



Australian
Competition &
Consumer
Commission

Public inquiry into final access determinations for fixed line services

Final Decision

October 2015



Australian Competition and Consumer Commission

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Contents

List of abbreviations and acronyms	i
Glossary.....	iv
Executive Summary.....	x
1 Introduction	1
Part A: Pricing approach – primary price terms.....	4
2 ACCC approach to pricing the fixed line services.....	5
3 Pricing methodology	13
4 Operating expenditure.....	20
5 Capital expenditure.....	49
6 Weighted Average Cost of Capital	66
7 Taxation payments.....	96
8 Demand forecasts	100
9 Other pricing issues	112
10 Impacts of the National Broadband Network	125
11 Cost allocation.....	160
12 Term of the final access determinations	171
13 Revenue requirement and primary prices	176
Part B: Pricing approach – supplementary price terms	190
14 Connection charges for fixed line services.....	191
15 Internal interconnection cable (IIC).....	204
Part C: Scope of the application of the SAOs.....	209
16 Geographic exemption	210
17 Carrier specific exemptions	226
Part D: Non-price terms and conditions.....	228
18 Non-price terms and conditions	229
Appendices.....	230
A Appendix A: Relevant legislative framework for final access determinations	231

B Appendix B: Description of the declared fixed line services239

C Appendix C: Submissions received241

D Appendix D: Fixed principles provisions256

E Appendix E: FAD instruments259

List of abbreviations and acronyms

AASB	Australian Accounting Standards Board
ABM	Activity Based Management
ACCC	Australian Competition and Consumer Commission
ACG	Allen Consulting Group
ACMA	Australian Communications and Media Authority
ADSL	Asymmetric Digital Subscriber Line
AER	Australian Energy Regulator
AGVC	Aggregating Virtual Circuit
AUD TBVAL	Australian dollar denominated Telstra BVAL
BBM	Building Block Model
BBM RKR	Building Block Model Record Keeping Rule
BVAL	Bloomberg Valuation Service
CAF	cost allocation framework
CAN	Customer Access Network
CAPM	capital asset pricing model
CCA	Competition and Consumer Act 2010
CGS	Australian Commonwealth Government Securities
c-i-c	commercial in confidence
CPI	Consumer Price Index
CSD	Customer Service Delivery
CSP	Carriage Service Provider
DGM	dividend growth modelling
DSL	Digital Subscriber Line
DSLAM	Digital Subscriber Line Access Multiplexer
DRP	debt risk premium
DTCS	Domestic Transmission Capacity Service
ESAs	Exchange Service Areas

FAC	Fully Allocated Cost
FAD	Final Access Determination
FDD	further draft decision
FDs	final determinations
FHOA	financial heads of agreement
FLSM	Fixed Line Services Model
FOAS	Fixed Originating Access Service
FPPs	fixed principles provisions
FTAS	Fixed Terminating Access Service
FTTN	Fibre to the Node
FTTP	Fibre to the premises
FTTB	Fibre to the building
FTTdp	Fibre to the Distribution Point
GBR	government bond rate
GST	Goods and Services Tax
HFC	Hybrid Fibre Coaxial
IAD	Interim Access Determination
IIC	Internal Interconnection Cable
IMA	Ian Martin Advisory
IMC	Investment Management Committee
ITS	Information Technology Solutions
L2TP	layer 2 tunnelling protocol
LCS	Local Carriage Service
LSS	Line Sharing Service
LTIE	Long Term Interests of End-users
MDF	Main Distribution Frame
MNM	Managed Network Migration
MOU	Minutes of Use

MRP	market risk premium
MTAS	Mobile Terminating Access Service
MTM	Multi Technology Mix
NBN	National Broadband Network
NECM	Network Electricity Consumption Model
NPTC	non-price terms and conditions
PAC	Partially Allocated Cost
POI	Points of Interconnect
POTS	Traditional voice-only services supplied over Telstra's PSTN
PPI	producer price index
PSTN	Public Switched Telephone Network
PSTN OA	Public Switched Telephone Network Originating Access service
PSTN TA	Public Switched Telephone Network Terminating Access service
RAB	Regulatory Asset Base
RAF	Regulatory Accounting Framework
RFS	Ready for Service
RKR	Record Keeping Rule
SIOs	Services in Operation
TEBA	Telstra Exchange Building Access
TPA	Third Party Access
TSO	Telstra Service Operations
ULLS	Unconditioned Local Loop Service
VLAN	Virtual Local Area Network
WACC	Weighted Average Cost of Capital
WLR	Wholesale Line Rental
YTM	yield to maturity

Glossary

Access determination	Written determinations made by the ACCC relating to access to a declared service after conducting a public inquiry, specifying any or all of the terms and conditions for compliance with any or all of the standard access obligations.
access seeker	Telecommunications companies that seek access to the declared service (that is, the right to use the declared service).
access provider	Telecommunications companies that provide access to a declared service.
ADSL	Asymmetric Digital Subscriber Line. A technology for transmitting digital information at high data rates on existing copper phone lines. It is called asymmetric because the download and upload speeds are not symmetrical (that is, download is faster than upload).
AGVC	Aggregating Virtual Circuit (AGVC) is technically only used to support customers on older Asynchronous Transfer Mode (ATM) protocol DSLAMs. Customers on newer Ethernet protocol DSLAMs require an Ethernet AGVC equivalent – a Virtual Local Area Network (VLAN).
Band	The geographic classification of exchange service areas (ESAs)
Band 1	Band 1 means the following ESAs located in central business districts: (a) NSW (City South, Dalley, Haymarket, Pitt, Kent); (b) QLD (Charlotte, Edison, Roma Street, Spring Hill); (c) South Australia (Flinders, Waymouth); (d) Victoria (Batman, Exhibition, Lonsdale); and (e) WA (Bulwer, Pier, Wellington)
Band 2	An ESA with more than 108.4 services in operation in a square kilometre area at the time this determination is made, which is not a Band 1 ESA
Band 3	An ESA with 6.56 or more, but less than 108.4, services in operation in a square kilometre area at the time this determination is made
Band 4	An ESA with 6.55 or less services in operation in a square kilometre area at the time this determination is made.
Building Block Model Record Keeping Rule	The Building Block Model Record Keeping Rule (BBM RKR) requests information on forecast and actual data from Telstra relating to operating expenditure, capital expenditure, depreciation and demand that is required to effectively implement the Fixed Line Services Model (FLSM). The FLSM is used as part of the ACCC's building block model-approach to determine prices for the declared fixed line services and wholesale ADSL.

capital expenditure	<p>Capital expenditure refers to the amount spent by Telstra to acquire or upgrade any asset or part of an asset included in the FLSM Asset Classes.</p> <p>Capital expenditure forecasts are an input into calculating prices for the declared fixed line services. Forecast annual capital expenditure is rolled into the RAB each year and forms a component of the revenue requirement through the return on and of capital.</p>
cost allocation factors	<p>Each service's share of the aggregate revenue requirement is calculated by applying cost allocation factors to the total operating, capital and tax costs associated with each of the asset classes in the FLSM. The cost allocation factors represent the share of costs incurred in supplying a particular service.</p>
Customer Access Network	<p>The Customer Access Network (CAN) is the portion of Telstra's fixed network of copper wires and related infrastructure that connects each telephone end-user to the network switch at their local exchange. The CAN is used to supply customers with a range of fixed line services, including the declared fixed line services.</p>
Comparison Statement	<p>The Comparison Statement refers to the document Telstra submitted under the BBM RKR that compares forecasts of the previous regulatory period with actual figures for that period.</p>
Core network	<p>The Core network comprises Telstra's exchanges and the infrastructure interconnecting them used for the purpose of transmitting calls and data.</p>
declaration inquiry	<p>The process by which the ACCC holds a public inquiry to determine whether a service should be declared.</p>
declared service	<p>A service that the ACCC regulates under Part XIC of the CCA. Once declared, a service provider must supply the service to other parties in accordance with the standard access obligations.</p>
Definitive Agreements	<p>Agreements made between Telstra and NBN Co as revised in December 2014 in relation to the migration of customers from Telstra's fixed line network to the NBN and for NBN Co to lease and acquire certain infrastructure from Telstra.</p>
DSLAM	<p>Digital Subscriber Line Access Multiplexer. A device which makes use of the copper access lines to provide high data rate services, enabling broadband services to be provided over copper lines. It is located in a telephone exchange that links many customer DSL connections (copper wires) to a core IP network via a backhaul system.</p>
DTCS	<p>Domestic Transmission Capacity Service. The regulated transmission service.</p>
end-user	<p>Retail consumers of telecommunication services.</p>
exchange	<p>Place where various numbers and types of communication lines are switched so as to establish a connection between two telephones. The</p>

	exchange also houses DSLAMs, allowing end-users to connect to the internet.
Exchange Service Area	An exchange service area is a geographic area generally serviced by a single Exchange
Explanatory Statement	The Explanatory Statement refers to the document Telstra submitted under the BBM RKR that describes the methodology for the forecast estimates, assumptions used, cost drivers and any other observations from Telstra.
FAD	Final Access Determination. The FAD is made by the ACCC and sets the terms and conditions (including prices) relating to access to a declared service.
FOAS	Fixed Originating Access Service. Enables a telephone call to be connected from the caller to a point of interconnection with another network. The new name of the previously declared PSTN OA service.
Forecast period	The forecast period corresponds to the five year period, from 2014–15 to 2018–19, to which the BBM RKR information request applied and for which Telstra has generated forecasts of the NBN rollout, demand and expenditures in its forecast model.
FTAS	Fixed Terminating Access Service. Enables a telephone call to be carried from the point of interconnection to the party being called on another network. The new name for the previously declared PSTN TA service.
fixed line services	Telecommunications services provided over fixed networks, such as Telstra's copper network and HFC networks. The 'declared fixed line services' are the seven fixed line services – the ULLS, LSS, WLR, LCS, FOAS, FTAS and wholesale ADSL.
fixed principles provision	A FAD may contain a fixed principles provision, which allows a provision in an FAD to have an expiry date after the expiry date of the FAD. Such a provision would allow the ACCC to 'lock-in' a term so that it would be consistent across multiple FADs.
FLSM	The Fixed Line Services Model (FLSM) is used as part of the ACCC's building block model-approach to determine prices for the declared fixed line services.
Internal interconnection cable	Internal interconnection cable (IIC) is a twisted copper pair cable connecting an access seeker's equipment to Telstra's customer access network and is essential to an access seeker being able to obtain an unconditioned local loop service or line sharing service.
LCS	The declared Local Carriage Service. Enables access seekers to resell local calls to end-users without having to invest in their own network and switching equipment. The LCS is purchased in conjunction with the WLR service.

Listed carriage services	<p>The Telecommunications Act 1997 defines listed carriage services as:</p> <ul style="list-style-type: none"> • a carriage service between a point in Australia and one or more other points in Australia; • a carriage service between a point and one or more other points, where the first mentioned point is in Australia and at least one of the other points is outside Australia; • a carriage service between a point and one or more other points, where the first mentioned point is outside Australia and at least one of the other points is in Australia. <p>A point includes a mobile or potentially mobile point, whether on land, underground, in the atmosphere, in outer space, underwater, at sea or anywhere else. A point is taken to be a point in Australia if that point is: in the atmosphere, in or below the stratosphere and above Australia.</p>
LSS	<p>The declared Line Sharing Service. Enables access seekers to share the use of the copper line connecting consumers to the telephone exchange, allowing them to provide fixed internet services using their own equipment.</p>
Main Distribution Frame	<p>The main distribution frame (MDF) is a set of terminal points providing a means of interconnection between pairs of wires. An MDF is used in many multi-dwelling residential and large commercial premises as a means of interconnection between Telstra's copper wire customer access network and the internal telephone wiring of the premises. There is also an MDF at the local telephone exchange which provides a point of interconnection between the main feeder network cables and the equipment inside the exchange.</p>
MTAS	<p>The declared Mobile Terminating Access Service. A wholesale service provided by a mobile network operator (MNO) to fixed line operators and other MNOs to connect – or 'terminate' – a call on its mobile network. It enables calls to be made to consumers on mobile phone networks.</p>
National Broadband Network	<p>National Broadband Network means a national telecommunications network for the high-speed carriage of communications, where NBN Co has been, is, or is to be, involved in the creation or development of the network. To avoid doubt, it is immaterial whether the creation or development of the network is, to any extent, attributable to:</p> <p>(a) the acquisition of assets that were used, or for use, in connection with another telecommunications network; or</p> <p>(b) the obtaining of access to assets that are also used, or for use, in connection with another telecommunications network</p>
NBN Co	<p>NBN Co means NBN Co Limited (ACN 136 533 741), as the company exists from time to time (even if its name is later changed).</p>
operating expenditure	<p>Operating expenditure refers to all ongoing direct and indirect operating expenditure relating to the fixed line services provided by Telstra.</p>

	Forecast operating expenditure forms a cost block in the building block approach.
<i>propex</i>	Project-based operating expenditure (propex) is a term Telstra uses to distinguish operating expenditure associated with capital outlay from other direct and indirect operating expenditure types.
<i>PSTN</i>	Public Switched Telephone Network. The fixed telephone network that allows the public to make and receive telephone calls via switching and transmission facilities and utilising analogue and digital technologies.
<i>Regulatory period</i>	The regulatory period corresponds to the four year period, from 2015–16 to 2018–19, for which required revenues and declared service prices are determined. However, the period for which the declared service prices will apply is less than four years since the FADs have effect from 1 November 2015 to 30 June 2019.
<i>retail service provider</i>	Companies that offer telecommunications services to end-users.
<i>revenue requirement</i>	The revenue requirement refers to the aggregate revenue requirement calculated by the FLSM that allows Telstra to recover its cost of supplying regulated services.
<i>Special access undertaking</i>	A document given by the access provider proposing the terms and conditions on which it will offer access to its services (if approved by the ACCC, access seekers can obtain supply on these terms).
<i>TEBA</i>	Telstra Exchange Building Access. This refers to space designated for access seeker use in Telstra’s exchanges. It encompasses access to floor space, equipment racks or rack space and services such as power, security and air-conditioning. TEBA also includes access to cable trays and the internal interconnection cables contained in them.
<i>transmission</i>	The carriage of voice, data or other communications.
<i>ULLS</i>	The declared Unconditioned Local Loop Service. Allows access seekers to use the copper line connecting end-users to the local telephone exchange, allowing them to provide both fixed internet (broadband) and voice services using their own DSLAMs and other exchange equipment.
<i>Wholesale ADSL</i>	The declared Wholesale ADSL service. Allows access seekers to purchase a Wholesale ADSL product from Telstra and resell internet services to end-users.
<i>WLR</i>	The declared Wholesale Line Rental service. For a monthly ‘per-user’ charge, it allows access seekers to purchase a line rental service from Telstra, which includes access to the copper line and associated services (including a dial tone and telephone number) supplied using Telstra’s equipment.

Zone 1	Zone 1 means the Zone of that name (as it stood on 13 May 2013) on the ADSL enabled exchange list that Telstra maintains for the purpose of calculating monthly end-user access charges for a Service, and for the avoidance of doubt includes Zone 1(a).
Zone 2/3	Zone 2/3 means the amalgam of the zones named Zone 2 and Zone 3 (as they stood on 13 May 2013) on the ADSL enabled exchange list that Telstra maintains for the purpose of calculating monthly end-user access charges for a Service.

Executive Summary

The ACCC has concluded its public inquiry to make final access determinations (FADs) for the seven declared fixed line services supplied by Telstra on its copper PSTN and DSL networks.¹ The seven declared fixed line services are the:

- unconditioned local loop service (ULLS)
- line sharing service (LSS)
- wholesale line rental service (WLR)
- local carriage service (LCS)
- fixed originating access service (FOAS)
- fixed terminating access service (FTAS)
- wholesale ADSL.

This report covers the ACCC's final decision on price and non-price terms and conditions and also the scope of the standard access obligations included in the FADs for the next regulatory period commencing on 1 November 2015 and finishing on 30 June 2019 (see appendix E of the report for the instruments).

During its inquiry into making the FADs, the ACCC has considered a number of complex pricing issues, the most significant of which has been the unique circumstances of the rollout of the National Broadband Network (NBN) and its impact on Telstra's fixed line assets. These circumstances relate to the arrangements Telstra has entered into regarding the migration of services from its network to the NBN, the sale and leasing of certain assets of its fixed line network to NBN Co, and changes in the NBN plan and timing that have occurred since the inquiry began. The ACCC noted during the course of the inquiry that there are no regulatory precedents for addressing these circumstances and that it would take time for it to consider and consult on the issues raised. Also, changes to NBN arrangements that directly affected the ACCC's pricing decision have occurred since the inquiry started. In particular, a significant delay to the inquiry was understandably caused by the need for Telstra to update its demand and expenditure forecasts following the change to the multi technology mix (MTM) architecture for the NBN.

The ACCC's final decision is for a one-off 9.4 per cent decrease in the primary prices of the declared fixed line services. The ACCC has set prices that provide certainty for all parties and which are based on the costs of providing services on Telstra's fixed line network as Australia transitions to the NBN.

The final decision on prices reflects the ACCC's estimation of the prudent and efficient costs that should be recovered by Telstra for provision of these services and its view that access seekers should not incur higher charges as a result of costs associated with Telstra's arrangements with NBN Co. These costs include expenditures that relate to the provision of services to NBN Co by Telstra and the costs associated with asset redundancy and under-utilisation that is due to the migration of services off Telstra's customer access network (CAN) and onto the NBN. In reaching this decision the ACCC considered the commercial arrangements that Telstra entered into with NBN Co—the Definitive Agreements (DAs)—including the lease and transfer of assets, the migration of services and the receipt of infrastructure and migration payments. The ACCC considers that users of the fixed line network

¹ The ACCC made its declaration decision on the ULLS, LSS, WLR, LCS, FOAS, and FTAS services on 17 April 2014. The ACCC declared the wholesale ADSL service in February 2012

have not caused the asset redundancy and under-utilisation resulting from NBN migration. The ACCC considers that it would be contrary to the long term interests of end-users (LTIE) for costs to be allocated to users of the fixed line network who do not cause them when Telstra has been provided with the opportunity to be compensated for those costs, and when Telstra is receiving ongoing revenues that represent an avenue for their recovery.

The ACCC's treatment of the effects of declining demand due to NBN migration is distinguished from the treatment of declining demand for other reasons, such as the substitution of mobile services for fixed line services by consumers (discussed further below). The distinction in the case of NBN migration is that Telstra has another avenue through which it can recover costs and the assets of its network are no longer available for use after migration to the NBN. This is in contrast to declining demand due to changes in technology and consumer preferences. In those circumstances there is no alternative avenue to compensate for lost fixed line revenue and assets continue to be available for use to provide fixed line services.

The ACCC's final decision of a one-off 9.4 per cent decrease in the primary prices of the declared fixed line services is reflected in the new prices set out in table 1.

Table 1 Final decision on charges for regulated fixed line services

Service	Unit	Current charges	Final decision charges
ULLS Bands 1 to 3	\$ per line per month	16.21	14.68
ULLS Band 4	\$ per line per month	48.19	43.65
WLR	\$ per line per month	22.84	20.69
LSS	\$ per line per month	1.80	1.63
LCS	¢ per call	8.90	8.06
FOAS & FTAS	¢ per minute	0.95	0.86
Wholesale ADSL Zone 1	\$ per port per month	24.44	22.14
Wholesale ADSL Zone 2/3	\$ per port per month	29.66	26.87
Wholesale AGVC/VLAN	\$ per Mbps per month	32.31	29.27

In reaching its decision on the primary prices to apply to the declared services, the ACCC has formed views on the following main issues:

- the cost allocation framework used to determine the regulated revenue to be recovered through the regulated charges
- the prudent and efficient level of operating expenditure and capital expenditure for the provision of fixed line services
- the treatment of costs that arise because of the NBN
- the setting of regulated charges through a uniform price change.

In addition there are a number of external factors that materially affect the prices determined for the fixed line services. These are:

- the release by NBN Co of a revised NBN plan and rollout schedule in August 2015
- a reduction in Telstra's cost of capital since regulated charges were set in 2011

- a low level of inflation in 2015.

The approaches that the ACCC has taken on each of these issues and on other relevant aspects of its decision are summarised below.

Cost Allocation

The ACCC's final decision is to implement a fully allocated cost framework for determining the prices of fixed line services. The ACCC has utilised the detailed cost allocation framework (CAF) developed by Telstra as the starting point for allocating Telstra's costs to declared fixed line services. The costs allocated to declared services represent the revenue that Telstra can expect to recover over the term of the FAD through regulated charges and form the basis for setting those charges.

The fully allocated cost framework means that the effect on unit costs of declining demand for fixed line services that is due to substitution of mobile services will be shared proportionally across all users of the network. This is a change from the treatment in the 2011 FADs when access seekers did not bear a share of the costs of declining utilisation of Telstra's network that is due to consumer choice to substitute mobile services for fixed line services.

However, as discussed above, the ACCC does not consider that it is appropriate for access seekers to bear the costs of declining demand due to the migration of services to the NBN. This is because users of the fixed line network do not cause this decline in demand or the loss of scale economies that result and because Telstra has been provided with an opportunity to be compensated for these costs under the DAs, and is receiving replacement revenues which provide an avenue for their recovery. This is not the case for other sources of declining demand such as fixed-to-mobile substitution. Moreover, it reflects the fact that, as a consequence of the Telstra-NBN arrangements, excess capacity in Telstra's network caused by NBN migration will no longer be available for use after migration to the NBN. This is also not the case for excess capacity caused by other sources of declining demand.

Prior to making adjustments to cost allocation factors to prevent regulated charges rising as a result of NBN induced loss of economies of scale, the ACCC has implemented a number of specific adjustments to the CAF. These adjustments reflect the assessment and recommendations provided by Analysys Mason in its independent report for the ACCC. A significant adjustment is for the ducts and pipes asset class however, in this case, the ACCC has modified the adjustment recommended by Analysys Mason. This is to reflect that use of ducts and pipes by the fixed line services does not cease at the same time as NBN use commences but continues for a period after an area is ready for (NBN) service until services are activated on the NBN. Cost allocation is discussed in chapter 11 of this report.

Operating Expenditure

The ACCC reached its final decision on the prudent and efficient level of operating expenditure used to determine the regulated charges following an exhaustive process of information gathering. The ACCC notes that this inquiry is the first occasion on which Telstra has been required to provide its expenditure and demand forecasts under the building block model record keeping rule (BBM RKR) and that Telstra's initial response under the BBM RKR became immediately overtaken by the change in the NBN plan to a multi-technology mix architecture. The ACCC acknowledges Telstra's efforts to meet these challenges and provide to the ACCC the information required to reach its decision.

The ACCC's final decision on Telstra's operating expenditure is that base-year operating expenditure; forecast operating expenditure; non-NBN related propex; choice and application of productivity and cost indices; the forecast fault rate and consideration of the capex-opex trade-off are prudent and efficient. The ACCC was assisted in reaching this decision based on further information and greater transparency provided by Telstra on these items in response to the draft decision.

However, the ACCC's final decision is that NBN-related propex is not prudent and efficient and is therefore excluded from Telstra's allowable operating expenditures. The ACCC's final decision is based on an update of Telstra's operating expenditure forecast model for the most recent forecasts of NBN rollout plans released by NBN Co in August 2015 (chapter 4).

Capital Expenditure

The ACCC has also reached a final decision on the prudent and efficient level of capital expenditure to be used to roll forward the regulatory asset base (RAB) in the fixed line services model (FLSM) used to determine prices. The final decision maintains the draft and further draft decision to exclude from forecasts any NBN-related capital expenditure on the basis that this expenditure is incremental to the NBN and should be recovered from the NBN and its users (and not other users of the fixed line network). The ACCC's final decision is that the forecast capital expenditures, excluding NBN-related capital expenditure, are prudent and efficient. The final decision on capital expenditure is based on the update of Telstra's capital expenditure forecast model for the most recent forecasts of NBN rollout plans released by NBN Co in August 2015.

The further information and greater transparency provided by Telstra on its capital expenditure forecasts in response to the draft decision assisted the ACCC to reach a decision to accept Telstra's proposed forecasting methodology and capital expenditure forecasts (determined on the basis of the updated NBN rollout information). The ACCC also undertook a crosscheck of Telstra's capital expenditure forecasts by generating its own alternative forecasts. This supports a view that Telstra's capital expenditure forecasts are prudent and efficient (chapter 5).

Accounting for the impacts of the NBN

The NBN affects the operation of Telstra's fixed line network and the costs Telstra incurs in a number of ways. The ACCC's final decision is to remove all costs that it has identified as caused by NBN migration from regulated revenues and charges. As noted above, the ACCC has disallowed operating expenditures and capital expenditures that are incremental to the NBN.

More significantly, the NBN is replacing Telstra's fixed line network as the infrastructure used to provide fixed line telecommunications services in Australia, with this transition facilitated by commercial arrangements between Telstra and NBN Co.

Under these arrangements, Telstra will: migrate its customer base to the NBN; sell and lease certain infrastructure to NBN Co; and receive corresponding payments for doing so. Further, Telstra has undertaken to only provide fixed line services over the NBN where the NBN is deployed.

The ACCC is confirming in its final decision the positions set out in its position statement of October 2014 and for which implementation was set out in the March 2015 draft decision and June 2015 further draft decision. These are as follows:

- Assets that are leased by NBN Co will be dealt with through the CAF. The most significant of the assets that NBN Co will lease from Telstra is access to the duct and pipe network. As the NBN rollout progresses, the share of the costs of the ducts and pipes asset class allocated to NBN will increase and the share allocated to fixed line services will decrease.
- Assets that are sold to NBN Co will be removed from the fixed line services RAB using the regulatory values established within the FLSM. These assets include the copper tails where FTTN is deployed (that is, the copper between the nodes and customer premises).

- Assets that are made redundant by the rollout will also be removed from the RAB using regulatory values. These assets include, among others, copper in Telstra's customer access network (CAN) (other than copper tails in FTTN areas) and certain PSTN switching assets.
- Assets that become under-utilised as services migrate to the NBN, and which consequently exhibit loss of economies of scale, will have cost allocation adjustments applied to prevent access seekers incurring increased unit costs that are caused by NBN migration. The costs associated with this loss of economies of scale are not caused by users of the fixed line network. Further, the ACCC considers that Telstra has been provided with an opportunity to ensure that it was compensated for such costs under the DAs. Further, Telstra is receiving ongoing replacement revenues which represent an avenue for the recovery of these costs. Accordingly, the ACCC's final decision is that the costs associated with the loss of economies of scale that will occur as a result of NBN migration should not be reflected in regulated revenues or charges. To determine the adjustment to remove the effect of the loss of economies of scale, the ACCC has estimated the unit costs to supply declared services if NBN-induced under-utilisation were not to occur (chapter 10).

Uniform price change

The final decision is to set regulated charges on the basis of the uniform change in all prices that enables Telstra to recover the costs that the ACCC has allocated to the declared services.

This approach maintains the relativities between the regulated charges established in the 2011 and 2013 FADs rather than estimating each charge on the basis of service specific revenues and demand. In reaching its decision to apply a uniform price change, the ACCC has balanced the benefits of stability in relative prices with the potential short-term efficiency losses from prices diverging from their underlying costs in order to produce an outcome in the LTIE.

The ACCC considers that its final decision on prices will not disrupt the transition of services to the NBN. Rather, the ACCC considers that its decision will promote efficiency and competition during the transition and is in the LTIE.

The ACCC decided not to adopt its proposal for a larger price reduction for the AGVC/VLAN service and a lesser uniform change for the remaining regulated charges on the basis that it did not have stakeholder support. Also, the ACCC has not made any changes to the geographic price structures for ULLS, Wholesale ADSL or FOAS and FTAS (chapter 13).

Incorporating latest information on the NBN plan and rollout schedule

In August 2015, NBN Co released its 2016 Corporate Plan which included new information regarding the NBN, in particular, changes to the relative coverage of the technologies making up the MTM and in the rollout schedule. This is the first substantive update of the NBN plan since NBN Co released its Strategic Review in December 2013.

The ACCC considers that its final decision should be based on the most up-to-date information regarding the NBN rollout available to it. Therefore, the ACCC has made its final decision on demand and expenditure forecasts that have been updated with this latest information. It has done this using the forecast model Telstra submitted to the inquiry for the purpose of readily updating forecasts in the event of better information on the NBN rollout. The ACCC has reviewed the performance of Telstra's forecast model with the updated NBN information incorporated and is satisfied that it appropriately adjusts demand and expenditure forecasts in a manner consistent with the forecasting methodologies and assumptions submitted to the inquiry by Telstra and accepted by the ACCC for the purposes of making its final decision.

The 2016 Corporate Plan has forecast that the rollout will proceed more slowly for the first three years of the regulatory period compared with the previous forecasts used by Telstra. This is due to a delayed launch of the HFC component of the MTM compared with earlier forecasts

and means that the number of services remaining on Telstra's fixed line network is generally higher than previously forecast while expenditures do not rise proportionally due to the lack of responsiveness of a significant proportion of operating expenditures to the NBN rollout. Telstra has explained that this lack of responsiveness is due to an inability to rationalise the network and reduce overheads until the migration of services to the NBN is completed. The delayed rollout means these costs are retained within the fixed line services cost base, and shared across a larger number of services for longer than was previously considered in the draft and further draft decisions (chapters 4, 5 and 8).

Demand forecasts

The ACCC's final decision is to accept demand forecasts for fixed line services using the two step approach proposed by Telstra of:

- Firstly, determining 'pre-NBN' demand levels on a 'no-NBN' assumption
- Secondly, adjusting the pre-NBN demand forecasts by subtracting forecast migration of services to the NBN to obtain the 'post-NBN' demand forecasts for each service

The ACCC has set pre-NBN demand forecasts for the fixed line services at the levels set out in the March 2015 draft decision.

To obtain the post-NBN forecasts for the final decision the ACCC has updated the demand forecasts proposed in the March draft decision to reflect the updated NBN plan and schedule for the rollout and service activation released by NBN Co in August 2015 (chapter 8).

WACC

The ACCC's final decision is to maintain the weighted average cost of capital (WACC) framework of the draft decision with the exception of the methodology for estimating the debt risk premium and to adopt an updated real vanilla WACC of 3.42 per cent (6 per cent nominal). This compares with a nominal WACC of 8.54 per cent that applied at the time of the 2011 FADs and is a significant factor in prices being lower this time.

The methodology the ACCC has adopted to estimate the debt risk premium for the final decision is a benchmark cost of debt using a simple average of selected Bloomberg and RBA curves. The increase in the WACC from 5.89 per cent (nominal) for the further draft decision is caused by a rise in the nominal debt risk premium under the revised methodology, offset in part by a reduction in the estimate of the risk free rate (chapter 6).

Inflation

The CPI was 1.5 per cent in 2014-15 and the ACCC notes that this low rate has contributed to regulated charges being lower than if inflation had been within the Reserve Bank's target range of 2.0 to 3.0 per cent.

Movement in uniform price change between further draft decision and final decision

A number of changes have occurred between the further draft decision of a 9.6 per cent decline in prices to a 9.4 per cent decline in the final decision. Individually some of these factors are significant but they overall netted out with the outcome that there is not a material difference between the June 2015 estimate and the October 2015 final decision.

Changes that have had a downward impact on prices between the further draft and final decisions are:

- The updated NBN rollout information (sections 4.12, 5.9 and 8.5.2)

- The implementation of adjustments to the CAF following recommendations by Analysys Mason (chapter 11)
- A low level of inflation for the 2015 financial year.

Changes that have had an upward impact on prices between the further draft and final decisions are:

- A higher cost of capital (chapter 6)
- Adjustments to the estimation of unit costs without NBN-induced asset under-utilisation used to make the NBN adjustment to cost allocation factors (section 10.4.6)

Term of the access determination

The ACCC's final decision is that the FAD price terms for all seven declared fixed line services will apply from 1 November 2015 to 30 June 2019.

The ACCC has also decided not to include a 'trigger and review' mechanism at the mid-point of the FAD term in its final decision.

In the draft decision, the mid-point trigger and review mechanism was considered because the uncertainty of the NBN rollout and migration introduced the risk that declared service prices may deviate from cost reflective levels.

The ACCC considers that the trigger and review mechanism is now unnecessary. This is because the ACCC's final decision to adjust allocation factors for NBN-induced loss of economies of scale has mitigated the potential effect of NBN rollout uncertainty on prices (chapter 12).

Supplementary charges

The ACCC's final decision on supplementary charges is to:

- Set connection charges for three of the fixed line services. The ACCC's final decision is not to allow a separate disconnection charge for the unconditioned local loop service (ULLS) and an early termination charge for the wholesale asymmetric digital subscriber line (ADSL) services (Chapter 14).
- To include an IIC charge of \$0.051 (excluding GST) per month per pair installed in the FAD price terms. This charge is determined by applying the same uniform price decrease as for the primary price terms to the current IIC charge (Chapter 15).

Scope of the standard access obligations

The ACCC's final decision on the scope of the application of the SAOs and the FADs is:

- That the SAOs and the FADs for WLR and LCS should apply to all geographic areas, including CBD areas.
- To include a term in the wholesale ADSL FAD that limits the application of the SAOs and the FAD to Telstra in relation to the supply of wholesale ADSL.
- That the SAOs and the FADs for all remaining fixed line services should apply to all carriers and carriage service providers.

Non-price terms and conditions

- On 24 August 2015, the ACCC released a combined report that set out the ACCC's views on the non-price terms and conditions for the fixed line services. The ACCC maintains and now adopts those views in the combined report as its final decision on the non-price terms and conditions for the fixed line services. Non-price terms and conditions are discussed in chapter 18 of the report.

Fixed principles provisions

The fixed principles provisions included in the 2011 fixed line services FADs and updated for the 2013 wholesale ADSL FAD remain in effect until 30 June 2021 and are at appendix D of the report.

1 Introduction

The Australian Competition and Consumer Commission (ACCC) has concluded a public inquiry commenced in July 2013 under Part 25 of the *Telecommunications Act 1997* into making final access determinations (FADs) under section 152BC of the *Competition and Consumer Act 2010* (CCA) for the seven declared fixed line services (FAD inquiry). The seven declared fixed line services are the:

- unconditioned local loop service (ULLS)
- line sharing service (LSS)
- wholesale line rental service (WLR)
- local carriage service (LCS)
- fixed originating access service (FOAS)
- fixed terminating access service (FTAS)
- wholesale ADSL.

A description of the declared fixed line services is at appendix B to this final decision.

This report sets out the reasons for the ACCC's final decision on the FAD terms for:

- the primary prices for the declared fixed line services²
- the supplementary price for the connection/disconnection charges and the internal interconnection cable (IIC) charges³
- the application of the standard access obligations in CBD areas and to specific carriers and
- non-price terms and conditions.

The ACCC published its final report on non-price terms and conditions (NPTC) in August 2015.⁴ The NPTC report is relevant to the non-price terms and conditions for a number of declared services – including fixed line, mobile and domestic transmission capacity services (DTCS).

In reaching its final decision on the FAD terms for the fixed line services, the ACCC has considered submissions made on: the August 2015 consultation paper on proposed changes to the pricing of the AGVC/VLAN; the June 2015 further draft decision; the March 2015 draft decision; the October 2014 position statement on the treatment of Telstra-NBN Co arrangements; and the July 2014 discussion paper on the fixed line services FAD inquiry.

² The primary prices for the declared services are charges for direct use of the services.

³ The supplementary prices refer to additional charges incurred in using the services, for example, IIC charges and connection and disconnection charges. The Commission's draft decision on connection and disconnection was released with the draft decision on non-price terms and conditions in March 2015.

⁴ <https://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fad-inquiries-non-price-terms-conditions-supplementary-prices/final-report>

1.1 Background

The ACCC made FADs for six declared fixed line services in July 2011 and made a FAD for the wholesale ADSL service in May 2013. All seven FADs were due to expire on 30 June 2014.

On 18 June 2014 the ACCC extended, under section 152BCF(10) of the CCA, the expiry date of the 2011 and 2013 FADs to be the day immediately before the day on which the access determinations for the next regulatory period come into force.

A number of factors meant that the ACCC was not able to complete the FAD inquiry before the original expiry date of the previous FADs:

- Statutory time requirements for the provision of, and subsequent disclosure arrangements, relating to Telstra's response to the request for information under the Building Block Model Record Keeping Rule (BBM RKR) issued in July 2013.
- Changes to the NBN architecture meant that there was a significant change in Telstra's operating environment due to the change in the NBN policy and plan. This necessitated a revision to Telstra's response to the BBM RKR and caused delays in the ACCC having available to it the information on demand and costs for Telstra's fixed line network it required to make its decision on the primary price terms for the FADs.
- The need to provide adequate opportunity for consultation with stakeholders on a range of complex pricing issues the ACCC considered during its inquiry. These pricing issues include the approach on the Telstra-NBN Co arrangements, cost allocation and declining demand, and assessment of the demand and expenditure forecasts Telstra submitted.

The ACCC extended the inquiry period for making the FADs by the maximum period of six months on four occasions. The ACCC published, under section 152BCK(3) of the CCA, notices of extension to the decision making period on 11 December 2013, 2 July 2014, 10 December 2014 and 1 July 2015. On 18 June 2014 the ACCC also varied several of the fixed line services FADs following a variation inquiry that commenced on 17 April 2014. The variations to the FADs specified price and non-price terms for the supply of the LCS and WLR service in CBD areas and specified a regulated price for the internal interconnection cable (IIC) service, a supplementary service required for the supply of the ULLS and LSS.

1.2 Public inquiry process to date

On 11 June 2014, the ACCC gave a notice to Telstra for the disclosure of information that has been provided under the BBM RKR. The ACCC also published a statement of reasons to accompany the notice.

On 24 July 2014, the ACCC published its primary price terms discussion paper for the FAD inquiry. The ACCC also published a supplementary report providing additional information on Telstra's cost allocation proposal which compared Telstra's proposed cost allocation approach to the approach taken in the previous fixed line FADs.

The ACCC conducted a technical workshop on 28 August 2014 which provided access seekers the opportunity to seek further information regarding the FLSM, Telstra's cost allocation proposal and its BBM RKR response.

On 22 October 2014, the ACCC released its position statement on how it intended to account for the arrangements between Telstra and NBN Co in determining primary prices in the FAD inquiry, in advance of a more comprehensive draft decision. The Telstra-NBN Co arrangements are set out in the Definitive Agreements executed in June 2011 and renegotiated in December 2014. Matters covered in the Definitive Agreements include the migration of customers to the NBN and NBN Co's acquisition and use of Telstra's infrastructure.

The ACCC engaged WIK-Consultant to report on the prudence and efficiency of Telstra's operating expenditure and capital expenditure forecasts submitted on 3 October 2014. A public version of the consultant's report was published on the ACCC website with the draft decision.

On 11 March 2015, the ACCC released its draft decision on the primary price terms for the declared fixed line services. Along with the ACCC's draft decision on the uniform price decrease of 0.7 per cent, the ACCC set out its draft decision on the supplementary price terms for IIC charges and the scope of the application of the SAOs.

After the release of the draft decision, the ACCC engaged Analysys Mason to undertake further assessment and verification of Telstra's proposed cost allocation model. A public version of the consultant's report was published on the ACCC website with the further draft decision.

On 29 June 2015, the ACCC released its further draft decision to address issues outstanding from its March 2015 draft decision on primary price terms. The ACCC's further draft decision was for a one-off 9.6 per cent decrease in the primary prices of the declared fixed line services, for the period commencing on 1 November 2015 and finishing on 30 June 2019. The most significant factors which contributed to the change in the estimated price movement in the further draft decision included: adjustments to ensure that access seekers would not incur higher charges as a result of the loss of economies of scale due to the NBN; revisions to Telstra's forecast operating expenditure; and updates to reflect changes to the CPI forecast and the risk free rate used in the estimation of the weighted average cost of capital (WACC).

On 14 August 2015 the ACCC released a targeted consultation paper on a proposal for an alternative approach to setting the charge for the AGVC/VLAN component of the wholesale ADSL service.

1.3 Structure of report

This final decision report on primary price terms for the declared fixed line services is structured as follows:

Part A (Chapters 2–13) sets out the ACCC's final decision on the primary price terms for the declared fixed line services and the ACCC's reasons for reaching its decision.

Part B (Chapters 14–15) sets out the ACCC's final decision on the supplementary price terms for connection/disconnection charges and IIC charges.

Part C (Chapters 16–17) sets out the ACCC's final decision on exemptions – including CBD exemptions and carrier specific exemptions.

Part D (Chapter 18) sets out the ACCC's final decision on the non-price terms and conditions applicable to the fixed line services FADs.

Appendix A sets out the relevant legislative framework for making FADs.

Appendix B provides a description of the declared fixed line services.

Appendix C provides a summary of the submissions received by the ACCC to date to this inquiry on primary price terms.

Appendix D sets out the fixed principles provision in the FADs.

Appendix E provides the FAD instruments.

Part A: Pricing approach – primary price terms

2 ACCC approach to pricing the fixed line services

This chapter sets out the legislative framework under which the ACCC may make a FAD. It also provides a general explanation of the ACCC's approach in considering the matters listed in section 152BCA of the CCA and sets out the overarching assessment framework under which specific pricing issues are discussed and determined in Part A of this report.

2.1 Legislative requirements

Under the CCA, the ACCC may make a FAD that specifies terms and conditions of access to a declared service, which must include terms and conditions relating to price or a method of ascertaining price.⁵ This enables the ACCC to determine pricing as well as other terms and conditions for access for a declared service which access seekers can rely on if they are unable to commercially agree on prices with the access provider.

The CCA requires the ACCC to take a number of matters into account when making a FAD, which are:

- whether the FAD will promote the long-term interests of end-users (LTIE), which involves considering the extent to which the FAD is likely to result in the achievement of the following objectives:
 - Promoting competition in markets for listed services
 - Achieving any-to-any connectivity
 - Encouraging the economically efficient use of, and economically efficient investment in, the infrastructure by which the listed services are supplied, and any other infrastructure by which listed services are, or are likely to become, capable of being supplied
- the legitimate business interests of a carrier or carriage service provider who supplies, or is capable of supplying, the declared service, and the carrier's or provider's investment in facilities used to supply the declared service
- the interests of all persons who have rights to use the declared service
- the direct costs of providing access to the declared service
- the value to a person of extensions, or enhancement of capability, whose cost is borne by someone else
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility
- the economically efficient operation of a carriage service, a telecommunications network or a facility.⁶

In considering whether a FAD is likely to encourage the economically efficient use of, and economically efficient investment in, infrastructure by which listed services are supplied, or are capable of being supplied, the ACCC must have regard to:

⁵ Sections 152BC(1) and (8) of the CCA.

⁶ Section 152BCA(1) of the CCA.

- whether it is or is likely to become technically feasible for the services to be supplied and charged for having regard to certain matters⁷
- the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope
- the incentives for investment in the infrastructure by which the services are supplied, or any other infrastructure by which services are, or are likely to become, capable of being supplied, which must involve consideration of the risks involved in making the investment.⁸

The ACCC may also take into account the supply of other eligible services by the access provider and any other matters that it considers relevant.⁹

More details on the relevant legislative frameworks for making an FAD are provided in appendix A.

2.2 Application of the legislative requirements to pricing the fixed line services

The ACCC uses a building block model (BBM) pricing methodology to determine prices for Telstra's declared fixed line services. This approach was adopted by the ACCC in the 2011 fixed line services FAD inquiry following an extensive consultation process. The ACCC implemented the BBM pricing methodology to setting prices through the fixed line services model (the FLSM), which was developed during the 2011 FAD inquiry. The ACCC also included a set of fixed principles in the 2011 FADs that give form to the building block pricing framework. Identical fixed principles were subsequently included in the 2013 wholesale ADSL FAD.

The ACCC set out in its final report for the 2011 FAD inquiry how it had regard to the legislative requirements when establishing the BBM pricing methodology and including fixed principle provisions to apply until 30 June 2021 (discussed in chapter 15 of the 2011 FLS FAD). In particular, the BBM pricing methodology estimates prices that are based on efficiently incurred costs and enables the access provider to recover those efficiently incurred costs, including a commercial return on its investment. These features of the BBM promote competition by enabling access seekers to obtain bottleneck monopoly services at prices that are based on the costs of providing those services and encourage the economically efficient use of, and the economically efficient investment in, the infrastructure by which the listed services are supplied. This, together with the fixed principles provisions that locked in an initial value for the regulatory asset base (RAB) and specified how certain pricing inputs within the BBM pricing methodology are to be determined,¹⁰ ensures transparency and certainty in the setting of regulated charges. For these reasons (discussed fully in the 2011 FAD report)¹¹ the ACCC considers that the pricing methodology established for the fixed line services, including both the BBM and fixed principles provisions, are in the LTIE.

In this decision, the ACCC has not reiterated in detail how regard to the legislative requirements was had when adopting the fixed principles (which give form to the BBM pricing methodology used for this decision), which is set out in the ACCC's 2011 decision.¹² In this

⁷ Section 152AB(6)(a)(i), (ii), (iii).

⁸ Sections 152AB(6) and (7A) of the CCA.

⁹ Section 152BCA(2) and (3) of the CCA.

¹⁰ Further information on the 2011 fixed line services FAD inquiry can be found on the ACCC website: <http://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fixed-line-services-final-access-determination-fad-2011>.

¹¹ ACCC, Inquiry to make final access determinations for the declared fixed line services, Final Report, July 2011.

¹² Ibid.

decision, the ACCC has set out how it has had regard to the legislative requirements when determining the inputs within the BBM pricing methodology and making decisions on other pricing issues that were not considered in the 2011 FADs. The former are discussed in the relevant chapters of Part A of this decision and the latter are addressed in this chapter.

