify/explain what additional evidence would be required to satisfy the ACCC that the TEA model is fully optimised?*

The ACCC considers that undertakings should be based on estimates that are efficient and forward looking, as these go towards the legislative criteria the ACCC is required to consider.

6. *Does the ACCC find that actual historic costs of trenching should be included in Telstra's cost study?*

The ACCC notes that under the legislative criteria, it is required to consider Telstra's actual costs in a number of areas, including s 152AH(1) where it is required to consider the legitimate business interests of the carrier or carriage service provider concerned .

7. *Should Telstra's access pricing be based upon actual incurred costs or forward-looking efficient costs?*

The ACCC considers that Telstra's access price must meet the legislative criteria.

8. *Is it the ACCC's view that the "proxy for trench sharing in new estates" is made to mimic a forward-looking estimate of the costs of a new network build over time?*

The ACCC's views are set out at page 87 of the draft decision. If Telstra believes that the approach taken at page 87 is incorrect, it should make submissions on the point. In this regard, the ACCC notes that in Telstra's *Response to the Draft Decision*, it has already made a submission on this point at page 80.

The ACCC further notes the overlap between this question, and question 21 below.

9. *Should Telstra apply the "realities of network deployment" exception to include cumulative (historic) measures of necessary network reinforcement and*

stranded investment costs in its study due to the realities of shifting demand over time?

The ACCC considers that a cumulative measure is a proxy of the level of trench sharing in the current environment. Furthermore, in this instance, the ACCC does not consider that Telstra's stranded investment is relevant, as this is a business risk that Telstra bears the burden for, rather than access seekers.

10. Regarding page 53 of the draft decision, could the ACCC clarify/explain the basis and evidence relied upon for the sentence "in a substantial majority of cases, local copper pairs were installed in turf and only subsequently paved over".

The ACCC notes that page 78 of the ACCC's draft decision indicates that Optus, Network Strategies, as well as Ovum, indicated that Telstra did not incur trenching costs of the same magnitude as those included in the TEA model. The ACCC has no evidence before it to suggest that these views are inappropriate or incorrect. The ACCC notes that it would appear legitimate to assume that the network was rolled out new estate by new estate.

The ACCC also notes that a request for further information on this area was issued to Telstra on 16 December 2008. Whilst the ACCC is currently reviewing the material provided by Telstra on 13 March 2009 in response to this request, it notes that an inadequate period of history is covered.

11. Could the ACCC clarify/explain what has changed since 21 November 2007, when the ACCC found TSLRIC+ should be applied to the ULLS in the ACCC's 2007 ULLS pricing principles determination?

The ACCC has not changed its view since 21 November 2007. The ACCC continues to believe that TSLRIC can be implemented in a way that meets the legislative criteria. However the ACCC considers it would be remiss if it did not take into account changing market conditions, and notes that it is open to other approaches that may be submitted by parties in an undertaking.

12. Could the ACCC explain/provide the workings and analysis underlying the information in Table 6.1 of the draft decision?

The ACCC notes that it supplied information in response to this question in its letter dated 18 December 2008. Furthermore, the ACCC acknowledges Telstra's letter of 17 February 2009 as a submission on this issue.

13. Could the ACCC provide the excel spreadsheets or other computer model runs which were performed by the ACCC in running its scenarios with "other parameter values", which led the ACCC to conclude that there is "significant doubt as to whether the Proposed Monthly Charge of \$30 is reasonable?"

The ACCC notes that it supplied information in response to this question in its letter dated 18 December 2008. Furthermore, the ACCC acknowledges Telstra's letter of 17 February 2009 as a submission on this issue.

14. *Does the ACCC consider the “other parameter values” relied upon in its determination to be a reasonable set of inputs?*

It is not for the ACCC determine whether or not alternative inputs are reasonable. In relation to this point, the ACCC notes Telstra submission dated 18 November 2008,³ which states:

The ACCC’s task in assessing Telstra’s Undertaking is to determine whether the standard TSLRIC+ pricing approach adopted in Telstra’s Undertaking meets the criteria in ss152BV(2) and 152AH of the TPA. The relevant provisions **do not** support an assessment of whether **an alternative** preferred by an access seeker or the ACCC is **‘more’ preferable or ‘more’ reasonable**. (emphasis added)

15. *In any case, could the ACCC provide a complete set of values for inputs into the TEA model that it used in arriving at its draft decision to reject the undertaking?*

The ACCC notes that it supplied information in response to this question in its letter dated 18 December 2008. Furthermore, the ACCC acknowledges Telstra’s letter of 17 February 2009 as a submission on this issue.

16. *Telstra does not believe that ‘entrance facility costs’ are recovered in TEBA charges and would appreciate clarification/explanation of the source for this assertion.*

The ACCC notes that its request for further information dated 16 December 2008 requested Telstra clarify the meaning of ‘entrance facility costs’ as it considered there was insufficient detail in TEA model documentation.⁴ After this request was issued, the ACCC notes Telstra made a submission on this issue⁵ and on 13 March 2009 responded to the request for further information.

The ACCC notes that it has also sought further information from other interested parties to clarify the meaning of ‘entrance facility costs’. Public versions of these documents have been placed on the ACCC’s website.

17. *Could the ACCC clarify/explain whether this conclusion [p 123-134 of the draft decision] means that the ACCC no longer considers economic asset lives to be appropriate and considers that regard should only be had to the operational (physical) lives of assets?*

The ACCC considers that the draft decision is sufficiently clear on this point. If Telstra wishes to make submissions on this point, it should do so; however the ACCC notes that Telstra has already made a submission on asset lives in response to the ACCC’s draft decision.⁶

18. *Could the ACCC clarify/explain why it believes that next generation technology would not affect the operational (physical) lives of assets?*

³ Telstra, *Telstra’s Ordinary Access Undertaking for the Unconditioned Local Loop Service: Response to Access Seeker Submissions*, 18 November 2008, p. 7

⁴ Telstra, *Telstra’s Efficient Access Model – Model Documentation*, 3 March 2008, p. 22.