The ACCC has considered the following key issues in setting prices for the declared fixed line services:

- a revised cost allocation framework
- updating inputs for determining capital and operating expenditure based on NBN Co's updated NBN rollout plans as set out in its 2016 Corporate Plan
- the exclusion of NBN-related capital and operating expenditure from the FLSM
- the impacts of the NBN.
- a uniform price change for the declared fixed line services

How the ACCC has considered these issues in setting prices for the declared fixed line services is discussed below, in addition to the detailed discussion in Part A of the decision. The application of the legislative requirements is also noted throughout this decision.

2.3 Revised cost allocation framework

The ACCC's final decision is to adopt a cost allocation framework that fully allocates the costs of the fixed line network. A consequence of this is that the costs of declining demand due to all sources of declining demand, including mobile substitution for fixed line services, are now shared by access seekers in proportion with their use of the network. The ACCC's treatment of NBN-induced declining demand is addressed in chapter 10.

Substitution from fixed line to mobile services by end users results in excess capacity and under-utilisation of fixed line assets. This declining market due to consumer choice results in higher unit costs for which Telstra does not have replacement revenues and which it cannot avoid in the short term. Allocation of a share of these costs through regulated charges ensures that access seekers bear a share of the costs that are due to consumer choice. This will promote competition and encourage the economically efficient use of, and the economically efficient investment in, the infrastructure used to supply the listed services.

The ACCC considers that Telstra's legitimate business interests are met through the revised cost allocation framework because it is able to recover its efficiently incurred costs, including the costs of declining utilisation of its fixed line network due to mobile substitution.

2.4 Updating inputs for determining capital and operating expenditure based on NBN Co's updated NBN rollout plans

The ACCC's final decision takes into account the most up to date information on the rollout of the NBN. In August 2015, NBN released an updated rollout plan and schedule in its 2016 Corporate Plan.¹³ The ACCC has updated the inputs to the forecast model submitted by Telstra¹⁴ with the latest information on the rollout provided by NBN Co (see 4.4.2). This affects the operating and capital expenditure forecasts used in the FLSM as well as the rate of

¹³ NBN (2016), *Corporate Plan 2016*, August 2015.

¹⁴ Telstra (2015) Fixed Services Forecast Model v1.2 May 2015.

allocation (between the fixed services and the NBN) and rate of disposal of existing fixed network assets to the extent these are governed by the NBN roll out.

The use of the updated NBN rollout information, by making use of the best information available, will ensure that expenditure forecasts are more reflective of the overall costs expected to be incurred by Telstra over the course of the forecast period compared with the case if this information had not been used. Accordingly, the ACCC considers the use of this information will better encourage the economically efficient use of, and the economically efficient investment in, infrastructure and assist in the promotion of competition.

In taking Telstra's legitimate business interests into account, the ACCC considers that the use of the updated rollout information contributes to allowing Telstra to recover the efficient costs of supplying the declared services, including the costs of efficient investments. It also means access seekers will face prices that more closely reflect the direct costs of providing access to the declared services.

The ACCC also considers that the use of the updated information provides for greater transparency and certainty for access seekers about the historic and forecast growth trends in declared fixed line services in the transition to the NBN. This is considered to be important for helping to promote continued investment and competition in fixed line services markets.

2.5 The exclusion of NBN-related capital and operating expenditure from the FLSM

The ACCC's final decision is that Telstra's forecast operating and capital expenditures are prudent and efficient with the exception of NBN-related expenditures, which the ACCC has excluded from expenditure forecasts (see chapters 4 and 5). The ACCC considers that NBN-related expenditures are incremental to NBN and therefore future users of the NBN network, not current users of the Telstra's fixed line services, should incur the costs of NBN-related expenditures.¹⁵

The ACCC considers that the final prices for the declared fixed line services are based on prudent and efficient operating and capital expenditure forecasts and are therefore in the LTIE. This is because the determination of operating and capital expenditures that reflect the prudent and efficient costs of supply will encourage the economically efficient use of, and the economically efficient investment in, infrastructure and promote competition in the markets for listed services.¹⁶

In taking Telstra's legitimate business interests into account, the ACCC considers that the final decision forecast operating and capital expenditures provide sufficient allowance for Telstra to recover its prudent and efficient costs that are incurred in the provision of fixed line services over the regulatory period.¹⁷

The ACCC considers that NBN-related expenditures are not a direct cost that is required for the provision of fixed line services. Therefore, the removal of NBN-related expenditures ensure that access seekers only contribute to the recovery of the direct costs of expenditures required for the provision of fixed line services.¹⁸

¹⁶ Paragraph 152AB(2)(c) and (e).

¹⁷ Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

¹⁸ Paragraph 152BCA(1)(d) – direct cost of providing access to the declared service.

2.6 Impacts of the NBN

The ACCC considers that the LTIE is promoted by its adjustments to account for the impacts of the NBN in the determination of prices for the declared fixed line services.¹⁹

In the absence of these adjustments, the ACCC does not consider that the LTIE would be promoted. The ACCC considers that the risks of distortionary impacts on access seekers' incentives are great. This would adversely impact economically efficient investment in and economically efficient use of the infrastructure necessary to provide fixed line services,²⁰ as well as adversely impacting the promotion of competition in the fixed line market.²¹ This is discussed further below.

Access prices that allow for the recovery of efficient costs—and do not include scope for monopoly profits—will facilitate access to the infrastructure services required by access seekers to provide a range of communications services to end-users.

As discussed in chapter 10, the ACCC has accounted for the impacts of the NBN with the following adjustments in the FLSM:

- NBN Co's acquisition of Telstra's copper assets is accounted for by treating a proportion of the RAB value of the copper cables asset class as a disposal each year.
- NBN-induced asset redundancy is accounted for by treating a proportion of the RAB value of relevant assets as a disposal each year.
- NBN Co's leasing of assets is reflected in the cost allocation framework by including the NBN as an explicit user of relevant FLSM asset classes.
- NBN-induced asset under-utilisation is accounted for by adjusting allocation factors for relevant FLSM asset classes.

The treatment of sold and redundant assets as disposals for the purposes of rolling forward the RAB will ensure that access prices allow for the recovery of only efficient costs. This is because it will mean that any assets no longer used to provide fixed line services as a result of migration to the NBN are not included in the RAB, and that the costs associated with these assets are not reflected in access prices. These adjustments will therefore ensure that Telstra will not recover costs through regulated prices that are not efficiently incurred in providing regulated fixed line services. The adjustments will ensure that the regulated revenue requirement allows for the recovery of efficient costs and a normal commercial return on efficient investment, which is in Telstra's legitimate business interests.²² This approach will encourage the economically efficient use of and economically efficient investment in infrastructure and it will promote competition in the markets for listed services.

Adjustments to cost allocation factors to reflect NBN Co's leasing of Telstra's fixed line assets ensure that an appropriate share of the aggregate revenue requirement is allocated to the declared fixed line services. Cost allocation factors are intended to reflect each service's share of the total efficient costs incurred in providing fixed line services. As such, they represent the share of the regulated revenue requirement recoverable from each declared fixed line service. It is necessary to reflect NBN Co's usage of Telstra's fixed line assets in the calculation of cost allocation factors so that these shares do not allow for a disproportionate share of total efficient costs to be allocated to, and between, regulated services. These adjustments will encourage

¹⁹ The objective of any-to-any connectivity is not relevant to the ACCC's approach to accounting for the impacts of the NBN as it does not affect connectivity between telecommunications networks.

²⁰ Paragraph 152AB(2)(d).

²¹ Paragraph 152AB(2)(c).

²² Paragraph 152BCA(1)(b).

the economically efficient use of and economically efficient investment in infrastructure and will promote competition in the markets for listed services.²³

The ACCC considers that it would not be in the LTIE for users of fixed line services to pay for assets they do not use. The treatment of sold and redundant assets as disposals, and the adjustment of cost allocation factors to reflect NBN Co's leasing of assets, ensure that access prices allow for the recovery of only the efficient costs of supplying the declared fixed line services. The ACCC considers that it would be contrary to the interests of access seekers for access prices to reflect costs that are greater than what is efficient, as this would inhibit their ability to compete with Telstra in the downstream fixed line market. This approach will ensure that access seekers do not pay for assets they do not use.²⁴

The treatment of sold and redundant assets as disposals will ensure that any costs that are not direct costs of providing access to the declared services are not included in regulated revenues and charges.²⁵ Further, adjusting allocation factors to reflect NBN Co's usage of Telstra's fixed line assets ensures that costs are appropriately allocated to and between the declared services. These adjustments will, in turn, ensure that allocation factors allocate an appropriate share of both direct and indirect costs to the relevant declared services.

The treatment of sold and redundant assets as disposals, and the adjustment of cost allocation factors to reflect NBN Co's leasing of assets, contribute to ensuring that access prices allow for the recovery of only the efficient costs of supplying the declared fixed line services. This will contribute to allowing Telstra to recover the costs of necessary maintenance expenditures and network asset replacement costs required to ensure that the declared fixed line services are provided in a safe and reliable manner.²⁶ This will also contribute to providing Telstra with an incentive to operate the fixed line network in an economically efficient manner.²⁷ The ACCC has taken into account the costs and demand associated with other eligible services supplied using Telstra's fixed line network in determining its approach to account for the impacts of the NBN.²⁸ In particular, adjusting cost allocation factors to reflect NBN Co's leasing of assets ensures that an appropriate share of costs are allocated to and between the declared services. These adjustments ensure that only those costs incurred in providing the declared fixed line services are allocated to those services. The costs associated with providing other services are therefore excluded from the regulated revenue requirement.

Adjustments to cost allocation factors to account for NBN-induced asset under-utilisation ensure that the costs attributed to the resulting excess capacity are not allocated to remaining users of the fixed line network. This will mean that access seekers will not pay, in addition to their own use of the network, for the progressive under-utilisation of the network that will occur as a consequence of NBN migration. Given the significant amount of excess capacity that will accumulate in Telstra's fixed line assets throughout the regulatory period, without these adjustments access seekers would be required to bear the associated costs which they have neither caused nor are able to put to future use. Ultimately, not making the adjustment would lead to a distortion of access seekers' incentives to efficiently acquire and use Telstra's declared fixed line services, and to efficiently invest in the complementary infrastructure necessary to effectively compete in the downstream fixed line market. This would be contrary to the LTIE. The ACCC also considers that it would be contrary to the interests of access seekers to pay access prices that reflect costs which Telstra had an opportunity to recover through the DAs, and that it would be contrary to the interests of access seekers to pay access prices that reflect costs that Telstra has already recovered through DA payments.²⁹

²³ Paragraphs 152AB(2)(c) and (d).

²⁴ Paragraph 152BCA(1)(c).

²⁵ Paragraph 152BCA(1)(d).

²⁶ Paragraph 152BCA(1)(f).

²⁷ Paragraph 152BCA(1)(g).

²⁸ Subsection 152BCA(2).

²⁹ Paragraph 152BCA(1)(c).

The prices calculated as a result of these adjustments will allow Telstra to recover the efficient costs of providing access to the declared services net of the costs attributed to NBN-induced loss of economies of scale. As discussed in section 10.4.2, the ACCC considers that Telstra has been provided with an opportunity to ensure that it was compensated for such costs through the DAs. Further, the ACCC considers that the payments Telstra is receiving under the DAs represent replacement revenues which provide an avenue for the recovery of such costs. While the ACCC has not had regard to the quantum of these payments in making the adjustments, it is clear that Telstra will be in receipt of a significant amount of compensation for the permanent loss of its fixed line customer base to the NBN. It cannot be known whether or not these payments precisely offset the quantum of the costs the ACCC has attributed to NBN-induced loss of economies of scale. In any case, the ACCC is of the view that Telstra has been provided with an opportunity for compensation under the DAs.

On balance, the ACCC considers that Telstra's incentives for efficient investment are unlikely to be affected as a result of these adjustments. This is supported by the evidence presented in section 10.4.3 which indicates that Telstra is of the view that it will not be made worse off by either the rollout of the NBN or the adjustments foreshadowed in the ACCC's further draft decision.

As noted in section 10.4.3, iiNet submitted in response to the further draft decision that, given the migration payments Telstra is receiving under the DAs, if the ACCC were to allocate the costs associated with NBN-induced loss of economies of scale to access seekers, there would be double recovery by Telstra. The ACCC agrees that, without adjustments to remove the costs attributed to NBN-induced under-utilisation from regulated revenues, there would be a degree of double recovery by Telstra. The ACCC considers that it would be beyond Telstra's legitimate business interests to recover costs through regulated charges in respect of which it has been provided with an opportunity to recover through the DAs. Further, the ACCC considers that it would be beyond Telstra's legitimate business interests to recover costs through regulated charges that have already been recovered through DA payments.

The regulated revenue requirement calculated as a result of the NBN-induced under-utilisation adjustments includes a share of the direct costs of providing access to the declared services. The ACCC does not consider that the requirement to take into account the direct costs of providing access to the declared services mandates that all costs should be recovered through regulated charges. The costs associated with NBN-induced loss of economies of scale that have been removed from regulated revenues, for which Telstra had an opportunity to be compensated under the DAs, and in respect of which Telstra has been provided with an avenue for recovery, include the remaining share of the direct costs of providing access.

The regulated revenue requirement calculated as a result of the NBN-induced under-utilisation adjustments includes a share of the costs of necessary maintenance expenditures and network asset replacement costs required to ensure that the declared fixed line services are provided in a safe and reliable manner. The costs associated with NBN-induced loss of economies of scale that have been removed from regulated revenues, for which Telstra had an opportunity to be compensated under the DAs, and in respect of which Telstra has been provided with an avenue for recovery, include the remaining share of the costs of necessary maintenance expenditures and network asset replacement costs required to ensure that the declared fixed line services are provided in a safe and reliable manner.³⁰

2.7 A uniform price change for the declared fixed line services

The ACCC has applied a uniform price change in setting prices for the declared fixed line services. This is discussed in chapter 13. This approach to setting prices differs from that used in 2011 and 2013 when regulated charges were calculated for each declared service on the basis of the costs allocated to that service and the demand for that service.

³⁰ Paragraph 152BCA(1)(f).

The final decision provides for a uniform 9.4 per cent fall in the prices of all declared fixed line services from their existing prices. This reflects the decline in prices from current levels required to allow Telstra to recover the costs allocated to the declared services.

The ACCC notes that it has balanced several considerations in the adoption of the uniform price change. In particular, the ACCC balanced the maintenance of relative price stability with responding to changes in demand and cost relativities between services in order to produce an outcome in the LTIE. The ACCC recognises that changes in relative prices that reflect changes in relative costs may also promote the economically efficient use of, and the economically investment in, infrastructure.

However the ACCC also notes the unique circumstances of the compulsory migration to the NBN and the now limited period before the transition is completed. Therefore any efficiency losses as a consequence of not allowing price relativities to move with the cost relativities will be of relatively short duration and the ACCC considers that the benefits of stability in relative prices in promoting competition in the lead up to the NBN are expected to outweigh any efficiency losses.

The ACCC considers that using a uniform pricing approach that allows an overall revenue requirement to be met will ensure that prices for the declared fixed line services are based on the prudent and efficient costs of providing the declared fixed line overall.³¹ This will allow access seekers to obtain access to the declared fixed line services on reasonable price terms for the purpose of providing downstream services and thereby promote competition in downstream markets.³²

The ACCC considers that the uniform price reduction and the retention of the existing price structures maintains consistency and continuity with the ACCC's decision on prices in previous FADs for the fixed line services and minimises the scope for some access seekers to be disadvantaged over others in the lead-up to the NBN depending on the mix of regulated services they acquire.³³

³¹ Paragraph 152BCA(1)(b).

³² Paragraph 152AB(2)(c) and paragraph 152BCA(1)(c).

3 Pricing methodology

Key Points

- The ACCC has used a building block pricing methodology to determine charges for Telstra's declared fixed line services.
- The ACCC developed the fixed line services model (the FLSM) during the 2011 FAD inquiry to calculate prices for the declared fixed line services. In the final decision, the ACCC has used the FLSM to determine prices for the next regulatory period.
- Prices were calculated in the FLSM in three key steps: determining annual revenue requirements for each asset class; allocating costs to declared services; and determining prices from allocated costs.
- The ACCC obtained information on Telstra's expenditure and demand forecasts under the building block model record-keeping rule in late 2013. Telstra subsequently provided updated forecasts that reflected more recent information on its forecast demand and forecast expenditures.
- Telstra submitted a forecast model to enable consistent updating of its demand and expenditure forecasts with new information on the NBN rollout.
- The ACCC has updated the forecast model on the basis of the updated NBN rollout schedule in NBN's 2016 corporate plan.
- The 2011 and 2013 FADs contain a set of fixed principles that apply until 30 June 2021. These fixed principles give form to the BBM methodology used to estimate prices. The ACCC has not included any additional fixed principles in the FADs for the next regulatory period.

3.1 Introduction

The ACCC has used a building block model (BBM) pricing methodology to determine prices for Telstra's declared fixed line services. This approach was adopted by the ACCC in the 2011 fixed line services FAD inquiry following an extensive consultation process.³⁴ The ACCC had previously used a combination of total service long run incremental cost (TSLRIC) and retail-minus-retail-cost (RMRC) methodologies for setting indicative prices under the negotiate-arbitrate regulatory framework. The ACCC implemented the BBM approach to setting prices through the fixed line services model (the FLSM). The ACCC also included a set of fixed principles in the 2011 FADs that specify how certain pricing inputs within the BBM framework should be determined until 30 June 2021. The ACCC included equivalent fixed principle provisions in the 2013 FAD for the wholesale ADSL service.

The ACCC has used the FLSM to determine primary prices for Telstra's declared fixed line services to be included in the FADs for next regulatory period. This chapter provides an overview of the FLSM, its key inputs, the role of information provided by Telstra under the BBM record-keeping rule (RKR) and the process by which prices for declared services were determined (detailed analysis and the ACCC's final decisions on the various pricing matters are discussed in the following chapters). Key changes to several elements of the FLSM are also briefly discussed.

³⁴ Further information on the 2011 fixed line services FAD inquiry can be found on the ACCC website: <http://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fixed-line-services-final-access-determination-fad-2011>.

This chapter also provides an overview of the fixed principles and sets out the ACCC's final decision on whether new fixed principles should be included in the FADs for the next regulatory period. It also provides the ACCC's views on the factors that should be considered when deciding to make a fixed principle.

3.2 The fixed line services model

The FLSM calculates a price for each declared service based on a range of key inputs. The three main steps followed in the FLSM to calculate prices are described below.

Annual revenue requirements are determined for each asset class

The FLSM contains 22 asset classes, which reflect the assets used to supply declared fixed line services and other services.

Each asset class is assigned a regulatory asset base (RAB), which is rolled forward on an annual basis. Capital expenditure on asset classes is added to the RAB each year while depreciation (which is based on the RAB value and asset lives for that asset class) and asset disposals are subtracted.

A revenue requirement for each asset class is then determined for each year. The four components of the revenue requirement for each year are:

- operating expenditure (see **chapter 4**)
- return on capital – this is determined by multiplying the opening RAB of an asset class for that year by the cost of capital (see **chapter 6** for discussion of the cost of capital)
- depreciation
- an allowance for taxation payments (see **chapter 7** for discussion of the treatment of imputation credits).

The revenue requirement for each asset class represents the annualised costs of investing in and operating the assets in that asset class during the applicable forecast period.

Costs of the assets are allocated to declared services

Each asset class's revenue requirement represents the total annualised cost of the asset class. However, most assets are used to provide a range of different services, both declared and non-declared. To determine the costs associated with providing declared services, the revenue requirements for each asset class are allocated to declared services and other regulated and unregulated services using cost allocation factors.

Each asset class has a set of cost allocation factors. Each cost allocation factor specifies the percentage of that asset class's revenue requirement that is to be allocated to a particular declared service.

The cost allocation factors adopted in the 2011 FADs were based on a cost model developed for the ACCC by Analysys Mason, and were adjusted annually in line with changes in demand for declared services. Telstra has proposed an alternative set of cost allocation factors based on a fully allocated approach that takes into account all services supplied using the fixed line network, including those both regulated and unregulated.

In this final decision, the ACCC has adjusted Telstra's fully allocated cost approach to reflect most of the assessment and recommendations provided by Analysys Mason in its report to the

ACCC.³⁵ The ACCC has also made adjustments to the cost allocation framework to ensure that the effects of the loss of economies of scale caused by the migration of fixed line services to NBN are not reflected in regulated charges (see chapter 10).

Prices are determined from allocated costs/revenue requirements

The asset class costs allocated to each declared service for each year are added together to derive a service-specific revenue requirement for those services.

For the 2011 and 2013 FADs, a price was calculated for each year by dividing the service specific revenue requirement for the service by its forecast demand (see 100 for discussion of demand forecasts). For ULLS services, a separate price was determined for ULLS bands 1-3 and for ULLS band 4, while separate prices were determined for wholesale ADSL port charges (which are charged on a per SIO basis, with separate prices for zone 1 and zones 2 and 3) and capacity charges (which are charged on a per Mbps basis).

For each declared service, prices calculated for each year were then averaged over the forecast period to determine the FAD price.

In the current FAD inquiry, Telstra proposed an alternative approach to individual price setting for the next regulatory period. Telstra proposed that the prices for all declared services be changed once, on a uniform basis across all services, at the start of the regulatory period by an amount that is expected to allow Telstra to recover the total or overall revenue requirement for all declared services across all asset classes over the regulatory period.

The ACCC's final decision is to determine a one-off uniform price change for all declared fixed line services following a similar method to that proposed by Telstra. This differs from the current approach, where the price for each declared service is based directly on its service specific revenue requirement and demand.

The approach to setting prices for individual services using the uniform price change method is discussed in 176.

Update and audit of the FLSM

The FLSM was developed for the 2011 FADs and was amended for the 2013 FAD to include assets used to supply the wholesale ADSL service. For the current inquiry the ACCC has made certain adjustments to the FLSM, including:

- A revised cost allocation framework and a mechanism to adjust allocations to reflect NBN-induced loss of economies of scale (discussed in chapters 10 and 11)
- A mechanism for calculating a uniform price change across all services (discussed in chapter 13)
- A mechanism for calculating the value of NBN-related disposals (discussed in chapter 10)
- Revised asset lives for new capital expenditure for particular assets (discussed in chapter 9)

The ACCC engaged Marsden Jacob Associates (MJA) to audit the revised FLSM to ensure that it is free from error, internally consistent and continues to perform as intended. MJA also updated the FLSM user manual. MJA found no problems or errors with the functioning of the

³⁵ Analysys Mason (2015), Final Report for the Australian Competition and Consumer Commission – confidential version, Assessment and verification of inputs into Telstra's Cost Allocation Framework, 16 June 2015,.

FLSM but suggested some measures to update the presentation of the model. The ACCC has published MJA's audit report with this final decision.

3.3 Building block model record-keeping rule

The ACCC has the ability to make record-keeping rules (RKR) that require carriers or carriage service providers to keep or retain relevant records. The RKR may also require the carrier or carriage service provider to prepare reports based on these records, and to provide those reports to the ACCC.

In August 2012, the ACCC made the building block model RKR (BBM RKR), which requires Telstra to provide the ACCC with historical and forecast information on operating expenditure and capital expenditure for all asset classes, forecast asset lives for all asset classes and historical and forecast information on demand for declared services.³⁶ The BBM RKR provides a formal mechanism for the ACCC to obtain key information from Telstra, when requested, that allows it to effectively operate the FLSM. The ACCC previously had to rely on other means to collect the required data, such as collecting data from Telstra on an ad hoc basis or from the regulatory accounting framework.³⁷

On 13 September 2013, the ACCC made a request to Telstra under the BBM RKR to provide the required information up to and including the 2018-19 financial year. Telstra provided this information, including supporting material, on 25 November 2013. Telstra provided additional material on 10 February 2014 in response to a further ACCC information request. Following a consultation process on the disclosure of Telstra's BBM RKR response, a public version was published on the ACCC website on 24 July 2014. Confidential versions were made available to access seekers under confidentiality arrangements.

Telstra revised its data on several occasions since its initial submission under the BBM RKR. Telstra's revisions and response to information requests included:

- 3 October 2014 — revised expenditure and demand forecasts. Telstra stated that these forecasts were based on more up-to-date assumptions about the NBN rollout and reflected actual data for 2013-14.
- 7 October 2014 — Telstra provided its forecast model and forecast model documentation alongside a revised and a public version of the 3 October 2014 material. Telstra also provided two consultants' reports which were referred to as the Balchin report and the Smart report.
- 15 December 2014 — a proposed amended FLSM and documentation, including amendments to allow for determination of new FAD prices. This included: adjustments to incorporate Telstra's new forecasts of expenditure; updates to economic parameters used; adjustments to incorporate Telstra's proposed cost allocation framework; and additional sheets to allow the FLSM to accommodate alternative NBN rollout scenarios.
- 19 January 2015 — an updated proposed FLSM incorporating the Internal Interconnection Cable (IIC) and Telstra Exchange Building Access (TEBA).
- 6 February 2015 — a revised amended FLSM including revised amended forecast expenditures.

³⁶ The ACCC subsequently varied the RKR in June 2013 to include information for the wholesale ADSL service.

³⁷ More information for the Regulatory Accounting Framework is available at the ACCC's website at: <https://www.accc.gov.au/regulated-infrastructure/communications/monitoring-reporting/regulatory-accounting-framework>

- 12 March 2015 – mapping of Telstra’s general ledger expenditures to fixed line asset classes.
- 1 May 2015 — revised amended forecast expenditures.
- 2 June 2015 — a revised amended fully allocated cost model.

Telstra’s operating and capital expenditure forecasts are discussed in chapters 4 and 5 respectively, while its demand forecasts are discussed in chapter 8.

3.4 Fixed principles

An access determination may contain ‘fixed principles’ provisions that lock in certain matters until a nominal termination date.³⁸ Both price and non-price terms and conditions can be designated as fixed principles provisions. They are intended to give the ACCC the ability to provide regulatory certainty in certain circumstances.³⁹

Fixed principles for the declared fixed line services (apart from wholesale ADSL) were made in the 2011 FADs. Identical fixed principles were subsequently included in the 2013 wholesale ADSL FAD. The fixed principles provisions for all declared fixed line services apply until 30 June 2021, and therefore provide industry with certainty over time about how the ACCC will estimate prices for these services. The fixed principles provisions specify:

- an initial value of the regulatory asset base
- a RAB roll forward mechanism
- the components of the revenue requirement
- factors the ACCC will take into account in determining the prudence and efficiency of capital and operating expenditure forecasts
- a process for assessing demand forecasts
- that a vanilla WACC is to be used to calculate the return on capital, with the cost of equity estimated using the CAPM
- that tax liabilities will be calculated using the statutory corporate tax rate, and
- principles that apply in the determination of cost allocation factors.⁴⁰

The 2015 FADs for the declared fixed line services will come into force before the nominal termination date specified in the fixed principles. Therefore, the ACCC must include the same fixed principles provisions in the new FADs.⁴¹

The fixed principles provisions in the 2011 FADs and included in the 2013 FAD were made by the ACCC having regard to the matters in subsection 152BCA(1) of the CCA.⁴² The ACCC considered that making fixed principles provisions will promote the LTIE by providing certainty about how the ACCC will estimate prices for the declared fixed line services after the end of the

³⁸ Section 152BCD(1) of the CCA

³⁹ Explanatory Memorandum to the *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010* (Cth), p. 144.

⁴⁰ ACCC, *Inquiry to make final access determinations for the declared fixed line services – Final Report (public version)*, July 2011, Appendix C, clause 6.

⁴¹ Section 152BCD(3) of the CCA

⁴² ACCC, *Inquiry to make final access determinations for the declared fixed line services – Final Report (public version)*, July 2011, p. 149-152.

regulatory period.⁴³ In particular, in specifying the cost components (or 'building blocks') used to estimate the revenue requirement, the ACCC considered that the fixed principles would promote the LTIE, be in the legitimate business interests of the access provider and be in the interests of access seekers.

The ACCC has decided not to vary or remove any of the fixed principles carried over from the previous FADs, nor to make any new fixed principles.

In response to the ACCC's July 2014 discussion paper, the Department of Communications submitted that it would be desirable for the ACCC to provide long term certainty in relation to how it intends to account for arrangements between Telstra and NBN Co under the Definitive Agreements in determining prices for the fixed line services.⁴⁴ The Department suggested that the ACCC could do this by making a fixed principle in relation to the treatment of NBN Co's payments to Telstra under these arrangements.

Following on from the October 2014 position statement in relation to this issue, the ACCC has decided not to make such a fixed principle. The purpose of indicating the ACCC's position on this issue in October 2014 was to provide greater regulatory certainty in the particular circumstances of the renegotiation of the July 2011 Definitive Agreements. The ACCC considered that this certainty was achieved by stating its position on the issue, and that a fixed principle was neither appropriate nor required. The ACCC notes that those renegotiations are now concluded with the signing of revised Definitive Agreements in December 2014.

In general, the ACCC considers that a decision on whether to make a fixed principle should carefully balance considerations of providing regulatory certainty with retaining regulatory flexibility and discretion. A lack of certainty about a regulator's approach can potentially result in underinvestment, particularly when firms consider there is a risk that they may not be able to recover sunk costs. Conversely, a lack of flexibility in regulation can also be detrimental, particularly where the regulatory approach cannot adapt to changing circumstances or where regulatory error is locked in.

The ACCC considers that it is important to identify the risks and benefits that may arise from making a fixed principle in order to determine an appropriate balance between certainty and flexibility. Accordingly, the ACCC considers that there are a range of factors that should be considered when deciding to make a fixed principle. A fixed principle may be appropriate where, for example, it would create or strengthen incentives for efficient investment and expenditure. On the other hand, a fixed principle may not be appropriate where, for example, there is a lack of certainty during the term of the fixed principle. This may involve uncertain industry developments, changing technology, and potential changes in the policy environment.

The ACCC considers that the fixed principles that currently apply are supported by these considerations. **Appendix D** reproduces the fixed principles provisions from the 2011 and 2013 FADs.

3.5 Telstra's forecast model

As noted, Telstra submitted a forecast model to the ACCC during the inquiry⁴⁵ that enables its demand and expenditure forecasts to be updated as new information on the NBN becomes available.

In August 2015, NBN Co released its 2016 Corporate Plan that included new information on the NBN plan and rollout schedule. The ACCC has used the forecast model submitted by Telstra to

⁴³ ACCC, *Inquiry to make final access determinations for the declared fixed line services – Final Report (public version)*, July 2011, page 149.

⁴⁴ Department of Communications, *Final access determinations for fixed line services—primary price terms: Submission to the ACCC*, October 2014, p. 2.

⁴⁵ Telstra (2015), *Fixed Services Forecast Model v1.2*, May 2015.

update the demand and expenditure forecasts used in the FLSM to determine the regulated charges.

The August 2015 rollout plan contains updated and more detailed rollout plans in terms of the number of premises 'Ready for Service' (RFS) for each of the technologies within the multi technology mix (MTM) NBN and 'Activated' for the years 2013–14 to 2017–18. NBN Co also released updated figures for the number of premises expected to be covered by the NBN at the end of the rollout (i.e. the number of premises covered by calendar year 2020).

The ACCC has updated Telstra's most recent version of its forecast model (provided in May 2015) using the following steps:

- The ACCC has adopted NBN Co's RFS rollout schedule as the Cumulative NBN rollout rate/plan for 2014–15 to 2017–18 and its Activation schedule as the Cumulative Brownfield Migration rate/plan for 2014–15 to 2017–18. As NBN Co did not forecast RFS or Activation figures for 2018–19, the ACCC has estimated them as a simple average of the 2017–18 and calendar year 2020 values.
- The adoptions reflect more up-to-date information about expected NBN rollout in the forthcoming regulatory period. They are an update to Telstra's methodology which effectively interpolates between a start and an end value. The ACCC recognises that Telstra's methodology and information were based on publicly available information on the NBN rollout plans at the time of submission.
- To separate FTTN and FTTB, a ratio derived from the number of FTTN and FTTB premises from the November 2013 Strategic Review was used. This proxy was used as NBN Co did not disaggregate its FTTN rollout to FTTN and FTTB.

4 Operating expenditure

Key Points

- The ACCC's final decision is that Telstra's base-year operating expenditure, forecast operating expenditure, non-NBN related propex, the forecast fault rate and consideration of the capex-opex trade-off are prudent and efficient.
- The ACCC's final decision is that Telstra's choice and application of productivity and cost indices are prudent and efficient.
- The ACCC's final decision is that NBN-related propex is not prudent and efficient and is excluded from Telstra's FLSM operating expenditures. The amount of NBN-related propex to be excluded from FLSM operating expenditures is \$[c-i-c starts] [c-i-c ends] million in real terms over the regulatory period. The amount of NBN-related propex to be excluded is lower than the amount excluded in the further draft decision of \$[c-i-c starts] [c-i-c ends] million in real terms.
- The ACCC's final decision is that a total operating expenditure of \$[c-i-c starts] [c-i-c ends] million in real terms for the four year regulatory period from 1 July 2015 to 30 June 2019 is prudent and efficient. The final decision operating expenditures are \$[c-i-c starts] [c-i-c ends] million (\$2009) higher over the regulatory period when compared to the further draft decision of \$[c-i-c starts] [c-i-c ends] million (\$2009).

4.1 Introduction

This chapter sets out the ACCC's final decision on each of the aspects of operating expenditure on which it reached draft decisions in the March 2015 draft decision (draft decision)⁴⁶ and the June 2015 further draft decision (further draft decision).⁴⁷ The chapter examines the submissions of Telstra and other stakeholders in response to the draft and further draft decisions and details how the ACCC's final decision is formed. It includes consideration of Telstra's responses and revisions that were submitted prior to and after the further draft decision. Section 4.2 summarises the ACCC's positions on Telstra's proposed operating expenditure in the draft decision and further draft decision. Section 4.3 provides an overview of the final decision on operating expenditure. The following sections set out final positions on each of the operating expenditure issues that the ACCC has considered in reaching its final decision. The sections include summaries of additional material provided by Telstra since the draft decision and submissions from Telstra and other stakeholders in response to the draft decision and further draft decision on the relevant issues.

In August 2015, NBN released an updated rollout plan and schedule in its 2016 Corporate Plan.⁴⁸ The ACCC has updated the inputs to the forecast model submitted by Telstra⁴⁹ with the latest information on the rollout provided by NBN (section 4.4). The change in the rollout schedule changes the following inputs in the forecast model over the regulatory period 2015–16 to 2018–19:

- the annual pace of the rollout ('premises passed')

⁴⁶ ACCC (2015), *Public inquiry into final access determinations for fixed line services – primary price terms*, draft decision, 11 March 2015.

⁴⁷ ACCC (2015), *Public inquiry into final access determinations for fixed line services – primary price terms*, further draft decision – outstanding issues, June 2015.

⁴⁸ NBN, *Corporate Plan 2016*, August 2015.

⁴⁹ Telstra. *Fixed Services Forecast Model v1.2* May 2015.

- the forecast fixed line SIO migration from Telstra to NBN
- the forecast operating and capital expenditures, and
- the forecast NBN-related capital expenditure and NBN-related propex.

The impact of the updated NBN rollout plan and schedule on final decision forecast operating expenditures is discussed in section 4.12.1.⁵⁰

4.2 Draft decision and further draft decision on Telstra's operating expenditures

The ACCC's March 2015 draft decision on Telstra's forecast operating expenditure was based on information provided and submissions made by Telstra up to January 2015. The ACCC reached a draft decision on Telstra's proposed application of productivity and cost indices to its forecast operating expenditure and on Telstra's proposal to include NBN-related propex in its fixed line operating expenditures.

However, the ACCC did not reach a draft decision on the prudence and efficiency of Telstra's proposed base year operating expenditure, forecast operating expenditure, propex, the forecast fault rate and the capex-opex trade-off. These issues were considered in the further draft decision. In June 2015, the ACCC reached a further draft decision that these operating expenditures are prudent and efficient subject to some further information and clarification from Telstra. The ACCC's draft decision and further draft decision are summarised for each issue in sections 4.5 to 4.11.

4.3 Overview of the final decision on operating expenditures

Under a BBM approach, forecast operating expenditures should reflect prudent and efficient costs.⁵¹ The ACCC's final decision follows the fixed principles provisions which provide that the following matters are relevant to whether forecast operating expenditures reflect prudent and efficient costs:

1. the access provider's level of operating expenditure in the previous regulatory period
2. the reasons for proposed changes to operating expenditure from one regulatory period to the next regulatory period
3. any relevant regulatory obligations, or changes to such obligations, applicable to providing the declared fixed line services and
4. any other matters relevant to whether forecasting operating expenditures reflect prudent and efficient costs.⁵²

The ACCC has taken into account the above factors in assessing whether the following inputs into the BBM proposed by Telstra reflect prudent and efficient costs:

- base year operating expenditure
- forecast operating expenditure
- propex
- cost and productivity indices
- forecast fault rate operating expenditure

⁵⁰ NBN, *Corporate Plan 2016*, August 2015.

⁵¹ Clause 6.9 of the fixed principles provisions.

⁵² Clause 6.9 of the fixed principles provisions.

- inclusion of NBN-related propex, and
- the capex-opex trade-off.

The ACCC's final decision is that Telstra's forecast operating expenditures on the basis of updated rollout assumptions are prudent and efficient with the exception of NBN-related propex, which the ACCC has excluded from Telstra's proposed forecast operating expenditure. The amount of NBN-related propex to be excluded is \$[c-i-c starts] [c-i-c ends] million which is smaller than the \$[c-i-c starts] [c-i-c ends] million excluded in the further draft decision over the regulatory period 2015–16 to 2018–19. The reduction is due to several factors including an updated rollout schedule, a correction in the calculation of forecast NBN-related propex, a change to the CPI and the correction of minor calculation errors (identified by Optus⁵³ and the ACCC) and an adjustment to forecast TEBA rack usage (see chapter 11) in Telstra's forecast model.

Under the updated rollout schedule and as a result of the specified revisions and corrections, the ACCC's final decision operating expenditure is \$[c-i-c starts] [c-i-c ends] million (\$2009) over the regulatory period. The impact of the final decision on Telstra's real forecast operating expenditures are summarised in Table 4.1 below.

Table 4.1 Telstra's proposed forecast operating expenditures and the ACCC's draft and further draft decision and final decision (2009 dollars)

	2015–16	2016–17	2017–18	2018–19	TOTAL
Telstra Proposed Fixed Line Opex (January 2015)	[c-i-c starts] [redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ACCC Draft Decision*	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Telstra Proposed Fixed Line Opex (May 2015)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ACCC Further Draft Decision**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
ACCC Final Decision (New rollout forecast)***	[redacted]	[redacted]	[redacted]	[redacted]	[redacted] [c-i-c ends]

* The adjustment includes the ACCC's draft decision that the annual forecast change of the CPI should be 2.42 per cent for the financial years 2014–15 to 2018–19.

** Note the adjustments are subject to rounding error.

*** The adjustment includes the ACCC's final decision that the annual forecast change of the CPI is 2.5 per cent for the financial years 2015–16 to 2018–19. The ACCC Final Decision operating expenditure is subject to a rounding adjustment.

Source: Telstra, Fixed Services Forecast Model v1.1 (Jan2015); Telstra, Fixed Services Forecast Model v1.2 (May 2015).

⁵³ Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues, Public inquiry into final access determinations for fixed line services – primary price terms*, confidential version, July 2015, p. 8.

Assessment of approach against section 152BCA matters

The ACCC considers that the allowed forecast operating expenditures reflect prudent and efficient costs. As discussed in sections 2.2 and 3.4 of this decision, the fixed principles provisions in the 2011 FADs and included in the 2013 FAD were made by the ACCC having regard to the matters in subsection 152BCA(1) of the CCA.⁵⁴ In particular, the ACCC had regard to the LTIE, among other matters, in specifying that forecast operating expenditures should reflect prudent and efficient costs and the matters that are relevant to considering whether forecast operating expenditures reflect prudent and efficient costs.

The ACCC considers that as an input into the determination of efficient costs and efficient prices, prudent and efficient forecast operating expenditures will promote competition in the markets for listed services. The ACCC considers that supply of the listed services that are based on prudent and efficient operating expenditures will remove obstacles to users gaining access to listed services.⁵⁵

The ACCC considers that the responsiveness of Telstra's forecast operating expenditures to forecast changes in demand is both prudent and efficient, and will encourage the economically efficient use of, and economically efficient investment in, the infrastructure by which listed services are, or are likely to become capable of being, supplied.⁵⁶

The ACCC considers that as inputs into the supply of listed services and the determination of listed service prices, prudently and efficiently incurred operating expenditures will encourage the economically efficient use of, and economically efficient investment in the infrastructure by which listed services are supplied and any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁵⁷

The ACCC considers that the determination of prudent and efficient forecast operating expenditures is likely to result in the achievement of the objective in subsection 152AB(2)(e) (economically efficient use of, and the economically efficient investment in, infrastructure).⁵⁸ This is because in the determination of prudent and efficient forecast operating expenditures, the ACCC had regard to the following matters:

- (a) the technology that is in use, available or likely to become available and its influence on the supply and charging for listed services
- (b) the costs that would be involved in supplying and charging for the listed services are reasonable or likely to become reasonable
- (c) the effects, or likely effects, that supply, and charging for, the listed services would have on the operation or performance of telecommunications networks
- (d) the legitimate commercial interests of the supplier of the listed services, including the ability of the supplier to exploit economies of scale and scope, and

⁵⁴ ACCC, *Inquiry to make final access determinations for the declared fixed line services – Final Report (public version)*, July 2011, pages 149 – 152.

⁵⁵ Paragraph 152AB(4) – In determining the extent to which a particular thing is likely to result in the achievement of the objective referred to in paragraph (2)(c), regard must be had to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services.

⁵⁶ Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE; Paragraph 152AB(2)(e) – the objective of encouraging the economically efficient use of, and economically efficient investment in: (i) the infrastructure by which listed services are supplied; (ii) any of infrastructure by which listed services are, or are likely to become, capable of being supplied.

⁵⁷ Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE; Paragraph 152AB(2)(e) – the objective of encouraging the economically efficient use of, and economically efficient investment in: (i) the infrastructure by which listed services are supplied; (ii) any of infrastructure by which listed services are, or are likely to become, capable of being supplied.

⁵⁸ Paragraph 152AB(6) – the extent to which a particular thing is likely to result in the objective referred to in Paragraph 152AB(2)(e).

- (e) the incentives for investment in infrastructure by which the listed services are supplied and any other infrastructure by which the services are, or are likely to become, capable of being supplied.⁵⁹

In respect of Telstra's base year operating expenditures, the ACCC considers that through Telstra's extensive provision of information and mapping of its general ledger expenses, only direct costs incurred in the provision of listed services are allocated to listed services. These direct costs include all those costs necessary for the ongoing operations of listed services including appropriate shares of overhead supporting expenditures. The shares are based on algorithms that are derived from well-accepted common cost allocation rules, such as allocations based on relative materiality of direct operating expenditures.⁶⁰

The ACCC considers that since only direct costs, including an appropriate share of indirect costs, are included in the determination of allowable listed service revenues, the costs and revenues associated with providing other services are not included in the revenue requirement for listed services.⁶¹

The ACCC considers that its final decision on forecast operating expenditures provides a sufficient allowance for Telstra to recover its prudent and efficient costs that are incurred in the provision of listed services over the regulatory period.⁶² The ACCC further considers that an efficient forecast expenditure allowance will enable Telstra to recover the costs of operating expenditures that are required for the safe and reliable operation of its listed services.⁶³

In relation to the responsiveness of Telstra's operating expenditures to changes in demand, the ACCC also considers that adopting a cost-based approach with a forecast efficient expenditure allowance to pricing listed services ensures that prices are set with regard to the efficient costs of supplying these services. This will allow access seekers to compete more effectively in downstream markets where each of the listed services is an input to supplying services in the downstream (e.g. retail) markets.⁶⁴ The ACCC also considers that an efficient expenditure allowance will encourage the efficient operation of the service and other carriage services provided by the access provider's network. Using the FLSM, only efficient costs are included in calculating the revenue requirement that is used for the determination of prices.⁶⁵

The ACCC considers that Telstra's extensive provision of information on propex has demonstrated that access seekers will only pay for direct costs of propex that are required for the provision of listed services. The direct cost of propex also includes an appropriate share of overhead costs necessary to support the ongoing commitment of propex spends. The shares are based on algorithms that are derived from well-accepted common cost allocation rules, such as allocations based on relative materiality of direct operating expenditures.⁶⁶

The ACCC considers that, through Telstra's application of prudent and efficient cost and productivity indices, and through Telstra's forecast responsiveness of its cost centres to changes in its cost drivers, only efficient operating expenditure inputs will be included in the FLSM over the regulatory period. This will ensure that prices for listed services are based on the prudent and efficient costs of providing access. Prices that reflect prudent and efficient costs allow access seekers to obtain access to the listed services on reasonable price terms for

⁵⁹ Paragraph 152AB(6) – the extent to which a particular thing is likely to result in the objective referred to in Paragraph 152AB(2)(e).

⁶⁰ Paragraph 152BCA(1)(d) - direct cost of providing access to the listed service.

⁶¹ Paragraph 152BCA(2) – supply of one or more other eligible services

⁶² Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

⁶³ Paragraph 152BCA(1)(f) – operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility.