⁵ Telstra, *Response to the ACCC’s Draft Decision*, 23 December 2008, p. 68.

⁶ Telstra, *Response to the ACCC’s Draft Decision*, 23 December 2008, pp. 114-116.

The ACCC considers the draft decision is sufficiently clear on this point. If Telstra wishes to make submissions on this point, it should do so.

19. *Could the ACCC please confirm if it gives weight to Ovum's conclusion that the vendor prices in the TEA model, for trenching and ducting specifically, are historical costs, particularly with regard to Telstra's evidence that vendor prices are current?*

The ACCC will consider all information submitted to it, including Ovum's conclusions regarding vendor prices. The weight to be given to the conclusions will depend on submissions received and any information that Telstra has provided pursuant to the s 152BT request dated 23 January 2009.

20. *If so, could the ACCC please confirm whether it considers it reasonable to carry the vendor prices in the TEA model forward one year, with the ACCC's price trends, as Ovum suggested is appropriate.*

The ACCC does not have a settled view on the matter. Therefore, and for the purpose of making submissions, Telstra should assume that the ACCC does consider it reasonable.

21. *What is the precise basis for the ACCC's estimate that "a trench sharing value of between 13-17 per cent approximate cumulative trench sharing potential in new estates" and please clarify/explain how the calculation of the percentages was performed?*

The ACCC notes that it supplied information in response to this question in its letter dated 18 December 2008. Furthermore, the ACCC acknowledges Telstra's letter of 17 February 2009 as a submission on this issue.

22. *Does the ACCC consider that a Band 2 measure of the "cumulative trench sharing potential in new estates" would be more appropriate for a Band 2 cost model, rather than a national estimate?*

The ACCC does not have a settled view on the matter. Therefore, Telstra should assume for the purposes of submissions that the ACCC does consider this.

23. *Referring to page 76 of the draft decision, what precise categories of equipment are priced too high and what does the ACCC consider to be an appropriate cost for the equipment?*

The ACCC's preliminary reasoning on this is set out at page 76.

24. *Referring to page 42 of the draft decision, can the ACCC please provide all the documents used by the ACCC in its international benchmarking including the adjustment made to the Ovum report referenced in footnote 70 to convert the prices into Australian dollars?*

The ACCC notes that it supplied information in response to this question in its letter dated 18 December 2008. This letter indicated that “[i]t is relevant to note that the ACCC will update this methodology in its final decision on Telstra’s ULLS Undertaking.” Furthermore, the ACCC acknowledges Telstra’s letter of 17 February 2009 as a submission on this issue.

25. *Does the ACCC take the concept of purchasing power parity into consideration in its determination? How is purchasing power parity calculated?*

The ACCC notes that it supplied information in response to this question in its letter dated 18 December 2008. Furthermore, the ACCC acknowledges Telstra’s letter of 17 February 2009 as a submission on this issue.

26. *Could the ACCC please have Ovum supply Telstra with materials and references underlying the raw Ovum data?*

The ACCC notes that this particular report was not prepared specifically for the ACCC – it is a report prepared by Ovum which is available for purchase by members of the public. In the event Telstra wishes to view the report, it should contact Ovum.

27. *Please clarify/explain the extent to which the ACCC considers prior and future regulatory periods should be considered in the calculation of the appropriate level of compensation for access services during Telstra’s undertaking period, so that Telstra can have proper regard to these factors in its pricing proposal.*

The ACCC considers Telstra has had the opportunity to make any comments it wishes to in relation to this issue.

28. *Please clarify/explain whether the ACCC considers Telstra should have regard to any under recovery of either direct costs or TSLRIC+ in the provision of ULLS in prior regulatory periods in the pricing of ULLS during the period the Undertaking will be in effect?*

The ACCC has no settled view on the point. Therefore, for the purposes of making submissions, Telstra should assume that the ACCC does so consider.

Weighted Average Cost of Capital

Your letter dated 17 February 2009 also raises the ACCC’s use of Ovum’s WACC. As indicated above the ACCC intends to treat your letter as a submission, and will therefore deal with this, and the other issues raised in your letter in the final decision. However the ACCC notes that in assessing whether Telstra’s WACC is reasonable, it will rely on various sources information including advice provided by Ovum, submissions from interested parties, as well as any other relevant information.

Further submissions

The ACCC notes that in its letters seeking further information dated 16 December 2008 and 23 January 2009 it requested Telstra “[w]hen supplying the requested information... [to] provide any submissions on these points at the same time.”

However Telstra's response indicates that "Telstra will provide further submissions shortly."⁷

As you would be aware, the legislative criteria imposes a statutory timeframe on the ACCC regarding the time it takes to assess an undertaking. This means that it is necessary that parties adhere to the timelines outlined by the ACCC. Accordingly, in the event Telstra wishes to make further submissions in relation to any of the issues raised in this letter or in relation to issues raised in the ACCC's requests for further information dated 16 December 2008 and 13 January 2009, the ACCC requests these submissions by **close of business Friday 27 March 2009**.

A copy of this letter and the earlier correspondence from Telstra, will be placed on the ACCC website. Interested parties who wish to make submissions on the points raised in this letter will also be given until Friday 27 March 2009 to lodge their submissions.

Should you have any questions regarding this letter, please contact Matthew Gillet on (03) 9290 6971.

Yours sincerely



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⁷ Telstra, *Letter to the ACCC: Telstra's Band 2 ULLS Undertaking – Response to s152BT information requests and further submissions*, 13 March 2009.