⁶⁴ Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the listed service

⁶⁵ Paragraph 152BCA(1)(g) – economically efficient operation of a carriage service, a telecommunications network or a facility

⁶⁶ Paragraph 152BCA(1)(d) - direct cost of providing access to the listed service.

the purpose of providing downstream services and thereby promotes competition in downstream markets.⁶⁷

Telstra's application of cost and productivity indices, at predictable rates of change, will provide certainty for both the access provider and access seekers about how costs are expected to change over time. Such certainty encourages economically efficient investment in the infrastructure and promotes competition in the markets for carriage services.⁶⁸

The ACCC considers that the removal of NBN-related propex from Telstra's forecast operating expenditures ensures that Telstra does not recover costs from listed service customers that are incurred by someone else – that is, future users of the NBN. The ACCC considers that NBN-related propex is incremental to the NBN and therefore future users of the NBN, not current users of the Telstra's listed services, should incur the costs of NBN-related propex.⁶⁹ The ACCC considers that NBN-related propex is not a direct cost of propex that is required for the provision of listed services. Therefore, the removal of NBN-related propex ensures that access seekers only incur direct costs of propex required for the provision of listed services.⁷⁰

The ACCC considers that Telstra's forecast growth of its fault rate is prudent and efficient and that the operating expenditure allowances provided for the forecast fault rate will ensure the safe and reliable operation of any carriage service, telecommunications network or facility.⁷¹ The ACCC also considers that the operating expenditure allowances for the growth in Telstra's forecast fault rate will be sufficient for Telstra to recover its prudent and efficient forecast operating expenditures that are required for the rectification of faults.⁷²

The ACCC considers that the predictable path of forecast operating expenditure allowances promotes regulatory certainty. The ACCC is of the view that considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs.⁷³

4.4 Updated NBN rollout

Prior to the August 2015 update to the NBN rollout, the best information available to Telstra and the ACCC was that contained in the Strategic Review released by NBN Co in December 2013.⁷⁴ Compared to that information, there is now a forecast increase in the total number of premises to be passed by 2018–19 and an overall increase in the annual pace of the rollout. However, in the forecast model the updated rollout schedule results in fewer fixed line SIOs migrating to the NBN over the first three years of the regulatory period. Only at the end of 2018–19 are more fixed line SIOs forecast to be migrated under the updated rollout schedule.

⁶⁷ Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE; Paragraph 152AB(2)(c) – the objective of promoting competition in markets for listed services;

⁶⁸ Paragraph 152AB(2)(c) and (e). Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE

⁶⁹ Paragraph 152BCA(1)(e) – value to a person of extensions, or enhancement of capability, whose cost is borne by someone else.

⁷⁰ Paragraph 152BCA(1)(d) - direct cost of providing access to the listed service.

⁷¹ Paragraph 152BCA(1)(f) – operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

⁷² Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

⁷³ Paragraph 152BCA(3) – This subsection states the ACCC may take into account any other matters that it thinks are relevant when making a FAD.

⁷⁴ NBN, *Strategic Review*, Final Report, 12 December 2013.

4.4.1 The updated rollout: The first three years of the regulatory period

The updated rollout has two distinct but opposing effects on forecast operating expenditures in the first three years of the regulatory period, this is because:

- the cumulative number of premises passed is greater by 2017–18⁷⁵; but
- considerably fewer SIOs are migrated to NBN by 2017–18.

In the revised rollout plan, the cumulative number of premises passed in the first two years is lower than in the previous roll out plan. This accelerates significantly in 2017–18 such that the total cumulative number of premises passed by end 2017–18 is greater than under the previous roll out. However, because there is a lag of around one year between passing of premises and migration of premises to the NBN, considerably fewer SIOs are migrated to NBN by end 2017–18 under the revised rollout reflecting the slower pace of passing of premises in the preceding years.

As a result, in the first three years of the regulatory period, Customer Service Delivery (CSD) operating expenditures and Networks operating expenditures are higher relative to CSD and Networks operating expenditures under previous rollout assumptions since these expenditures are wholly or partly caused by the number of fixed line services in operation.⁷⁶

However, the amount of non-NBN propex to be included in forecast operating expenditures declines over the first three years of the regulatory period. Propex is a share of forecast capital expenditure and (non-NBN) capital expenditures⁷⁷ are negatively related to the annual pace of the rollout.⁷⁸ While the cumulative number of premises passed is lower for 2015–16 and 2016–17 under the updated rollout, the substantial increase in the cumulative number of premises passed by 2017–18 has raised the average annual pace of the premises passed over the first three years of the regulatory period. As a result, the amount of propex to be included in forecast operating expenditure falls over the first three years of the regulatory period under the updated rollout.

The net effect of the updated rollout over the first three years of the regulatory period is an increase in forecast operating expenditures (relative to forecast operating expenditures under previous rollout assumptions) since the fall in the amount of propex is more than offset by the increase in CSD and Networks operating expenditures due to fewer SIOs migrating by 2017–18.

4.4.2 The net effect of the updated rollout on forecast operating expenditures

By the end of 2018–19, Telstra is forecast to operate and maintain considerably fewer SIOs compared to the previous rollout schedule. The net effect of the updated rollout is that, over the entire regulatory period, aggregate CSD and Networks operating expenditures are slightly lower than aggregate CSD and Networks expenditures under previous rollout assumptions.

Forecast operating expenditures are further reduced by the fall in propex. By the end of the regulatory period the cumulative and annual average number of premises passed is higher under the updated rollout. Since propex is (indirectly) negatively related to the pace of the

⁷⁵ From the date the rollout started and for the first three years of the regulatory period.

⁷⁶ Wholesale Group operating expenditures are also demand determined but these expenditures are not included in the forecast of total operating expenditure.

⁷⁷ For CAN asset classes and data equipment

⁷⁸ The annual pace of the rollout in year t equals the cumulative number of premises passed in year t minus the cumulative number of premises passed in year $t-1$.

rollout, under the updated rollout the propex amount to be included in forecast operating expenditures is lower when compared to the propex amount under the previous rollout assumptions.

Overall, when including the fall in overhead expenditures associated with the reduction in CSD, Networks and propex operating expenditures, total forecast operating expenditures under the updated rollout are \$[c-i-c starts] [c-i-c starts] million (\$2009) lower when compared to total forecast operating expenditures under previous rollout assumptions,

The updated rollout has also increased NBN-related expenditures (capital expenditure and propex). NBN-related expenditures increase because these outlays are positively related to the pace of the rollout. As a result, this has increased the amount of NBN-related propex to be removed over the regulatory period (although this amount is more than offset by other revisions and corrections in the final decision).⁷⁹

See section 4.12 for further explanation on the impact of the updated rollout schedule on forecast operating expenditures.

The ACCC's final decision with respect to each of the operating expenditures is set out in detail below.

Where base year and forecast expenditure amounts are designated as being in 'real terms', this means real 2009 dollars (i.e. deflated to 2009 dollars using CPI).

4.5 Efficiency and prudence of Telstra's 2013–14 base year operating expenditure

4.5.1 ACCC's further draft decision

In response to the ACCC's draft decision concerns on the relevance, prudence and efficiency of Telstra's base year FLSM operating expenditure, Telstra provided further information on its operating expenditures that included a comprehensive mapping of its general ledger expenditures to fixed line asset classes.

On the basis of the information and for the purposes of the further draft decision, the ACCC could sufficiently scrutinise the traceability of fixed line operating expenditure from Telstra's general ledger to its fixed line asset classes. However, in its May 2015 submission, Telstra also presented further revisions to its fixed line operating expenditures which raised ACCC concerns about the degree of uncertainty and discretion around Telstra's estimates of its base year operating expenditure. While the ACCC had concerns relating to Telstra's discretion to allocate expenditures from the general ledger to fixed line services, the ACCC's further draft decision was, on the basis of the additional information Telstra had provided since the draft decision, to accept Telstra's base year operating expenditures for 2013–14 as both prudent and efficient.⁸⁰

The ACCC's further draft decision was also to reverse its draft decision to remove Telstra's proposed adjustment to its business unit support mark-up based on further information provided by Telstra. The ACCC's further draft decision was that Telstra's proposed upward adjustment to its business unit support mark-up is prudent and efficient.

⁷⁹ This includes a correction to the calculation and removal of NBN-related propex, a small change in the CPI, correction of minor calculation errors (identified by Optus and the ACCC) and an adjustment to forecast TEBA rack usage in Telstra's forecast model. See also: Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues, Public inquiry into final access determinations for fixed line services – primary price terms*, confidential version, July 2015, p. 8.

⁸⁰ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms, further draft decision – outstanding issues*, June 2015, p. 30.

The ACCC's further draft decision on base year operating expenditure was contingent on Telstra providing the ACCC with information to support its approach for allocating fault rectification activity to fixed line services and to explain what property rental costs are incurred by the fixed line services.

In regard to the first of these issues, [c-i-c starts] [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c ends]

On the matter of property rental costs incurred by the fixed line services, [c-i-c starts] [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c ends]

4.5.2 Submissions to the further draft decision

Telstra

In its response to the further draft decision Telstra submitted additional information on the allocation of indirect fault reporting costs to fixed line services and the allocation of property rental costs associated with the supply of fixed lines services.⁸⁴

[c-i-c starts] [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

⁸¹ Telstra, *Further explanation of FY2014 operating costs identified as relevant to the FLSM*, March 2015, commercial-in-confidence, p. 20.

⁸² Telstra, *Public inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision, 1 May 2015, Confidential Version*, Appendix 4, pp. 245-248.

⁸³ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms, further draft decision – outstanding issues*, June 2015, p. 30.

⁸⁴ Telstra, *Public inquiry into final access determinations for fixed line services – primary prices, Response to ACCC further draft decision*, 17 July 2015, Confidential Version, p. 34.

⁸⁵ *ibid*, p. 62.

⁸⁶ *ibid*, p. 63.

⁸⁷ Telstra, *Further explanation of FY2014 operating costs identified as relevant to the FLSM*, March 2015, commercial-in-confidence, p. 20; Telstra, *Public inquiry into final access determinations for fixed line services – primary prices, Response to ACCC further draft decision*, 17 July 2015, Confidential Version, p. 63.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] [c-i-c ends]

Optus

Optus submitted that the ACCC appears to be satisfied that Telstra has provided sufficient information on the mapping of costs from the general ledger to FLSM asset classes while also observing Telstra has an incentive to inflate costs allocated to the regulated fixed line services.⁹²

Optus has also identified an error in the operating expenditure worksheet. Optus submitted that the formulas for Telstra exchange building access (TEBA) and Other Third Party Access (TPA) racks should be revised as it refers to the wrong cells in the demand forecasts. The current model results in the overstating of the number of TEBA and Other TPA racks and therefore leads to an overestimate of electricity consumption in the Networks cost centre. Correcting for this error reduces the total forecast electricity expenditure to be incurred in the Networks cost centre.⁹³

⁸⁸ Telstra, *Further explanation of FY2014 operating costs identified as relevant to the FLSM*, March 2015, commercial-in-confidence, p. 20; Telstra, *Public inquiry into final access determinations for fixed line services – primary prices*, Response to ACCC further draft decision, 17 July 2015, Confidential Version, p. 63.

⁸⁹ Telstra, *Public inquiry into final access determinations for fixed line services – primary prices*, Response to ACCC further draft decision, 17 July 2015, Confidential Version, pp. 63-64.

⁹⁰ *ibid.*, p. 64.

⁹¹ *ibid.*, pp. 64-65.

⁹² Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues*, *Public inquiry into final access determinations for fixed line services – primary price terms*, confidential version, July 2015, p. 7.

⁹³ *ibid.*, p. 8.

4.5.3 ACCC final assessment and decision

In response to the further draft decision, Telstra has provided sufficient information and evidence in response to the ACCC's outstanding queries on the allocation of annual building rental costs and sufficient explanation of CSD fault reporting expenditure and CSD fault rectification expenditure. The ACCC acknowledges the concerns of Optus in relation to Telstra's incentives to inflate operating expenditure estimates. However, on the basis of the further information and evidence provided by Telstra in support of its operating expenditures, the ACCC's final decision is that Telstra's proposed base year operating expenditures are prudent and efficient.

The ACCC acknowledges Optus' finding of a minor error in Telstra's calculation of TEBA racks and other third party access racks in its proposed forecast operating expenditures. The ACCC has corrected this error. The ACCC also identified and corrected another minor calculation error in Telstra's forecast of the electricity consumption of other third party racks. Telstra had failed to include a 30 per cent mark-up for overhead power consumption (for example, air conditioning) when accounting for the change in power consumption of third party access racks (NBN). This mark-up has now been added to the change in power consumption of third party access racks and has slightly increased electricity consumption expenditure for Networks.

4.6 The responsiveness of Telstra's operating expenditure to changes in demand

4.6.1 ACCC further draft decision

In the further draft decision, the ACCC noted considerable uncertainty and variation around Telstra's forecast operating expenditures. Telstra had demonstrated that it had considerable discretion in choosing the allocation methods to estimate its base year operating expenditure and such discretion has material effects on its forecast of operating expenditures.^{94, 95}

The further draft decision stated that scope for such discretion may elevate the risk of Telstra proposing to include imprudent and inefficient expenditures in the FLSM.

However, the ACCC stated in the further draft decision that Telstra had provided the ACCC with considerably more information on:

- the mapping of its operating expenditures from its general ledger to FLSM asset classes for the base year, and
- how particular technical constraints and the nature of the NBN rollout may inhibit Telstra from substantially reducing its network operating expenditures over the forecast period.

⁹⁴ For example, in its response to the draft decision, Telstra had claimed that its particular choices of allocation methods for Networks resulted in \$[c-i-c starts] [redacted] [c-i-c ends] million less FLSM operating expenditure for 2013–14 and possibly several times that amount for its forecast operating expenditure over the forecast period. Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, p. 18.

⁹⁵ In its response to the draft decision, Telstra had also stated that it may include considerably more FLSM relevant operating expenditure in the future. For example, through further analysis of its general ledger in response to the draft decision, Telstra had identified a further \$[c-i-c starts] [redacted] [c-i-c ends] million that may be relevant to FLSM asset classes that it had decided not to include because more thorough analysis was required. Telstra also stated it did not have time to review other business units where even further FLSM relevant operating expenditure may be identified. Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, p. 8, p. 220.

On the basis of the further information Telstra had provided, the ACCC's further draft decision was that Telstra's forecast operating expenditures were likely to be both prudent and efficient.⁹⁶

4.6.2 Submissions to the further draft decision

Telstra

Telstra provided an extensive response on the issue of the responsiveness of operating expenditure to demand in its submission of May 2015 and did not submit further on the issue in its response to the further draft decision.

iiNet

iiNet submitted that the ACCC must not accept Telstra's forecast operating expenditure unless the ACCC is satisfied that Telstra's forecast operating expenditure presents prudent and efficient costs.⁹⁷ While iiNet acknowledged Telstra's extensive provision of information in support of its operating expenditures, iiNet remained concerned that the fundamental information asymmetries and lack of transparency mean that much of the information is accepted at face value.

iiNet submitted that Telstra should not be permitted to use a request for transparency as an opportunity to adjust its forecast operating expenditure upwards, otherwise Telstra will have no incentive to provide accurate and transparent forecasts. iiNet further submitted that if the ACCC deemed it appropriate to revisit the issue of forecast operating expenditure due to Telstra submitting yet further revised operating expenditure, the ACCC should use the January 2015 forecast operating expenditure for the purposes of the FLSM.⁹⁸

Optus

Optus submitted that there is considerable information asymmetry in the assessment of the prudence and efficiency of forecast expenditure limits. Optus considered that there is substantial doubt over the prudence of Telstra's forecast expenditure. It argued that the further draft decision had increased allowable expenditure by [c-i-c starts] [c-i-c ends] per cent over the period of the FAD and it appears implausible that a publicly listed company would allow such forecasts of operating costs in the face of significant drops in demand without market reaction.⁹⁹

Optus submitted that the ACCC had only made minimal changes to the operating expenditure forecasts provided by Telstra and it was not clear that the further draft decision adequately responds to issues raised in the response to the draft decision.

Optus remained concerned that when the ACCC has a range of reasonable values to choose from, it appears to choose values that promote Telstra's business interests over the interests of its customers and competition.¹⁰⁰

⁹⁶ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms, further draft decision – outstanding issues*, June 2015, pp. 35-36.

⁹⁷ iiNet, *Public inquiry into final access determinations for fixed line services – primary price terms, Further Draft Decision – Outstanding Issues*, June 2015, Confidential Version, p. 3.

⁹⁸ *ibid.*, p. 5.

⁹⁹ Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues, Public inquiry into final access determinations for fixed line services – primary price terms*, confidential version, July 2015, p. 3.

¹⁰⁰ *ibid.*, p. 7.

Macquarie Telecom

Macquarie Telecom submitted that it retained concerns regarding whether Telstra's forecast operating expenditure is accurate and consistent with the long term interests of end users. Macquarie submitted that the information asymmetry and the lack of visibility of Telstra's forecasts could potentially lead to an imprudent and inefficient level of expenditure.¹⁰¹

Macquarie considered that the ACCC should not accept any forecast expenditure figures above those already provided by Telstra. Macquarie submitted that if Telstra has undertaken even further revisions, the ACCC should accept the forecasts provided in January 2015 with appropriate adjustments to remove NBN propex and any other inappropriate inclusions for the provision of fixed line services.¹⁰²

4.6.3 ACCC final assessment and decision

While the ACCC had regard to stakeholders' concerns, the ACCC also considers that Telstra has provided substantial further information and evidence that:

- its mapping of expenditures from general ledger to FLSM asset classes, including its updated operating expenditures provided in May 2015, best reflect causal relations between the supply of fixed line services and the expenditures incurred in its general ledger, and
- that technical constraints and the nature of the NBN rollout may inhibit Telstra from substantially reducing its network operating expenditures for certain cost centres in response to falling demand, but overall Telstra's operating expenditures are sufficiently responsive to forecast changes in demand.

Therefore, the ACCC's final decision is that Telstra's forecast operating expenditure and the responsiveness of Telstra's forecast operating expenditure to changes in demand are both prudent and efficient.

4.7 Propex

4.7.1 ACCC further draft decision

The ACCC's further draft decision found that Telstra's proposed propex (excluding NBN-related propex) was both prudent and efficient. However, several outstanding concerns remained and the ACCC sought further clarification from Telstra on propex attributions to cost centres.

Telstra's March 2015 submission identified approximately \$[c-i-c starts] [redacted] [c-i-c ends] million of propex for 2013–2014 originating from 'other' cost centres.¹⁰³ The ACCC was concerned that Telstra did not identify these cost centres in which a considerable amount of FLSM-relevant propex was attributed.

Telstra's response to the ACCC draft decision included propex adjustments and attributions of propex to identifiable cost centres. These adjustments and attributions were provided by Telstra's consultant, KPMG. The revised breakdown of the propex spend by originating cost centre is provided in the right-hand column of Table 4.2.

¹⁰¹ Macquarie Telecom, *Public inquiry into final access determinations for fixed line services – primary price terms, Further draft decision – Outstanding issues – June 2015*, Submission by Macquarie Telecom, 21 July 2015, p. 1.

¹⁰² *ibid.*, p. 2.

¹⁰³ Telstra, *Further explanation of FY2014 operating costs identified as relevant to the FLSM*, March 2015, commercial-in-confidence, p. 88.

Table 4.2 Telstra’s proposed propex by cost centre (2013–14, million \$ nominal)

Cost Centre	Telstra’s March 2015 response	Telstra’s response to draft decision - KPMG (May 2015)
CSD	[c-i-c starts] ██████████	██████████
Networks	██████████	██████████
ITS	██████████	██████████
TSO	██████████	██████████
Other Lines of Business/Cost Centres	██████████	██████████
Net reduction in propex undertaken by Telstra-KPMG	██████████	██████████
Total	██████████	██████████ [c-i-c ends]

Source: Telstra, *Further explanation of FY2014 operating costs identified as relevant to the FLSM*, March 2015, commercial-in-confidence, p. 88 and KPMG, *The basis for determining Telstra’s base year operating expenditure for fixed line services*, Gilbert and Tobin, April 2015, p. 138.

The propex spend for the 2013–14 base year of \$[c-i-c starts] ██████████ [c-i-c ends] million, and in the Telstra-KPMG response most of the propex originally attributed to ‘other’ cost centres was subsequently attributed to the Information Technology Solutions (ITS) cost centre. The Telstra-KPMG response also attributed some propex from ‘other’ cost centres to the Telstra Service Operations (TSO) cost centre.¹⁰⁴ Telstra-KPMG had also reduced total base year propex by \$[c-i-c starts] ██████████ [c-i-c ends] million so that the total propex could be reconciled with the base year propex in the FLSM (and in the March 2015 mapping from general ledger to FLSM asset classes).

While the ACCC considered that the Telstra-KPMG attribution of propex by identifiable cost centre improved the transparency and traceability of Telstra’s propex, it appeared that KPMG’s adjustment of \$[c-i-c starts] ██████████ [c-i-c ends] million had been undertaken to reconcile its estimated FLSM-propex amount with Telstra’s FLSM-propex estimate for the base year.¹⁰⁵

The ACCC was concerned that KPMG had reattributed a substantial amount of propex from ‘other’ cost centres to ITS (and to a lesser extent TSO) without any explanation. The substantial reattribution of propex from ‘other’ cost centres to ITS also did not seem to reflect the nature of these expenditures based on IMC code.¹⁰⁶ The ACCC was also concerned that the adjustments undertaken by Telstra highlighted a considerable degree of latitude and discretion around its estimates of propex for the base year and accordingly its forecast of propex.¹⁰⁷

On the basis of the more comprehensive itemisation and mapping of propex spends provided by Telstra following the draft decision and subject to some further clarification from Telstra on the propex spends allocated to the ITS costs centre, the ACCC’s further draft decision was to accept Telstra’s forecast of non NBN-related propex as prudent and efficient.¹⁰⁸

¹⁰⁴ KPMG, Gilbert and Tobin, *The basis for determining Telstra’s base year operating expenditure for fixed line services*, April 2015, p. 138.

¹⁰⁵ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms, further draft decision – outstanding issues*, June 2015, p. 40.

¹⁰⁶ *ibid*, pp. 40-41.

¹⁰⁷ *ibid*, p. 41.

¹⁰⁸ *ibid*, p. 42.

4.7.2 Submissions to the further draft decision

Telstra

In response to the further draft decision, Telstra confirmed that the total proposed propex amount of \$[c-i-c starts] [redacted] [c-i-c ends] million for the 2013–14 base year remains unchanged.¹⁰⁹ However, Telstra submitted that the ACCC had confused the information provided by KPMG.¹¹⁰ Telstra submitted that KPMG’s adjustments and attributions of propex, which included:

- the net adjustment of \$[c-i-c starts] [redacted] [c-i-c ends] million of FLSM-relevant propex
- the attribution of \$[c-i-c starts] [redacted] [c-i-c ends] million of FLSM-relevant propex to ITS and
- the attribution of \$[c-i-c starts] [redacted] [c-i-c ends] million of FLSM-relevant propex to TSO (Table 4.2 above),

were all incorrect.¹¹¹

Telstra provided a correct breakdown of FLSM-relevant propex and total propex by cost centre for 2013–14 (Table 4.3). Telstra confirmed that there has been no change to the FLSM-related propex for each cost centre since Telstra’s March 2015 submission.¹¹² The estimated FLSM-relevant propex attributed to ITS is \$[c-i-c starts] [redacted] [c-i-c ends] million and the estimated FLSM-relevant propex attributed to TSO is \$[c-i-c starts] [redacted] [c-i-c ends] million. For the avoidance of doubt, Telstra submitted that propex had not been reattributed or transferred to ITS (and TSO) since Telstra’s March 2015 submission.¹¹³

Table 4.3 Telstra’s July 2015 response: Propex by cost centre (2013–14, million \$ nominal)

Cost Centre		FLSM-relevant propex ^a)	Total Propex
CSD	CSD	\$[c-i-c starts] [redacted]	[redacted]
Networks	Consumer and Mobility Product Engineering	[redacted]	[redacted]
	Fixed and Data Access Engineering	[redacted]	[redacted]
	Transport and Routing Engineering	[redacted]	[redacted]
TSO		[redacted]	[redacted]
ITS		[redacted]	[redacted]
Other Lines of Business/Other Cost Centres		[redacted]	[redacted]
Total		[redacted]	[redacted] [c-i-c ends] m

¹⁰⁹ Telstra, *Public inquiry into final access determinations for fixed line services – primary prices, Response to ACCC further draft decision*, 17 July 2015, Confidential Version, p. 62.

¹¹⁰ *ibid.*, p. 57.

¹¹¹ *ibid.*, p. 57.

¹¹² *ibid.*, p. 58.

¹¹³ *ibid.*, p. 61.

Source: Telstra, *Public inquiry into final access determinations for fixed line services – primary prices, Response to ACCC further draft decision*, 17 July 2015, Confidential Version, pp. 60-61; ^a Telstra’s March 2015 information request response.

Telstra submitted that the FLSM-relevant propex amount of \$ [c-i-c starts] [c-i-c ends] million is still attributed to ‘other’ cost centres. Telstra acknowledged that it had not previously specified the sources of these other cost centres and submitted the following information to assist the ACCC in the identification of these cost centres.¹¹⁴ Table 4.4 provides a complete breakdown of FLSM-relevant propex by cost centre that is contained within Telstra’s ‘other’ cost centres.

Table 4.4 Telstra’s July 2015 response: FLSM-propex breakdown by cost centre within ‘other’ cost centres (2013–14, million \$ nominal)

‘Other’ cost centres/‘Other lines of business’	Propex related to FLSM
Other groups within Networks	
Enterprise and Business Product Engineering	\$ [c-i-c starts] [c-i-c ends]
Media	[c-i-c starts] [c-i-c ends]
Network Commercial Engineering	[c-i-c starts] [c-i-c ends]
Network Infrastructure Management	[c-i-c starts] [c-i-c ends]
Networks Delivery	[c-i-c starts] [c-i-c ends]
Networks ED Group Office	[c-i-c starts] [c-i-c ends]
Wireless Network Engineering	[c-i-c starts] [c-i-c ends]
Other Lines of Business within Telstra Operations Business Unit	
Telstra Operations – Other	[c-i-c starts] [c-i-c ends]
Telstra Operations – NBN delivery	[c-i-c starts] [c-i-c ends]
Other Corporate and Business Units within Telstra	
Telstra Retail BU (all Lines of Business)	[c-i-c starts] [c-i-c ends]
Global and Enterprise Services BU (all Lines of Business)	[c-i-c starts] [c-i-c ends]
Telstra Media Group BU	[c-i-c starts] [c-i-c ends]
Telstra Wholesale Group BU	[c-i-c starts] [c-i-c ends]
Corporate Accounting Group BU	[c-i-c starts] [c-i-c ends]
Corporate Unit – Business Support and Improvement	[c-i-c starts] [c-i-c ends]
Corporate Unit – Finance and Strategy	[c-i-c starts] [c-i-c ends]
Total ‘other’ cost centres/‘other lines of business’	[c-i-c starts] [c-i-c ends] m

Source: Telstra, *Public inquiry into final access determinations for fixed line services – primary prices, Response to ACCC further draft decision*, 17 July 2015, Confidential Version, pp. 64-65.

4.7.3 ACCC final assessment and decision

As a result of Telstra’s provision of further information, the transparency of FLSM-relevant propex by IMC code and FLSM-relevant propex by originating cost centre was improved.

¹¹⁴ *ibid*, pp. 64-65.

The ACCC considers that while KPMG's attributions and calculations were incorrect, KPMG had attempted to provide more visibility and transparency on Telstra's FLSM-relevant propex attributions. Telstra's March 2015 FLSM-propex attributions to cost centre are incomplete and opaque. For example, in Telstra's March 2015 response, FLSM-relevant propex attributed to Networks appeared to be negligible, at \$[c-i-c starts] [redacted] [c-i-c ends] million. However, when considering the propex attributions in Table 4.4, the correct FLSM-relevant propex amount originating from Networks is \$[c-i-c starts] [redacted] [c-i-c ends] million. In its March 2015 response, Telstra had also failed to identify the cost centres from which a significant amount of FLSM-relevant propex originated, such as the 'NBN delivery and NBN deal group' (\$[c-i-c starts] [redacted] [c-i-c ends] million of FLSM-relevant propex originates from this group – this has now been addressed in the data provided in Table 4.4.

The ACCC considers that in response to the further draft decision, Telstra had provided sufficient information and clarification on propex and the attribution of propex by cost centre. The ACCC's final decision is that Telstra's proposed base year and forecast propex (excluding NBN-related propex) are both prudent and efficient.

4.8 Telstra's proposed cost and productivity indices

4.8.1 Draft decision

In the draft decision, the ACCC considered that Telstra's proposed cost and productivity indices were prudent and efficient. However, the ACCC considered that Telstra's proposed forecast change in the CPI was too high, at 2.7 per cent per annum. The ACCC had adjusted the forecast change in the CPI from 2.7 per cent to 2.4 per cent per annum over the forecast period. In the further draft decision the forecast annual change in the CPI was revised to 2.5 per cent per annum over the regulatory period on the basis of the latest forecasts. The ACCC also had an outstanding concern that Telstra had not applied efficiency indices to all its cost centres including propex.¹¹⁵

4.8.2 Submissions to the draft decision

Telstra

In response to the ACCC's concern in the draft decision that Telstra had not applied efficiency indices to all its cost centres, Telstra stated that efficiency gains are assumed in areas where the relevant business unit has set efficiency targets. Telstra submitted that these business unit efficiency targets are not necessarily reflective of what has been achievable in practice, but rather reflect management objectives to drive business productivity and reduce costs. Telstra submitted that these projected efficiency gains are ambitious and are likely to overstate the true potential for efficiency gains.¹¹⁶

Telstra submitted that it has not assumed efficiency gains in its forecasting where such gains are not considered to be feasible by the relevant business units – this reflects the fact that there is less scope for efficiency gains in some areas.¹¹⁷

Telstra noted that no efficiency gains are assumed for building outgoings since there is limited scope to improve efficiency in this area. Telstra must continue to maintain its network buildings, and it does not anticipate that the cost of its maintenance and operations can be materially reduced.¹¹⁸

¹¹⁵ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms*, draft decision, 11 March 2015, p. 49.

¹¹⁶ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, p. 125.

¹¹⁷ *ibid*, p. 125.

¹¹⁸ *ibid*, p. 125.

Telstra also noted that no efficiency gains are assumed for fault repair since fault repair costs are a function of the fault rate, the number of SIOs and the unit costs of repairing faults. Telstra does not consider there to be scope for material efficiency gains in this area.¹¹⁹

Optus

Optus reiterated the concerns of the ACCC in relation to Telstra's inconsistent application of efficiency indices to its cost centres. Optus considered that Telstra's choice and application of cost and efficiency indices will need to be revisited because while the ACCC stated a preliminary view that the indices are reasonable, it did not provide any conclusions on the approaches taken in relation to Telstra's application of such indices.¹²⁰

4.8.3 ACCC final assessment and decision

In the draft decision, the ACCC required further explanation why Telstra had not applied indices, particularly efficiency indices, to all FLSM-relevant cost centres (CSD, Telstra Wholesale Group and propex) and the activity 'building maintenance and outgoings' within Networks.

In the final decision, the ACCC has considered Telstra's specific response to the ACCC draft decision on efficiency indices in combination with two other considerations that are necessary for the assessment of Telstra's application of efficiency indices:

- Telstra had provided considerable evidence (in response to the draft decision) that the forecast efficiency gains for its electricity consumption may be difficult to achieve. Telstra had provided evidence that power consumption in ESAs is unlikely to fall over time, despite the projected efficiency gains and the fall in demand.¹²¹
- For cost centres that flexibly respond to the decline in demand and yet have no recorded efficiency gains, the ACCC also considered the responsiveness of cost centre expenditures to changes in demand in the efficiency assessment.

Networks activity: 'building maintenance and outgoings'

For the Networks cost centre, the ACCC has considered the following:

1. evidence of a potential over-estimation of its forecast annual efficiency gains for electricity consumption, noting that electricity expenditure is on average more than three times greater than the expenditure on 'building maintenance and outgoings' which has no recorded efficiency gains, and
2. forecast annual efficiency gains of between [c-i-c starts] [c-i-c ends] and [c-i-c starts] [c-i-c ends] per cent per annum for all but one of Networks activities,

against Telstra's forecast of no efficiency gains for building maintenance outgoings in the Networks cost centre. When isolating the effect of efficiency gains, the combined Networks expenditures on electricity consumption, 'internal and contract network maintenance' and 'building maintenance and outgoings' (that is, expenditures largely within Telstra's control) fall by over [c-i-c starts] [c-i-c ends] per cent per annum over the regulatory period. This is despite no efficiency gains being recorded for the latter expenditure.

¹¹⁹ *ibid*, p. 125.

¹²⁰ Optus, *Submission in response to ACCC Draft Decision, Public Inquiry into final access determinations for fixed line services – primary price terms*, Confidential Version, April 2015, pp. 82-83.

¹²¹ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, pp. 97-106 and Appendix 5.

Given the decline in these combined expenditures from efficiency gains, including consideration of evidence that efficiency gains may be difficult to achieve, the ACCC considers that Telstra's application of efficiency indices to the Networks cost centre is prudent and efficient.

CSD, Telstra Wholesale Group and propex

The ACCC notes that while no projected efficiency gains are recorded for CSD (which includes fault reporting and fault repair), the Telstra Wholesale Group and propex, cost centres flexibly respond to changes in demand and the rollout. And the responsiveness of a cost centre's expenditures to changes in demand has also informed the ACCC's assessment of cost centre efficiency over time.

Given the expected significant change in fixed line service demand over the regulatory period, a more comprehensive assessment of a cost centre's efficiency also includes the measurement of a cost centre's forecast expenditures relative to the forecast volume of services it provides (the degree of technical efficiency)¹²² and consideration of the impact of a loss of scale on cost centre productivity.¹²³ Therefore, the ACCC considers that a more comprehensive assessment of efficiency includes the consideration of:

1. Telstra's application of cost and efficiency indices to its cost centre expenditures over time, since the application of cost and efficiency indices to expenditures affects the efficiency of a cost centre's expenditures relative to the volume of services it provides, and
2. The forecast responsiveness of cost centre expenditures to changing service volumes. Given the significant impact of NBN migration on fixed line service demand over the regulatory period, the responsiveness of cost centre expenditures to changing service volumes is also important in the assessment of efficiency for two reasons:

Firstly, given the significant forecast change in demand, an accurate forecast of expenditure avoided is necessary since the efficient avoidance of cost when demand falls is critical to the cost centre achieving technical efficiency.¹²⁴

Secondly, cost centres that are responsive or scaled to demand may find it difficult to record overall annual efficiency gains. Once cost centre operations are scaled to the decline in demand for services, the loss of productivity from the loss of economies of scale is unavoidable (assuming Telstra experiences increasing returns to scale in the provision of fixed line SIOs) and may offset or even dominate any other annual efficiency gains that could be achieved.

While Telstra does not expect annual efficiency gains for the CSD and Telstra Wholesale Group cost centres, these cost centre expenditures are forecast to be highly responsive to the loss of fixed line SIOs. Real CSD expenditures are projected to fall by [c-i-c starts] [c-i-c ends] per cent and real Wholesale Group expenditures are projected to fall by [c-i-c starts]

¹²² And the measure of 'technical progress' is the ability of a firm to become more technically efficient over time. Technical progress relates to the ability of a firm to produce more with a given amount of input quantities in the current period compared to the previous period.

¹²³ Coelli, Rao, O'Donnell and George Battese consider the effect of scale on productivity, Timothy Coelli, D.S. Prasada Rao, Christopher O'Donnell and George Battese (2005), *An Introduction to Efficiency and Productivity Analysis*, Second Edition, Springer, New York, p. 52.

¹²⁴ For example, while a cost centre may achieve annual efficiency gains of 6 per cent over the regulatory period, technical inefficiency may still arise if the cost centre could, but does not, proportionally reduce costs if the volume of services falls by half. The same cost centre may even be closer to 'full efficiency' and technical efficiency if it could not achieve annual efficiency gains of 6 per cent and yet proportionally reduced its expenditures in response to a fall in service volumes. 'Fully efficient' firms are defined in: Timothy Coelli, D.S. Prasada Rao, Christopher O'Donnell and George Battese (2005), *An Introduction to Efficiency and Productivity Analysis*, Second Edition, Springer, New York, pp. 52-53.

[c-i-c ends] per cent over the forecast period. In proportional terms, the reduction in Wholesale Group expenditures is almost as fast as the expected cumulative loss of fixed line SIOs over the forecast period under the updated rollout schedule (73 per cent).¹²⁵

In the draft decision, the ACCC also had concerns that cost and efficiency indices were not applied to projections of propex.¹²⁶ However, with the removal of NBN-related propex (considered below), real propex is forecast to fall by [c-i-c starts] [c-i-c ends] per cent over the forecast period, which is highly responsive to the expected cumulative loss of fixed line SIOs.

In addition to the consideration that CSD, Wholesale and propex are expected to avoid significant expenditures over the regulatory period, the ACCC also notes that once these cost centre operations are scaled to the volume of services remaining on the network, recording annual efficiency gains may be unrealistic given the loss of productivity that arises from a loss of scale. The loss of productivity from a loss of scale may offset or even dominate any annual efficiency gains that could be achieved by CSD, Telstra Wholesale Group and propex.

Telstra's response to the draft decision on the feasible scope and magnitude of its projected efficiency gains has addressed ACCC concerns about the inconsistency in the application of efficiency indices to its proposed expenditures.

For Networks, while annual efficiency gains are not recorded for one activity (building maintenance and outgoings), Networks expenditures within Telstra's control fall due to significant efficiency gains in other areas, and this is despite evidence that some recorded efficiency gains may be difficult to achieve.¹²⁷

For cost centres where forecast annual efficiency gains are not recorded, the ACCC considers that the expenditures incurred by these cost centres are efficient since these expenditures are highly responsive to a change in service volumes. This is because the ACCC's assessment of Telstra's application of efficiency indices to its cost centres is also informed by a more comprehensive measure of cost centre efficiency that also includes consideration of the responsiveness of cost centre expenditures to changes in service volumes and consideration of the effect of reduced scale on productivity and its impact on forecast efficiency gains.

Therefore, the ACCC's final decision is that Telstra's proposed application of cost and productivity indices to its cost centres is both prudent and efficient.

4.9 NBN-related propex

4.9.1 Draft decision

In the draft decision, the ACCC considered that Telstra's proposal to include NBN-related propex in its operating expenditure forecasts is not prudent and efficient since the NBN-related propex is incremental to the NBN. NBN-related propex was therefore excluded from Telstra's proposed operating expenditure forecasts.¹²⁸

The ACCC considered that Telstra had not demonstrated that fixed line services also benefit from NBN-related propex, indicating that the benefits and costs of this expenditure are specific or incremental to the NBN. NBN-related propex may still be mapped to the relevant asset classes if Telstra's cost allocation framework correctly allocated NBN-related propex costs to

¹²⁵ Based on the ACCC's final decision adjustments to Telstra, Fixed Services Forecast Model, version 1.2 (May 2015)

¹²⁶ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms, draft decision*, 11 March 2015, p. 49.

¹²⁷ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015.

¹²⁸ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms, draft decision*, 11 March 2015, p. 55.

NBN (such that fixed line services do not bear the cost of NBN-related propex). However, the ACCC noted that Telstra's cost allocation framework failed to appropriately account for the size of NBN-related propex relative to total operating expenditure for the relevant asset classes.¹²⁹

The ACCC's draft decision did not consider Telstra's 6 February 2015 proposed amendments to its NBN-related propex given the limited time to consider these amendments and because Telstra's propex adjustments had raised further concerns about the lack of transparency in the attribution of propex to asset classes.

4.9.2 Submissions

Telstra February 2015 submission

In its 6 February submission,¹³⁰ Telstra identified an error in the attribution of NBN-related capital expenditure and NBN-related propex to asset classes in its January 2015 operating expenditure forecasts. Telstra corrected this error by reallocating NBN-related capital expenditure and NBN-related propex from CA07 Other communications plant and equipment and CA09 Network buildings/support to CO07 Other communications plant and equipment and CO09 Network buildings/support.¹³¹

Telstra's 5 March 2015 response

In its 5 March 2015 response, Telstra submitted that NBN-related expenditure is appropriately attributed to FLSM asset classes since: firstly, this expenditure applies to the asset class in which it is attributed; and secondly, that internal consistency and unbiased allocations within a fully allocated cost framework requires that the relative use of a given asset by different services determines the allocation of cost with respect to that asset class (for the asset classes in which NBN expenditure is attributed).¹³²

Telstra's 12 March 2015 response

In its 12 March 2015 response, Telstra identified the NBN-related IMC project codes and their corresponding propex amounts for the 2013–14 base year. The propex amount for each IMC code is then mapped to FLSM asset classes.¹³³ Through the identification of NBN-related project IMC codes, a total NBN-related propex of \$[c-i-c starts] [redacted] [c-i-c ends] million is mapped to FLSM asset classes for the 2013–14 base year.¹³⁴

Telstra also provided an attribution of NBN-related propex by cost centre (although not all were identifiable in this submission). In Telstra's March 2015 submission, \$[c-i-c starts] [redacted] [c-i-c ends] million or approximately [c-i-c starts] [redacted] [c-i-c ends] per cent of total NBN-related propex that is mapped to FLSM asset classes originates from 'other' cost centres. The remaining [c-i-c starts] [redacted] [c-i-c ends] per cent of NBN-related propex originates from CSD, Networks, ITS and TSO.¹³⁵ (In its submission to the further draft decision, Telstra revealed that the NBN-related propex, which originates from 'other' cost centres, is attributed to the 'NBN delivery and NBN

¹²⁹ While Telstra had stated that its cost allocation for ducts and pipes includes an allocation to NBN for its use of Telstra's duct and pipe network, Telstra had not identified user-specific capital works, such as NBN-related duct remediation, as a relevant activity for which duct usage drivers (based on duct usage kilometres) are appropriate. Telstra, Fixed Services Forecast Model, v1.1 (Jan2015); Telstra, Cost Allocation Framework for the ACCC Fixed Line Services Model, Framework and Model Guide, Version 1, July 2014, Commercial in Confidence, pp. 17-21.

¹³⁰ This submission is available on the ACCC's website.

¹³¹ Telstra, Amendments to the Fixed Line Services Model, 6 February 2015, p. 14.

¹³² Telstra, *Fixed line services final access determination inquiry: ACCC request for information, Additional response to ACCC questions*, 5 March 2015, p. 3.

¹³³ Telstra, *Further explanation of FY2014 operating costs identified as relevant to the FLSM*, March 2015, commercial-in-confidence, pp. 222–228.

¹³⁴ *Ibid.*, pp. 222–228.

¹³⁵ *Ibid.*, pp. 222–228.

deal group'. However, the proposed NBN-related propex amount from this group has fallen from \$[c-i-c starts] [c-i-c ends] million to \$[c-i-c starts] [c-i-c ends] million.¹³⁶

Telstra's submission to the draft decision

Telstra considered that the ACCC's analysis of NBN-related expenditure is flawed and is inconsistent with the asset-based costing approach applied in the FLSM and the use of the fully allocated cost framework.¹³⁷ Telstra submitted that the ACCC's approach imagines a world in which there is no NBN rollout, and in which Telstra continues to provide legacy fixed line services on a stand-alone basis.

Telstra submitted that it does not provide the fixed line services on a standalone basis; rather, the fixed line services are supplied over a network that is also used to supply a range of other services. For this reason an asset-based costing approach is applied in the FLSM where all costs attributable to the FLSM are included in the FLSM and costs of each asset class are allocated among all users of that asset class in proportion to their relative usage.¹³⁸

Telstra submitted that the ACCC is assuming that, but for the NBN rollout, the NBN-related expenditure would have been entirely avoided. However, the ACCC does not consider the various other possible states of the world, absent the NBN rollout, such as:

- Telstra upgrading its fixed line network, needing to remediate ducts and other infrastructure to facilitate this; and/or
- Telstra continuing to supply services over the legacy copper network, and incurring maintenance costs of an ageing network.¹³⁹

Telstra considered that the ACCC appears to recognise that NBN access services are one of the services that Telstra needs to supply over the fixed-line, as it allows a portion of the FLSM costs to be allocated to these services. However, Telstra submits that the ACCC does not consider that the incremental costs of facilitating NBN access services should be included in the FLSM cost base.¹⁴⁰

Telstra submitted that the ACCC's approach is internally inconsistent and likely to result in Telstra under-recovering the costs of the fixed line network. Telstra stated that if NBN-related expenditure on fixed line assets were excluded from the cost base, it would not be legitimate or internally consistent to include NBN's use of the fixed line assets as part of the cost allocation framework.¹⁴¹

Telstra submitted an alternative framework for assessment of NBN-related expenditure. The alternative framework would address two questions:

- Is the expenditure attributable to a FLSM asset class or fixed line services?
- Is the expenditure on the relevant asset class prudent and efficient?¹⁴²

Telstra submitted if the answer is 'yes' to both questions then the expenditure must be included in the FLSM cost base. Telstra submitted that it is not appropriate to exclude expenditure on

¹³⁶ Telstra, *Public inquiry into final access determinations for fixed line services – primary prices, Response to ACCC further draft decision*, 17 July 2015, Confidential Version, pp. 59-60.

¹³⁷ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, p. 41.

¹³⁸ *ibid.*, p. 41.

¹³⁹ *ibid.*, p. 42.

¹⁴⁰ *ibid.*, p. 41.

¹⁴¹ *ibid.*, p. 42.

¹⁴² *ibid.*, p. 42.

the basis that it is incremental to the provision of a particular service, particularly in circumstances where that service's use is being taken into account in the allocation of costs.¹⁴³

Telstra further submitted that the remediation of duct infrastructure to facilitate the NBN rollout will have a significant long-term benefit for all users of the fixed-line network, and for all end users. It is not just Telstra and/or the NBN that will benefit from the investment over the long-term. All future users of the NBN will benefit. Allowing the duct network to deteriorate further would lead to higher costs for end-users over the long term, whether or not the NBN is rolled out.¹⁴⁴

In its May 2015 response to the draft decision Telstra submitted revised expenditure forecasts (Telstra Fixed Services Forecast Model v1.2). In these revised expenditure forecasts Telstra reduced the proposed NBN-related propex over the 2015–16 to 2018–19 regulatory period from \$[c-i-c starts] [c-i-c ends] million to \$[c-i-c starts] [c-i-c ends] million (\$2009) according to original ACCC calculations.¹⁴⁵

Telstra has also reversed its February 2015 reallocation of NBN-propex from the CAN, CA07 Other communications plant and equipment and CA09 Network buildings/support) to the Core, CO07 Other communications plant and equipment and CO09 Network buildings/support). As a result, all of Telstra's NBN-related propex is allocated to the CAN side of Telstra's fixed line network, with over [c-i-c starts] [c-i-c ends] per cent of NBN-related propex is allocated to CA01, CA07 and CA09.

Optus

Optus submitted that NBN-related expenditure should be regarded as incremental to the NBN and therefore should be recovered from users of NBN and not Telstra's fixed line network.¹⁴⁶

Frontier

In its submission on behalf of the Competitive Carriers Coalition, iiNet and Optus to the draft decision, Frontier considered that the ACCC needs to take further account of WIK-Consult's analysis which includes the removal of NBN-related expenditures from FLSM asset classes.¹⁴⁷

Macquarie

In its submission to the further draft decision Macquarie considered that the ACCC should only accept the forecasts provided for the purposes of the January 2015 forecast operating expenditure with appropriate adjustments to remove NBN propex and any other inappropriate inclusions for the provision of fixed line services.¹⁴⁸

4.9.3 ACCC final assessment and decision

The ACCC has considered the responses from Telstra and other stakeholders. While Telstra has stated that NBN-related expenditures will provide benefits for other users of the FLSM asset classes and that NBN-related expenditures supplant existing fixed line expenditures, Telstra has not demonstrated or provided evidence for these points. That is, Telstra has not

¹⁴³ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, p. 42.

¹⁴⁴ *ibid.*, p. 42.

¹⁴⁵ Telstra, *Fixed Services Forecast Model v1.2* (May 2015)

¹⁴⁶ Optus, *Submission in response to ACCC Draft Decision, Public Inquiry into final access determinations for fixed line services – primary price terms*, Confidential Version, April 2015, p. 54.

¹⁴⁷ Frontier, *Submission on the ACCC's draft decision on fixed line prices, A Report Prepared For the Competitive Carriers Coalition, iiNet and Optus*, May 2015, pp. 18-24.

¹⁴⁸ Macquarie Telecom, *Public inquiry into final access determinations for fixed line services – primary price terms, Further draft decision – Outstanding issues – June 2015, Submission by Macquarie Telecom*, 21 July 2015, p. 2.

demonstrated that these expenditures would be undertaken for the benefit of users other than the NBN in the absence of the NBN. Telstra has also stated the shared benefits are long-term¹⁴⁹, indicating that benefits may only accrue to users of the fixed line network once they have migrated to the NBN.

ACCC has considered Telstra's argument that NBN-related propex should be mapped to FLSM asset classes because these expenditures are prudent and efficient and because these expenditures are directly related to asset classes in which they are mapped. The ACCC considers that even if these expenditures are directly related to FLSM asset classes, NBN-related propex cannot be considered prudent and efficient for the provision of fixed line services since the proposed cost allocation factors require that fixed line users share the cost of an expenditure that is incremental to NBN.

In the draft decision, the ACCC considered that even though NBN-related propex is incremental to the NBN, NBN-related propex may be mapped to the relevant asset classes if Telstra's cost allocation framework can correctly allocate all these costs to the NBN. This way NBN-related propex may be mapped to the related asset classes and fixed line services would not incur the cost of NBN-related propex.¹⁵⁰

Table 4.5 identifies the NBN-related propex as a percentage of total operating expenditure¹⁵¹ for CA01 Ducts and pipes, CA07 Other communications plant and equipment and CA09 Network buildings/support over the regulatory period 2015–16 to 2018–19. Over [c-i-c starts] [c-i-c ends] per cent of NBN-related propex is mapped to these asset classes.¹⁵² The NBN-related propex share of operating expenditure is then compared to an estimate of Telstra's allocation of cost to the NBN for the same asset classes.

Since the ACCC considers that the NBN will entirely capture the benefits of NBN-related propex, the allocation of cost to NBN should at least correspond to the NBN-related propex share of operating expenditure for that asset class. However, for the relevant asset classes, the allocation of cost to NBN in Telstra's proposed cost allocation framework does not appropriately account for NBN-related propex.

¹⁴⁹ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, p. 42.

¹⁵⁰ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms, draft decision*, 11 March 2015, p. 55.

¹⁵¹ This approach results in a lower NBN-related propex share of total operating expenditure compared to calculating direct NBN-related propex as a share of direct operating expenditure. Such a result is because not all indirect costs are proportional to direct expenditures in the forecast operating expenditure worksheet (e.g. CSD indirect). It is the absence of a proportional relationship between indirect and direct operating expenditures that requires NBN-related propex be calculated as a share of total operating expenditure – if direct NBN-related propex was calculated as a share of direct operating expenditure, and this was used as a proxy for the share of NBN-related operating expenditure for a particular asset class, this would result in an upwardly biased estimate of the share of indirect costs attributed to NBN-related propex for that particular asset class.

¹⁵² To calculate NBN-related propex (including the mark-ups on NBN-related propex) as a share of total operating expenditure for an asset class, total operating expenditure without NBN-related propex is deducted from total expenditure including NBN-related propex. Since the ACCC's final decision on forecast operating expenditures include many adjustments and corrections in addition to the removal of NBN-related propex and the updated rollout, the isolation and identification of NBN-related propex for the calculation of the NBN-related propex shares in Table 4.5 necessitated that a copy of Telstra's forecast model was made and only adjusted for updated rollout assumptions and the removal of NBN-related propex. The total operating expenditures from the adjusted forecast model are then compared to Telstra's proposed operating expenditures (v1.2, May 2015) on the basis of the updated rollout. The NBN-related propex amounts and their share of Telstra's proposed total operating expenditures for the relevant asset classes can then be calculated. Note also that NBN-related propex is also spent on CA02 Copper Cables, CA03 Other Cables and CA04 Pair Gains Systems. However, NBN-related propex for these asset classes is less than 1 per cent of operating expenditure for these asset classes (average, 2015–16 to 2018–19).

Table 4.5 NBN-related propex as a proportion of total operating expenditure and the allocation of cost to the NBN by asset class, average 2015–16 to 2018–19

Asset Code	Asset Class	NBN-related propex as a percentage of total operating expenditure, average 2015–16 to 2018–19	Allocation of cost to NBN, average 2015–16 to 2018–19*
CA01	Ducts and pipes	[c-i-c starts] █████	█████
CA07	Other communications plant and equipment	█████	█████
CA09	Network buildings/support	█████	█████ [c-i-c ends]

Source: Telstra Fixed Services Forecast Model v1.2 May 2015; with updated rollout adjustments, Telstra CAF v1.3 June 2015, and Telstra Fixed Services Forecast Model v1.2 May 2015 with NBN-related propex removed and on the basis of the updated rollout

* Average over the regulatory period 2015–16 to 2018–19. For CA01, the average includes an estimate of NBN’s share of the duct usage by band (kilometres) based on an estimate of the forecast percentage acquisition of HFC over the period 2015–16 to 2018–19. The average is calculated on the basis of the updated rollout assumptions.

Telstra’s repeated revisions of its mapping of NBN-related propex to asset classes also raised concerns whether NBN-related propex is actually attributable to the relevant FLSM asset classes. For example, Telstra only began to record NBN-related propex for CA07 and CA09 in its January 2015 model (v1.1). Telstra then reallocated this expenditure to CO07 and CO09 in its February 2015 model (v1.1). In its May 2015 model (v1.2), Telstra reallocated this expenditure back to CA07 and CA09.

The ACCC’s final decision is that NBN-related propex is to be removed from Telstra’s forecast operating expenditure since this expenditure is incremental to NBN. On the basis of the updated rollout schedule, the removal of NBN-related propex results in a reduction of Telstra’s forecast operating expenditure of [c-i-c starts] █████ [c-i-c ends] over the regulatory period from 2015–16 to 2018–19 (\$2009).

The ACCC estimated the amount of NBN-related propex for removal on the basis of a number of steps:

- The removal of NBN-related propex spends from propex during the period 2011–12 to 2014–15 (in the capital expenditure worksheet). Since propex is hardcoded for these years, NBN-related propex is estimated by multiplying the NBN share of capital expenditure by the propex amounts during this period.¹⁵³ The removal of NBN-related propex from propex during this period ensures that NBN-related propex is not captured in forecast propex.
- Setting NBN-related capital expenditures to zero over the period from 2011–12 to 2018–19. Setting NBN-related capital expenditure to zero ensures that NBN-related propex is not captured in forecast propex.
- These adjustments provide an estimate of forecast propex and forecast operating expenditure without NBN-related propex.
- To determine the NBN-related propex amount to be removed, forecast operating expenditure without NBN-related propex is deducted from Telstra’s proposed forecast operating expenditure. This way, any overheads associated with NBN-related propex are also identified and removed.

¹⁵³ This is necessary since the forecast of propex is based on propex incurred during the years 2011–12 to 2014–15.

The NBN-related propex of [c-i-c starts] [REDACTED] [c-i-c ends] (\$2009) is smaller than the [c-i-c starts] [REDACTED] [c-i-c ends] million excluded in the further draft decision over the regulatory period. The change in the amount of NBN-related propex to be removed is due to several factors:

1. The updated NBN rollout. The NBN-related propex amount to be removed is larger since the updated rollout schedule projects more premises passed by 2018–19. The number of premises passed is a driver of NBN-related expenditures over the regulatory period (see section 4.12).
2. A correction in the calculation of forecast NBN-related propex. Forecast propex is based on historical propex as a share of historical capital expenditure multiplied by forecast capital expenditure. The approach to estimating forecast NBN-related propex requires that all NBN-related capital expenditures from 2011–12 to 2014–15 be set to zero in the capital expenditure forecast worksheet. This allows for the calculation of NBN-related propex by deducting forecast operating expenditures without NBN-related propex from forecast operating expenditures that include NBN-related propex.

Previously, historical NBN-related capital expenditures were not set to zero and therefore NBN-related capital expenditure was unintentionally captured in the forecast of propex. This resulted in a downwardly biased forecast of fixed line propex and an upwardly biased forecast of NBN-related propex. The correction has reduced the amount of NBN-related propex to be removed.

3. A change in the CPI and the correction of minor calculation errors (identified by Optus¹⁵⁴ and the ACCC) in Telstra's operating expenditure and demand worksheets.
4. A modification to the forecast model to maintain access seeker TEBA racks constant at base year levels rather than decreasing during the course of the forecast period. This change makes access seeker's demand for racks consistent with Telstra's constant demand for its own racks during the period, and follows an Analysys Mason recommendation (see chapter 11). Since TEBA racks were originally adjusted downwards as a result of the NBN rollout, holding TEBA racks constant increases forecast electricity consumption expenditure and slightly increases forecast operating expenditures.

4.10 The forecast fault rate

4.10.1 ACCC further draft decision

In the further draft decision, the ACCC considered that Telstra had submitted sufficient information that the forecast rate of growth in the fault rate is entirely explained by network factors alone, which rules out any anticipated growth in the fault rate that is directly caused by the NBN rollout. Therefore, the ACCC's further draft decision was that Telstra's forecast operating expenditure relating to its forecast growth in the fault rate was both prudent and efficient.

4.10.2 ACCC final decision

There were no submissions in response to the ACCC's further draft decision on Telstra's forecast fault rate. The ACCC's final decision is that Telstra's forecast growth of its fault rate is both prudent and efficient.

¹⁵⁴ Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues, Public inquiry into final access determinations for fixed line services – primary price terms*, confidential version, July 2015, p. 8.

4.11 Capex-opex trade-off

4.11.1 ACCC further draft decision

In the further draft decision, the ACCC considered that while Telstra had not explicitly recognised the capex-opex trade-off, it had appropriately considered the capex-opex trade-off in its forecast expenditures as it continues to substitute capital expenditure for operating expenditure. The ACCC's further draft decision was that Telstra had adequately accounted for any trade-off that may occur between its forecast capital expenditure and operating expenditure and that these expenditures are therefore efficient and prudent in this respect.

4.11.2 ACCC final decision

There were no submissions in response to the ACCC's further draft decision on Telstra's consideration of the capex-opex trade-off. The ACCC's final decision is that Telstra has adequately accounted for any trade-off that may occur between its forecast capital expenditure and operating expenditure and that these expenditures are prudent and efficient.

4.12 The updated NBN rollout plan and schedule

In August 2015, NBN released an updated rollout plan and schedule in its 2016 Corporate Plan,¹⁵⁵ and accordingly, the ACCC has updated the NBN rollout schedule in the forecast model submitted by Telstra.¹⁵⁶ The information on its rollout provided by NBN Co includes for the first time, forecasts of premises activated on each of the Multi-Technologies Mix (MTM) technologies.¹⁵⁷

In the draft decision, the ACCC considered that the latest NBN rollout forecasts should be adopted before the release of the final decision. The ACCC stated that it will assess 'the reasonableness of alternative expenditure and demand forecasts given the most up-to-date expectations about the rollout of the NBN.'¹⁵⁸ While the ACCC noted that it had not assessed the performance of Telstra's forecast model under alternative assumptions, the ACCC stated that it would review the model in light of new information in the future.¹⁵⁹ In the final decision, the ACCC had undertaken a review of the forecast model on the basis of transparency and verifiability of a change in NBN rollout assumptions on the forecast of FLSM demand and expenditure inputs.

The ACCC considers that updating the NBN rollout assumptions in the forecast model allows for the assessment of the changes to demand and expenditure forecasts that follow from the updated NBN rollout schedule. The forecast model employs verifiable and transparent algorithms that link rollout parameters to FLSM model inputs, and a change in rollout assumptions in the forecast model results in an automatic and consistent update of both demand and expenditure forecasts. This is also explained by Telstra in its submission to the ACCC (2014) discussion paper¹⁶⁰ on the forecast model:

Relationships between the NBN rollout, demand for fixed line services and expenditure requirements have been codified in the Forecast Model, so that if the NBN rollout scenario changes, forecasts of demand and

¹⁵⁵ NBN, *Corporate Plan 2016*, August 2015.

¹⁵⁶ Telstra, *Fixed Services Forecast Model v1.2 May 2015*.

¹⁵⁷ NBN, *Corporate Plan 2016*, August 2015, p. 65.

¹⁵⁸ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms*, Draft Decision, March 2015, p. 159.

¹⁵⁹ *ibid*, pp. xiii-xiv.

¹⁶⁰ ACCC, *Public Inquiry into final access determinations for fixed line services – primary price terms*, Discussion Paper, July 2014, pp. 17-26.

expenditure requirements (and consequently the calculated revenue requirement) will update in a consistent manner.¹⁶¹

[c-i-c starts] [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c ends]

For operating expenditure, the ACCC considers that the updated NBN rollout has automatically updated 2014–15 costs in the operating expenditure worksheet of the forecast model. The updated rollout automatically updates demand and demand-sensitive operating expenditures for CSD and Networks (and demand-sensitive operating expenditures for the Telstra Wholesale Group).

[c-i-c starts] [REDACTED] [c-i-c ends] Because propex is hardcoded for 2014–15, and because the updated rollout is considerably slower for 2014–15, the propex for 2014–15, which is an input to propex forecasts, may be larger. This is because propex is a share of forecast capital expenditure, where the latter expenditure (excluding NBN-related capital expenditure) is negatively related to the pace of the rollout.

Nonetheless, the ACCC considers that while Telstra had rollout data from 2013–14 in the forecast model, Telstra did not functionally relate the 2014–15 propex to the rollout. This is in contrast to Telstra linking operating expenditure for CSD, Networks and the Wholesale Group to demand (SIOs) for 2014–15. [c-i-c starts] [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c ends]

The ACCC notes that the forecast model also automatically updates NBN-related propex forecasts since the rollout is a driver of NBN-related capital expenditure. While 2014–15 propex is hardcoded and the premises passed for 2014–15 under the updated rollout is considerably lower, the potential effect of this slower rollout on NBN-related propex and therefore on propex is largely removed since, in the ACCC’s final decision, NBN-related propex is removed from previous and forecast propex spends in the forecast model.¹⁶⁴

The amount of NBN-related propex that is identified and removed over the regulatory period can be calculated from the steps outlined section 4.9.3. During the regulatory period, more premises are passed under the updated rollout, which increases NBN-related capital expenditure and increases the amount of NBN-related propex that is identified for removal.

While the ACCC notes Telstra’s concerns on the updating of the forecast model, the ACCC considers that Telstra’s model includes the information it needs to sufficiently scrutinise the

¹⁶¹ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Discussion Paper*, 3 October 2014, Confidential Version, p. 49.

¹⁶² Telstra, *Public inquiry into final access determinations for fixed line services*, letter on updated NBN rollout parameters 7 September 2015, Confidential, pp. 1–2.

¹⁶³ Telstra’s forecast of propex for 2014–15 was its budgeted propex for that year. Telstra (2014) *Forecast Model v1.05 Framework and Guide to Forecast Assumptions*, October 2014, Commercial-in-Confidence, p. 54.

¹⁶⁴ The potential effect of this slower rollout on 2014–15 propex is *largely* removed since the ACCC had to estimate the NBN-related propex amounts for the years 2011–12 to 2014–15.

revised forecast demand and expenditures in the forecast model on the basis of the updated NBN rollout parameters.

4.12.1 The impact of the updated rollout schedule on forecast operating expenditures

As a result of the updated rollout schedule, more premises are forecast to be passed and more SIOs migrated to the NBN by 2018–19. However, during the first three years of the regulatory period, considerably fewer SIOs are forecast to be migrated to the NBN.

Therefore, the updated rollout results in Telstra operating and maintaining more fixed line SIOs over the first three years of the regulatory period compared to the previous rollout. Forecast operating expenditures are larger over the first three years because CSD expenditures and, to some extent, Networks expenditures, are caused by the number of fixed line services in operation (Wholesale Group operating expenditures are also demand-determined but these expenditures are not included in the forecast of operating expenditure that is mapped to asset classes). However, by 2018–19 there are significantly more SIOs migrated to the NBN so that overall CSD and Networks operating expenditures are slightly lower over the regulatory period under the updated rollout.

The updated rollout also reduces the forecast fixed line propex. The updated rollout in the forecast model reduces discretionary, AROS and demand-driven capital expenditures over the regulatory period since these expenditures (for CAN asset classes and data equipment) are negatively related to the pace of the rollout. The forecast propex amount falls over the regulatory period because propex is a share of these capital expenditures.

NBN-related propex is also affected by the updated rollout. Since more premises are forecast to be passed by 2018–19, Telstra’s proposed NBN-related expenditures (capital expenditures and propex) increase because these outlays, which include duct remediation expenditures, depend on the pace of the rollout. The reduction in Telstra’s forecast operating expenditures as a result of removing NBN-related propex is \$[c-i-c starts] [redacted] [c-i-c ends] million (\$2009) for the regulatory period.¹⁶⁵

On the basis of the change in the rollout schedule, the removal of NBN-related propex, and several adjustments and corrections to forecast operating expenditures, the ACCC’s final decision operating expenditures are \$[c-i-c starts] [redacted] [c-i-c ends] million (\$2009) over the regulatory period. When the effect of the rollout is considered in isolation and given all the final decision adjustments and corrections to forecast operating expenditures, the updated rollout reduces forecast operating expenditures by [c-i-c starts] [redacted] [c-i-c ends] million (\$2009) from \$[c-i-c starts] [redacted] [c-i-c ends] million (\$2009).

However, when compared to the further draft decision, the increase in forecast operating expenditures caused by the final decision adjustments and corrections more than offset the reduction in operating expenditures caused by the updated rollout. The final decision operating expenditures are \$[c-i-c starts] [redacted] [c-i-c ends] million (\$2009) higher over the regulatory period when compared to the further draft decision of \$[c-i-c starts] [redacted] [c-i-c ends] million (\$2009).

¹⁶⁵ This also includes a small forecast change in the CPI, a correction of minor calculation errors (identified by Optus and the ACCC) in Telstra’s operating expenditure and demand worksheets and an adjustment to forecast TEBA rack usage. See also: Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues, Public inquiry into final access determinations for fixed line services – primary price terms*, confidential version, July 2015, p. 8.

5 Capital expenditure

Key Points

- The ACCC's final decision is that total capital expenditure of [c-i-c starts] [REDACTED] [c-i-c ends] for the 2014–15 to 2018–19 period is prudent and efficient. This is based on an update of Telstra's capital expenditure forecast model for the most recent forecasts of NBN rollout plans released by NBN Co in August 2015.
- The ACCC maintains its draft and further draft decision to exclude NBN-related capital expenditure from the fixed line services model (FLSM). This is on the basis that this expenditure is incremental to NBN and should be recovered from the NBN and its users (and not other users of the fixed line network). The amount of NBN-related capital expenditure to be excluded is [c-i-c starts] [REDACTED] [c-i-c ends] over the 2014–15 to 2018–19 period after updating for the most recent August 2015 rollout plans.
- In reaching its final decision, the ACCC notes that Telstra has provided substantially more information to further explain its submission on its capital expenditure forecasts. Telstra has also responded to concerns raised in the draft decision regarding the level of transparency in relation to capital expenditure forecasts with more detailed information and explanations.
- The ACCC has also undertaken a crosscheck of Telstra's capital expenditure forecasts by generating its own alternative forecasts. This supports a view that Telstra's capital expenditure forecasts are prudent and efficient.

5.1 Introduction

Capital expenditure forecasts are an input into the fixed line services model (FLSM) for estimating prices for the declared fixed line services. The FLSM updates the regulatory asset base (RAB) each year to incorporate forecast annual capital expenditure, depreciation and asset disposals for that year. Forecast capital expenditure is added to the RAB each year and forms a component of the revenue requirement through the return on and of capital in the FLSM.

NBN Co released updated NBN rollout plans in August 2015 (August 2015 rollout plan) as part of its Corporate Plan 2016.¹⁶⁶ This is the most up-to-date forecast of the Multi-Technology-Mix (MTM) NBN rollout plan available to the ACCC since the 2013 Strategic Review.¹⁶⁷

The ACCC notes that NBN rollout plans are an important input for determining the capital expenditure forecasts in the FLSM. This is because they are a key input to determining demand over the fixed line work during the NBN rollout which, in turn, is a key driver of capital expenditure. Changes to the NBN rollout also affect the amount of forecast NBN-related capital expenditure that the ACCC is removing from the capital expenditure forecasts.

As part of its submission and methodology on expenditure and demand forecasts, Telstra provided the ACCC with a forecast model for the purpose of producing consistent forecasts when new information on the NBN rollout becomes available.¹⁶⁸ The ACCC noted in its draft

¹⁶⁶ NBN Co, *Corporate Plan 2016*, August 2015, p. 39, 60 & 63.

¹⁶⁷ NBN Co has also released rollout plans in its November 2014 Corporate Plan for 2014–17. However, these rollout plans were not materially different to those in the Strategic Review.

¹⁶⁸ Telstra, *Forecast model v 1.05– framework and guide to forecast assumptions*, October 2014, p. 4.

decision that it will review Telstra's forecast model in light of new information in the future if necessary.¹⁶⁹

As noted in Chapter 2, the ACCC has reviewed the performance of Telstra's forecast model under the updated NBN rollout assumptions. The ACCC's final decision is to update the forecasts for demand, operating expenditure and capital expenditure forecasts used to determine regulated charges for the most up-to-date information on the NBN rollout and plan.

Therefore, the ACCC final decision for the capital expenditure forecasts is based on NBN Co's most recent rollout plans (August 2015). The ACCC notes that updating for NBN Co's August 2015 rollout plans only impacts the magnitude of the final decision for capital expenditure forecasts and does not affect the substantive analysis of issues regarding Telstra's capital expenditure forecasts considered during the inquiry.

In updating for the August 2015 rollout plans, the ACCC notes that capital expenditure forecasts for 2015–16 to 2018–19 are affected. The 2014–15 capital expenditure is not impacted by the new rollout plans as Telstra has 'hardcoded' this expenditure in its forecast model.

The ACCC has considered Telstra's concern that an updated of the rollout requires an update of the 2014–15 costs.¹⁷⁰

While 2014–15 capital expenditure is hardcoded and the premises passed for 2014–15 under the updated rollout is considerably lower, the potential effect of this slower rollout on 2014–15 capital expenditure is unlikely to be significant for the following reasons:

- Telstra's forecast methodology includes capital expenditure related to on-going projects in its 2014–15 capital expenditure. In combination with its statement that [c-i-c starts] [redacted] [c-i-c ends],¹⁷¹ only projects and expenditures that are reasonably expected to be undertaken are included in the 2014–15 capital expenditure.
- The potential effect of the slower rollout on 2014–15 NBN-related capital expenditure is largely removed since, in the ACCC's final decision, NBN-related capital expenditure is removed from the forecasts for 2014–15 to 2018–19.

This chapter sets out the ACCC's final decision on Telstra's proposed capital expenditure forecasts. All figures, tables and charts in this chapter are set out in real terms (\$2009 dollars) unless noted otherwise (i.e. deflated to 2009 dollars using CPI inflation).

5.2 Draft decision and further draft decisions on Telstra's capital expenditures

The ACCC's March 2015 draft decision on Telstra's forecast capital expenditure was based on information Telstra had provided up to January 2015. The ACCC's June 2015 further draft decision on Telstra's capital expenditure forecasts was based on revised capital expenditure forecasts submitted by Telstra in May 2015 and additional information Telstra provided after the March 2015 draft decision.¹⁷²

¹⁶⁹ ACCC, *Public inquiry into final access determinations for fixed line services-primary price terms: Draft decision (draft decision)*, March 2015, p. xiv.

¹⁷⁰ Telstra, Letter regarding public inquiry into final access determinations for fixed line services, 7 September 2015.

¹⁷¹ Telstra, Main submission to the draft decision, p. 134.

¹⁷² ACCC, *Public inquiry into final access determinations for fixed line services-primary price terms: Further draft decision-outstanding issues (further draft decision)*, June 2015, p. 46.

The further draft decision assessed Telstra's submissions and responses on the three outstanding issues identified in the ACCC draft decision on capital expenditure: Telstra's forecast methodology; Telstra's forecast capital expenditure for transmission equipment and the relevance of certain investment management committee (IMC) capital projects to FLSM asset classes.

- In the draft decision, the ACCC considered that Telstra's proposed forecast methodology did not provide sufficient evidence of the relationship between cost drivers and its forecast capital expenditures. In Telstra's responses since March 2015 (including its submission to the draft decision) Telstra demonstrated that, through a number of quantitative and qualitative adjustments, its forecast methodology effectively considers the impact of changing demand conditions and the NBN rollout on forecast capital expenditures.
- In the further draft decision, the ACCC considered Telstra's responses in addition to the ACCC modelling of alternative capital expenditure forecasts undertaken to provide a cross-check of the reasonableness of Telstra's forecast capital expenditure. On the basis of these considerations the ACCC found Telstra's capital expenditure forecast methodology to be reasonable.¹⁷³ The ACCC's further draft decision was to accept Telstra's methodology for forecasting capital expenditure.
- In the draft decision the ACCC considered that Telstra's forecast capital expenditure for transmission equipment lacked evidence of a relationship between demand-related capital expenditure and the increasing allocation of the cost of this asset class to declared fixed line services. The ACCC noted that it may make adjustments to forecast capital expenditure for this asset class in the absence of further information from Telstra.
- In the further draft decision, the ACCC considered Telstra's responses to the draft decision on its capital expenditure forecast methodology in combination with information that supported strong forecast growth in data traffic over the forecast period.¹⁷⁴ The ACCC's further draft decision was also informed by cost allocation advice from Analysys Mason which endorsed Telstra's platform allocators for the transmission technologies.¹⁷⁵ On the basis of these considerations, the ACCC's further draft decision was that Telstra's forecast capital expenditure for transmission equipment is both prudent and efficient.
- In the draft decision, the ACCC noted that some IMC capital projects that are mapped to FLSM assets did not appear relevant to the provision of fixed line services [c-i-c starts] [redacted] [c-i-c ends]. The ACCC noted that it may remove these project expenditures from FLSM asset classes in the absence of further information from Telstra that demonstrated their relevance.
- In its submission to the draft decision and other responses since March 2015, Telstra provided extensive information on the relevance of these IMC project expenditures to FLSM asset classes. The ACCC further draft decision considered that Telstra had sufficiently demonstrated the relevance of these expenditures to the FLSM asset classes. The ACCC's further draft decision was that these IMC project capital expenditures are prudent and efficient.¹⁷⁶

The further draft decision maintained the draft decision to exclude NBN-related capital expenditure from the capital expenditure forecasts.¹⁷⁷ Telstra's submission to the draft decision and other responses since March 2015 supported the ACCC's draft decision that this

¹⁷³ ACCC, Further draft decision, pp. 61–62.

¹⁷⁴ ACCC, Further draft decision, pp. 63–64.

¹⁷⁵ ACCC, Further draft decision, pp. 64.

¹⁷⁶ ACCC, Further draft decision, pp. 65–66.

¹⁷⁷ ACCC, Further draft decision, pp. 59–60.

expenditure is incremental to the NBN¹⁷⁸. The ACCC maintained its draft decision that this expenditure should be recovered from the NBN and its users (and not users of the declared fixed line services and the fixed line network). The amount of NBN-related capital expenditure to be excluded from Telstra's proposed total forecast capital expenditure of [c-i-c starts] [redacted] [c-i-c ends] in real terms was [c-i-c starts] [redacted] [c-i-c ends] over the 2014–15 to 2018–19 period.¹⁷⁹

5.3 Submissions to the further draft decision

Several access seekers made submissions to the further draft decision on Telstra's forecast capital expenditures.

Access seekers submitted that they held concerns with regard to the prudence of Telstra's forecast expenditure. In particular, Macquarie and iiNet submitted that they remain concerned with information asymmetry between Telstra and the ACCC, and that this has led to the ACCC accepting values at face value.

iiNet submitted that Telstra should not be able to use a request for forecast transparency to re-submit and adjust upwards expenditure forecasts, and that Telstra's May 2015 forecasts are unlikely to represent prudent and efficient costs because they are higher than forecasts which were based on historical costs.¹⁸⁰

Macquarie re-iterated that the ACCC should not accept any forecast expenditure figure above those already provided by Telstra, and that great latitude has been provided to Telstra during the inquiry.¹⁸¹

Optus submitted that it is concerned the ACCC has, when presented with a choice of reasonable values to decide upon, promoted 'Telstra's business interest over the interests of consumers and competition'.¹⁸²

Given that Telstra's submission in response to the ACCC's draft decision on NBN-related capital expenditure was extensive, submissions on NBN-related capital expenditure are considered separately below.

5.4 The ACCC's final assessment and decision

Under the BBM regulatory approach and the fixed principles provisions, forecast capital expenditures should reflect prudent and efficient costs.¹⁸³ The fixed principles provisions specify that the following matters are relevant to whether capital expenditure forecasts reflect prudent and efficient costs:

- The access provider's level of capital expenditure in the previous regulatory period
- Reasons for proposed changes to capital expenditure from one regulatory period to the next regulatory period

¹⁷⁸ ACCC, Further draft decision, p. 64.

¹⁷⁹ ACCC, Further draft decision, pp. 59–60.

¹⁸⁰ iiNet, *Public inquiry into final access determinations for fixed line services—primary price terms: Further draft decision-Outstanding issues—Submission by iiNet Limited (submission to the further draft decision)*, July 2015, p. 5.

¹⁸¹ Macquarie *Public inquiry into final access determinations for fixed line services—primary price terms: Further draft decision-Outstanding issues—Submission by Macquarie Telecom (submission to the further draft decision)*, July 2015.

¹⁸² Optus, *Submission in response to ACCC further draft decision outstanding issue (submission to the further draft decision)*, July 2015, p. 7.

¹⁸³ Clause 6.10 of the fixed principle provisions.

- Whether the access provider's asset management and planning framework reflects best practice
- Any relevant regulatory obligations, or changes to such obligations, applicable to providing the relevant declared fixed line services
- Any other matters relevant to whether forecast capital expenditures reflect prudent and efficient costs.

The ACCC has taken into account the above factors and stakeholder submissions in assessing the prudence and efficiency of Telstra's proposed forecast capital expenditure with regard to the following:

- Telstra's methodology for the forecast of capital expenditure
- Telstra's proposed forecast of demand-related capital expenditure (particularly the forecast capital expenditure for transmission equipment)
- The inclusion of certain IMC capital projects that do not appear related to the fixed line services
- Telstra's proposal to include NBN-related capital expenditure in its forecast capital expenditures.

To ensure that capital expenditure forecasts appropriately reflect the NBN rollout and efficient and prudent costs anticipated to occur over the period, the ACCC's final decision is based on NBN Co's most recent rollout plans (August 2015).

The ACCC's final decision is that Telstra's forecast methodology and forecast capital expenditures produced by its forecast model using updated information on the NBN rollout are prudent and efficient with the exception of NBN-related capital expenditure. The ACCC considers that NBN-related capital expenditure is incremental to the NBN rollout and should be recovered from the NBN and not users of Telstra's fixed line network.¹⁸⁴ It would not be prudent or efficient to recover this cost from users of the declared fixed line services and the fixed line network.

The ACCC's final decision on Telstra's forecast capital expenditure is set out in table 5.1 below. The ACCC considers that a forecast capital expenditure of [c-i-c starts] [REDACTED] [c-i-c ends] in real terms for the 2014–15 to 2018–19 period is prudent and efficient.

¹⁸⁴ ACCC, Draft decision, p. 73.

Table 5.1: Telstra’s forecast capital expenditure and ACCC final decision (million, \$2009)

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
Telstra May 2015 forecast (not updated for August 2015 rollout plan) ^a	[c-i-c starts]					
Telstra May 2015 forecast (updated for August 2015 rollout plan)						
ACCC final decision (updated for August 2015 rollout plan) ^c						[c-i-c ends];

Source: ACCC analysis a: nominal real \$ conversion is based on Telstra’s inflation assumption for the purpose of determining its forecasts; c: nominal real \$ conversion is based on updated ACCC inflation adopted for the further draft and final decision.

The ACCC’s final decision is for forecast capital expenditure [c-i-c start] [c-i-c end] in 2018–19.

The ACCC’s final decision on Telstra’s forecast methodology, Telstra’s forecast demand driven capital expenditure, the inclusion of certain IMC capital projects and NBN-related capital expenditure is discussed in detail below.

Assessment of approach against section 152BCA matters

The ACCC considers that Telstra’s capital expenditure forecasts reflect prudent and efficient costs. As discussed in section 3.4 of this decision, the fixed principles provisions in the 2011 FADs and included in the 2013 FAD were made by the ACCC having regard to the matters in subsection 152BCA(1) of the CCA.¹⁸⁵ In particular, the ACCC had regard to the LTIE, among other matters, in specifying that capital expenditure forecasts should reflect prudent and efficient costs and the matters that are relevant to considering whether capital expenditure forecasts reflect prudent and efficient costs.

The ACCC considers that its final decision that Telstra’s capital expenditure forecasts (with the exception of NBN-related capital expenditure) reflects prudent and efficient costs will promote the LTIE.¹⁸⁶

The capital expenditure reflects the prudent, efficient costs of supply and will contribute to: determining cost-based prices; and allowing the service provider a commercial return. As a result, this will encourage the economically efficient use of, and the economically efficient investment in, infrastructure and hence promote competition in the relevant markets for carriage services.¹⁸⁷ Access seekers will be able to acquire the listed services at prices that are based on efficient and prudent capital expenditure which will promote access to the listed services.¹⁸⁸

In considering the extent to which the final decision capital expenditure would promote the economically efficient use of, and the economically efficient investment in, infrastructure, the ACCC takes into account the legitimate commercial interests of Telstra and the incentives for investment by setting an efficient and prudent capital expenditure that reflects the direct cost of

¹⁸⁵ ACCC, *Inquiry to make final access determinations for the declared fixed line services – Final Report (public version)*, July 2011, pages 149 – 152.
¹⁸⁶ Paragraphs 152BCA(1)(a) and 152AB(2).
¹⁸⁷ Paragraphs 152AB(2)(c) and (e).
¹⁸⁸ Paragraph 152AB(4).

supply.¹⁸⁹ In setting the final decision capital expenditure forecasts, the ACCC has had regard to whether it is technically feasible for the listed services to be supplied and charged for.¹⁹⁰ The ACCC considers that the final decision capital expenditure forecasts would contribute to the efficient and prudent cost of supply (which will allow equally efficient access seekers to compete with Telstra on their own merits), promote access to the listed services, and promote the efficient operation of Telstra's fixed line network.

The final decision on the capital expenditure methodology provides sufficient allowance for Telstra to recover its prudent and efficient capital expenditure that is incurred in the provision of listed services.. This takes into account the legitimate business interests of the service provider, the interests of all persons who have rights to use the listed services, the direct costs of providing the listed services and the economically efficient use of and the economically efficient investment in infrastructure.¹⁹¹

By excluding non-ongoing capital expenditure from transmission expenditure and limiting annual growth of this expenditure, the final decision also sets prices that are based on the direct costs of transmission assets, thereby allowing access seekers to compete more effectively in downstream markets where listed services that include transmission costs are inputs to supplying services in those markets.¹⁹²

The prudent mapping of expenditure to FLSM asset classes allows efficient and prudent costs of supply to be appropriately allocated to the listed services through the use of cost allocation factors. This will contribute to determining prices that are based on the cost of assets used to supply them, allows the service provider a commercial return on investments, promotes competition in the markets for carriage services and encourages the economically efficient use of, and the economically efficient investment in, infrastructure.¹⁹³

In not adjusting capital expenditure forecasts on the basis of IMC codes, the final decision allows Telstra to recover its prudent and efficient capital expenditure for assets that are used in the provision of listed services..¹⁹⁴

The ACCC also considers that adopting a cost-based approach (via the FLSM) with efficient expenditure allowance will encourage the economically efficient operation of the access provider's network and usage of services provided over the network.¹⁹⁵

The ACCC's consideration of the exclusion of NBN-related capital expenditure against the matters set out in subsection 152BCA(1) is set out in chapter 2.4.

5.5 Telstra's methodology for forecasting capital expenditure

5.5.1 The ACCC's further draft decision

In the draft decision, the ACCC considered that Telstra's proposed forecast methodology did not provide sufficient evidence of the relationship between cost driver volumes and its forecast capital expenditures. In the further draft decision, the ACCC noted that despite further information from Telstra on its forecast methodology, there was limited recognition of how cost driver volumes would affect Telstra's forecast capital expenditures.

¹⁸⁹ Paragraphs 152AB(6)(b) and (c).

¹⁹⁰ Paragraphs 152AB(6)(a)

¹⁹¹ Paragraphs 152BCA(1)(b), (c), (d) and (g); 152AB(2)(e).

¹⁹² Paragraphs 152BCA(1)(c), (d) and (g); 152 AB(2)(c) and (e).

¹⁹³ Paragraphs 152BCA(1)(b), (d) and (g); 152AB(2)(c) and (e).

¹⁹⁴ Paragraphs 152BCA(1)(b) and (d).

¹⁹⁵ Paragraphs 152BCA(1)(g) and 152AB(e).

However, the ACCC observed that Telstra's forecast methodology contains several adjustments that effectively limit the growth of its forecast capital expenditures. For example, Telstra 'caps' the growth of certain capital expenditure [c-i-c starts] [redacted] [c-i-c ends] and excludes non-ongoing expenditures from its capital expenditure forecasts.¹⁹⁶ Telstra's adjustments modify forecast capital expenditures compared to that of a simple linear extrapolation of historical capital expenditure observations.

The ACCC also considered alternative capital expenditure forecasts as a cross-check for Telstra's forecasts in the further draft decision.¹⁹⁷ The ACCC did this by estimating alternative capital expenditure forecasts (exclusive of NBN-related capital expenditure) for the following two scenarios:

- Using Telstra's 2014–15 capital expenditure forecast as the base annual expenditure for 2015–16 to 2018–19
- Using the average of Telstra's historical capital expenditure (from 2011–12 to 2014–15) as the base annual expenditure for 2015–16 to 2018–19.

The ACCC then generated forecasts for each scenario on both 'with NBN rollout' and 'without NBN rollout' assumptions. Based on this analysis, the ACCC considered that Telstra's forecast methodology appears reasonable on the following bases:¹⁹⁸

- Telstra's capital expenditure (exclusive of NBN-related capital expenditure) forecast was: (i) below the ACCC's alternative forecasts without NBN rollout adjustment¹⁹⁹, and (ii) within the range of the ACCC's alternative forecasts with NBN roll-out adjustment.
- As noted above, Telstra forecast methodology included a number of adjustments to improve the reasonableness of its capital expenditure forecasts.

While the ACCC noted the absence of information on the relationship between cost driver volumes and capital expenditures, the ACCC considered that Telstra has endeavoured to provide justification and information for its capital expenditure forecasts.

The ACCC also noted Telstra's submission on the practical difficulty²⁰⁰ of projecting capital expenditures at the asset level, which is required for the estimation of a relationship between cost drivers and capital expenditures.

On the basis of the above considerations, the ACCC's further draft decision was that it accepts Telstra's proposed capital expenditure forecast methodology.

5.5.2 The ACCC's final assessment and decision

For its final decision, the ACCC has updated Telstra's capital expenditure for the latest information on NBN rollout as announced by NBN Co in its Corporate Plan for the 2016 financial year released in August 2015 using the forecast model submitted to the inquiry by Telstra (see section 5.5). While the update for the new NBN information affects the expenditure

¹⁹⁷ ACCC, Further draft decision, pp.61–62.

¹⁹⁸ *ibid.*, pp. 61–62.

¹⁹⁹ [c-i-c starts] [redacted] [c-i-c ends]

²⁰⁰ [c-i-c starts] [redacted] [c-i-c ends]

forecasts, it does not affect Telstra’s forecast methodology and Telstra’s assumptions used to develop forecasts, on which the ACCC has reached its final decision.

The ACCC maintains the view that an appropriate forecast of capital expenditure would be based on a forecast of cost driver volumes (i.e. demand for fixed line services and asset quantities).

The ACCC considers that, in the further information that it has provided,²⁰¹ Telstra has demonstrated that its forecast methodology effectively accounts for the cost driver-capital expenditure relationships through the application of a number of qualitative and quantitative adjustments to its forecast of capital expenditures:

- For actual FLSM capital expenditures from 2011–12 to 2014–15, which form the basis of trend forecasts of capital expenditure, a large number of capital projects are removed since they are due to end in 2013–14 or 2014–15 or because they are both small and highly volatile. For example, Telstra has ‘set aside’ almost [c-i-c starts] [c-i-c ends] (in nominal dollar terms) of past capital expenditure attributable to the FLSM Asset Classes that are not expected to continue past 2013–14.
- In addition to setting aside capital expenditures that are not expected to continue past 2013–14, Telstra has not included the emergence of new capital projects in its forecasts. The selective removal of existing, FLSM-relevant capital projects combined with no consideration of the emergence of new capital projects may result in a downwardly-biased trajectory of forecast capital expenditure spends.
- The trend growth rate of certain capital expenditures established on the basis of historical observations is capped to [c-i-c starts] [c-i-c ends]. Absent this adjustment, the capital expenditure would be [c-i-c start] [c-i-c end] million higher in nominal terms.
- The forecast methodology explicitly takes into account and reduces forecast capital expenditure for assets affected by the NBN rollout. Telstra’s methodology [c-i-c starts] [c-i-c ends]

Together these adjustments reduce the capital expenditure forecasts by [c-i-c starts] [c-i-c ends] (in nominal terms) for the period from 2014–15 to 2018–19.²⁰² The ACCC therefore agrees with Telstra’s statement that its forecast methodology ‘does not rely simply on historic or linear trends, but overlays a series of adjustments that reflect conservative (prudent) assumptions regarding forecast capital expenditure.’²⁰³ The ACCC considers that these adjustments contribute to ensuring the forecast capital expenditures are prudent and efficient.

The ACCC also considers that the capital expenditures actually incurred during the years 2011–12 to 2013–14 may also reflect Telstra’s incentive to minimise costs over the 2011 FAD forecast period as the majority of Telstra’s costs and revenues are unregulated.²⁰⁴ Therefore, the gains captured by Telstra through lower capital expenditures in the 2011 FAD forecast period may now be shared with access seekers since these lower expenditures form the basis of Telstra’s forecast capital expenditure trends.

²⁰¹ Telstra, Main submission to the draft decision, pp. 24, 127–130, 129, 136 & 138.

²⁰² Telstra, *Response to draft decision: Public inquiry into final access determinations for fixed line services primary prices (main submission to the draft decision)*, 1 May 2015, pp. 136 & 138.

²⁰³ Telstra, main submission to the draft decision, p. 129.

²⁰⁴ Telstra, *Public inquiry into final access determinations for fixed line services primary price terms—Response to Discussion Paper*, 3 October 2014, pp. 49–50.

The ACCC again notes Telstra’s submission on the practical difficulty²⁰⁵ of estimating actual and forecast capital expenditure at the asset level given the extensive number and heterogeneity of assets in Telstra’s fixed line network. Telstra submitted that it does not routinely record or systematically store information at the asset level for capital budgeting purposes. The ACCC considers that Telstra’s more aggregated IMC project level approach to the estimation and forecast of FLSM-relevant capital expenditures is reasonable given the adjustments undertaken as part of Telstra’s forecast methodology.

In the further draft decision the ACCC considered access seekers’ submission to compare Telstra’s forecast with ACCC forecasts as a useful cross-check for the assessment of Telstra’s forecasts. The ACCC has analysed alternative approaches to forecasting Telstra’s capital expenditure.²⁰⁶ As noted in the further draft decision, the analysis involved scaling down capital expenditure in line with the NBN rollout using two base level starting scenarios:

- Adopt Telstra’s 2014–15 capital expenditure forecast as the level of annual expenditure excluding NBN related expenditures for 2015–16 to 2018–19
- Adopt the average of Telstra’s historical capital expenditure (from 2011–12 to 2014–15) as the level of annual expenditure excluding NBN related expenditures for 2015–16 to 2018–19.

The ACCC notes that the four-year average alternative capital expenditure forecasts (after excluding NBN capital expenditure) in the further draft decision contained an error where all Core expenditure (instead of only ‘Data equipment’) was reduced for the impact of the NBN rollout. The ACCC has corrected this error and the updated alternative forecasts are produced in the table below:²⁰⁷

Table 5.2: ACCC forecasts and alternative ACCC forecasts for 2014–15 to 2018–19 updated for August 2015 rollout plans (\$2009 million)

	Pre-NBN rollout scale down ²⁰⁸	After NBN rollout scale down
ACCC forecasts using Telstra methodology ^a	[c-i-c start] [redacted]	[redacted]
Alternative ACCC forecast (2014-15 base) ^a	[redacted]	[redacted]
Alternative ACCC forecast (4 year average for 2011–12 to 2014–15) ^a	[redacted]	[redacted] [c-i-c end]

Source: ACCC analysis; ^aBased on the ACCC’s updated inflation assumptions for the May further draft decision.

The ACCC notes the following regarding the analysis from Table 5.2:

- Pre-NBN rollout adjustment, Telstra’s forecast methodology results in a forecast capital expenditure [c-i-c starts] [redacted] [c-i-c ends] for the period 2014–15 to 2018–19 that is less than the alternative forecasts of [c-i-c starts] [redacted] [redacted] [c-i-c ends].

205 [c-i-c starts] [redacted]
[redacted]
[redacted]
[redacted] [c-i-c ends]

206 ACCC, Further draft decision, pp. 61–62.

207 ACCC, Further draft decision, pp. 61–62.

208 Telstra’s methodology [c-i-c starts] [redacted]
[redacted]
[redacted]
[redacted] [c-i-c ends]

- After the NBN rollout adjustment, Telstra’s methodology results in a forecast capital expenditure [c-i-c starts] [REDACTED] [c-i-c ends], after removing NBN costs, that is less than the alternative forecasts result in [c-i-c starts] [REDACTED] [c-i-c ends]

The ACCC notes iiNet’s submission for adopting the alternative ACCC forecast in the further draft decision (four-year average for 2011–12 to 2014–15). iiNet stated that it is less than Telstra’s forecasts (post-NBN rollout scale down) and historical costs are ‘more likely to represent the higher end’ of capital expenditure forecasts.

As discussed above, the ACCC has corrected an error in its draft decision analysis. It notes that, following the correction, Telstra’s methodology (post-NBN rollout scale down and excluding NBN-specific capital expenditure) results in forecast capital expenditure below the alternative forecasts.

ACCC final assessment and decision

In reaching its final decision, the ACCC has had regard to further information provided by Telstra and access seeker submissions. While Telstra’s forecast methodology has certain limitations, Telstra’s methodology includes reasonable and informed adjustments to its trend forecasts that effectively relate (forecast) volumes to the capital expenditures they cause.

The ACCC notes that Telstra’s forecast methodology overlay adjustments to a linear trend that is based on an extrapolation of historical capital expenditure observations. Both the historical capital expenditure observations that determine the trend and the forecast trend itself have been adjusted to reasonably reflect anticipated capital expenditure requirements for the legacy fixed line network during the NBN rollout.

The ACCC also considered alternative capital expenditure forecasts for cross-checking Telstra’s forecasts. Based on this analysis, the ACCC considered that Telstra’s forecast methodology appears reasonable.²⁰⁹

Therefore, having regard to the LTIE and other matters in section 152BCA(1), the ACCC’s final decision is that it accepts Telstra’s capital expenditure forecast methodology and also to remove NBN-related capital expenditure (this is discussed in more detail in section 5.8).

5.6 Certain demand-related capital expenditure

In the draft decision, the ACCC considered that Telstra’s methodology for forecasting capital expenditure did not provide sufficient evidence on the relationship between demand-related capital expenditure for transmission assets and the [c-i-c starts] [REDACTED] [c-i-c ends] to declared fixed line services.²¹⁰

In the further draft decision, the ACCC considered that demand-driven capital expenditure for transmission assets is likely to continue during and beyond the NBN rollout.²¹¹ This is because there is growing demand for data transmission capacity and transmission assets are likely to service end-users on the NBN and Telstra’s fixed line network.

The ACCC remained concerned that Telstra’s demand-related capital expenditure forecast for transmission assets were not derived from cost drivers. However, Telstra’s approach has resulted in relatively [c-i-c starts] [REDACTED] [c-i-c ends] forecasts for the period 2015–16 to 2018–19 despite recent and prospective growth in traffic. The ACCC also considered that Telstra, as part of its forecast methodology, made adjustments (i.e. limiting the forecast transmission

²⁰⁹ ACCC, Further draft decision, pp. 61–62.

²¹⁰ ACCC, Further draft decision, p. 63.

²¹¹ ACCC, Further draft decision, pp. 63–64.

capital expenditure) on the reasonableness of demand-driven capital expenditure for transmission assets.²¹²

Further, Analysys Mason has endorsed Telstra's platform allocators for the transmission technologies. The ACCC's further draft decision was therefore to not adjust forecast capital expenditure for transmission equipment on the basis that Telstra's methodology has produced reasonable capital expenditure forecasts.²¹³

5.6.1 The ACCC's final assessment and decision

There were no submissions to the ACCC's further draft decision on Telstra's proposed forecast capital expenditure for the transmission asset class.

The ACCC considers that Telstra's forecast capital expenditure for transmission assets is prudent and efficient on the following basis:

- Demand-driven investment in capital expenditure for transmission assets is likely to continue even without the NBN rollout due to increasing demand for data transmission capacity.
- Telstra has forecasted relatively [c-i-c starts] [redacted] [c-i-c ends] demand-driven capital expenditure for transmission equipment for the period 2014–15 to 2018–19 despite recent and prospective growth in data traffic:
 - the amount of data traffic has increased at an average annual rate of 56 per cent since December 2009²¹⁴
 - data traffic growth is likely to continue (e.g. due to increasing usage of data-intensive applications).²¹⁵

The ACCC further considers that Telstra's forecast of demand-driven capital expenditure for the transmission asset class is determined by Telstra's forecast methodology, which includes a number of discretionary adjustments undertaken by Telstra to moderate and improve the reasonableness of its capital expenditure forecasts. For example, Telstra limits the annual growth of certain capital expenditure to [c-i-c starts] [redacted] [c-i-c ends]. On the basis of this assessment and having regard to the LTIE and other matters in section 152BCA(1), the ACCC's final decision is to not adjust forecast capital expenditure for transmission equipment. The ACCC's final decision is that Telstra's forecast of capital expenditure for the transmission asset class is prudent and efficient.

²¹² ACCC, Further draft decision, p. 64.

²¹³ ACCC, Further draft decision, p. 64.

²¹⁴ ABS, 8153.0—Internet Activity Survey Australia, December 2014, volume of data downloaded by access connections, available at:

<http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8153.0Main+Features1December%202014?OpenDocument>

²¹⁵ ABC, <http://www.abc.net.au/news/2013-05-31/internet-traffic-to-triple-in-four-years/4725126> ; <http://www.nbnc.com.au/corporate-information/media-centre/media-releases/aussie-ifamilies-hungry-for-fast-broadband.html>; http://www.arnet.com.au/article/463349/ip_traffic_2017_alone_may_larger_than_all_internet_history_cisco

Broughton, Kenny, *Domestic bandwidth requirements in Australia—A forecast for the period 2013–2023*, 26 May 2014

5.7 Capital projects by IMC codes

5.7.1 The ACCC's further draft decision

In the draft decision, the ACCC raised concerns that certain IMC project codes [c-i-c starts] [redacted] [c-i-c ends] cover activities that may not directly relate to the declared fixed line services and/or skew capital costs to a specific asset class.²¹⁶ The ACCC also raised concerns with Telstra's provision of top IMC project codes for 2014–15 but not for subsequent years (2015–16 to 2018–19).²¹⁷

In its responses since March 2015 (including the submission to the draft decision), Telstra provided further evidence for the relevance of those IMC project codes that the ACCC had identified as a concern. Telstra has also provided further information indicating that capital expenditure for these IMC codes can be traced to the FLSM asset classes.²¹⁸ The provision of further information also satisfied the ACCC that the IMC project codes in question were not NBN-related capital expenditures.

Further, the ACCC noted Telstra's submission that [c-i-c start] [redacted] [c-i-c end], so that only projects and expenditures that are reasonably expected to be undertaken are mapped to the services (via cost allocation factors) and assets.

On the basis of the above considerations and the further information that Telstra had provided, the ACCC's further draft decision was not to make adjustments to capital expenditure on the basis of IMC project codes. The ACCC considered that the inclusion of these IMC project codes was reasonable. However, the IMC projects for NBN-related capital expenditure projects remain excluded (this issue is considered below as part of NBN-related capital expenditure).

5.7.2 The ACCC's final assessment and decision

In reaching its final decision, the ACCC has had regard to submissions from access seekers and Telstra and to further information provided by Telstra.

The ACCC notes concern from iiNet and Macquarie about the information asymmetry between Telstra and the ACCC on forecast capital expenditures.^{219 220} However, the ACCC considers that for the IMC project codes, Telstra has provided sufficient information and evidence that these project codes related to the FLSM asset classes to which they were mapped, and that they are not NBN-related capital expenditures.

The ACCC is also satisfied that Telstra's forecasting approach [c-i-c start] [redacted] [c-i-c end].²²¹ This way, only projects that Telstra is likely to undertake will inform capital expenditure forecasts. Telstra submitted that this approach ensures that it only invests in those capital projects that appropriately respond to business conditions, such as a change in demand for services. The ACCC considers that such an approach can improve the cost causality of forecast capital expenditures since the forecasts of FLSM-relevant IMC projects are based on potentially more accurate expectations of business conditions (given the short term nature of the forecasts). The ACCC's final decision is that Telstra's mapping of (non-NBN related) IMC project codes to FLSM asset classes is prudent and efficient. The ACCC, having regard to the LTIE and other

²¹⁶ ACCC, Draft decision, March 2015, pp. 77–78.

²¹⁷ ACCC, Draft decision, p. 77.

²¹⁸ Telstra, Main submission to the draft decision, p. 133.

²¹⁹ Macquarie, Submission to Further Draft Decision.

²²⁰ iiNet, Submission to Further Draft Decision.

²²¹ Telstra, Main submission to the draft decision, p. 134.

matters in section 152BCA(1), will not make adjustments to capital expenditure forecasts on the basis of IMC project codes.

5.8 NBN-related capital expenditure

5.8.1 The ACCC's draft and further draft decision

In the draft decision, the ACCC considered that Telstra's proposal to include NBN-related capital expenditure in its forecast capital expenditure was not appropriate since such expenditure is incremental to NBN and should be recovered from the NBN and its users.²²² On the basis of these considerations, the ACCC draft decision excluded NBN-related capital expenditure from the FLSM.²²³

The further draft decision maintained the draft decision to exclude NBN-related capital expenditure from the capital expenditure forecasts as Telstra submission and response to information requests continued to support this expenditure as incremental to the NBN.²²⁴ The amount of NBN-related capital expenditure to be excluded from Telstra's proposed total forecast capital expenditure was [c-i-c starts] [REDACTED] [c-i-c ends] over the 2014–15 to 2018–19 period.²²⁵ This amount corresponds to Telstra's revised NBN-related capital expenditure in its May 2015 forecast.

Submissions to the ACCC's draft decision

Telstra considered that the ACCC's analysis of NBN-related expenditure is flawed and is inconsistent with the asset-based costing approach applied in the FLSM and the use of the fully allocated cost framework.²²⁶

Telstra submitted that the ACCC's approach imagines a world in which there is no NBN rollout, and in which Telstra continues to provide legacy fixed line services on a stand-alone basis. Telstra submitted that it does not provide the fixed line services on a standalone basis; rather, the fixed line services are supplied over a network that is also used to supply a range of other services. For this reason an asset-based costing approach is applied in the FLSM where all costs attributable to the FLSM are included in the FLSM and costs of each asset class are allocated among all users of that asset class in proportion to their relative usage.²²⁷

For NBN-related duct remediation expenditure, Telstra submitted that all services make use of Telstra's duct network and stand to benefit from the remediation activities carried out under the NBN duct remediation program. Therefore the costs of remediation of the shared asset should be borne by all services that will make use of it over the forecast period.²²⁸ Telstra further submitted that the remediation of duct infrastructure to facilitate the NBN rollout will have a significant long-term benefit for all users of the fixed-line network, and for all end users.²²⁹

Telstra also submitted that the ACCC's approach of excluding NBN capital expenditure is internally inconsistent and is likely to result in Telstra under-recovering the costs of the fixed line network. Telstra stated that if NBN-related expenditure were excluded from the cost base,

²²² ACCC, Further draft decision, pp. 64–65.

²²³ ACCC, Draft decision, p. 73; Further draft decision, pp. 64–65

²²⁴ ACCC, Further draft decision, pp. 59–60.

²²⁵ ACCC, Further draft decision, pp. 59–60.

²²⁶ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, p. 41.

²²⁷ Telstra, Main submission to draft decision, 1 May 2015, p. 41.

²²⁸ Telstra, Main submission to draft decision, 1 May 2015, p. 25.

²²⁹ Telstra, Main submission to draft decision, 1 May 2015, p. 42.

it would not be legitimate or internally inconsistent the cost allocation framework to include NBN's usage of the fixed line assets.²³⁰

Optus submitted that NBN-related capital expenditure should be regarded as incremental to the NBN and therefore should be recovered from users of NBN and not Telstra's fixed line network.²³¹

In its submission to the draft decision Frontier considered that the ACCC needs to take further account of WIK-Consult's analysis which includes the removal of NBN-related expenditures from FLSM asset classes.²³²

In its submission to the further draft decision Macquarie agrees with the ACCC that NBN specific costs should be removed from provision of fixed line services.²³³

In its submission to the further draft decision, iiNet considers that it cannot promote the LTIE to require users of fixed line legacy services to pay higher prices in order to recover the cost of investments that are for the specific purpose of the NBN rollout. Accordingly, iiNet believes the ACCC's draft decision on this issue is sound and is in accordance with the Fixed Principles and the LTIE.²³⁴

5.8.2 The ACCC's final assessment and decision

The ACCC has considered the responses from Telstra and other stakeholders in reaching its final decision. While Telstra has stated that NBN-related capital expenditures will provide benefits for other users of the FLSM asset classes and that NBN-related capital expenditures supplant existing fixed line capital expenditures, Telstra has not demonstrated or provided evidence to support this submission. Telstra has also stated the shared benefits are long-term²³⁵, indicating that benefits may only accrue to users of the fixed line network after they have migrated to the NBN.

The ACCC notes that even if NBN-related capital expenditures are directly related to FLSM asset classes, NBN-related capital expenditure nevertheless cannot be considered prudent and efficient for the provision of fixed line services because the cost allocation factors proposed by Telstra allocate to fixed line users a share of the cost of these assets. Given this allocation of costs to fixed line services, it is not prudent or efficient to include capital expenditure that is incremental to NBN.

The ACCC also notes iiNet's submission that removing NBN-specific capital expenditure is in accordance with the Fixed Principles because 'it cannot...require users of fixed line legacy services to pay higher prices in order to recover the cost of investments that are for the specific purpose of the NBN rollout'.²³⁶ The ACCC considers that this statement refers to the fixed principle provision on cost allocation, which requires that if there is reliable information on the direct costs of providing a service, those direct costs should be attributed to the services in which they relate.²³⁷ In this case, NBN-related capital expenditure should be directly attributed to NBN and future users of NBN services.

On the basis of this assessment and having regard to the LTIE and relevant matters in section 152BCA(1) (see chapter 2), the ACCC's final decision is that NBN-related capital expenditure

²³⁰ Telstra, Main submission to draft decision, 1 May 2015, p. 42.

²³¹ Optus, Submission to the draft decision, Confidential Version, April 2015, p. 54.

²³² Frontier, *Submission on the ACCC's draft decision on fixed line prices, A Report Prepared For the Competitive Carriers Coalition, iiNet and Optus*, May 2015, pp. 18-24.

²³³ Macquarie Telecom, Submission to the further draft decision, 21 July 2015, p. 2.

²³⁴ iiNet, Submission to the further draft decision, Confidential Version, June 2015, p. 6.

²³⁵ Telstra, Main submission to the draft decision, 1 May 2015, p. 42.

²³⁶ iiNet, Submission to the further draft decision, June 2015, p. 6.

²³⁷ ACCC, Public inquiry to make final access determinations for the declared fixed line services, Discussion paper, April 2011, p. 258.

is incremental to NBN and therefore should be excluded from Telstra’s capital expenditure forecasts. The ACCC considers that it would not be efficient or prudent to recover NBN-related costs from users of the fixed line network.

The ACCC notes that NBN rollout plans are an important input for determining the amount of NBN-related capital expenditure in the forecasts. To ensure that NBN-related capital expenditure appropriately reflects the rollout and efficient and prudent costs anticipated to be incurred over the period, the ACCC considers that it should be updated when more up-to-date rollout information becomes available. In accordance with this view, the ACCC has updated its determination of the amount of NBN-related capital expenditure to be excluded from the capital expenditure forecasts.

Therefore, the ACCC’s final decision is to exclude [c-i-c starts] [redacted] [c-i-c ends]²³⁸ million of NBN-related capital expenditure from the FLSM after updating for the August 2015 rollout plan.

5.9 Effect of updating for NBN Co’s August 2015 rollout plan

The ACCC’s final decision is to set a forecast capital expenditure of [c-i-c starts] [redacted] [c-i-c ends] for the 2014–15 to 2018–19 period (figure below). The ACCC has updated the final decision for NBN Co’s most recent rollout plans (August 2015 rollout plan) to ensure that capital expenditure forecasts appropriately reflect the most up-to-date impact of the NBN rollout and efficient and prudent costs anticipated to occur over the period 2014–15 to 2018–19.

Table 5.3: Telstra’s forecast capital expenditure and ACCC further draft and final decisions (million, \$2009)

	2014–15	2015–16	2016–17	2017–18	2018–19	Total
<i>Telstra May 2015 forecast updated for August 2015 rollout plan</i>	[c-i-c starts] [redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
<i>Annual change</i>		[redacted]	[redacted]	[redacted]	[redacted]	
<i>ACCC final decision updated for August 2015 rollout plan</i>	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
<i>Annual change</i>		[redacted]	[redacted]	[redacted]	[redacted]	
<i>ACCC final decision not updated for August 2015 rollout plan</i>	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
<i>Annual change</i>		[redacted]	[redacted]	[redacted]	[redacted]	[c-i-c ends]

Source: ACCC analysis

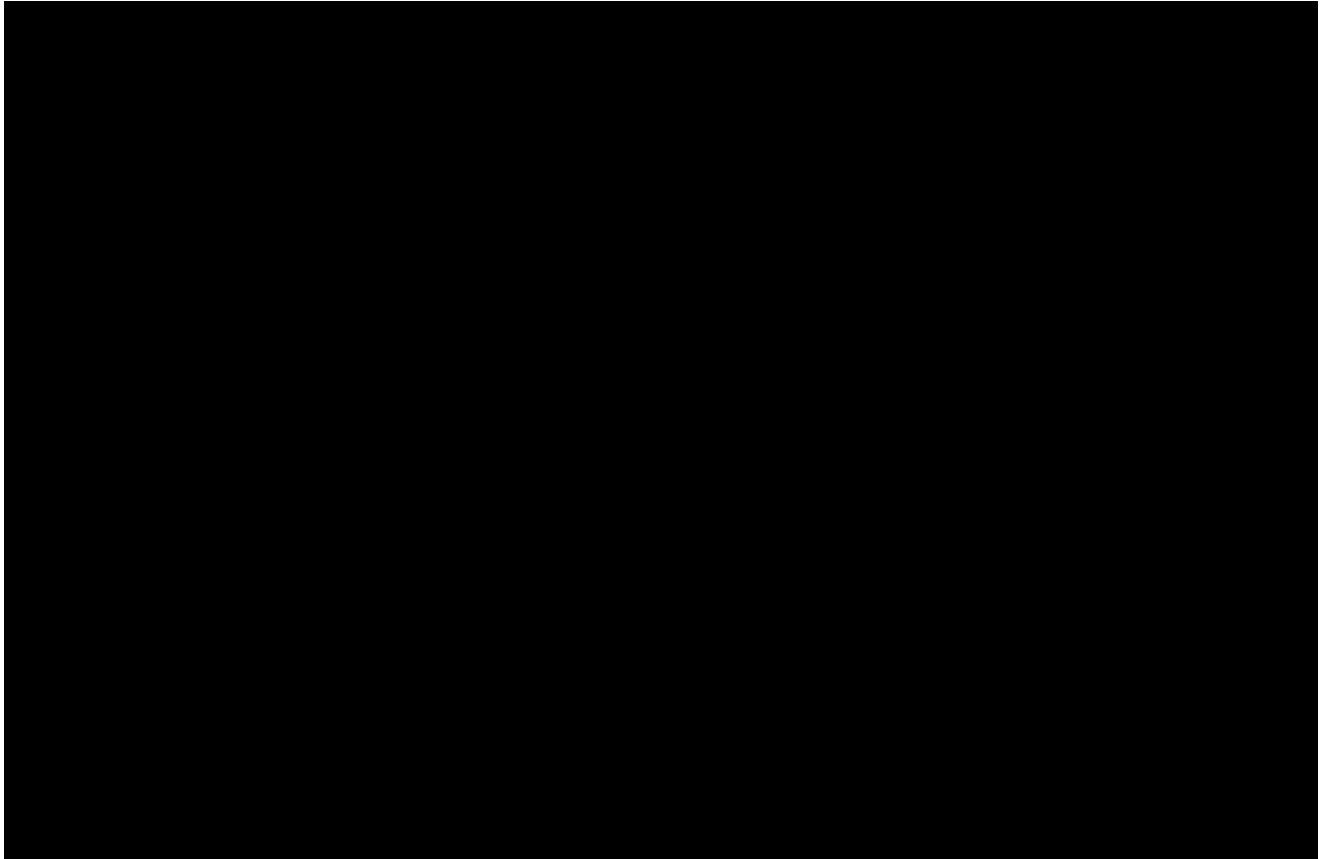
The ACCC notes the following consequences of updating the final decision for the August 2015 rollout plans:

- The final decision results in total capital expenditure forecasts of [c-i-c start] [redacted] [c-i-c end] compared to not updating for the August 2015 rollout plans [c-i-c start] [redacted] [c-i-c end].

²³⁸ This is based on the difference between Telstra’s May 2015 forecasts (updated for the August 2015 rollout plans) and the ACCC’s final decision for capital expenditure forecasts.

- Forecast capital expenditure [c-i-c start] [redacted] [c-i-c end] and [c-i-c start] [redacted] [c-i-c end] in the later years of the period compared to not updating for the August 2015 rollout plan (figure 5.1).

Figure 5.1: Comparison of further draft and final decision on capital expenditure [c-i-c start]



[c-i-c end]Source: ACCC analysis

- The final decision capital expenditure forecasts [c-i-c start] [redacted] [c-i-c end] over the period 2014–15 to 2018–19. This compares with a decline of [c-i-c start] [redacted] [c-i-c end] from not updating for the August 2015 rollout plans.
- The final decision to remove NBN-related capital reduces capital expenditure by [c-i-c start] [redacted] [c-i-c end] represents an increase of [c-i-c start] [redacted] [c-i-c end] per cent compared to not updating for the August 2015 rollout plans [c-i-c start] [redacted] [c-i-c end]. This is driven by the faster NBN rollout rate from the August 2015 rollout plans.

6 Weighted Average Cost of Capital

Key Points	
The ACCC's final decision is to maintain the existing weighted average cost of capital (WACC) framework and adopt a real vanilla WACC of 3.42 per cent (6 per cent nominal), based on the following parameters:	
Parameter	ACCC approach
Risk-free rate	Based on the 10 year Commonwealth Government Securities (CGS) yields, using an averaging period of 20 business days. The nominal risk-free rate for the draft decision is set at 2.76 per cent.
Expected inflation	Based on a geometric average of ten years of forecast inflation. Expected inflation used in estimating FAD prices is 2.50 per cent.
Market risk premium (MRP)	Set at 6 per cent as the majority of evidence is more consistent with a 6 per cent MRP.
Equity beta	Set at 0.7 consistent with the approach adopted in previous ACCC decisions and current evidence.
Equity issuance costs	The ACCC's final decision is to exclude equity issuance costs from the WACC.
Debt risk premium (DRP)	Based on the difference in yield between a chosen debt proxy and the 10 year CGS rate. The debt proxy is a simple average of the A-rated Bloomberg Valuation curve and RBA non-financial corporate bond yield. The DRP used for the final decision is 1.74 per cent.
Gearing ratio	Set at 40 per cent debt and 60 per cent equity.
Debt issuance cost	Updated using the methodology developed by Allen Consulting Group (ACG). The debt issuance cost used for the final decision is 0.07 per cent.
Debt beta	The ACCC's final decision is to set the debt beta at zero per cent.
Gamma (value of imputation credits)	Set at 0.45 for consistency with the approach adopted in previous ACCC decisions.

A firm's weighted average cost of capital (WACC) is the risk-adjusted rate of return on capital required by debt and equity providers to the firm. The WACC is an important input for the FLSM because the 'return on capital' component of the building block model (BBM) is calculated as the product of the WACC and the value of the regulatory asset base (RAB). The WACC is discussed in this chapter.

The ACCC used a real vanilla WACC (which was derived from a nominal WACC) for the declared telecommunications services in the FLSM for the 2011 final access determinations (FADs) and the 2013 Wholesale ADSL FAD. The vanilla WACC is calculated as the weighted average of the cost of debt and cost of equity according to the following formula:

$$WACC_{vanilla} = \frac{D}{V} \times E[Kd] + \frac{E}{V} \times E[Ke]$$

where

D = the value of debt

E = the market value of equity

V = the value of debt and the market value of equity

$E[K_d]$ = the required/expected cost of debt

$E[K_e]$ = the required/expected cost of equity

For consistency with the vanilla WACC, the cash flows modelled in the FLSM are post-tax and include the benefits from imputation credits as well as the interest tax shield (that is, the tax deductible interest payments).

6.1 WACC estimate

The ACCC's draft decision was to maintain the use of a vanilla WACC to estimate the return on capital in the FLSM.²³⁹ The draft decision estimated a real vanilla WACC of 2.9 per cent (5.4 per cent nominal) which was updated in the June 2015 further draft decision (FDD). The parameters underlying this estimate were explained in the March 2015 draft decision and are summarised in the rest of this section.

In considering its WACC estimates for the final decision, the ACCC took into account submissions on the WACC and more up-to-date information on the WACC parameters. The parameter values used to estimate the WACC for the Draft Decision, Further Draft Decision and the Final Decision are set out in the figure below.

Table 6.1: ACCC's final decision on Telstra's WACC parameters

WACC parameter	Telstra's proposal	ACCC draft decision (March 2015)	ACCC further draft decision (June 2015)	ACCC final decision
Nominal risk-free rate	3.66%	2.50%	2.90%	2.76%
Expected inflation	2.5%	2.42%	2.50%	2.50%
Real risk-free rate	1.13%	0.07%	0.39%	0.25%
Nominal debt risk premium	1.4%	0.94%	1.09%	1.74%
Debt issuance cost	0.07%	0.07%	0.07%	0.07%
Market risk premium	6.5%	6%	6%	6%
Equity beta	0.8	0.7	0.7	0.7
Debt gearing	40%	40%	40%	40%
Gamma	0.25	0.45	0.45	0.45
Equity issuance costs	0%	0%	0	0%
Nominal vanilla WACC	7.37%	5.43%	5.89%	6%
Real vanilla WACC	4.75%	2.93%	3.30%	3.42%

Source: ACCC draft and further draft decisions and analysis.

6.2 Submissions

This section summarises key issues raised in submissions to the draft decision.

²³⁹ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms – draft decision*, March 2015, p. 81.

Telstra submitted that the ACCC should consider ‘whether the overall WACC outcome is reasonable’.²⁴⁰

Telstra stated that the WACC set in the draft decision is the lowest WACC set by Australian regulators that Telstra is ‘aware of over the past 2 years’ and ‘lower than...recent decision of the ACCC in the telecommunications sector’ and ‘recent estimate of Telstra’s cost capital by independent market practitioners’.²⁴¹

In relation to individual parameters, Telstra submitted that ‘the ACCC has not considered whether its traditional estimation methods remain appropriate in current market conditions’ and has ‘relied on a new and untested data source’.²⁴² Telstra submitted that the ACCC’s approach is ‘illogical and unreasonable’ as the WACC ‘moves...in lock step with the risk free rate’ and leads to a WACC that ‘falls by more than the decline in the risk free rate’.²⁴³

Telstra submitted that ‘other regulators have acknowledged that traditional methods may not be appropriate in all market conditions’ and ‘there is evidence that the ACCC’s traditional method is delivering unreasonable results’.²⁴⁴ Telstra stated that ‘the ACCC must review its traditional approach and consider how it may need to be amended in order to ensure a more reasonable outcome’.²⁴⁵

Optus was supportive of the ACCC’s approach for estimating five parameters (the risk free rate, DRP, MRP, gearing and debt issuance costs).²⁴⁶ Optus submitted that alternative values should be used for two parameters (equity beta and gamma, which are discussed in their respective sections).²⁴⁷ Optus submitted that the WACC must use Telstra’s actual variables where available.²⁴⁸

Ian Martin Advisory (IMA) submitted that the nominal WACC of 5.89 per cent in the further draft decision is too low.²⁴⁹ IMA stated that a low WACC will discourage private capital from investing in regulated access infrastructure and will create long term harm for all players.²⁵⁰

IMA submitted that the nominal WACC for Telstra should be 8.5 per cent and no lower than 8 per cent.²⁵¹

6.3 ACCC final decision

The ACCC’s final decision is to maintain the use of a vanilla WACC to estimate the return on capital in the FLSM for the following reasons:

²⁴⁰ Telstra, Response to draft decision: Public inquiry into final access determinations for fixed line services primary prices (main submission to the draft decision), p. 146.

²⁴¹ Ibid., pp. 26–27.

²⁴² Ibid., p. 147.

²⁴³ Ibid., p. 147.

²⁴⁴ Ibid., pp. 147–148.

²⁴⁵ Ibid., p. 148.

²⁴⁶ Optus, *Submission in response to ACCC draft decision–Public inquiry into final access determinations for fixed line services–primary price terms (submission to draft decision)*, April 2015, pp. 105, 107 & 113.

²⁴⁷ Optus, Submission to the draft decision, pp. 110–114.

²⁴⁸ Optus, *Submission in response to ACCC Further Draft Decision–Outstanding Issues: Public inquiry into final access determinations for fixed line services–primary price terms (submission to the further draft decision)*, July 2015, p. 4 & 14.

²⁴⁹ IMA, *Submission to the ACCC Fixed Line Services Inquiry 2013 regarding discount rates*, 5 August 2015, p. 1.

²⁵⁰ IMA, *Submission to the ACCC Fixed Line Services Inquiry 2013 regarding discount rates*, 5 August 2015, p. 2.

²⁵¹ IMA, *Submission to the ACCC Fixed Line Services Inquiry 2013 regarding discount rates*, 5 August 2015, pp. 1 & 4.

- It is specified in the fixed principles provisions (FPPs).
- The FLSM contains a tax building block to explicitly estimate corporate tax liabilities so the WACC does not need to take account of the impact of corporate taxes on required returns.

In determining the WACC estimates for the final decision, the ACCC has also had regard to:

- previous ACCC decisions on Telstra's WACC
- the most recent evidence and analysis from recent AER WACC final decisions for various energy businesses (2015 AER final decisions)²⁵²
- Telstra's WACC proposals made in its submission to the ACCC's July 2014 discussion paper on primary price terms, and
- Telstra and access seeker submissions to the ACCC's draft decision.

In response to Telstra's submission on current market condition, the ACCC notes McKenzie and Partington has observed that there is no clear consensus on the relationship between the DRP, MRP and the risk free rate as experts have differed in their opinions.²⁵³ Further, Partington has also noted that movements in the risk free rate do not necessarily have 'direct parallels in movements of the' MRP.²⁵⁴

The ACCC notes Telstra's argument on flight to quality indicating increasing risk aversion and therefore an increasing risk premium.²⁵⁵ The ACCC is not persuaded by this argument for the following reasons:

- Analysis by Partington does not support increasing risk aversion.²⁵⁶
- Partington noted that a "search for yield" can accompany the 'flight to quality' with the outcome of investors accepting a lower risk premium.²⁵⁷
- Telstra's proposition of a 'flight to quality' increasing risk premiums appears inconsistent with its proposition of a 'search for yield' decreasing risk premiums and it has not demonstrated what the net effect on its risk premiums is.

However, the ACCC has changed its approach for the DRP based on further information submitted by Telstra in its draft decision submission and the ACCC's further analysis of alternative measures of Telstra-specific cost of debt (which was not available at the draft decision). This further information and analysis indicates that the AUD TBVAL under-estimates the DRP relative to alternative measures of Telstra-specific cost of debt. This is discussed in more detail in the DRP section. The methodology and data used to derive the parameter estimates in the March 2015 draft decision, the submissions on those parameters and the ACCC's updated parameter estimates are discussed below.

Assessment of approach against section 152BCA matters

The ACCC considers that its final decision on the inputs to the WACC will promote the LTIE.²⁵⁸

²⁵² AER, Final decision, Jemena Gas Networks (NSW)Ltd Access Arrangement 2015–20, June 2015, <http://www.aer.gov.au/node/24741>.

²⁵³ Michael McKenzie and Graham Partington, Report to the AER—the relationship between the cost of debt and the cost of equity, 14 March 2013, pp. 10–17.

²⁵⁴ Partington, Report to the AER: Return on equity (updated), April 2015, p. 74.

²⁵⁵ Telstra, Main submission to draft decision, p. 147.

²⁵⁶ Partington, Report to the AER: Return on equity (updated), April 2015, p. 72.

²⁵⁷ *ibid.*, p. 72.

The final decision on the WACC will allow for the economically efficient operation of the listed services as they are based on the efficient rate of return required by the access provider for providing these services.²⁵⁹

The final decision WACC reflects the prudent, efficient rate of return and will contribute to: determining cost-based price; and allowing the service provider a commercial return. As a result, this will encourage the economically efficient use of, and the economically efficient investment in, infrastructure and promote competition in the markets for carriage services.²⁶⁰ Access seekers will be able to acquire the listed services at prices that are based on efficient and prudent capital expenditure which will promote access to the listed services.²⁶¹

In considering the extent to which the final decision capital expenditure would promote the economically efficient use of, and the economically efficient in, infrastructure, the ACCC takes into account the legitimate commercial interests of Telstra and the incentives for investment by setting a WACC that is commensurate with current market conditions and robust evidence.²⁶² In setting the final decision WACC, the ACCC has had regard to whether it is technically feasible for the listed services to be supplied and charged for.²⁶³ The ACCC considers that the final decision WACC would contribute the efficient and prudent cost of supply (which will allow equally efficient access seekers to compete with Telstra on their own merits), promote access to the listed services, and promote the efficient operation of Telstra's fixed line network.

This is because a forward looking risk free rate that is commensurate with market conditions for funds will promote competition in the markets for the carriage services and encourage the economically efficient use of, and the economically efficient investment in, infrastructure. Further, the CGS yield is an appropriate proxy for the forward looking risk free rate and also has regard to the market for equity funds. In making this decision, the ACCC has taken into account the direct costs of providing access to the listed services, a service provider's legitimate business interests and the interests of all persons who have rights to use the regulated service.²⁶⁴

An MRP that appropriately reflects the expected risk premium investors require over the risk-free return will promote competition in the markets for the carriage services and encourage the economically efficient use of, and the economically efficient investment in, infrastructure.²⁶⁵

In setting an MRP that reflects the most robust evidence (i.e. average historical excess returns) and is consistent with the majority of evidence, it will contribute to a rate of return above the risk-free rate that is commensurate with investor expectations. As a result, the service provider will be able to recover the efficient and direct costs of supplying the regulated fixed line services.²⁶⁶

In addition, the final decision MRP will contribute to a rate of return is in the service provider's legitimate business interests and allows for recovery of efficient costs.²⁶⁷ This will also be in the interests of all persons who have rights to use the regulated service.²⁶⁸

²⁵⁸ Paragraphs 152BCA(1)(a) and 152AB(2)

²⁵⁹ Paragraphs 152BCA(1)(g) and 152AB(2)(e).

²⁶⁰ Paragraphs 152AB(2)(c) and (e).

²⁶¹ Paragraph 152AB(4).

²⁶² Paragraphs 152AB(6)(b) and (c).

²⁶³ Paragraphs 152AB(6)(a)

²⁶⁴ Paragraphs 152BCA(1)(b), (c) and (d); 152 AB(2).

²⁶⁵ Paragraphs 152AB(2)(c) and (e); 152BCA(1)(g).

²⁶⁶ Paragraph 152BCA(1)(d).

²⁶⁷ Paragraph 152BCA(1)(b).

²⁶⁸ Paragraph 152BCA(1)(c).

The ACCC considers that its final decision on the equity beta will promote the LTIE. This is because an equity beta that is commensurate with the international benchmarking of comparable telecommunications firms will promote competition in the markets for the carriage services and encourage the economically efficient use of, and the economically efficient investment in, infrastructure.²⁶⁹

In determining the equity beta, the ACCC has had regard to the change in systematic risk exposure since 2011, international benchmarking and Telstra's observed equity beta. This contributes to a rate of return that appropriately reflects Telstra's systematic risk exposure. As a result, this will be in the service provider's legitimate business interests and the interests of all persons who have rights to use the regulated service.²⁷⁰ In making this decision, the ACCC has also taken into account the direct costs of providing access to the listed services.²⁷¹

The ACCC considers that its final decision for the DRP will promote the LTIE. This is because a DRP that is consistent with alternative measures of Telstra-specific cost of debt and allows for appropriate recovery of the cost of debt will account for the direct cost of providing access to the listed services, promote competition in the markets for the carriage services and encourage the economically efficient use of, and the economically efficient investment in, infrastructure.²⁷²

In determining the final decision for DRP, the ACCC did not adopt its draft decision approach (proposed use of AUD TBVAL) as further analysis indicated that this would under-estimate Telstra's cost of debt. This allowed a DRP that is more consistent with Telstra's cost of debt for the final decision. In making this decision on the DRP, the ACCC has taken into account the direct costs of providing access to the listed services, and the service provider's legitimate business interests.²⁷³

The ACCC considers that its final decision for gamma will promote the LTIE. This is because a gamma that is consistent with Telstra's historical payout ratio and the market wide utilisation rate will appropriately and efficiently adjust the rate of return for the impact of imputation credits. This avoids over-compensating the service provider and helps promote competition in the markets for the carriage services and encourage the economically efficient use of, and the economically efficient investment in, infrastructure.²⁷⁴

In determining the final decision for gamma, the ACCC has had regard to a range of considerations and studies. Setting a gamma that is consistent with Telstra's dividend payout behaviour and in a manner that is consistent with recent regulatory decisions contributes to a rate of return that meets the efficient costs of providing access to the listed services. As a result, this will be in the service provider's legitimate business interests and the interests of persons who have rights to use the regulated service.²⁷⁵

6.3.1 Cost of equity

The cost of equity is a direct input into the vanilla WACC formula. As specified by the FPPs, the cost of equity is estimated using the capital asset pricing model (CAPM).

6.3.1.1 Risk-free rate

The risk-free rate return refers to the return an investor gets from holding an asset with a promised repayment amount and no risk of default. As noted in the March 2015 draft decision, the Australian Commonwealth Government Securities (CGS) are typically used as a proxy for the risk-free asset.

²⁶⁹ Paragraphs 152AB(2)(c) and (e); 152BCA(1)(c) and (g).

²⁷⁰ Paragraphs 152BCA(1)(b) and (c).

²⁷¹ Paragraph 152BCA(1)(d).

²⁷² Paragraphs 152AB(2)(c) and (e).

²⁷³ Paragraphs 152BCA(1)(b) and (d).

²⁷⁴ Paragraphs 152BCA(1)(d); 152AB(2)(c) and (e).

²⁷⁵ Paragraphs 152BCA(1)(b) and (c).

ACCC draft decision

The ACCC's draft decision was to maintain the previous approach for estimating the risk-free rate used in the 2011 FADs and the 2013 Wholesale ADSL FAD.²⁷⁶

- The nominal risk-free rate was estimated using the 10 year Australian CGS yields. A 20 business-day averaging period was adopted for the CGS yields to reduce the impact of day-to-day market volatility.
- The real risk-free rate was estimated by deflating the nominal risk-free rate by the expected inflation using the Fisher equation:

$$\frac{1+i}{1+\pi} = 1+r$$

where

i = nominal interest rate

π = expected inflation rate

r = real interest rate

- The ACCC estimated expected inflation using a 10 year geometric average of RBA inflation forecasts (where available) and the mid-point of the RBA's inflation target (i.e. 2.5 per cent).

Submissions

Telstra stated that it does 'not propose any changes to the methodology for estimating the risk free rate, provided that other WACC parameters are estimated on a consistent basis and that the overall WACC outcome is reasonable'.²⁷⁷

Optus submitted that it 'supports the ACCC's approach for risk-free rate consistent with its previous regulatory decisions'.²⁷⁸

Ian Martin Advisory (IMA), in an independent submission, submitted that the government bond rate (GBR) does not reflect the underlying risk free rate at the peak and trough of the economic cycle due to the RBA having a larger influence and the risk free rate reflecting more of RBA's monetary policy/reserve rate decision to influence economic activity/inflation targeting.²⁷⁹

IMA stated that the RBA's cash rate decisions can lower the GBR which subsequently flow through to the cost of debt. However, the impact on the cost of equity may be the reverse.²⁸⁰

IMA stated Officer and Bishop noted that the primary variable of Telstra's WACC over 2000 to 2014 was the risk free rate.²⁸¹ IMA noted Officer and Bishop's advice on the risk to investment of setting the WACC too low.

²⁷⁶ ACCC, Public inquiry into final access determinations for fixed line services – primary price terms – draft decision, March 2015, p. 83.

²⁷⁷ Telstra, Main submission to the draft decision, p. 149.

²⁷⁸ Optus, Submission to the draft decision, p. 105.

²⁷⁹ IMA, Submission to the ACCC Fixed Line Services Inquiry 2013 regarding discount rates, 5 August 2015, p. 1.

²⁸⁰ *ibid*, pp. 2–3.

²⁸¹ *ibid*, p. 3.

IMA noted that the risk free rate is a key driver for WACC and can vary significantly over time. IMA noted that the low real risk free rate in the FDD and DD are not 'credible', does not account for intertemporal preference and would send a wrong signal to the capital markets.²⁸²

IMA submitted that the real risk free rate in Australian capital markets is more likely around 3 per cent and no lower than 2.5 per cent.²⁸³

ACCC final decision

The ACCC's final decision is to maintain the draft decision approach for estimating the nominal risk-free rate, the real risk-free rate and forecast inflation. The ACCC maintains the use of CGS yields for estimating the nominal risk free rate for the following reasons:

- The CGS yield is a forward looking risk free rate commensurate with prevailing conditions in the market for funds close to the commencement of regulatory period. As such this risk free rate has regard to the prevailing conditions in the market for equity funds.²⁸⁴
- The risk free rate measures the return an investor would expect from an asset with no default risk.²⁸⁵ CGS are low default risk securities issued by the Australian Government, and are an appropriate proxy.
- IMA has not provided evidence to justify a higher real risk free rate of 2.5–3 per cent.
- Professor Partington has noted that a low interest rate is not a 'compelling' argument for increasing the benchmark risk free rate above the long term government bond rate.²⁸⁶

In updating its estimate of the risk-free rate for the final decision, the ACCC has used the same CGS bonds to calculate the risk-free rate as in the March 2015 draft decision. The ACCC has updated its estimate of the risk-free rate by taking the 20 business day average to 31st August 2015 which gives a nominal risk-free rate of 2.76 per cent.

Expected inflation has also been updated for the RBA's latest short-term inflation forecasts.²⁸⁷ In calculating expected inflation, the ACCC has used a ten-year geometric average of RBA's short-term inflation forecasts and the mid-point of the RBA's inflation target range (2.5 per cent). The updated inflation forecast is 2.50 per cent. Using the estimated nominal risk-free rate and expected inflation, the real risk-free rate is 0.25 per cent.

6.3.1.2 Market risk premium (MRP)

The market risk premium (MRP) is the expected risk premium investors require over the risk-free return to be willing to invest in a well-diversified risky market portfolio. The MRP is not directly observable.

²⁸² *ibid*, pp. 3–4

²⁸³ *ibid*, p. 4.

²⁸⁴ AER, JGN final decision, Attachment 3 - Rate of Return, June 2015, pp. 3–44.

²⁸⁵ *ibid*, pp. 3–44.

²⁸⁶ Partington, Report to the AER: Return on equity (updated), April 2015, p. 74.

²⁸⁷ RBA, Statement on monetary policy, August 2015 available at: <http://www.rba.gov.au/publications/smp/2015/aug/pdf/0815.pdf>

ACCC draft decision

The ACCC's draft decision was to adopt an MRP of 6 per cent as the majority of evidence considered indicated that 6 per cent is appropriate.²⁸⁸

- The AER's most recent study of historical excess returns produces an MRP estimate of 6 per cent. The ACCC placed the most reliance on this source of information as it is the most robust source of evidence for estimating the MRP.
- Survey evidence is more supportive of an MRP of 6 per cent as opposed to 6.5 per cent.
- The AER's study of three types of conditioning variables (dividend yields, credit spreads and implied volatility) suggest that market conditions are relatively stable. In particular, evidence from the implied volatility study supports an MRP of no greater than 6 per cent.
- Recent Australian Competition Tribunal decisions has not found error in a MRP estimate of 6 per cent.
- An MRP of 6 per cent is consistent with previous ACCC decisions for the regulated fixed line telecommunications services.
- An MRP of 6 per cent gives less weight to dividend growth modelling (DGM) due to a number of concerns identified in the AER's 2013 WACC guideline and its recent NSW and ACT decisions. In addition, the ACCC noted that the AER gave weight to the DGM in determining the MRP for the 2013 WACC guideline due to changes in its regulatory framework which are not applicable here.

Submissions

Telstra submitted that 'maintaining an MRP of 6 per cent in current market conditions is unreasonable'.²⁸⁹

Telstra submitted that the measures given weight by the ACCC are 'measures of past market conditions'.²⁹⁰ Telstra stated that 'no weight has been given to estimates of the MRP from the DGM' and noted that 'significant weight' must be given to the DGM as its results 'provide the only reliable indication of current market conditions'.²⁹¹

Telstra stated that 'the DGM is a simple and transparent method for estimating the current MRP which has been used by numerous regulatory bodies, including the AER'.²⁹² Telstra stated that 'current estimate of the MRP produced by the AER's DGM are significantly above the historic average of 6' and 'would imply a range for the MRP of 7.65%–8.85%' based the risk free rate of 2.5 per cent in the draft decision.²⁹³

Telstra submitted that SFG's analysis and market return implied by the AER's DGM implies that the MRP 'has increased as the risk free rate has declined'.²⁹⁴ Telstra concluded that 'an

²⁸⁸ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms – draft decision*, March 2015, pp. 84–88.

²⁸⁹ Telstra, Main submission to the draft decision, pp. 3; letter from van Beelen to Goldwater, 13 May 2015.

²⁹⁰ *ibid.*, p. 155.

²⁹¹ *ibid.*, p. 155.

²⁹² *ibid.*, p. 155.

²⁹³ *ibid.*, p. 155–156.

²⁹⁴ *ibid.*, p. 156.

estimate of 6.5% is likely to understate the current MRP as current evidence indicates that the MRP is likely to be in excess of 7%.²⁹⁵

Optus submitted that it 'supports...a MRP of 6%'.²⁹⁶ Optus submitted that an MRP of 6 percent is appropriate based on the AER and ACCC consideration of historical average excess returns, market surveys and dividend growth models.²⁹⁷ Optus stated that 6 per cent is within a reasonable range for the AER.²⁹⁸

Optus submitted that Telstra's proposal of 6.5 per cent MRP should not be accepted for the following reasons:²⁹⁹

- 6.5 per cent 'is a departure from previous AER decisions which consistently adopted 6%'
- A shift to 6.5 per cent 'can be largely attributed to the AER's use and consideration of DGM estimates of the MRP'.

Optus noted that the AER's adoption of 6.5 per cent 'is due to factors relevant for the electricity sector not the communications sector':³⁰⁰

- The AER's adoption of 6.5 per cent MRP is within the electricity network provider context where the use rate of distributed imputation credits is generally higher than that accepted within the fixed line telecommunications context
- Optus noted that 'more weight should be placed on telecommunications specific factors' and 'less weight placed on conclusions which are specific to other industries'.³⁰¹

ACCC final decision

Recognising the MRP cannot be directly observed, the ACCC has had regard to the views expressed in submissions and a range of evidence in setting the MRP. In this assessment the ACCC must apply its judgement to interpret the information before it. The ACCC's final decision is to maintain an MRP of 6 per cent as the majority of evidence is more consistent with a 6 per cent MRP:

- Historical excess returns³⁰²—The ACCC has placed the most reliance on this source of information as this is the most robust source of evidence for estimating the MRP.³⁰³ Table 6.2 below sets out AER's most recent study of arithmetic and geometric average historical excess returns estimated over different sample periods up until the 2014 calendar year end.³⁰⁴ Arithmetic averages range between 5.8 and 6.4 per cent and geometric averages range between 3.9 and 4.9 per cent. Under current market conditions, the historical returns produce a MRP estimate of 6.0 per cent from within the range.³⁰⁵

²⁹⁵ *ibid*, p. 156.

²⁹⁶ Optus, Submission to the draft decision, p. 106.

²⁹⁷ *ibid*, pp. 107–109.

²⁹⁸ *ibid*, p. 106.

²⁹⁹ *ibid*, p. 105.

³⁰⁰ *ibid*, p. 106.

³⁰¹ *ibid*, p. 106.

³⁰² Historical excess returns have been used to estimate a forward looking MRP on the view that investors base their forward looking expectations on past experience,

³⁰³ AER, *Explanatory statement rate of return guideline (appendices)*, 17 December 2013, p. 78.

³⁰⁴ The AER has traditionally taken historical excess returns as a calendar year-end estimate. For consistency, and given these change slowly throughout time, we maintain this convention.

³⁰⁵ AER, JGN final decision, Attachment 3 - Rate of Return, June 2015, pp. 3–330.

Table 6.2: Historical excess returns

Sampling period	Arithmetic average	Geometric average
1883–2014	6.2	4.9
1937–2014	5.9	4.0
1958–2014	6.4	4.0
1980–2014	6.3	3.9
1988–2014	5.8	4.1

Source: AER, *JGN final decision – Cost of capital*, June 2015, pp.3-331.

- Survey evidence—surveys of market practitioners consistently supported 6 per cent as the most commonly adopted value for the MRP. Survey estimates explore investor expectations about the MRP. They achieve this by directly asking investors and market practitioners what their expectations are and/or what they apply in practice.³⁰⁶ During the development of the AER’s 2013 WACC guideline, the evidence from a review of relevant surveys supported an MRP of 6 per cent.³⁰⁷ The AER has updated its surveys in the 2015 final decision for Jemena Gas Networks (JGN) which still supports an MRP of 6 per cent.³⁰⁸ The mean and median MRP across a number of surveys is more supportive of an MRP of 6 per cent as opposed to 6.5 per cent as indicated in the table below (Table 6.3).

Table 6.3: Key findings of MRP survey

Survey	Numbers of responses	Mean (%)	Median (%)	Mode (%)
Fernandez et al (Jan 2013)	73	5.9	6.0	N/A
KPMG (2013) ^b	19	N/A	6.0	6.0
Fernandez et al (June 2013)	17	6.8	5.8	N/A
Asher and Hickling (2013)	46	4.8	5.0	6.0
Fernandez et al (2014)	93^a	5.9	6.0	N/A
Asher and Hickling (2015)	27	4.4	4.6	6.0
Fernandez et al (2015)	40	6.0	5.1	N/A

³⁰⁶ *ibid*, pp. 3–346.

³⁰⁷ AER, *Rate of Return Guidelines* (appendices), December 2013, p. 92.

³⁰⁸ AER, *JGN final decision*, Attachment 3 - Rate of Return, June 2015, pp. 3–347.

Sources: Fernandez, Arguirreamalloa and Corres, *Market Risk Premium used in 82 Countries in 2012*, IESE Business School, January 2013; KPMG, *Valuation Practices Survey 2013*, February 2013; Fernandez, Arguirreamalloa and Linares, *Market Risk Premium and Risk Free Rate used for 51 countries in 2013*, IESE Business School, June 2013; Asher and Hickling, *Equity Risk Premium Survey*, Actuary Australia, December 2013; Fernandez, Linares, Acin, *Market Risk Premium used in 88 countries in 2014*, IESE Business School, June 2014; Asher and Hickling, *Equity Risk Premium Survey 2014*, Actuary Australia, 16 April 2015; Fernandez, Ortiz, Acin, *Discount Rate (Risk-Free Rate and Market Risk Premium) used in 44 countries in 2015: a survey*, IESE Business School, 23 April 2015.

Notes: a) The 2014 survey did not report the response rate. AER staff obtained this information from Professor Fernandez via email correspondence on 22 July 2014.

b) While this survey had 23 market participants, 19 specified what MRP they used.

- Conditioning variables—the AER considered three types of conditioning variables as they may provide useful insights into market conditions: dividend yields, credit spreads and implied volatility. Most recent evidence continues to suggest market conditions are relatively stable which supported an MRP of no greater than 6 per cent.³⁰⁹
- Recent Australian Competition Tribunal decisions—in a series of recent decisions, the Australian Competition Tribunal has not found error in a MRP estimate of 6.0 per cent. These include, the APA GasNet appeal, the Dampier to Bunbury Natural Gas Pipeline (DBNGP) appeal, the WA Gas Networks (WAGN) appeal and the Queensland/South Australia gas appeal.³¹⁰ Similarly, the Tribunal found no error in the ERA's decisions for ATCO Gas Australia's (formerly WAGN) and DBNGP's access arrangements.³¹¹ In both these decisions, the ERA considered the available information and exercised its judgement to determine the appropriate MRP. The Tribunal subsequently found no error in the ERA's determination of a 6.0 per cent MRP.
- An MRP of 6 per cent is consistent with previous ACCC decisions for the regulated fixed line telecommunications services.³¹²
- The ACCC also gives no weight to DGM, given the concerns discussed in the ACCC's draft decision.³¹³ In its recent decision, the AER noted that 'while DGM estimates of the MRP have increased since the draft decision, other information considered by the AER indicated either no change or an easing in the MRP. The AER also continues to note concerns with DGM including:³¹⁴
 - DGMs are highly sensitive to assumptions. This includes assumptions about the long term dividend growth rate and the length of transition to long term growth.
 - Results are also sensitive to errors in analyst forecasts.
 - Its consultants (McKenzie and Partington) consider DGMs can produce upward biased estimates.

³⁰⁹ *ibid*, pp. 3–35 & 350–355.

³¹⁰ Australian Competition Tribunal, *Application by APA GasNet Australia (Operations) Pty Limited (No 2) [2013] ACompT 8*, 18 September 2013, paragraphs 227–308; Australian Competition Tribunal, *Application by WA Gas Networks Pty Ltd (No 3) ACompT 12*, 8 June 2012, paragraphs 105–8; Australian Competition Tribunal, *Application by DBNGP (WA) Transmission Pty Ltd (No 3) [2012] ACompT 14*, 26 July 2012, paragraphs 161–3; Australian Competition Tribunal, *Application by Envestra Limited (No 2) [2012] ACompT 4*, 11 January 2012, paragraphs 145 and 148.

³¹¹ Australian Competition Tribunal, *Application by WA Gas Networks Pty Ltd (No 3) ACompT 12*, 8 June 2012, paragraphs 105–8; Australian Competition Tribunal, *Application by DBNGP (WA) Transmission Pty Ltd (No 3) [2012] ACompT 14*, 26 July 2012, paragraphs 161–3.

³¹² For example, ACCC, *Unconditioned local loop services – pricing principles and indicative prices*, June 2008, p. 17; ACCC, *2011 FADs final report*, July 2011.

³¹³ ACCC, Draft decision, pp. 86–88.

³¹⁴ AER, JGN final decision, Attachment 3 - Rate of Return, June 2015, pp. 3–314–315.

6.3.1.3 Equity beta

The equity beta is a measure of systematic risk. It is measured by the standardised correlation between the returns of a firm with the returns of the overall market. Systematic risks are those that investors cannot diversify away from. A firm's exposure to these risks depends on its activities and level of financial leverage.

ACCC draft decision

The ACCC's draft decision was to maintain an equity beta of 0.7 for Telstra for the following reasons:³¹⁵

- Updated international benchmarking of comparable telecommunications firms supported an equity beta of 0.7.
- An update of Telstra's equity and asset betas indicates that sensitivity to systematic risk for Telstra has declined since the 2011 FADs (where an equity beta of 0.7 was adopted for Telstra).
- Asset betas for comparable firms internationally appear to have remained stable since the 2011 FADs.
- The benchmark asset and equity betas are likely to be higher than those for Telstra's fixed line network alone, as Telstra and international comparable firms provide services using both fixed and mobile networks.

Submissions

Telstra submitted that 'the equity beta should be increased to at least 0.8 to properly compensate for risk exposure'.³¹⁶ Telstra noted that 'it would be unreasonable to maintain an equity beta of 0.7 given Telstra's relatively high exposure to systematic risk compared to other regulated businesses and current empirical evidence'.³¹⁷

Telstra made the following submissions on the draft decision's analysis of Telstra facing higher risk exposure than other Australian regulated businesses:

- It is not clear why income elasticity would not be relevant to the assessment of systematic risk exposure, as it affects the 'exposure of the regulated business to fluctuations in economic activity'.³¹⁸ Telstra reiterated that the income elasticity of demand for fixed line services is significantly high than in other regulated industries.
- The decision as to choice of form of regulation between revenue cap and price regulation will impact on exposure to systematic risk'.³¹⁹ Telstra noted that the risk of actual demand being different from forecast demand is not borne by the regulated business under a revenue cap.
- Not allowing unders/overs adjustment may 'incentivise efficient expenditure' and also 'increases expenditure risk for the regulated businesses'.³²⁰

³¹⁵ ACCC, Draft decision, pp. 90–95.

³¹⁶ Telstra, Main submission to the draft decision, p. 161.

³¹⁷ *ibid.*, p. 161.

³¹⁸ *ibid.*, pp. 157–158

³¹⁹ *ibid.*, p. 158.

³²⁰ *ibid.*, p. 158.

- ‘The cost and risk of unforeseen events cannot be reflected in Telstra’s ex ante expenditure’. Further, ‘Telstra bears the risk associated with unforeseen events’ as there is no pass through mechanisms³²¹.
- The different form of regulation applied to Telstra, the nature of the telecommunications industry and the higher income elasticity of demand means that ‘it is more exposed to systematic risk, relative to many other regulated businesses’.³²² Telstra maintained that it would be unreasonable to maintain an equity beta at the lower end of the range of values for regulated infrastructure businesses in Australia.

Telstra submitted the ACCC should use the adjusted equity beta estimates from Bloomberg when analysing equity beta for international telecommunications businesses. Telstra stated that the use of raw beta estimates would likely underestimate the true forward looking beta for businesses with a beta of less than one due to the assumption of mean reversion (to a market average beta) over time.³²³

Telstra submitted that, when de-levering equity betas estimates for international businesses, it is not appropriate to apply the Monkhouse formula which assumes dividend imputation.³²⁴ Telstra states this is because only New Zealand in the international benchmarking has a similar dividend imputation system. Telstra noted that the updated equity beta and asset betas (in March 2015) continues to support an asset beta of at least 0.5.³²⁵

Optus submitted that it disagrees with Telstra’s approach for equity beta.³²⁶ Optus stated that ‘greater weight should be placed upon the direct observed equity beta of Telstra’ and the ACCC’s benchmarking feature firms with characteristics (i.e. integrated mobile-fixed operator or with international businesses) that will ‘generally lead to higher risk profile’.³²⁷

Optus submitted that ‘Chorus should be regarded as a close comparator’ for the regulated fixed line services as it is a pure-play wholesale fixed line operator of the local access network.³²⁸ Optus made the following observations based on Chorus:

- The New Zealand Commerce Commission is proposing to use Chorus’ ‘observable equity beta when setting WACC for its regulated fixed line services’.³²⁹
- The average asset beta for Chorus since demerger of Telecom New Zealand support ‘the view that fixed line businesses are exposed to lower levels of systematic risk than non-fixed line operations’.³³⁰
- The ACCC should ‘have greater regard to asset betas from Chorus’ and other pure-play fixed line operations, as well as ‘choose an equity beta below the average identified from its comparator set that includes businesses with non-fixed line operations’.³³¹

Optus submitted that an asset beta of around 0.3 to 0.35 is an appropriate choice in the FLSM, ‘consistent with Telstra’s own asset beta and relevant international comparators’.³³²

³²¹ *ibid*, p. 158.

³²² *ibid*, p. 158.

³²³ *ibid*, p. 159.

³²⁴ *ibid*, p. 160.

³²⁵ *ibid*, p. 160.

³²⁶ Optus, Submission to the draft decision, p. 110.

³²⁷ *ibid*, p. 110.

³²⁸ *ibid*, p. 110.

³²⁹ *ibid*, p. 111.

³³⁰ *ibid*, p. 111.

³³¹ *ibid*, p. 111.

³³² *ibid*, p. 112.

Optus also submitted that the move to a full allocation method' and the NBN-Telstra Definitive Agreements should result in less risk for Telstra. Optus supported the draft decision to reject claims of increased risk for Telstra and noted that 'there is no evidence to support Telstra's claim that it faces higher systematic risk' since the 2011 FADs.³³³

In its submission to the further draft decision, Optus submitted that the ACCC should set equity beta using actual Telstra values which results in a value of 0.4.³³⁴ Optus also stated that the ACCC should replace Spark NZ with Chorus in its benchmarking table because the fixed line network in New Zealand is owned by Chorus which results in an average equity beta 'around 0.67'.³³⁵

IMA submitted that an equity beta of less than 0.9 is not fair to equity investors and undermines capital efficiency.³³⁶ IMA noted that the ACCC set an equity beta for Telstra of 0.7 for 2011–14 when government was negotiating with Telstra and higher values were set for other regulated utilities during the same period. IMA submitted that a low equity beta of 0.7 for Telstra takes from shareholders gains in capital efficiency and efficient capital management (post privatisation) and transfers them to access seekers.³³⁷

ACCC final decision

The ACCC's final decision is to maintain an equity beta of 0.7. In reaching this decision, the ACCC has had regard to views expressed in submissions and the updated estimates of equity and asset betas for Telstra and international telecommunications firms.

The ACCC notes that updated international benchmarking of comparable telecommunications firms continue to support an equity beta of 0.7. The update indicates that the average 5 year monthly equity beta is 0.65 and the equivalent weekly beta is 0.74 (table 6.4) which yields an average of 0.7.

³³³ *ibid*, p. 112.

³³⁴ Optus, *Submission in response to the ACCC further draft decision—Outstanding issues: Public inquiry into final access determinations for fixed line prices—primary price terms (Submission to the further draft decision)*, July 2015, p. 14.

³³⁵ Optus, *Submission to the further draft decision*, p. 14.

³³⁶ IMA, *Submission to the ACCC Fixed Line Services Inquiry 2013 regarding discount rates*, 5 August 2015, p. 3.

³³⁷ *ibid*, p. 3.

Table 6.4: Updated international benchmarking (5 year data)³³⁸

	Monthly equity beta	Weekly equity beta	Monthly asset beta	Weekly asset beta
AT&T Inc	0.30	0.62	0.21	0.44
CenturyLink Inc	0.71	0.75	0.38	0.40
Verizon Communications Inc	0.33	0.62	0.21	0.40
Cincinnati Bell Inc	1.29	1.19	0.29	0.27
BCE Inc	0.06	0.28	0.04	0.19
BT Group PLC	0.95	0.87	0.66	0.60
Telekom Austria AG	0.43	0.58	0.20	0.27
Telecom Italia SpA	0.96	0.89	0.27	0.26
Hellenic Telecommunications Organization SA	1.08	0.93	0.41	0.36
TDC A/S	0.35	0.46	0.21	0.28
TeliaSonera AB	0.43	0.68	0.31	0.49
Telefonica SA	1.04	0.92	0.50	0.44
Deutsche Telekom AG	0.72	0.70	0.34	0.34
Orange SA (Formerly France Telecom)	0.66	0.87	0.29	0.38
Koninklijke KPN NV	0.29	0.78	0.13	0.34
Swisscom AG	0.44	0.47	0.32	0.33
Nippon Telegraph & Telephone Corp	0.49	0.67	0.28	0.37
Singapore Telecommunications Ltd	0.67	0.73	0.58	0.64
PCCW Ltd	0.41	0.40	0.19	0.18
Bezeq The Israeli Telecommunication Corp Ltd	1.25	0.87	0.82	0.57
Spark New Zealand Ltd	1.15	1.44	0.86	1.08
Telstra Corp Ltd	0.39	0.48	0.30	0.37
Average	0.65	0.74	0.35	0.41

Source: ACCC analysis of Bloomberg data as at July 2015. The ACCC has removed Portugal Telecom SGPS SA from the international benchmarking as it was formally acquired by the Altice in June 2015. The Altice Group is a multinational cable and telecommunications company: <http://altice.net/altice-group/>

The ACCC notes Telstra's submission for an equity beta of 0.8 is based on higher systematic risk exposure indicated by an asset beta of at least 0.5. The ACCC has updated asset betas for comparable firms internationally (table 6.5) and note that they continue to be relatively similar

³³⁸ The equity beta of a firm is observed from market data and reflects the effect of that firm's leverage (debt). The asset beta of a firm adjusts that firm's equity beta to remove the effect of leverage. The ACCC's benchmarking approach requires the equity beta estimates sourced from Bloomberg to be de-levered and re-levered using the Monkhouse formula in order to compute comparable estimates of the equity beta.

to those from the 2011 FADs. This indicates that risk exposure for comparable firms appear to have remained stable since the 2011 FADs and supports an equity beta of 0.7.

Table 6.5: Updated international benchmarking of telecommunications firms by Telstra and the ACCC

Average estimates	2011 FADs	Telstra estimate (March 2015)	ACCC update (July 2015)
5 year monthly asset beta	0.34	0.52	0.35
5 year weekly asset beta	0.39	0.56	0.41

Source: ACCC analysis.

The ACCC also notes that the updated equity and asset betas for Telstra lay at the lower end of the international benchmark range which suggests that Telstra's risk exposure is likely to be lower than for comparable international telecommunications firms.

Further, the ACCC continues to consider that the equity beta for fixed line services would be lower than that of business lines such as mobile communications. Since Telstra and international comparable firms provide services using both fixed and mobile networks, the benchmark asset and equity betas are likely to be higher than Telstra's fixed-line network alone.

The ACCC considers that the equity beta needs to appropriately reflect the systematic risk exposure to as part of determining the legitimate cost of providing the declared services and cost-reflective prices. It recognises that an equity beta specifically for Telstra's fixed line network is not observable and a value of 0.7 is higher than Telstra's whole-of-business equity beta. However, the ACCC notes that a value of 0.7 is consistent with the updated benchmark values for comparable firms. The ACCC considers that the benchmark values incorporate investors' assessments of the demand and other risks involved in providing telecommunications services, including the fixed line services.

The ACCC has considered the effect of de-levering the raw equity betas using Telstra's formula provided in its 30 January 2015 Response to Information Request.³³⁹ The ACCC notes that the average asset beta in the 2011 FADs would be 0.41³⁴⁰ and that it is 0.43³⁴¹ in July 2015 using Telstra's formula. Both results are materially less than Telstra's proposed asset beta of at least 0.5 and support the ACCC's view that systematic risk exposure has remained relatively stable since 2011.

The ACCC notes Telstra's argument for using adjusted equity betas instead of raw equity betas. However, the ACCC is not persuaded for the following reasons:

- Telstra has not provided evidence that Telstra's systematic risk will revert towards the mean systematic risk of the market portfolio (i.e. 1) over time.
- The adjusted equity beta is also known as the 'Blume adjustment'. It is an adjustment that is not time dependent and is based on a sample of US firms over different time periods.³⁴²

³³⁹ Telstra, Fixed line services final access determination inquiry: ACCC request for information: Annexure 2, 30 January 2015.

³⁴⁰ Using Telstra's formula, the average 5 year monthly asset beta is 0.38 and the average 5 year weekly asset beta is 0.43. An average of the two is 0.41.

³⁴¹ Using Telstra's formula, the average 5 year monthly asset beta is 0.4 and the average 5 year weekly asset beta is 0.47. An average of the two is 0.43.

³⁴² ACCC, Assessment of Telstra's Unconditioned Local Loop Service Band 2 monthly charge undertaking: Final Decision, April 2009, p. 225.

The ACCC notes Telstra’s submission on the income elasticity of demand for fixed-line services is higher than for other regulated industries in support of an equity beta of 0.8. The ACCC does not find Telstra’s argument persuasive for the following reasons:

- The study on income elasticity of demand for fixed line services noted by Telstra is from 1994. Telstra has not provided updated or current evidence of the income elasticity of demand for fixed line services.
- Telstra has not provided evidence on the relationship (if any) between the income elasticity of demand for fixed line services and systematic risk exposure.

The ACCC notes Optus’ submission on including Chorus when setting the value of the equity beta. The ACCC has computed average equity and asset betas from international benchmarking for the following scenarios: (i) include only Spark (the draft decision approach), (ii) replace Spark with Chorus and (iii) include both Spark and Chorus (see Table 6.6).

Table 6.6: Average equity and asset betas from international benchmarking for impact of including Chorus

Average value from international benchmarking	5 Year monthly equity beta	5 year weekly equity beta	5 year monthly asset beta	5 year weekly asset beta
(i) With Spark	0.65	0.74	0.35	0.41
(ii) Replace Spark with Chorus ³⁴³	0.69	0.73	0.35	0.38
(iii) With both Chorus and Spark	0.71	0.76	0.37	0.41

Source: ACCC analysis.

The ACCC notes that the average equity beta from the three scenarios continues to support and be more consistent with a value of 0.7 for the following reasons:

- The five year monthly equity beta is 0.65 for scenario (i), 0.69 for scenario (ii) and 0.71 for scenario (iii). The ACCC continues to place more weight on estimates based on monthly data sampling than weekly as it is likely to remove trading effects.
- Systematic risk exposure does not appear to have changed significantly since the 2011 FADs as the updated 5 year monthly and weekly asset betas for all three scenarios are materially less than Telstra’s submission of 0.5.

6.3.1.4 Equity issuance costs

Equity issuance costs are the fees associated with issuing new equity capital.

ACCC draft decision

The ACCC’s draft decision was that Telstra should not be compensated for equity issuance costs in the WACC.³⁴⁴

Submissions

³⁴³ <https://www.nzx.com/files/attachments/145157.pdf>

Chorus was separated from Telecom New Zealand in a demerger in December 2011 and separately listed on the New Zealand stock exchange. As standalone equity beta for Chorus is not available for the complete five year period, the ACCC has estimated Chorus’ equity and asset betas based on information since the demerger.

³⁴⁴ ACCC, Draft decision, p. 95.

No submission was received on equity issuance costs.

ACCC final decision

The ACCC's final decision is that equity issuance costs should not be included in the WACC.

6.3.2 Cost of debt

6.3.2.1 Debt risk premium (DRP)

The debt risk premium (DRP) accounts for debt-specific risk compensation over and above the risk-free rate. The DRP is dependent on the firm's gearing level, its credit rating, term of the debt and other factors.

The DRP is derived as the difference between the yield to maturity (YTM) on the chosen debt proxy (for example, 10 year A-rated bond yields) and the YTM on the chosen risk-free proxy (for example, the 10 year CGS bond yields).

The ACCC has previously used YTM from a benchmark bond index (Bloomberg's A-rated cost of debt benchmark—the fair yield curve) to estimate Telstra's DRP.³⁴⁵ Bloomberg ceased publishing A-rated fair value curves beyond seven years as of August 2009. However, Bloomberg has started publishing another source of benchmark cost of debt – the Bloomberg Valuation Service (BVAL) curve – in November 2013, with seven years as the longest term.

In considering the DRP, the ACCC does not propose to change the 10-year term-to-maturity and A-rated requirement for the chosen debt proxy. The ACCC will also continue to estimate the DRP as the difference between the YTM on the 10-year A-rated AUD bond yields and the YTM on the 10 year CGS bond yields.

ACCC draft decision

The ACCC's draft decision was to maintain the previous approach of using Telstra-specific nominal bond rate to estimate the cost of debt for the following reasons:³⁴⁶

- The use of a Telstra-specific approach is likely to give a more accurate estimate of Telstra's efficient cost of debt. Telstra is incentivised to minimise costs due to the majority of its revenue and costs being un-regulated, as Telstra has noted in its submission on its capital expenditure forecasts.³⁴⁷
- Further, Telstra's ability to inflate the secondary market yield of its bonds is also limited. There are also no close comparators or benchmark to Telstra as it is the sole operator of the only ubiquitous fixed line network in Australia and the only supplier of the declared fixed line services. As Telstra would have no incentive to operate inefficiently with respect to debt issuance, Telstra could be considered the benchmark firm. In addition, Telstra has incentives to be efficient in order to compete for investor funding on the market.
- A range of factors can affect the yield on firms' bonds (e.g. expected loss in case of default, embedded options, etc.) in addition to their credit rating, as recognised by Telstra.³⁴⁸ The bonds included in a benchmark (e.g. RBA and BVAL) index³⁴⁹ are

³⁴⁵ ACCC, *Public inquiry to make final access determinations for the declared fixed line services: discussion paper*, April 2011, p. 96.

³⁴⁶ ACCC, *Draft decision*, pp. 96–98.

³⁴⁷ Telstra, *Public inquiry into final access determinations for fixed line services primary price terms—Response to Discussion Paper*, 3 October 2014, pp. 49–50.

³⁴⁸ *ibid.*, p. 83.

unlikely to be good comparators for Telstra bonds despite similar credit ratings due to differences in those factors.

- The use of Telstra's bond yield would be consistent with the approach in the 2011 FADs and the 2013 Wholesale ADSL FAD.³⁵⁰

To implement the previous approach of estimating the DRP, the ACCC's draft decision was to use Australian dollar denominated Telstra BVAL (AUD TBVAL) over the same averaging period as the risk-free rate, to estimate the yield on the debt proxy. This is because TBVAL has data to match the 10 year TTM requirement for the debt proxy compared to alternative sources for yield on Telstra bonds.³⁵¹

Submissions

Telstra submitted that a 'Telstra specific [bond rate] may be appropriate', provided that data is available and the chosen Telstra-specific measure is reliable and robust.³⁵² Telstra noted the following concerns with TBVAL:

- Telstra's 30 March 2015 US-dollar bond issue 'provides the best possible information on the current cost to Telstra of raising ten-year debt'. The associated DRP will reflect the efficient DRP for Telstra.³⁵³
- Telstra's survey of lending institutions (March 2015) shows that 'the required DRP on 10 year Telstra bonds is currently around 1.78%'.³⁵⁴
- TBVAL estimates 'are significantly below any other indicator of the current cost of debt for Telstra and other A-rated businesses'. Telstra is concerned that TBVAL 'are not sufficient reliable, and not appropriate for use in this context'.³⁵⁵
- 'TBVAL estimates are implausible, in light of both current and historical measures of the cost of debt'.³⁵⁶
- 'The 'source data used by Bloomberg does not reflect the yield on newly issued Telstra debt' as the secondary market information from the Australian market is 'unlikely to be

³⁴⁹ The RBA does not provide publicly available information on the exact underlying bonds used for its A-rated corporate bond index construction. Instead it publishes criteria for bonds to be included in its index (which amongst other criteria, includes foreign currency bonds):

<http://www.rba.gov.au/publications/bulletin/2013/dec/3.html>

Bloomberg also publishes its bond selection criteria and provides on-the-day information on the underlying bonds used to construct its BVAL curves but does not keep historical records of these bonds.

As a Bloomberg search showed there is only one A-rated, AUD telecommunications bond (a Telstra bond maturing on 19 December 2023 with Bloomberg ID E19022241) with a term-to-maturity close to 10 years at 17 February 2015, neither RBA nor BVAL curves appear to be good comparators for Telstra's cost of debt.

³⁵⁰ ACCC, Inquiry to make final access determinations for the declared fixed line services: final report, July 2011, p. 68; ACCC, Public inquiry to make a final access determination for the Wholesale ADSL service: final report, May 2013, p. 38.

³⁵¹ ACCC, Draft decision, p. 98.

³⁵² Telstra, Main submission to the draft decision, p. 149.

³⁵³ *ibid.*, p. 150.

³⁵⁴ *ibid.*, p. 150.

³⁵⁵ *ibid.*, p. 151.

³⁵⁶ *ibid.*, p. 152.

representative of the return that would be required by investors on newly issued debt'.³⁵⁷

- TBVAL is 'not widely used or market accepted'.³⁵⁸

Telstra submitted that, if a Telstra-specific bond rate is to be used, the ACCC can use information from the US-dollar denominated 10-year Telstra bond issued in March 2015 and 'market pricing information periodically collected by Telstra'.³⁵⁹

Telstra stated that there is 'inconsistency between the DRP estimate and the assumed gearing level'. Telstra noted the ACCC assumes a 'gearing level that would not allow Telstra to maintain its A credit rating, but then assumes that Telstra can borrow at (or below) the cost of debt for an A rated business'.³⁶⁰

Optus supported the draft decision approach to adopt a Telstra specific nominal bond rate.³⁶¹

Optus also submitted that the ACCC should provide reasons for the change in the DRP between the draft decision and further draft decision for interested parties to assess how factors have been taken into account.³⁶²

ACCC final decision

The ACCC has had regard to views in submissions and a range of factors in reaching its final decision. The ACCC confirms its view to set the DRP as the difference in yield between the chosen debt proxy (with a term-to-maturity of 10 years and credit rating of A) and the 10 year CGS yield. The ACCC's final decision is to not adopt the AUD TBVAL (proposed in the draft decision) for estimating the debt proxy based on further information submitted by Telstra in its draft decision submission and the ACCC's analysis of alternative measures of Telstra-specific cost of debt in response to that submission. The ACCC's final decision is to estimate the debt proxy using benchmark measures of the cost of debt. That is, a simple average of A-rated Australian-dollar (AUD) Bloomberg Valuation (ABVAL) and RBA's non-financial corporate bond yield (RBA curve). This is discussed in more detail below.

Choice of debt proxy

In its submission to the draft decision, Telstra claimed the draft decision approach (i.e. AUD TBVAL) underestimated Telstra's DRP. Telstra proposed its 2015 USD bond (a 10-year bond issued on 30 March 2015) for estimating a Telstra-specific DRP and noted that the implied DRP on this bond's issuance was 1.94 per cent.³⁶³

To verify Telstra's claims, the ACCC has analysed DRP from AUD TBVAL and alternative measures of Telstra-specific cost of debt with TTM close to 10 years (Figure 6.1):³⁶⁴

- Telstra's 2015 USD bond³⁶⁵

³⁵⁷ *ibid.*, p. 153.

³⁵⁸ *ibid.*, p. 153.

³⁵⁹ *ibid.*, p. 153.

³⁶⁰ *Ibid.*, p. 154.

³⁶¹ Optus, *Submission in response to ACCC draft decision—Public inquiry into final access determinations for fixed line services—primary price terms*, April 2015, p. 113.

³⁶² Optus, *Submission in response to ACCC further draft decision—Outstanding issues: Public inquiry into final access determinations for fixed line services—primary price terms*, July 2015, p. 13.

³⁶³ Telstra, Main submission to the draft decision, p. 150.

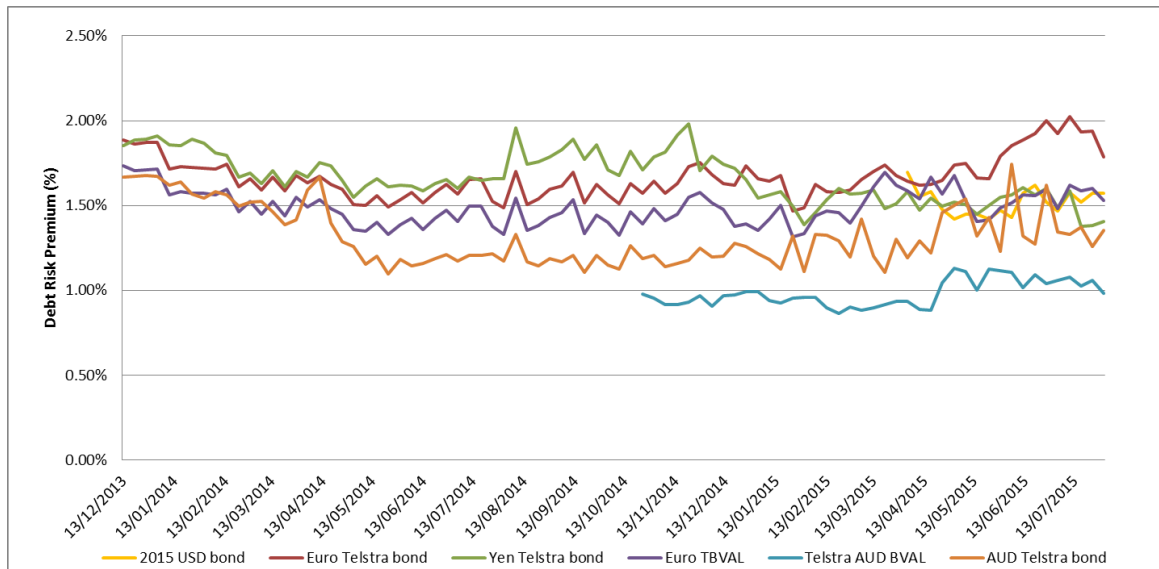
³⁶⁴ This is because the ACCC estimates the DRP based on a debt proxy with a TTM of 10-years and a credit rating of A. The ACCC note that there continues to be a lack of AUD denominated Telstra bonds with TTM of 10 years.

The comparison uses weekly data and estimates the DRP as the difference between the YTM and the risk free rate (of the relevant TTM).

- Other Telstra bonds with TTM close to 10 years,³⁶⁶ and
- Euro-denominated TBVAL.³⁶⁷

As these alternative measures are denominated in foreign currencies, the ACCC has converted yields for foreign currency debt costs into AUD equivalents. This conversion is necessary as yields denominated in different currencies are not directly comparable due to factors such as different interest rates.

Figure 6.1: Comparison of AUD TBVAL with alternative measures of Telstra-specific cost of debt



The ACCC notes the following observations from Figure 6.1:

- AUD TBVAL results in a DRP that ranges from 0.87 per cent to 1.13 per cent since Bloomberg published the curve in October 2014.
- The alternative measures of Telstra-specific cost of debt result in a DRP that ranges from 1.1 per cent to 2.03 per cent from December 2013 to July 2015 (Table 6.7).

³⁶⁵ Bloomberg ID: EK 8353493.

³⁶⁶ Bloomberg search indicated that there are four Telstra bonds on issue with TTM close to 10 years: the 2015 US-dollar bond, a Euro-denominated bond maturing in December 2023 (Bloomberg ID: EI9023967 with a TTM of 8.4 years), an AUD-denominated bond maturing in December 2023 (Bloomberg ID: EI9022241) and a Yen-denominated bond maturing in July 2024 (Bloomberg ID: EJ3406950 with a TTM of 9 years).

³⁶⁷ Bloomberg publishes a Euro-denominated Telstra Bloomberg Valuation (Euro TBVAL) curve.

Table 6.7: DRP range for alternative measures of Telstra-specific cost of debt

	Minimum	Maximum
2015 USD bond	1.42%	1.70%
Euro Telstra bond	1.47%	2.03%
Yen Telstra bond	1.38%	1.98%
Euro TBVAL 10 years	1.32%	1.73%
AUD Telstra bond	1.10%	1.74%
Average	1.34%	1.84%

- A bond's TTM declines over time (e.g. a 10-year bond issued on 1 January 2010 will have a TTM of 10 years at its issue date and a TTM of 5 years on 1 January 2015). When the TTM is 10 years, the alternative measures result in a DRP ranging from 1.65 per cent to 1.88 per cent, with an average of 1.73 per cent.

Table 6.8: DRP for alternative Telstra cost of debt measures with 10 year TTM

Ten Year TTM	DRP (%)
2015 USD bond	1.70%
Euro Telstra bond	1.88%
Yen Telstra bond	1.65%
Euro TBVAL 10 years	1.73%
AUD Telstra bond	1.67%
Average	1.73%

The ACCC considers that the DRP needs to appropriately reflect the debt-specific risk compensation over and above the risk-free rate as part of determining the legitimate cost of providing the declared services and cost-reflective prices. As figure 6.1 indicates DRP estimates from AUD TBVAL materially below alternative measures of Telstra-specific cost of debt, the ACCC considers that a different measure should be adopted for the debt proxy.

The ACCC considered using either an alternative measure of Telstra-specific cost of debt or benchmark measures of the cost of debt.

The ACCC notes the following considerations supporting and against implementing alternative measures of Telstra-specific cost of debt:

Table 9.8: Strengths and weaknesses of implementing alternative measures of Telstra-specific cost of debt

Strengths	Weaknesses
The secondary market return/yield on Telstra bonds may reflect more Telstra-specific factors than a benchmark measure of debt which is based on a wide range of AUD-denominated bonds with the same credit rating.	The conversion to AUD-denominated yield can be imprecise and there is potential to open complex regulatory debates on how to implement the conversion methodology (e.g. inputs and models used for conversion).
There continues to be a lack of 10 year A-rated AUD bonds for telecommunications businesses. Telstra foreign currency bond yields/TBVAL matches the TTM required by	Banks and other financial institutions use proprietary models to convert non-AUD yields to AUD-equivalent yields. Any conversion conducted by the ACCC (with the assistance

the debt proxy.	of consultants) would be an approximation of the actual costs involved.
Figure 6.1 indicates that alternative measures of Telstra's cost of debt would likely result in a more reasonable estimate of the DRP compared to AUD TBVAL. There would be a reduced level of transparency with regard to the estimation of the debt proxy. The YTM (and DRP) for relevant alternative Telstra-specific measures are largely denominated in foreign currencies and would need to be converted by the ACCC to AUD equivalents	The outputs of cross currency conversion can be influenced by a number of factors such as the demand and supply for currencies, credit risk of banks and the relationship between sovereign debt and banks' capital requirements ³⁶⁸ .

The ACCC notes the following strengths with implementing benchmark measures of cost of debt:

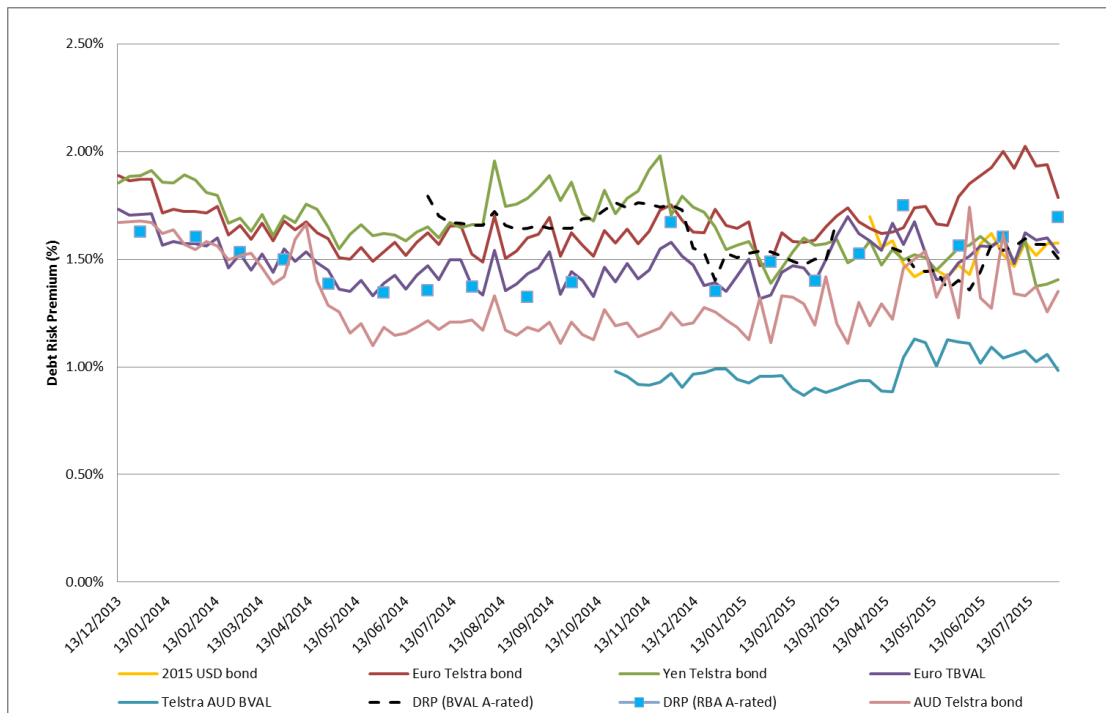
- It is independent information developed by finance experts with access to financial databases. These experts develop this independently from the regulatory processes and for the use of market practitioners.
- It is relatively more transparent and straight forward to implement as the ACCC itself does not need to convert foreign currency yields to AUD-denominated yield.
- It does not require conversion to AUD-denominated yield which can be imprecise.
- Banks and other financial institutions use proprietary models to convert non-AUD yields to AUD-equivalent yields. Any conversion conducted by the ACCC would be an approximation of the actual costs involved.
- The ACCC has previously preferred a benchmark cost of debt where available. The ACCC preferred a benchmark cost of debt during the 2011 FADs and used Telstra bond yield due to a lack of suitable benchmarks. The ACCC has previously used a benchmark cost of debt in 2009.

On balance, the ACCC's final decision is to adopt a benchmark approach for a number of reasons. In addition to the strengths noted above:

- The benchmark costs of debt (using the selected ABVAL and RBA curves) are consistent with alternative measures of Telstra-specific costs of debt (Figure 6.2).

³⁶⁸ Banks and financial institutions generally provide the financial instruments and arrangements for converting foreign-currency denominated debt into effectively AUD-denominated debt.

Figure 6.2: Comparison of benchmark cost of debt and alternative measures of Telstra cost of debt



- The ACCC preferred a benchmark cost of debt during the 2011 FADs and used Telstra bond yield due to a lack of suitable benchmarks. The ACCC has previously used a benchmark cost of debt in 2009.

The ACCC considered a range of options for implementing a benchmark measure of the cost of debt:

- Adopting benchmark cost of debt estimate based on one data provider (either the RBA or the ABVAL curve), or
- A simple average of the two.

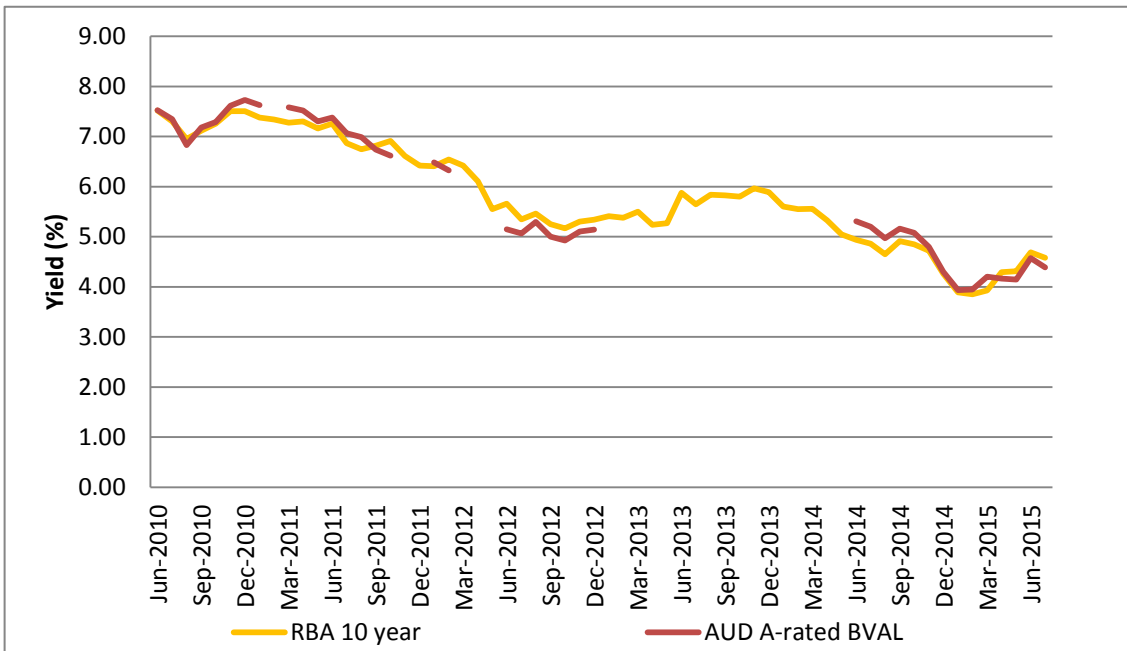
The ACCC notes that the AER, in adopting a simple average of the RBA and Bloomberg curves, has considered these options and reached the following conclusions:

- Neither curve is clearly superior in terms of bond section criteria and curve fitting (or averaging) methodologies.³⁶⁹
- There is no clear indication of one measure being consistently higher or lower than the other over time (Figure 6.3).
- Professor Lally noted that adopting a simple average of the two curves would likely reduce the estimation error.³⁷⁰

³⁶⁹ AER, *Jemena Gas Networks final decision 2015–20: Attachment 3–Rate of return*, June 2015, pp. 202–203.

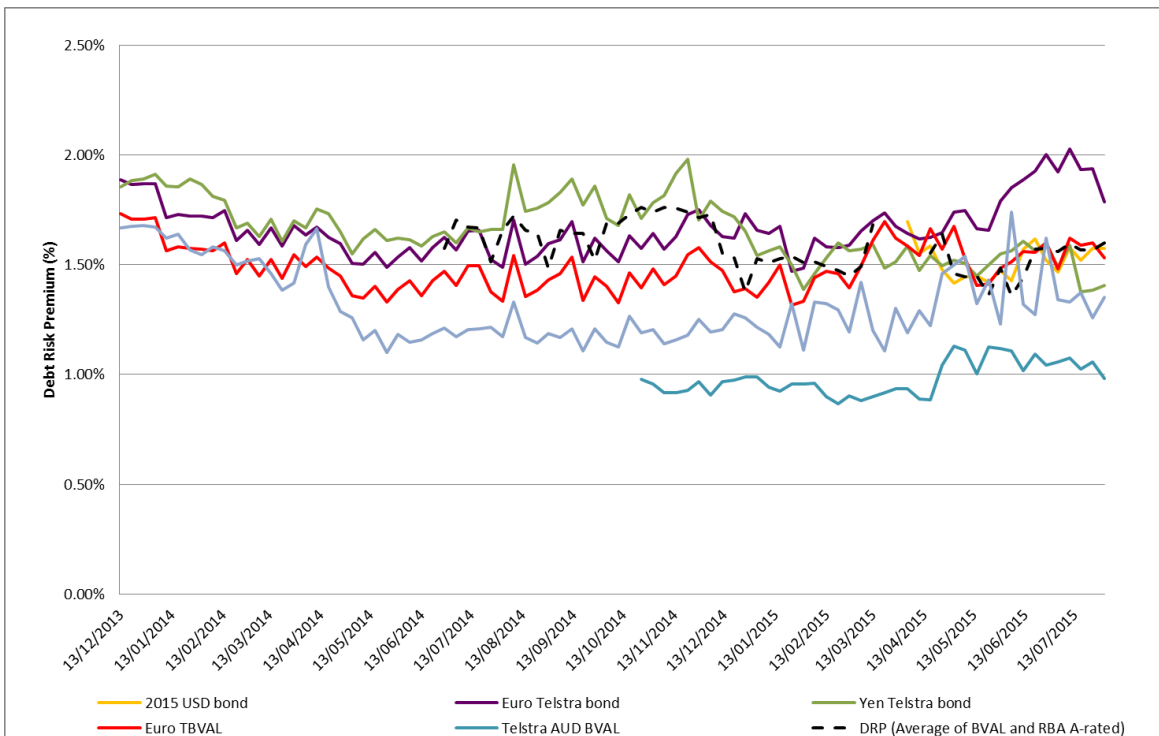
³⁷⁰ AER, *Jemena Gas Networks final decision 2015–20: Attachment 3–Rate of return*, June 2015, pp. 202–203.

Figure 6.3: Comparison of RBA and ABVAL



The ACCC also notes that an average of RBA and ABVAL curves would generally be within the range of DRP estimates from alternative Telstra cost of debt measures (Figure 6.4).

Figure 6.4: Comparison of average of benchmark cost of debt to alternative measures of Telstra-specific cost of debt



Based on the above considerations for implementation, the ACCC's final decision is to adopt a simple average of RBA and ABVAL curves over the same averaging period as the risk free rate to estimate the yield on the debt proxy.

The ACCC notes that the RBA curve is monthly and propose to interpolate to the same frequency as the ABVAL data (i.e. daily data) using a similar approach to that used by the AER.³⁷¹

Based on a 20 business day averaging period to 31 August 2015, the average of RBA and BBVAL curves result in a DRP of 1.74 per cent.

DRP and gearing ratio

The ACCC notes Telstra's submission that the draft decision DRP is inconsistent with the gearing ratio (debt to equity ratio of 40:60) assumed in the draft decision. Telstra argued that a 40:60 ratio is different from Telstra's actual gearing (e.g. 18:82 at 31 December 2014) and would lower Telstra's credit rating (from A to BBB) and lead to a higher cost of debt.

The ACCC does not find Telstra's submission supported by evidence from its most recent (2014–15) annual report, which shows a gearing ratio (48.3:51.7) close to 40:60.³⁷² The ACCC also notes that the gearing ratio used for regulatory purposes is based on a more stable longer term average, not on measures at a point in time (which was submitted by Telstra). Further, the ACCC observes that credit rating agencies (e.g. Moody's and Standard and Poor's) assess a firm's credit rating in terms of a range of factors³⁷³, and not solely on its gearing ratio.

6.3.2.2 Debt issuance cost

Debt issuance costs are the costs associated with raising debt. They can be recovered through a direct cash flow allowance or an adjustment to the WACC. In the past, the ACCC has accepted the inclusion of debt issuance costs in the return on debt in the WACC.³⁷⁴

ACCC draft decision

The ACCC's draft decision was to maintain its previous approach for estimating Telstra's debt issuance costs using a methodology devised by the Allen Consulting Group (ACG).³⁷⁵

Submissions

Optus supported no change to the ACCC's approach for debt issuance costs.³⁷⁶

ACCC final decision

The ACCC's final decision to maintain the previous approach for estimating Telstra's debt issuance costs. The ACCC also confirms its view that debt issuance costs should be set assuming six debt issues of \$500 million.

³⁷¹ AER, Jemena Gas Networks final decision 2015–20: Attachment 3–Rate of return, June 2015, pp. 210.

³⁷² Telstra, FY15 Annual Report, p. 25.

³⁷³ Moody's, *Rating methodology - Global Telecommunications Industry*, 28 December, 2010, p. 2. These factors include: 'Scale and business model, competitive environment and technical positions', 'operation environment', 'financial policy', 'operating performance' and 'financial strength'; Standard and Poor's, *Ratings Direct: Corporate methodology*, 19 November 2013, pp. 5–6. Standard and Poor's include factors such as industry risk, country risk, competitive position, capital structure and liquidity etc.

³⁷⁴ ACCC, *Inquiry to make final access determinations for the declared fixed line services: final report*, July 2011, p. 70.

³⁷⁵ ACCC, Draft decision, p. 98.

³⁷⁶ Optus, Submission to the draft decision, p. 113.

6.3.3 Imputation factor (gamma)

The gamma parameter represents the value of tax credits, otherwise referred to as imputation credits, generated by the regulated business that could be distributed in the form of franked dividends to shareholders.

Gamma has generally been defined for regulatory purposes as the utilisation rate multiplied by the imputation payout ratio:³⁷⁷

$$\gamma = \theta * F$$

where γ = gamma

θ = (theta) the utilisation rate of imputation credits represents the per dollar value of a distributed imputation credit

F = the imputation payout ratio is the proportion of imputation credits distributed to shareholders

In determining the WACC, the regulated business' capacity to pay imputation credits with dividends must be taken into account to avoid over-compensation.³⁷⁸ As the ACCC uses a vanilla WACC in the FLSM, the gamma is used to capture all tax effects, including imputation benefits, in the cash flows and tax liabilities estimated by the FLSM.

ACCC draft decision

The ACCC's draft decision was to maintain the gamma at 0.45.³⁷⁹ The ACCC had regard to Telstra-specific considerations related to its foreign ownership restriction and high payout ratio. The ACCC also had regard to the AER's 2013 WACC guideline and final decisions for NSW, ACT, and TAS energy networks revenue determination in maintaining the gamma at 0.45.

Submissions

Telstra maintained that 'the best estimate of gamma is 0.25' which reflects the 'best current estimate of the market wide distribution rate' (0.7) and 'the best estimate of theta' (0.35 from Professor Gray's Dividend drop off study.³⁸⁰ Telstra submitted that 'there is no reasonable basis to adopt a gamma of 0.45'.³⁸¹

Telstra noted that 'recent analysis by the AER demonstrates that the maximum possible value for theta is 0.43' which means that, even if a distribution rate of 1 was assumed, 'gamma could be no higher than 0.43'.³⁸² Telstra stated that 'the best evidence in relation to theta indicates a

³⁷⁷ John Handley, Report prepared for the AER – Advice on the value of imputation credits, 29 September 2014, p. 3.

³⁷⁸ Eligible shareholders are able to redeem imputation credits to reduce their personal tax liabilities means that part of the business' corporate tax payments represents pre-payment of personal tax on behalf of its shareholders. It is this pre-payment of personal tax that reduces the shareholders' personal tax liabilities or generates a tax refund. The personal tax benefits obtained from imputation credits effectively increase the rate of return received by shareholders from holding shares in the regulated business.

The total return to the shareholder will be the dividend plus the personal tax benefits from imputation credits. Shareholders will therefore be willing to accept a lower rate of return received in the form of dividends when they receive imputation credits with those dividends, compared to the rate of return required on shares that do not pay franked dividends.

³⁷⁹ ACCC, Draft decision, pp. 102–103.

³⁸⁰ Telstra, Main submission to the draft decision, p. 162.

³⁸¹ *ibid*, p. 161.

³⁸² *ibid*, p. 161.

value of 0.35' and was accepted by the Australian Competition Tribunal in the Energex review.³⁸³

Telstra noted that 'the ACCC appears to rely on estimates of the utilisation rate (theta) based on equity ownership rates'.³⁸⁴ Telstra submitted that 'equity ownership rates do not indicate the utilisation rate or value of imputation credits to investors'. Telstra added that 'theta can be no higher than the equity ownership rate and will in fact be lower due to factors which reduce the value of credits distributed to Australian investors'.

Telstra submitted that the 'distribution rate should be an economy wide measure' and the ACCC's 'estimate of gamma should not be based on estimates of the Telstra-specific distribution'.³⁸⁵

Optus submitted that '0.45 is the...minimum that should be adopted' for gamma.³⁸⁶ Optus noted that Telstra's dividend payments over the last 5 years supported a theta between 0.65 and 1.0' and a gamma 'at the top end of that range'.³⁸⁷

Optus stated that 'the ACCC's reluctance to set a value of gamma at 0.65 or more appears to be due to some weight being given to the SFG estimate for theta'. Optus submitted that SFG's estimate is an error and should not be given weight as it is 'an econometric estimate of the value of both cash dividends and franking credits for all ASX listed firms from 2001 to 2012'.³⁸⁸ Optus stated that there are data problems from including all firms listed on the ASX and the ACCC's task is not to 'estimate the cost of capital for the market as a whole'.³⁸⁹

Optus noted that 'the ACCC does not attempt to estimate beta for the market as a whole and then apply this to Telstra' and it does not make sense to 'estimate the value of theta for the market as a whole and apply that to Telstra'.³⁹⁰

Optus submitted that the best estimate of theta for Telstra's shareholders is 1.0 after examining Telstra's dividend payment over the last 5 years.³⁹¹ Optus added that assuming an average personal tax income tax rate of 15 per cent (which is the rate of tax paid for earnings within superannuation), the estimate value of theta is between 0.75 and 0.8.³⁹²

ACCC final decision

The ACCC considers that the gamma parameter needs to take into account Telstra's capacity to pay imputation credits with dividends to avoid over-compensation as part of determining the legitimate cost of providing the declared services and cost-reflective prices. Eligible investors will be willing to accept a lower rate of return received in the form of dividends when they receive imputation credits with those dividends, compared to the rate of return required on shares that do not pay franked dividends.

The ACCC's final decision is to maintain the gamma at 0.45. The ACCC has had regard to Telstra-specific considerations related to its higher payout ratio. The ACCC has also had regard to the AER's 2013 WACC guideline and recent regulatory decisions for energy networks revenue determination in maintaining the gamma at 0.45:

³⁸³ *ibid*, pp. 161–162.

³⁸⁴ *ibid*, p. 162.

³⁸⁵ *ibid*, p. 162.

³⁸⁶ Optus, Submission to the draft decision, p. 114.

³⁸⁷ *ibid*, p. 114.

³⁸⁸ *ibid*, p. 115.

³⁸⁹ *ibid*, p. 115.

³⁹⁰ *ibid*, p. 115.

³⁹¹ *ibid*, p. 115.

³⁹² *ibid*, p. 116.

- Telstra’s historical payout ratio indicated an estimate of 0.95 (10 year average to 2014-15 of 0.95), in combination with estimates of the utilisation rate from the AER (0.45–0.68),³⁹³ would support a Telstra gamma that is likely to be significantly higher than Telstra’s proposed 0.25.
- Given Telstra’s relatively high payout ratio, 0.45 is likely to be a conservative estimate as it is within the range of the AER’s estimates (0.3–0.5) and close to the adopted value of 0.4.
- In setting a gamma of 0.25, the Australian Competition Tribunal considered SFG’s study but also indicated that further work was required on the gamma, and that it would be open to consider a range of estimates for gamma and review its approach in the future.³⁹⁴ The AER has considered and incorporated the Australian Competition Tribunal’s comments and considered a range of approaches (tax statistics, equity ownership, implied market value approach) in reaching a range of 0.3–0.5.³⁹⁵ The ACCC’s value of 0.45 is within the AER’s range.
- Telstra’s submission noted AER’s tax statistics analysis indicated an upper bound of 0.43 for theta. The ACCC notes that the AER’s updated estimate of theta (0.45) in its 2015 JGN final decision, when combined with Telstra’s 10 year payout ratio (0.95), results in a gamma more consistent with a value of 0.45.³⁹⁶

6.3.4 Gearing ratio

The gearing level of a firm refers to the ratio of debt to equity that a firm uses to finance its capital. The gearing level is used to weight the return on equity and cost of debt in the WACC formula. Where the firm’s capital structure is highly geared (that is, the firm has a high level of debt) and holding all else equal, this implies greater financial risk for the firm and therefore a greater required rate of return for equity holders.

ACCC draft decision

The ACCC’s draft decision was to maintain the debt/equity ratio at 40:60, consistent with the approach from previous FADs.

Submissions

Optus supported ‘no change’ to the ACCC’s 40:60 assumption for gearing ratio.³⁹⁷

ACCC final decision

The ACCC’s final view is to maintain a debt/equity ratio of 40:60.

³⁹³ AER, *JGN final decision – Attachment 4: value of imputation credits*, June 2015, p. 4-17.

³⁹⁴ Australian Competition Tribunal, *Application by Energex Limited (Gamma) (No 5) [2011] ACompT 9*, May 2011; Australian Competition Tribunal, *Application by WA Gas Networks Pty Ltd (No 3) [2012] ACompT 12*, June 2012.

³⁹⁵ AER, *JGN final decision – Attachment 4: value of imputation credits*, June 2015, p. 4-38.

³⁹⁶ AER, *JGN final decision – Attachment 4: value of imputation credits*, June 2015, p. 4-17.

³⁹⁷ Optus, Submission to the draft decision, p. 113.

7 Taxation payments

Key Points

- The ACCC's final decision is to maintain the current approach to the calculation of tax in the FLSM.
- The FLSM currently bases the initial tax value for the assets included in the RAB on the written-down tax value in Telstra's tax accounts.
- Straight line depreciation is used as a proxy for the actual profile of Telstra's tax depreciation.
- The prices and charges in the FADs are exclusive of the Australian Capital Territory Utilities Tax and the Goods and Services Tax (GST)

7.1 Introduction

The calculation of tax in the FLSM follows the conventional accounting treatment of tax as it applies the corporate tax rate to profits, where profits are defined as revenue minus costs. The tax assessable profit under the building block approach is calculated as the pre-tax revenue requirement minus the three classes of tax deductible expenses – operating costs, tax depreciation and interest.

In contrast to the rest of the FLSM where calculations are undertaken in real terms, tax payable is calculated in nominal terms because tax liabilities are based on nominal values. Tax is assessed on nominal (not real) profits generated throughout each year and the magnitude of the tax deduction arising from interest expenses depends on the nominal interest rate, not the real interest rate. Tax depreciation and operating costs are also calculated in nominal terms for the purposes of assessing tax payable.

As a result, the tax calculations in the FLSM are performed in nominal terms, then converted into the base year terms and added to the real pre-tax revenue requirement to calculate the real revenue requirement including tax.

Initial tax asset value

The ACCC's current approach to setting the initial tax asset base is consistent with the AER's approach to setting the initial tax asset value based on the actual tax position of assets that constitute the RAB where possible.

The opening tax asset value at 1 July 2014 is \$10.852 billion.

Tax depreciation method

Tax depreciation is a tax deductible expense that is used as an input in the calculation of the business's tax liabilities. In the 2011 FAD, the ACCC confirmed the use of straight line depreciation for the estimation of tax depreciation. Straight-line depreciation involves dividing the initial asset value by the asset's useful life to calculate a constant depreciation expense each year. Using straight line depreciation complies with Australian tax rules and accepted conventions that favour the simplicity and transparency of the straight line method for tax purposes.

Other tax liabilities

In the 2011 FAD, the ACCC observed that Telstra may also be liable to pay other taxes, such as the GST. However, only corporate tax liabilities are included in the tax building block in the FLSM. The ACCC considered that any issues associated with incorrect pass-through of applicable taxes are not included in the FADs and can be resolved through binding rules of conduct (BROC).

7.2 Draft decision

The ACCC's draft decision is to maintain the current approach to calculating tax liabilities in the FLSM and to maintain its current approach to the treatment of other tax liabilities.

7.3 Submissions

While Telstra did not make a submission on the draft decision approach to the FLSM calculation of tax liabilities, Telstra noted that the calculation of the tax liabilities in the FLSM included an error in the interest rate applied to the debt. The calculations for the interest on debt in the sheet '10 Tax liabilities' for each of the years 2014–15 to 2018–19 does not refer to the revised cost of debt.³⁹⁸

Telstra also submitted that the ACCC appears to have applied inflation values and indices inconsistently through the FLSM. In some places the static value for inflation used in the WACC calculation is referenced in the formula, while in other places the cumulative inflation index table is referred to, and on occasion the static value for inflation used in the WACC calculation for the previous period is used.³⁹⁹

7.4 ACCC's final decision

The ACCC has corrected the error identified by Telstra in the FLSM calculation of tax liabilities and corrected the inconsistencies in the application of inflation values and indices through the FLSM. The ACCC has also commissioned a consultant (Marsden Jacob Associates (MJA)) to check all FLSM modelling calculations for the final decision.

The ACCC's final decision is to maintain the current approach of calculating tax liabilities in the FLSM and maintain its current approach to the treatment of other tax liabilities. The methodology adopted in the FLSM remains consistent with the conventional accounting treatment of tax.

Assessment of approach against section 152BCA matters

The ACCC considers that the calculation of tax liabilities as an input into the final decision setting of prices for the listed services is consistent with the objectives of promoting the long term interests of end users.

The ACCC considers that the access provider's taxation liabilities are calculated on the basis of the access provider's efficient costs and that the calculated taxation liabilities are an input into the efficient costs of supplying listed services. The efficient costs of supply will promote competition in markets for listed services and will promote the achievement of any-to-any connectivity in relation to carriage services that involve communication between end-users.⁴⁰⁰

³⁹⁸ Telstra (2015), *Public inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, 1 May 2015, p. 185.

³⁹⁹ *ibid*, p. 185.

⁴⁰⁰ Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE; Paragraph 152AB(2)(c) – the objective of promoting competition in markets for listed services; Paragraph 152AB(2)(d) – the

The ACCC considers that, as an input into the determination of efficient costs and prices for listed services, the calculation of tax liabilities will determine prices that promote competition in the markets for listed services, and in this regard the ACCC considers that supply of the listed service at efficient costs and prices will remove obstacles to users gaining access to listed services.⁴⁰¹

The ACCC considers that as an input into the determination of efficient building block costs and efficient listed service prices, the calculation of the access provider's taxation liabilities in the FLSM will encourage the economically efficient use of, and economically efficient investment in the infrastructure by which listed services are supplied and any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁴⁰²

The ACCC considers that the determination of the efficient tax building block is likely to result in the achievement of the objective in subsection 152AB(2)(e) (economically efficient use of, and the economically efficient investment in, infrastructure).⁴⁰³ This is because in the determination of the efficient tax building block the ACCC had regard to the following matters:

- (a) the technology that is in use, available or likely to become available and its influence on the supply and charging for listed services
- (b) the costs that would be involved in supplying and charging for the listed services are reasonable or likely to become reasonable,
- (c) the effects, or likely effects, that supply, and charging for, the listed services would have on the operation or performance of telecommunications networks.
- (d) the legitimate commercial interests of the supplier of the listed services, including the ability of the supplier to exploit economies of scale and scope;
- (e) the incentives for investment in infrastructure by which the listed services are supplied and any other infrastructure by which the services are, or are likely to become, capable of being supplied.⁴⁰⁴

The final decision calculation of tax liabilities provides sufficient allowance for Telstra to recover its prudent and efficient costs that are incurred in the provision of listed services over the regulatory period.⁴⁰⁵

The ACCC's also considers that adopting a cost-based approach to pricing listed services, which includes the calculation of tax liabilities, ensures that prices are set with regard to the efficient costs of supplying these services. This will allow access seekers to compete more

objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users.

⁴⁰¹ Paragraph 152AB(4) – In determining the extent to which a particular thing is likely to result in the achievement of the objective referred to in paragraph (2)(c), regard must be had to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services.

⁴⁰² Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE; Paragraph 152AB(2)(e) – the objective of encouraging the economically efficient use of, and economically efficient investment in: (i) the infrastructure by which listed services are supplied; (ii) any of infrastructure by which listed services are, or are likely to become, capable of being supplied.

⁴⁰³ Paragraph 152AB(6) – the extent to which a particular thing is likely to result in the objective referred to in Paragraph 152AB(2)(e).

⁴⁰⁴ Paragraph 152AB(6) – the extent to which a particular thing is likely to result in the objective referred to in Paragraph 152AB(2)(e).

⁴⁰⁵ Paragraph 152BCA(1)(b) – legitimate business interests of a carrier or carriage service provider

effectively in downstream markets where each of the listed services is an input to supplying services in the downstream (e.g. retail) markets.⁴⁰⁶

⁴⁰⁶ Paragraph 152BCA(1)(c) – interests of all persons who have rights to use the listed service

8 Demand forecasts

Key Points

- The ACCC final decision is to accept demand forecasts for fixed line services using the two step approach proposed by Telstra of:
 - first determining 'pre-NBN' demand levels on a 'no-NBN' assumption
 - adjusting the pre-NBN demand forecasts by subtracting forecast migration of services to the NBN to obtain the 'post-NBN' level forecast demand for each service
- The ACCC final decision is to set pre-NBN demand forecasts for the fixed line services at the levels set out in the March 2015 draft decision.
- In August 2015 NBN Co released its Corporate Plan for 2016 that included an updated NBN plan and schedule for the rollout and service activation that differed materially from the information provided in NBN Co's December 2013 Strategic Review and which was used for the demand forecasts considered in the March draft decision.
- To update the post-NBN demand forecasts the ACCC used NBN Co's forecasts for service activation in place of the values proposed by Telstra for service migration in the forecast model it submitted to the FAD inquiry in October 2015.

8.1 Introduction

Demand forecasts are required to determine the final access determination (FAD) primary price terms for the declared services. The fixed line services model (FLSM) also uses demand forecasts as inputs to determine cost allocation factors within the cost allocation framework that forms part of the FLSM. In addition, forecasts for operating and capital expenditure are dependent on demand forecasts.

In November 2013, Telstra provided demand forecasts for the five year forecast period (2014–15 to 2018–19) under the Building Block Model record keeping rule (BBM RKR).⁴⁰⁷ Telstra also provided an explanation of the methodology used to generate the forecasts and a comparison with historical values and trends. In preparing its BBM RKR demand forecasts Telstra accounted for NBN migration on the basis of NBN rollout information current at 30 June 2013 and acknowledged that it would need to update these forecasts to account for changes in NBN policy and rollout schedule when that information became available.

Telstra provided revised demand forecasts as part of a comprehensive revision of its BBM RKR forecasts with its submission of October 2014 to the ACCC's July 2014 discussion paper.⁴⁰⁸ Telstra's purpose was: to provide an expanded set of demand forecasts required by the cost allocation framework that it had submitted to the inquiry; to account for the change in NBN policy since it prepared its initial response to the BBM RKR; and to provide a forecast model that would enable its demand and expenditure forecasts to be readily updated as new information on the NBN rollout became available. Telstra's October 2014 forecasts reflected

⁴⁰⁷ Telstra, *Final Access Determinations (FADs) Inquiry – confidential response to information request under the BBM RKR*, November 2013.

⁴⁰⁸ Telstra, *Forecast model v 1.05– framework and guide to forecast assumptions*, October 2014, p. 4.

the adoption of the Multi Technology Mix (MTM) architecture and the associated rollout set out in NBN's December 2013 strategic review.

Telstra developed its demand forecasts by first forecasting demand as if the NBN was not occurring (pre-NBN forecasts) and then accounting for the NBN by determining a forecast of the number of services migrating to the NBN in each year of the forecast period.

In August 2015, NBN Co released its Corporate Plan for 2016.⁴⁰⁹ The Corporate Plan contained revisions to the NBN plan and targets for the rollout schedule. For the purposes of its final decision, the ACCC has used this latest information on the NBN rollout to determine updated demand and expenditure forecasts.

This chapter sets out the ACCC's final decision on the demand forecasts used for the purposes of setting primary price terms included in the final access determinations for the fixed line services.

8.2 Draft decision

In the March draft decision, the ACCC assessed the demand forecasts submitted by Telstra in October 2014, which were developed using the approach noted above of first developing pre-NBN forecasts and then subtracting services forecast to be migrated to the NBN to give the post-NBN forecasts submitted to the inquiry.⁴¹⁰

In reaching its draft decision on Telstra's October 2014 demand forecasts the ACCC considered the explanations and information Telstra provided on its forecast methodology and assumptions. This information was primarily provided in the November 2013 BBM RKR response and further explained in Telstra's October 2014 submission. The further information provided in October 2014 particularly relates to the trend and market share analysis on which Telstra based its pre-NBN demand forecasts.⁴¹¹

The ACCC remained concerned that some aspects of Telstra's forecasting methodology was not transparent and sought further information in January 2015.⁴¹² Notwithstanding this request for further information, the ACCC was able to reach a draft decision on the basis of information from other sources, such as the TEM reports (from the third quarter of 2011-12 to the fourth quarter of 2013-14) and CAN RKR which supported the demand forecasts submitted by Telstra in October 2014.⁴¹³

Telstra based its methodology for estimating pre-NBN demand forecasts on analysis of historic trends in service relativities and shares among major services, information on service volumes and the impact of exogenous factors on overall market size.⁴¹⁴ Telstra also sought internal views from product managers on market developments, such as those concerning wholesale customers that were considered likely to have an impact on demand for the declared services.

[c-i-c start]

⁴⁰⁹ NBN, Corporate Plan 2016, August 2015, available at: <http://www.nbnco.com.au/corporate-information/about-nbn-co/corporate-plan/corporate-plan.html>

⁴¹⁰ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Discussion Paper*, 3 October 2014, p. 51

⁴¹¹ Telstra, *Public Inquiry into final access determinations for fixed line services – primary prices, Response to Discussion Paper*, 3 October 2014, p. 51

⁴¹² ACCC, March Draft Decision, p. 121

⁴¹³ *Ibid.*, p. 118. The Telstra Economic Model (TEM) is a management accounting system used internally by Telstra for its own business planning purposes. Under clause 18 and schedule 9 of its SSU, Telstra commits to supplying financial reports that are drawn from its TEM, for publication by the ACCC.

⁴¹⁴ Telstra, Main submission, October 2014, p. 51.

[redacted]
[redacted]
[redacted]
[redacted] [c-i-c end] The ACCC concluded that the relative utilisation of ULLS and WLR is unlikely to differ significantly from Telstra's forecasts.⁴¹⁷

[c-i-c start] [redacted]
[redacted]
[redacted]

[redacted]
[redacted]
[redacted]
[redacted]
[redacted] [c-i-c end] The ACCC considered the reasonableness of PSTN FOAS/FTAS MOU and LCS MOU forecasts alongside observations from longer term trends and submissions from stakeholders and concluded that the forecasts were reasonable.

On the basis of its assessment of the information provided by Telstra and its own analysis, the ACCC considered that the forecasting methodology and assumptions used to determine its pre-NBN forecasts were reasonable.

To convert its pre-NBN demand forecasts to post-NBN forecasts, Telstra incorporated a 'Base Case' NBN scenario in the forecast model submitted in October 2014. This forecast model NBN scenario was based on the rollout schedule published by NBN Co in its December 2013 Strategic Review and assumptions regarding the rate of service migration to the NBN once an area became ready for service. To determine a forecast of the number of premises made ready for service each year Telstra applied a linear interpolation to the two rollout data points published by NBN Co—for December 2016 and December 2020. To estimate services migrated, Telstra assumed 55 per cent migrated after 12 months and 100 per cent after 24 months, on the basis of information available from those areas for which migration had commenced and consistent with the 18 month migration timeline.⁴¹⁹

The ACCC conducted an analysis on revised 'post-NBN' forecasts and compared these figures to forecasts provided in the November 2013 response to the BBM RKR information request.⁴²⁰ The ACCC made a number of key observations on Telstra's demand forecasts for declared services and how the forecasts were affected by the October 2014 revisions:

- [c-i-c start]
- [redacted]
[redacted]
[redacted]
[redacted]

 - [redacted]
[redacted]
[redacted]
[redacted]
[redacted]

⁴¹⁵ Telstra, Forecast Model Documentation, October 2014, p. 16.
⁴¹⁶ ACCC, March Draft Decision, March 2015, p. 119.
⁴¹⁷ *ibid.*
⁴¹⁸ Telstra, Forecast Model Documentation, October 2014, p.14.
⁴¹⁹ ACCC, March Draft Decision, p.113
⁴²⁰ *ibid.*, pp. 113-117

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] [c-i-c end]

The ACCC considered that the Strategic Review of December 2013 provided the best available information on the NBN rollout schedule at the time of the draft decision and that Telstra's methodology for forecasting the migration of services to the NBN was reasonable.⁴²² On the basis of this assessment, the ACCC's draft decision was that the post-NBN demand forecasts submitted by Telstra in October 2014 were reasonable and appropriate for the purpose of determining regulated charges for the fixed line services.

The ACCC notes that the forecast model submitted by Telstra in October 2014 was intended to allow the NBN assumptions that are used to generate post-NBN forecasts to be updated expeditiously when better information on the NBN rollout became available.⁴²³

8.3 Consultation on Wholesale ADSL

In July 2015, the ACCC requested information from stakeholders pertaining to the wholesale ADSL declared service. The ACCC requested this information to better understand how access seekers interacted with Telstra and made decisions when acquiring capacity from Telstra for the supply of the resale ADSL service. The ACCC also wanted to gain further understanding of the state of the market for broadband services in light of increased uptake of video streaming services, and how this may be impacting the demand for wholesale ADSL capacity.

8.4 Submissions

8.4.1 Telstra response to January 2015 information request

On 5 March 2015, Telstra provided the ACCC with a confidential response to a request for information from the ACCC dated 14 January 2015. Telstra's response provided material to alleviate concerns of a lack of transparency with the demand forecasting methodology. Telstra provided the underlying figures used to determine the pre-NBN forecasts for charts and other data provided to the ACCC in its October 2014 submission to the ACCC.⁴²⁴ This data focused on the methodology Telstra undertook to determine 'pre-NBN' demand forecasts, and included

⁴²¹ ACCC, March Draft Decision, March 2015, pp. 115-116

⁴²² *ibid.*, pp. 121-122

⁴²³ Telstra, Main Submission to Discussion Paper, October 2014, p. 52

⁴²⁴ Telstra, Response to Request for further information, 5 March 2015, Confidential Communication

figures for aggregate measures such as total fixed lines and total broadband lines, as well as percentage breakdowns for certain services.⁴²⁵

The data was provided from 2007-08 and improved the transparency in Telstra's methodology, allowing for comparisons to be made to data from other sources and to verify charts provided by Telstra in its October 2014 submission.⁴²⁶ This data and further information assisted the ACCC in its assessment of the methodology Telstra used to determine its pre-NBN forecasts for the declared fixed line services.

8.4.2 Submissions to draft decision

In submissions received to the draft decision, only Optus submitted concerns with some of the values and the methodology used to generate individual service demand forecast figures for input into the FLSM.

ULLS

Optus submitted that the forecast growth of the unbundled local loop service (ULLS) should be a non-linear growth trend.⁴²⁷ [c-i-c start] [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c end]

Optus also queried why, when band weighting is adopted, Telstra's forecast differed from the extrapolated historic trend.⁴³⁰ Optus was concerned that a higher proportion of ULLS SIOs in bands 3 and 4 would result in higher average cost for the ULLS service. [c-i-c start] [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c end]

FOAS/FTAS

Optus submitted on the fixed originating access service (FOAS) and fixed terminating access service (FTAS) that it was incorrect to assume Telstra's fixed core network would face a decline in traffic due to migration to NBN access lines.⁴³³ Optus submitted that NBN is an access only network and that the same voice switching and internet routers will be used for both legacy and next generation access lines while all call capabilities and internet content will be the responsibility of the RSPs.⁴³⁴ Optus considered that a major flaw in the forecast is that it assumed only Telstra's PSTN customers will make and receive phone calls (and that Telstra retail NBN customers will not make or receive phone calls). Optus submitted that the total fixed

⁴²⁵ *ibid.*

⁴²⁶ *ibid.*

⁴²⁷ Optus, Submission in response to ACCC draft decision, public version, May 2015, p. 27

⁴²⁸ Optus, Submission in response to ACCC draft decision, Confidential version, May 2015, p. 29

⁴²⁹ *ibid.*, p. 29

⁴³⁰ Optus, Submission in response to ACCC draft decision, public version, May 2015, p. 27

⁴³¹ Optus, Submission in response to ACCC draft decision, Confidential version, May 2015, p. 30.

⁴³² *ibid.*, p. 31

⁴³³ Optus, Submission in response to ACCC draft decision, public version, May 2015, p. 28

⁴³⁴ *ibid.*

calling base for core services should include both Telstra retail and wholesale PSTN and NBN SIOs.

Optus noted that the forecast usage (in minutes) in the FLSM (for retail PSTN calls, FOAS/FTAS calls and LCS calls) used assumptions applied from Telstra Retail and WLR SIOs. It also stated it was not clear how the estimated PSTN-only FOAS/FTAS cost applied to all of FOAS/FTAS calls originating and terminating on NBN access lines or HFC networks.⁴³⁵

Optus also queried why the demand forecast for FOAS/FTAS SIOs only used PSTN SIOs as the relevant base despite FLSM asset classes including assets that are used to provide next generation calling services to customers on NBN access lines.⁴³⁶ [c-i-c start]

[c-i-c end]

Wholesale ADSL

Optus submitted extensively on wholesale ADSL in response to the ACCC's draft decision. Optus stated that 'the forecast for wholesale ADSL SIOs did not include customers of wholesale-backhaul for Telstra's NBN wholesale product'.⁴³⁸ Optus considered it would be more appropriate to include NBN migration impacts in respect of wholesale ADSL end-users as the service would cease once customers migrate onto the NBN network.⁴³⁹

Optus submitted that 'backhaul products' used for wholesale ADSL would also be used to 'backhaul NBN originated data traffic'.⁴⁴⁰ Optus stated that this would also be the case for some transmission equipment.⁴⁴¹ A similar argument was presented for shared assets to 'backhaul retail and wholesale ADSL traffic'.⁴⁴² As these products use the same shared assets, Optus recommended the demand for both wholesale and retail ADSL, and wholesale and retail NBN should be separately identified, and the costs of shared assets allocated across the services based on the combined forecasted peak throughput rather than being based on SIOs.⁴⁴³

Optus questioned the faster forecast growth for Telstra retail ADSL peak usage compared to the forecast growth for wholesale ADSL peak usage.⁴⁴⁴ Optus stated it isn't reasonable that factors should be different between wholesale ADSL users and Telstra retail users. It argued there is a market wide trend for high traffic demand growth and that the factors driving end-user demand for internet services affects retail and wholesale customers equally.

Optus submitted that the pricing of wholesale capacity is the 'only reason' why wholesale ADSL usage would not grow at the same pace as Telstra's retail usage, and that the wholesale ADSL demand forecasts represent the backhaul capacity wholesale providers are willing to purchase for their end-users, not necessarily end-user demand.⁴⁴⁵ Optus considered that, if VLAN pricing was cost reflective, it would reflect the growth of end-user demand seen with Telstra retail end-users.⁴⁴⁶

[c-i-c start]

⁴³⁵ *ibid.*

⁴³⁶ *ibid.*

⁴³⁷ Optus, Submission in response to ACCC draft decision, Confidential version, May 2015, p. 33

⁴³⁸ Optus, Submission in response to ACCC draft decision, public version, May 2015, p. 29.; Telstra, 2014, Final access determinations (FADS) inquiry – Confidential response to information request under the BBM RKR, February, p.48

⁴³⁹ Optus, Submission in response to ACCC draft decision, public version, May 2015, p. 30.

⁴⁴⁰ *ibid.*

⁴⁴¹ *ibid.*

⁴⁴² *ibid.*, p. 31.

⁴⁴³ *ibid.*

⁴⁴⁴ *ibid.*

⁴⁴⁵ *ibid.*

⁴⁴⁶ *ibid.*

8.4.3 Submissions to August 2015 consultation on Wholesale ADSL

In its response to the July 2015 information request for the wholesale ADSL declared service, Telstra raised concerns with the ACCC regarding the provision of data on the demand forecasts for wholesale ADSL peak usage as requested by the ACCC. Telstra did not consider it appropriate to provide information on one component of its forecasts in isolation from other inter-related components, including operating and capital expenditure.⁴⁴⁸ The ACCC agreed that Telstra did not have to provide revised demand forecasts as it was not the intention of the ACCC to use a new set of forecasts for the wholesale ADSL service for input into the FLSM.

Telstra also stated in its response that updating the inputs for the FLSM for FY2014, including demand forecasts, has taken 18 months and that it would be a complex, unrealistic task 'to consider the model could be re-based on a consistent basis to FY2015 in a matter of weeks'.⁴⁴⁹

In its submission to the consultation on the AGVC/VLAN charge (discussed in section 13.3.5), Telstra submitted on the impact the proposed uniform price changes would have on the level of demand across the fixed line services. In particular, the level of wholesale ADSL capacity demanded would be heavily influenced by a price change of the magnitude proposed for the AGVC/VLAN charge.⁴⁵⁰

In Optus' submission to the consultation, it raised concerns about the distortion of demand that would likely eventuate from the ACCC's proposal.⁴⁵¹ Foxtel submitted to the consultation that it considers that an adjustment mechanism should be included for AGVC/VLAN charges given changing rates of traffic growth and volumes of capacity demanded could lead to Telstra over-recovering on costs.⁴⁵²

8.5 ACCC final assessment and decision

The ACCC has assessed the demand forecasts having considered submissions received and having had regard to the LTIE and other matters in section 152BCA(1). The ACCC also had regard to the Fixed Principle provisions, which specify that demand forecasts should:

- be based on an appropriate forecasting methodology
- be based on reasonable assumptions about the key drivers of demand
- be determined using the best available information before the ACCC, including historical data that can identify trends in demand; and
- be determined taking into account current demand and economic conditions.⁴⁵³

In doing so the ACCC considered the approach used by Telstra's of first determining pre-NBN forecasts and then determining NBN migration to determine post-NBN forecasts. In this regard the ACCC notes that the rollout of the NBN and the migration of services off Telstra's legacy fixed line network present unique circumstances for this pricing decision, including in setting

⁴⁴⁷ ACCC staff meeting with Optus on Wholesale ADSL, May 2015.

⁴⁴⁸ Telstra, Response to request for information on Wholesale ADSL, July 2015.

⁴⁴⁹ *ibid.*

⁴⁵⁰ Telstra, Submission to Consultation on Wholesale ADSL, August 2015.

⁴⁵¹ Optus, Submission to consultation on uniform price change proposal, August 2015.

⁴⁵² Foxtel, Submission to consultation on uniform price change proposal, August 2015.

⁴⁵³ Fixed Principle Provisions, clause 6.11.

demand levels for the next regulatory period. The ACCC's final decision is that the approach proposed by Telstra to first determine pre-NBN demand forecasts and then adjust for the effect of service migration to the NBN to determine post-NBN demand forecasts is appropriate.

Assessment of approach against section 152BCA matters

The ACCC's final decision is that the demand forecasts in the forecast model are based on reasonable and verifiable assumptions and, on the basis of the updated rollout assumptions, make use of the best information available. Accordingly, the ACCC considers that its final decision on demand forecasts meets the objectives of promoting the LTIE.

The ACCC's final decision on demand forecasts allows for an efficient level and share of costs to be allocated to the declared services to facilitate access to the infrastructure services required by access seekers to provide a range of communications services to end-users, promote competition in the markets for carriage services and encourage the economically efficient use of, and the economically investment in, infrastructure.

The ACCC considers that the access provider's legitimate business interests are met through its final decision on demand forecast as the forecasts are inputs into the FLSM that contribute to the calculation of the overall revenue requirement for fixed line services, which enables Telstra to recover the cost of efficient costs of supplying the declared services, including the costs of efficient investments.

The ACCC also considers that the final decision on demand forecasts provides transparency and certainty for access seekers about the historic and forecast growth trends in declared fixed line services in the transition to the NBN. This is considered to be important for helping to promote continued competition in the markets and encourage the economically efficient investment in the infrastructure.

8.5.1 Pre-NBN forecasts

The ACCC's final decision is that the pre-NBN demand forecasts submitted by Telstra in October 2014 are based on an appropriate forecasting methodology and reasonable assumptions. The pre-NBN demand forecasts that the ACCC has accepted are provided in table 8.1 below.

Table 8.1: Pre-NBN demand forecasts as submitted by Telstra in October 2014

	Units	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019
Wholesale Line Rental	SIOs	[c-i-c start]					
PSTN FOTAS	MOUs						
LCS	MOUs						
Unconditioned Local Loop	SIOs						
Spectrum Sharing	SIOs						
ADSL Wholesale	SIOs						
ADSL Retail	SIOs						
Wholesale Peak Usage	Mbps						[c-i-c end]

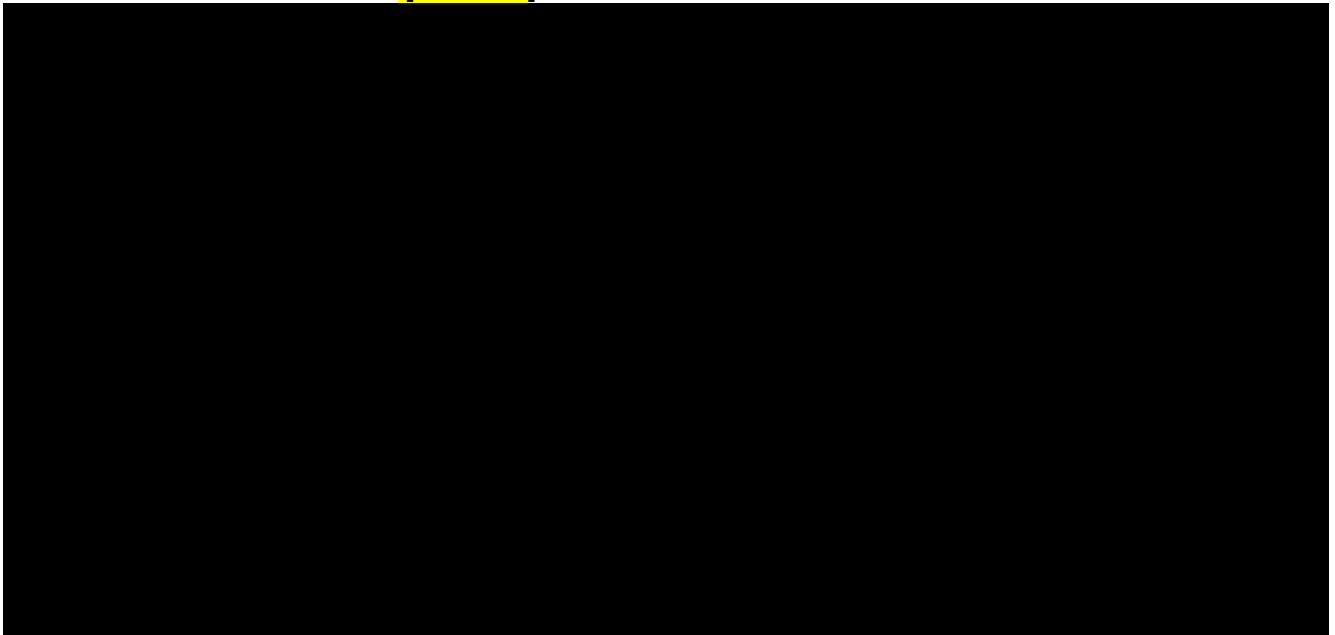
The ACCC is satisfied with the level of transparency in Telstra’s forecasting methodology. The ACCC considers the forecasts reasonable and appropriate to be inputted into the forecast model Telstra provided the ACCC (in October 2014) to generate post-NBN forecasts.

The ACCC addresses concerns raised regarding the pre-NBN demand forecasts in the following discussion.

ULLS

The ACCC is satisfied with Telstra’s revised pre-NBN ULLS forecasts submitted in October 2014 in terms of appropriateness of the methodology and the reasonableness of the assumptions used. The ACCC considers that, at this time of transition within the sector, Telstra’s forecasts for ULLS SIOs are reasonable.

Figure 8.1 ULLS SIOs actual data from 2007–2008 to 2013-14 and forecasts from 2014-15 to 2018-19. [c-i-c start]



[c-i-c end]

Source: Telstra forecast model, October 2014

The ACCC notes the submission from Optus that the band allocation observed in Telstra’s geographic profile deviates from the trend observable in historic data. The ACCC notes that the geographic profile of ULLS SIOs has a negligible impact on the final charge calculated for the service. From a cost perspective, the band allocation within Bands 1-3 and Band 4 does not impact on the calculation of unit costs. This is because unit costs determined for ULLS are based on the total amount of SIOs across all bands. The potential difference seen in Band 4 SIOs following a linear trend as Optus submits is a potential re-allocation of approximately [c-i-c] [redacted] [c-i-c] of total ULLS SIOs away from band 4 to Band 1-3 [c-i-c] [redacted] [c-i-c] and has no impact on the total number of SIOs.⁴⁵⁴

In light of these considerations, the ACCC’s final decision is that the demand forecasts for the ULLS are based on reasonable assumptions and are accepted for inclusion in the FLSM.

⁴⁵⁴ Figure derived from data in Telstra’s forecast model

FOAS/FTAS

The ACCC notes Optus' submission on the decline in FOAS/FTAS traffic due to NBN migration forecast by Telstra. The ACCC also notes this issue was addressed by Analysys Mason in its report on Telstra's cost allocation framework. The ACCC agrees with Analysys Mason's proposal that a proportion of these costs be allocated to the NBN or alternatively, that a pre-NBN forecast of traffic be used to unitise these costs.⁴⁵⁵ In the application of the loss of economies of scale adjustment to these asset classes, the ACCC has effectively implemented the first of Analysys Mason's proposals, as this adjusts for the excess costs of the assets due to reduced utilisation. It was therefore not necessary to alter Telstra's traffic forecasts to pre-NBN levels as well.

A discussion on cost allocation issues such as this one can be found in chapter 11.

Wholesale ADSL

[c-i-c start] [REDACTED]

[REDACTED]

[c-i-c end] The ACCC also considered recent developments in the market for broadband services and, in particular the increasing consumption of video streaming services. These concerns and developments contributed to the ACCC consulting on an alternative approach to pricing AGVC/VLAN capacity which was rejected by Optus and other access seekers.

The ACCC considers that the recent developments in broadband markets due to video-streaming services do indicate that there is a risk that the demand forecasts for AGVC/VLAN that the ACCC is accepting will be underestimated. However, the ACCC has decided not to make adjustments to the forecasts for the purposes of setting regulated charges.

The ACCC's reasons for this are twofold. First, the market developments are very recent and the information would not be a reliable basis on which to form forecasts for the regulatory period. Second, expenditure and demand forecasts are interdependent and an update of the AGVC/VLAN forecast could not be undertaken in isolation. It would take considerable time for Telstra to prepare and resubmit forecasts and for the ACCC to consult on the revised forecasts. The ACCC considers that such a delay to completing its inquiry is not warranted.

Concerns regarding the allocation of costs pertaining to the wholesale ADSL service are addressed and discussed in chapters 11 and 13.

⁴⁵⁵ Analysys Mason, *Assessment and verification of inputs into Telstra's Cost Allocation Framework, Final Report*, June 2015, p. 51.

⁴⁵⁶ ACCC staff meeting with Optus on Wholesale ADSL, May 2015.

⁴⁵⁷ Telstra email correspondence, 8 September 2015,

⁴⁵⁸ Optus, *Submission in response to ACCC draft decision*, Confidential version, May 2015, p. 35.

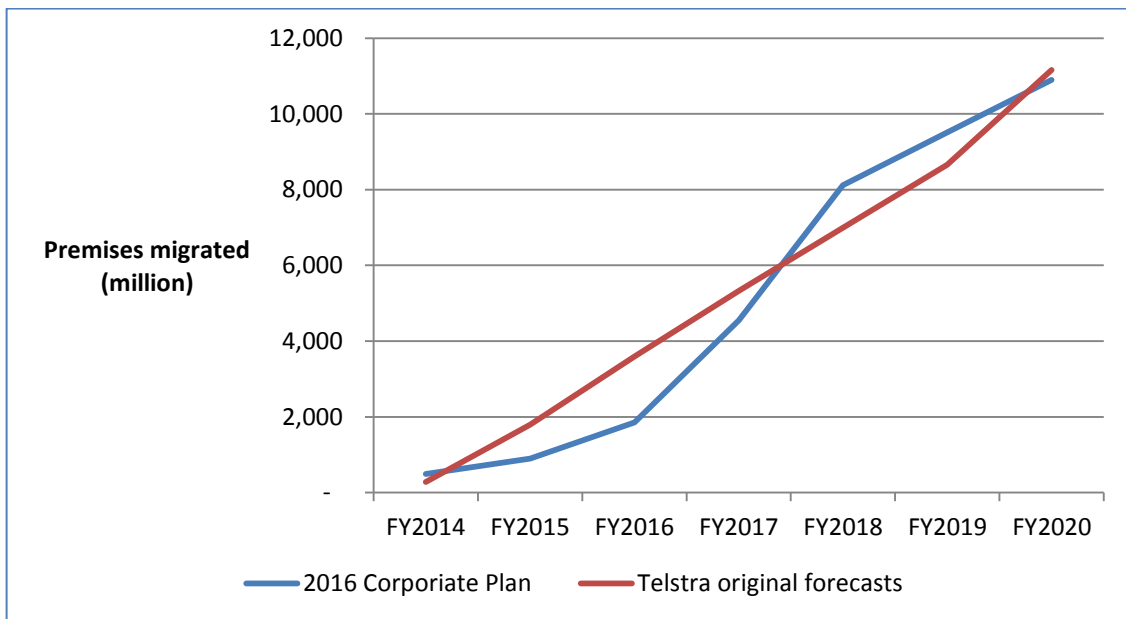
8.5.2 Post-NBN forecasts: updated NBN assumptions

In August 2015, NBN Co released its 2016 Corporate Plan. The corporate plan contains updated information on the NBN rollout plan and schedule. NBN Co has also provided its view on the rate of service activation in its updated NBN forecast.

The ACCC notes that NBN Co's updated rollout is materially different from that published for the MTM Scenario (Scenario 6) in its December 2013 Strategic Review on which Telstra based its demand forecasts (as can be seen in the figure 8.2 below). The latest forecasts show the premises made ready for service are now forecast to be less up to 2016-17 but that a forecast faster pace of rollout from 2015-16 on means that the rollout is still forecast to be completed by 2020.

The ACCC considers that this change to the NBN plan and rollout is material and that it is the best and most up-to-date information available to it to determine the regulated charges for the fixed line services. Further, the ACCC notes that Telstra's demand forecasts depend critically on its forecasts of services migrated from its network to the NBN. Therefore, the ACCC has decided to update Telstra's forecast model submitted to the inquiry with the latest information on the NBN.

Figure 8.2 Comparison of Telstra's original rollout assumptions and the 2016 Corporate Plan rollout forecast.



The ACCC has done this by updating the inputs to Telstra's forecast model for NBN Co's latest information on premises forecast to be ready for service in each year of the forecast period. Also, the ACCC is using NBN Co's forecasts of service activations in each year in place of the Telstra forecasts for service migrations each year. The ACCC notes that this update to the NBN data inputted to Telstra's forecast model does not affect the methodology and assumptions used by Telstra to determine its pre-NBN forecasts.

The ACCC final decision on demand forecasts is set out in table 8.2 below. For comparison, the demand forecasts submitted by Telstra based on the December 2013 rollout plan and schedule are set out in table 8.3.

Table 8.2: Final decision demand forecasts 2016 NBN corporate plan

	Units	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019
Wholesale Line Rental	SIOs	[c-i-c] ██████████	██████████	██████████	██████████	██████████	██████████
PSTN FOTAS	MOUs	██████████	██████████	██████████	██████████	██████████	██████████
LCS	MOUs	██████████	██████████	██████████	██████████	██████████	██████████
Unconditioned Local Loop	SIOs	██████████	██████████	██████████	██████████	██████████	██████████
Spectrum Sharing	SIOs	██████████	██████████	██████████	██████████	██████████	██████████
ADSL Wholesale	SIOs	██████████	██████████	██████████	██████████	██████████	██████████
ADSL Retail	SIOs	██████████	██████████	██████████	██████████	██████████	██████████
Wholesale Peak Usage	Mbps	██████████	██████████	██████████	██████████	██████████	██████████ [c-i-c]

Table 8.3: Demand forecasts submitted by Telstra based on 2013 NBN strategic review

	Units	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019
Wholesale Line Rental	SIOs	[c-i-c] ██████████	██████████	██████████	██████████	██████████	██████████
PSTN FOTAS	MOUs	██████████	██████████	██████████	██████████	██████████	██████████
LCS	MOUs	██████████	██████████	██████████	██████████	██████████	██████████
Unconditioned Local Loop	SIOs	██████████	██████████	██████████	██████████	██████████	██████████
Spectrum Sharing	SIOs	██████████	██████████	██████████	██████████	██████████	██████████
ADSL Wholesale	SIOs	██████████	██████████	██████████	██████████	██████████	██████████
ADSL Retail	SIOs	██████████	██████████	██████████	██████████	██████████	██████████
Wholesale Peak Usage	Mbps	██████████	██████████	██████████	██████████	██████████	██████████ [c-i-c]

9 Other pricing issues

Key Points

- This chapter sets out the ACCC's final decisions on three modelling inputs that are not discussed elsewhere in the report and that have implications for the pricing of the fixed line services. These are: cash flow timing assumptions; the approach to indexation in the FLSM; and asset lives.
- The ACCC considers that assumptions relating to the timing of cash flows in the FLSM should be considered with other cash flow timing assumptions in determining whether they are appropriate. The ACCC considers that the inconsistent assumptions in the FLSM relating to the timing of capital expenditure and revenue may result in over-compensation. The ACCC's final decision is to achieve consistency with respect to cash flow timing assumptions by removing the half-WACC adjustment to capital expenditure.
- The ACCC's final decision is to align the indices used to convert FLSM inputs and outputs between real and nominal terms, and to use the CPI as the measure of inflation for all conversions. The ACCC's final decision on the forecast level of inflation as measured by the CPI is 2.5 per cent.
- The ACCC's final decision is that, based on the information provided by Telstra in response to the draft decision, only a limited departure from the asset lives established in the previous FADs is justified.

9.1 Introduction

This chapter sets out the ACCC's final decision on three modelling input issues that are not discussed elsewhere in the report and that have implications for the pricing of the fixed line services. The first of these issues relates the assumptions made about the timing of cash flows that are reflected in the FLSM. The second relates to the inflation index used to convert FLSM inputs and outputs between real and nominal terms. Finally, the third issue concerns the asset lives for new capital expenditure added to the RAB.

9.2 Draft decision

This section summarises the ACCC's draft decision on the three other pricing issues.

Timing of cash flows

The ACCC's draft decision was to remove the half-WACC adjustment to capital expenditure in the FLSM. This was to align the assumptions made about the timing of cash flows and remove any bias or over-compensation that may result from any inconsistency. This was also to maintain consistency with the approach taken by the ACCC for the NBN Co SAU.⁴⁵⁹

Indexing

The ACCC's draft decision was to align the price indices used to convert inputs and outputs to real and nominal terms in the FLSM, and to use the CPI as the measure of inflation for all

⁴⁵⁹ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms – Draft Decision*, March 2015, p. 126.

conversions. The ACCC considered that the benefits of aligning the method of conversion outweighed any benefit that may exist in using specific equipment and labour indices. The ACCC proposed that it would calculate the index used to convert inputs and outputs to real and nominal terms (respectively) using actual CPI for years where it is available (as published by the ABS) and the ACCC's forecast of CPI for subsequent years.⁴⁶⁰

The ACCC's forecast of CPI for the draft decision was calculated by taking the 10-year geometric average of: the RBA's forecasts of CPI for the years available; and the mid-point of the RBA's target band (that is, 2.5 per cent) for subsequent years. This produced a forecast CPI of 2.4 per cent.

Asset lives

The ACCC's draft decision was that, based on the information provided by Telstra for its BBM RKR response, a departure from the asset lives established in the 2011 and 2013 FADs was not justified or appropriate.⁴⁶¹ The ACCC noted that if these asset lives were used in place of the total asset lives in the FLSM, it would have had the effect of accelerating the depreciation schedule for most asset classes and materially increasing the regulated revenue requirement and, in turn, prices for the declared services (all else being equal). The ACCC made one exception to this, which was to accept a shortening of the asset lives for copper cables due to the impact of the NBN roll-out on the basis that it would maintain Telstra's incentives for efficient investment in these assets.⁴⁶²

9.3 Submissions

This section summarises the submissions received in response to the draft decision on the three other pricing issues.

Timing of cash flows

None of the submissions to the draft decision commented further on this issue.

Indexing

Telstra did not comment on the ACCC's decision to use a single inflation index, but was concerned that the ACCC had applied inflation values and indices inconsistently through the FLSM. It noted that in some cases the static value for inflation used in the WACC calculation is referenced in a formula, while in other places the cumulative inflation index table is referred to, and on occasion the static value for inflation used in the WACC calculation for the previous period is used.⁴⁶³

Frontier Economics on behalf of the CCC, iiNet and Optus submitted that after further consideration it had determined that the CPI should not be used to deflate input costs incurred by businesses. It claimed the reasons for the ACCC to support the use of the CPI over a producer price index (PPI) did not withstand scrutiny and note that the use of the CPI to deflate Telstra costs produces higher access prices than if a PPI for communications equipment was used.⁴⁶⁴

⁴⁶⁰ *ibid.*, pp. 126-127.

⁴⁶¹ *ibid.*, p. 127.

⁴⁶² *ibid.*, p. 128.

⁴⁶³ Telstra, *Public inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision*, May 2015, p. 185.

⁴⁶⁴ Frontier Economics, *Submission on the ACCC's draft decision on fixed line prices, A Report Prepared For the Competitive Carriers Coalition, iiNet and Optus*, May 2015, pp. 37-39.

Optus argued that the application of indexing should be revisited, at a minimum to ensure consistency. It noted the application of the 2.4 per cent CPI by the ACCC for the draft decision lead to Telstra's real opex being larger.⁴⁶⁵

Asset lives

Telstra submitted that, except for copper cables (for which Telstra agrees the life should be 7.5 years in 2014-15), the asset lives proposed in the draft decision for new capital expenditure for the FLSM asset classes did not reflect the best and most up-to-date information available, and were inaccurate in material respects. It claimed that the asset lives proposed by Telstra reflect the economic lives of the fixed-line assets and were the product of detailed and thorough service life review process undertaken by Telstra in the ordinary course of business and provided detailed information to outline this process and to explain and support its proposed asset lives.⁴⁶⁶

Telstra submitted that by contrast, the asset lives applied in the 2011 FAD were based on a theoretical international benchmarking exercise undertaken 5-6 years ago and in some cases the asset lives used in the Analysys model also related to a different set of assets to the FLSM asset classes, leading to substantially different (and in almost all cases, longer) lives.⁴⁶⁷

Frontier Economics submitted that it was not justifiable for the ACCC to accept Telstra's proposals for shorter asset lives. It argued that there was no per se reason why the asset lives for regulatory purposes should match the asset lives determined by a regulated monopoly for its own commercial purposes.⁴⁶⁸

Frontier also argued that it was not appropriate for the ACCC to accept a shorter asset life for copper cables as proposed in the draft decision. This was on the basis that not all of the copper cables (and notably distribution cables) were likely to be stranded by the NBN under the multi-technology-model and that the NBN commercial agreements should compensate Telstra for the residual value of the copper at the time the NBN roll-out is completed.⁴⁶⁹

9.4 Final decision

This section sets out the ACCC's final decision on the three other pricing issues.

Timing of cash flows

Having had regard to the LTIE and the other matters in section 152BCA(1) of the CCA, the ACCC's final decision is to remove the half-WACC adjustment to capital expenditure in the FLSM.

As noted in the March 2015 draft decision, the half-WACC adjustment is intended to reflect the assumption that capital expenditure is incurred evenly throughout the year—half way through the year on average. To compensate the access provider for the period of time between when capital expenditure is assumed to be incurred (mid-year on average) and when a return on capital is provided (at the beginning of the following year), capital expenditure is uplifted by half of the WACC as it is rolled into the RAB.⁴⁷⁰

However, the FLSM also assumes that the return on and of capital occurs at the end of each year. This assumption is reflected in the calculation of the annual revenue requirement, which

⁴⁶⁵ Optus, *Submission in response to ACCC Draft Decision, Public Inquiry into final access determinations for fixed line services – primary price terms*, April 2015, pp. 82-83.

⁴⁶⁶ Telstra, *Response to Draft Decision*, May 2015, p. 163.

⁴⁶⁷ *ibid.*, pp. 163-173.

⁴⁶⁸ Frontier Economics, *Submission on the ACCC's draft decision on fixed line prices*, May 2015, p. 31

⁴⁶⁹ *ibid.*, pp. 31-33.

⁴⁷⁰ ACCC, *Draft Decision*, March 2015, p. 75.

is based on the opening value of the RAB and regulatory depreciation in a given year. This assumption does not reflect the actual timing of cash flows, since revenues are actually received throughout the year. The ACCC maintains the view that, given the reality of cash flow timing, the end-of-year assumptions regarding capital-related revenues may result in a higher revenue requirement than would be the case if the timing of revenue inflows were estimated more precisely.

The ACCC considers that, while the mid-year capital expenditure assumption in the FLSM may appear reasonable in isolation, its inconsistency with the end-of-year assumptions made about the receipt of revenue creates the potential for over-compensation. The ACCC's final decision is to correct this inconsistency by removing the half-WACC adjustment to capital expenditure. The ACCC considers that this is a simple and transparent means of aligning the assumptions made about the timing of cash flows, and removing any potential for bias or over-compensation that may result from an inconsistent approach. This will ensure that access prices allow Telstra to recover the efficient costs of providing access to the declared services. This will, in turn, promote the LTIE as it will encourage the economically efficient use of, and the economically efficient investment in infrastructure, and will promote competition in markets for listed services. In addition, ensuring that access prices allow for the recovery of efficient costs of supplying the declared fixed line services promotes the interests of both Telstra and access seekers, and allows Telstra an opportunity to recover the direct overall costs of the supply of these services.

Indexing

Having had regard to the LTIE and the other matters in section 152BCA(1) of the CCA, the ACCC's final decision is to align the price indices used to convert FLSM inputs and outputs between real and nominal terms, and to use the CPI as the measure of inflation for all conversions.

The ACCC has considered Frontier's submission on the ACCC's reasons for its draft decision on indexation in the FLSM. The ACCC maintains its view that aligning the indices used in the FLSM, and using CPI as the measure of inflation, is appropriate. As noted in the draft decision, this would result in a relatively more stable and predictable inflation index than if specific equipment and labour indices were used; would be consistent with common regulatory practice; and would be transparent.

Further, the ACCC considers that this approach would remove any potential bias that might arise from using different measures of inflation to convert values between real and nominal terms. The FLSM is a real model which operates in 2009 dollars; therefore it is necessary to convert any nominal dollar inputs to 2009 terms. Prices are calculated in real terms and then converted to nominal terms for the purposes of the FADs. Various price indices are used in the determination of expenditure forecasts (these indices are discussed in chapters 4 and 5). However, the ACCC considers that there is no per se reason why the indices used for the purpose of converting between overall real and nominal values within the FLSM should differ.

In addition, since the FLSM is a real model it requires the calculation of a real value of the WACC in determining revenue requirements. The real WACC in the FLSM is determined, in accordance with common regulatory practice, on the basis of a forecast of the CPI. The ACCC's approach to indexation in the FLSM is consistent with this practice.

The ACCC has calculated the index used to convert FLSM inputs and outputs to real and nominal terms (respectively) using actual headline CPI for years where available (as published by the ABS) and the ACCC's forecast of CPI for subsequent years. As discussed in chapter 6, the ACCC's forecast of CPI is calculated by taking the 10-year geometric average of: the RBA's forecasts of CPI for the years available; and the mid-point of the RBA's target band (that is, 2.5 per cent) for subsequent years. The ACCC's forecast of CPI for the purposes of this final decision is 2.5 per cent.

The ACCC considers that its approach to indexation will promote internal consistency within the FLSM and will remove any potential bias that might arise from using different indices for real-

nominal conversions. This will ensure that access prices allow Telstra to recover the efficient costs of providing access to the declared services. This will, in turn, promote the LTIE as it will encourage the economically efficient use of, and the economically efficient investment in infrastructure, and will promote competition in markets for listed services. In addition, ensuring that access prices allow for the recovery of efficient costs of supplying the fixed line services promotes the interests of both Telstra and access seekers, and allows Telstra an opportunity to recover the direct costs of supply.

Asset lives

Having had regard to the LTIE and the matters in section 152BCA(1) of the CCA, the ACCC's final decision is to maintain current FLSM asset lives except where Telstra has provided adequate information which suggests that a departure from these asset lives is appropriate. The ACCC does not accept truncated (or 'end-dated') asset lives to reflect the NBN rollout for the purposes of rolling forward the RAB.

Asset lives are used in the FLSM to determine a depreciation schedule for each asset class and facilitate the rolling forward of the RAB. During the 2011 FAD inquiry, Telstra advised the ACCC that it was unable to provide reliable information for the determination of asset lives. Consequently, the ACCC estimated asset lives for CAN and core assets based on the asset lives used in Telstra's TEA (Telstra Efficient Access) model and the Analysys cost model, respectively. The ACCC revised some of these asset lives after Telstra provided further information.⁴⁷¹ This approach was also adopted for the 2013 wholesale ADSL FAD.⁴⁷² In the FLSM, the initial RAB—that is, the depreciated value of the FLSM asset classes as at 30 June 2009—is rolled forward using the remaining lives of the assets in place at that time, while the RAB for capital expenditure in 2009-10 onwards is rolled forward separately using total asset lives for new assets.

In the March draft decision, the ACCC considered that, based on the information provided by Telstra in its BBM RKR explanatory statement, a departure from the asset lives established in the 2011 and 2013 FADs was not justified or appropriate.⁴⁷³ However, the ACCC noted that it would accord with regulatory best practice to review FLSM asset lives if better and more up-to-date information were to become available.⁴⁷⁴ The draft decision made an exception for copper cables on the basis of encouraging incentives for efficient investment in copper cable assets.⁴⁷⁵

Telstra provided further information on its proposed asset lives in its submission to the draft decision. In particular, Telstra provided the service lives of asset categories in its internal systems and how these asset lives are used to determine weighted average asset lives for the FLSM asset classes.⁴⁷⁶ Telstra also provided a copy of an annual service life review process document prepared for Telstra by Ernst and Young. Further, Telstra provided its views in relation to the ACCC's use of the Analysys model in determining FLSM asset lives for the 2011 FADs.⁴⁷⁷

As noted above, in the March draft decision the ACCC stated that it would accord with regulatory best practice to review asset lives if better and more up-to-date information were to become available. However, for any change to be considered appropriate, the ACCC must be satisfied of the justification for any proposed amendments. The ACCC has taken the approach that unless satisfactory justification for a proposed amendment is provided, current FLSM asset lives are to be maintained.

⁴⁷¹ ACCC, *Public inquiry to make final access determinations for the declared fixed line services – Discussion paper*, April 2011, p. 59.

⁴⁷² ACCC, *Public inquiry to make a final access determination for the Wholesale ADSL service – Final Report*, May 2013, p. 30.

⁴⁷³ ACCC, *Draft Decision*, March 2015, p. 127.

⁴⁷⁴ *ibid.*, p. 128.

⁴⁷⁵ *ibid.*, p. 128.

⁴⁷⁶ Telstra, *Response to Draft Decision*, May 2015, p. 270.

⁴⁷⁷ *ibid.*, p. 163.

With the exception of the switching equipment asset classes, Telstra has not provided an explanation for why its proposed asset lives, some of which are substantially lower than FLSM asset lives (and many of which are themselves based on past Telstra service life reviews), should be adopted. However, in the interest of regulatory best practice, the ACCC has analysed Telstra's proposed asset lives (and the service lives of the individual asset categories on which they are based) to determine what information may reasonably be used to revise FLSM asset lives. In undertaking this review, the ACCC has had regard to the asset lives proposed by Telstra in this FAD inquiry—including individual asset category lives and these assets' proportionate contribution to the depreciated value of FLSM asset classes—and other sources of information such as Telstra's TEA model and Telstra's submissions to the 2011 FAD inquiry.

ACCC review of FLSM asset lives

As discussed in chapter 10, the ACCC's final decision is that users of the fixed line network should not bear the costs associated with NBN-induced asset redundancy and under-utilisation. These costs include unrecovered depreciation as a result of the NBN rollout. Therefore, in order to maintain consistency with this aspect of the ACCC's decision, the NBN should not be a consideration in the determination of asset lives. It is evident that Telstra's asset lives reflect the NBN, as many are truncated (or 'end-dated'). Telstra has not specified which asset lives are directly impacted by NBN considerations beyond copper cables, nor has it explained why asset lives in general are now truncated. In any case, some asset lives proposed by Telstra—for assets which under earlier Telstra service life reviews determined a life of [cic] [redacted] [cic] or more—are significantly shorter. For example, Telstra has proposed an asset life of [cic] [redacted] [cic] or less for 'pair gain systems' and 'CAN radio equipment', meaning that any capital expenditure for these asset classes would effectively be expensed.

The ACCC considers that the best and most recent indication of Telstra's asset lives that do not reflect the NBN are those in Telstra's TEA model. As such, the ACCC has had regard to the asset lives in the TEA model as a 'check' when determining whether to accept Telstra's proposed asset lives. The most recent version of the TEA model available to the ACCC is from 2009. The model's documentation states that asset lives used in the model are provided by Telstra's accounting department and are based on studies of Telstra's actual asset lives.⁴⁷⁸ Further, the ACCC has had regard to Telstra's submission in the 2011 FAD inquiry, and in particular a report by RBB Economics which reviewed Telstra's approach to calculating asset lives under its 'asset service life review' and estimated Telstra's CAN and core asset lives, including adjustments to reflect the impact of the NBN.

For several CAN assets, Telstra has proposed asset lives that are truncated and/or are significantly lower than FLSM asset lives, which are themselves based on Telstra's TEA model. These asset classes include: CA01 Ducts and pipes, CA02 Copper cables, CA04 Pair gain systems, CA05 CAN radio bearer equipment, and CA07 Other communications plant and equipment. Telstra has not provided an explanation for why these asset classes are now truncated or why their levels are substantially lower than those determined by Telstra previously. In all cases, the current FLSM asset lives align with those in Telstra's TEA model. The ACCC has therefore retained current FLSM asset lives for these asset classes.

Regarding copper cables, the ACCC's draft decision was to accept Telstra's proposed asset lives. However, given the ACCC's final decision in relation to the costs associated with NBN-induced asset redundancy and under-utilisation, truncating asset lives to reflect the rollout of the NBN would not be appropriate. The costs associated with the NBN-induced redundancy of copper cables include unrecovered depreciation, and in accordance with the ACCC's final decision, it would not be appropriate for users of the fixed line network to bear these costs.

For the remaining asset classes, the ACCC has either retained current FLSM asset lives (for other reasons), made adjustments to FLSM asset lives based on Telstra's submission, or accepted Telstra's proposed asset lives—either as proposed or with adjustments. The reason

⁴⁷⁸ Telstra, *Telstra's Efficient Access Model – User Guide*, March 2008, p. 88.

for these decisions, and the methodology used for any adjustments, is set out in the table below.

The ACCC considers that, where current FLSM asset lives are retained, they will continue to ensure that access prices allow Telstra to recover the efficient costs of providing access to the declared services. Where the ACCC has adjusted asset lives, this has been to ensure that they reflect better and more complete information, where relevant. This will, in turn, promote the LTIE as it will encourage the economically efficient use of, and the economically efficient investment in infrastructure, and will promote competition in markets for listed services. In addition, ensuring that access prices allow for the recovery of efficient costs of supplying the declared fixed line services promotes the interests of both Telstra and access seekers, and allows Telstra an opportunity to recover the overall direct costs of supply.

Table 9.1: Telstra proposed asset lives and ACCC final decision

Asset class	Current FLSM asset life	Telstra proposal (2014-15)	Revised FLSM asset life	ACCC final decision
CA01 Ducts and pipes	35.00	[cic] [redacted] [cic]	35.00	Retained FLSM asset life – see text above.
CA02 Copper cables	20.00	[cic] [redacted] [cic]	20.00	Retained FLSM asset life – see text above.
CA03 Other cables	20.00	[cic] [redacted] [cic]	20.00	Under Telstra’s proposal, software and fibre-related equipment are end-dated with no justification. Fibre cables have a constant service life of [cic] [redacted] [cic], which broadly aligns with the inter-exchange cable asset life in the FLSM (38 years). In 2011 Telstra proposed [cic] [redacted] [cic] for fibre cables (RBB report). According to Telstra’s asset register, around [cic] [redacted] [cic] of costs relate to fibre-related equipment, while costs associated with software contribute less than [cic] [redacted] [cic]. Therefore, the ACCC has retained the FLSM asset life of 20 years to reflect the expected shorter asset life for fibre-related equipment.
CA04 Pair gain systems	12.00	[cic] [redacted] [cic]	12.00	Retained FLSM asset life – see text above.
CA05 CAN radio bearer equipment	12.00	[cic] [redacted] [cic]	12.00	Retained FLSM asset life – see text above.
CA06 Other CAN assets	12.00	[cic] [redacted] [cic]	[cic] [redacted] [cic]	Based on information available to the ACCC in 2011, this asset class was made up of multiplexing assets and therefore the asset life for CA04 pair gain systems (12 years) was used. However, according to Telstra’s 2014 asset register [cic] [redacted] [cic] relate to customer premises NTUs. These assets

Asset class	Current FLSM asset life	Telstra proposal (2014-15)	Revised FLSM asset life	ACCC final decision
				are given a constant service life by Telstra of [cic] [cic]. The ACCC does not have past information on asset lives for this type of equipment, however given that IT assets in the TEA model have the same life, the ACCC considers that [cic] [cic] is reasonable and has revised the FLSM asset life accordingly.
CA07/CO07 Other communications plant and equipment	[cic] [cic]	[cic] [cic]	[cic] [cic]	Retained FLSM asset life – see text above.
CA08/CO08 Network land	10,000.00	10,000.00	10,000.00	Telstra has not proposed an asset life that differs from the current FLSM asset life.
CA09/CO09 Network buildings/support	[cic] [cic]	[cic] [cic]	[cic] [cic]	<p>Under Telstra’s proposal, most asset categories have constant service lives, while some are end-dated. However, given that the weighted average asset lives decrease at a rate much lower than 1 year per year, this suggests that the costs attributed to the end-dated assets are relatively small. The proposed FLSM asset life in FY2015 is [cic] [cic] years, whereas in the FLSM it is [cic] [cic] years.</p> <p>Despite this difference, the Telstra asset categories that make up this weighted average have asset lives that broadly align with comparable assets in Telstra’s TEA model. The difference between Telstra’s proposed FLSM asset life and the current FLSM asset life is therefore the result of the weightings, which are based on capex in FY2014.</p> <p>The ACCC has therefore accepted Telstra’s asset category lives, but has determined an overall FLSM life using the asset categories’ depreciated values from Telstra’s 2014 asset register as a weight rather than 2014 capex. This is</p>

Asset class	Current FLSM asset life	Telstra proposal (2014-15)	Revised FLSM asset life	ACCC final decision
				consistent with the method used in Telstra's cost allocation framework for determining intra-asset class proportionate costs (e.g. port and other switching assets and different types of transmission technology). Since no justification is provided for assets that are end-dated, the ACCC has held the FY2015 asset life constant. This gives a weighted average asset life of [cic] [redacted] [cic].
CA10/CO10 Indirect capital assets	10.00	[cic] [redacted] [cic]	[cic] [redacted] [cic]	<p>All asset categories under Telstra's proposal have constant service lives except for the IT asset which is end-dated. This IT asset class is the most substantial, and according to the 2014 asset register makes up around [cic] [redacted] [cic] of depreciated costs.</p> <p>The other assets' lives broadly align with the comparable indirect assets in Telstra's TEA model. The FY2015 asset life for the IT asset aligns with the TEA model asset life for IT assets, but then falls over time as a result of end-dating.</p> <p>Therefore the ACCC has held the FY2015 asset life for the IT asset constant and used depreciated values from Telstra's asset register to give a weighted average FLSM asset life of [cic] [redacted] [cic]. The current FLSM asset life for indirect assets is 10 years, and this reflects the indirect assets in the TEA model. However, according to Telstra's asset register the IT asset makes up [cic] [redacted] [cic] of the asset class' costs, and IT assets in the TEA model have an asset life of [cic] [redacted] [cic].</p>
CO01 Switching equipment (local)	27.00	[cic] [redacted] [cic]	9.00	<p>According to Telstra's asset register, [cic] [redacted] [cic] of depreciated costs relate to assets for which Telstra has proposed end-dated asset lives, with no justification. The ACCC has therefore not accepted these asset lives</p> <p>The current FLSM asset life for local switching equipment is based on the</p>

Asset class	Current FLSM asset life	Telstra proposal (2014-15)	Revised FLSM asset life	ACCC final decision
				<p>Analysys model. Telstra has indicated in its submission which assets in the Analysys switching equipment asset class are not present in the FLSM local switching asset class, and noted this as a reason why the FLSM asset life is not appropriate.</p> <p>Removing the assets not mapped by Telstra to the FLSM asset class from the Analysys model results in a weighted average asset life of approximately 9 years. This aligns with the TEA model for local switching assets. Therefore the ACCC has revised the FLSM asset life to 9 years.</p>
CO02 Switching equipment (trunk)	25.00	[cic] [cic]	[cic] [cic]	<p>According to Telstra's asset register, [cic] of depreciated costs relate to software assets for which Telstra has proposed a service life of [cic]. This broadly aligns with the TEA model asset life for software [cic]. Therefore the ACCC has revised the FLSM asset life to [cic].</p>
CO03 Switching equipment (other)	20.00	-	20.00	<p>Under Telstra's proposal, all assets are end-dated. However 2014 capex for this asset class was [cic], resulting in an asset life of [cic]. Telstra has forecast capex for other switching equipment over the forecast period, and as such an asset life is required. Since no justification is provided for the end-dating of these assets, the ACCC has retained the FLSM asset life of 20 years.</p>
CO04 Inter-exchange cables	38.00	[cic] [cic]	[cic] [cic]	<p>Under Telstra's proposal, all asset categories have a constant service life of [cic]. According to Telstra's asset register, [cic] relate to fibre optic cables. The ACCC has revised the FLSM asset life to [cic]—this is broadly in line with the TEA model and the Analysys model, both of which use [cic] for fibre.</p>

Asset class	Current FLSM asset life	Telstra proposal (2014-15)	Revised FLSM asset life	ACCC final decision
CO05 Transmission equipment	[cic] [redacted] [cic]	[cic] [redacted] [cic]	[cic] [redacted] [cic]	<p>According to Telstra’s asset register, [cic] [redacted] [cic] of depreciated costs relate to assets for which Telstra has proposed end-dated asset lives. These assets are PDH and SDH transmission equipment.</p> <p>The WDM asset has a constant service life of [cic] [redacted] [cic], which broadly aligns with the current FLSM asset life. Given the significant contribution of SDH to depreciated costs, the ACCC has used [cic] [redacted] [cic] to approximate an alternative to an end-dated life for this asset category. This is more conservative than the TEA model which has an SDH asset life of [cic] [redacted] [cic].</p> <p>Re-calculating Telstra’s proposed asset lives with these changes gives [cic] [redacted] [cic] for FY2015. When using Telstra’s asset register for weights rather than FY2014 capex, this gives [cic] [redacted] [cic]. This aligns with the current FLSM asset life of [cic] [redacted] [cic]. Therefore, the ACCC has retained FLSM asset life.</p>
CO06 Core radio bearer equipment	16.00	[cic] [redacted] [cic]	16.00	<p>Under Telstra’s proposal, assets are grouped into a single Telstra asset category. Given that the weighted average asset life falls by around [cic] [redacted] [cic] per year it appears that the majority of costs relate to assets which have constant service lives.</p> <p>However, the proposed asset life for FY2015 is [cic] [redacted] [cic], falling to [cic] [redacted] [cic] by FY2019. This is significantly different from the FLSM asset life of 16 years. Telstra has not explained why there is such a large difference; therefore the ACCC has retained the FLSM asset life of 16 years. This aligns with the TEA model asset life for radio transmission, and with the asset life proposed by Telstra in 2011 (RBB report).</p>

Asset class	Current FLSM asset life	Telstra proposal (2014-15)	Revised FLSM asset life	ACCC final decision
CO11 LSS equipment	-	-	-	LSS equipment does not have an asset life as all assets are fully depreciated.
CO12 Data equipment	6.00	[cic] [redacted] [cic]	6.00	<p>The [cic] [redacted] [cic] of costs relate to assets which, under Telstra's proposal, have constant service lives; however some assets are end-dated. The weighted average asset life falls by around [cic] [redacted] [cic] per year.</p> <p>The proposed asset life for FY2015 is [cic] [redacted] [cic], falling to [cic] [redacted] [cic] by FY2019. The asset life for FY2015 aligns with the FLSM asset life of 6 years. Therefore, the ACCC has retained the FLSM asset life of 6 years.</p>

10 Impacts of the National Broadband Network

Key Points

- The circumstances in which the ACCC makes this final decision are unique. The NBN is replacing Telstra's fixed line network as the infrastructure used to provide fixed line telecommunications services in Australia, with this transition facilitated by commercial arrangements between Telstra and NBN Co known as the Definitive Agreements (DAs).
- Under these arrangements, Telstra will migrate its customer base to the NBN and will sell and lease certain infrastructure to NBN Co, and will receive corresponding payments for doing so. Further, Telstra has undertaken to only provide fixed line services over the NBN where the NBN is deployed.
- NBN migration will cause a loss of economies of scale in the operation of Telstra's fixed line network until it is decommissioned. The costs associated with this loss of economies of scale are not caused by users of the fixed line network.
- Having had regard to the LTIE and the other matters in section 152BCA(1) of the CCA, the ACCC's final decision is to account for the Telstra-NBN arrangements using the regulatory values approach. As part of this approach, the ACCC has maintained its draft decision to treat assets sold to NBN Co as asset disposals and removed them from the RAB at their regulatory value. To the extent that, under its leasing arrangements with Telstra, NBN Co uses fixed line assets that are also used to provide declared services, this is accounted for in the cost allocation framework of the FLSM.
- Further, having had regard to the LTIE and the other matters in section 152BCA(1) of the CCA, the ACCC's final decision is that the costs associated with the loss of economies of scale that will occur as a result of NBN migration should not be reflected in regulated revenues or charges. The ACCC considers that such costs should not be borne by users of the fixed line network yet to be migrated to the NBN. These users have not caused these costs, and Telstra has been provided with an opportunity to ensure that it was compensated for such costs under the DAs. Further, Telstra is receiving ongoing replacement revenues which represent an avenue for the recovery of these costs.
- To give effect to this final decision in the FLSM, the ACCC has made the following adjustments: assets that are sold to NBN Co and made redundant by NBN migration are treated as asset disposals in the roll forward of the RAB; Telstra's approach to reflecting NBN Co's use of fixed line assets in its cost allocation framework is maintained (with the exception of the adjustments discussed in chapter 11); and adjustments are made to allocation factors for assets that are under-utilised as a result of NBN migration.
- The ACCC, in making this final decision, has applied the fixed principles having regard to the matters in subsection 152BCA(1) of the CCA, including Telstra's legitimate business interests and the overarching objective of the LTIE. The ACCC's allocation of costs ensures that those costs which Telstra had an opportunity to recover (and for which Telstra has been provided with an avenue of recovery) through the DAs are not allocated to remaining users of the fixed line network.

10.1 Introduction

The circumstances in which the ACCC makes this final decision are unique. The NBN will replace Telstra's fixed line network as the infrastructure used to provide fixed line telecommunications services in Australia. The transition from Telstra's fixed line network to the NBN is occurring under arrangements between Telstra and NBN Co to migrate customers to the NBN and for NBN Co to lease and acquire certain infrastructure from Telstra.

The current arrangements between Telstra and NBN Co are formalised in the Definitive Agreements (DAs). The DAs were first signed in June 2011 and reflected a predominantly fibre-to-the-premises (FTTP) network design for the NBN. In December 2014, Telstra and NBN Co signed revised DAs which reflect the Government's multi-technology NBN policy. These arrangements between Telstra and NBN Co provide for the following key elements:

- customers will be migrated from Telstra's fixed line network as the NBN is rolled out
- NBN Co will lease certain infrastructure from Telstra
- certain assets will be transferred from Telstra to NBN Co.

The DAs also provide for migration payments and infrastructure payments to be made by NBN Co to Telstra:

- NBN Co will pay Telstra a one-off migration payment for each end-user disconnected from its copper network when they are migrated to the NBN in areas covered by NBN's fixed line network.⁴⁷⁹
- NBN Co will pay Telstra ongoing infrastructure payments for the lease of certain infrastructure. NBN Co will lease ducts, rack space in exchange buildings, and dark fibre links from Telstra. NBN Co will also pay Telstra a one-off payment for each lead-in conduit that is transferred to NBN Co as customers are migrated to the NBN.

Further, under the DAs, Telstra must exclusively use the NBN to provide fixed line services to premises where the NBN fixed line network is deployed.

Facilitated by these arrangements, the transition to the NBN will have significant impacts on the way Telstra's fixed line assets are used and raise difficult questions for the ACCC's determination of prices for the declared fixed line services. In reaching its decision, the ACCC has had regard to the matters in section 152BCA(1) of the CCA that it must take into account when making an access determination. Accordingly, the ACCC has had regard to the LTIE, which is the overarching objective of the telecommunications access regime of Part XIC.⁴⁸⁰

This chapter sets out the ACCC's final decision on accounting for the impacts of the NBN in determining prices for the declared fixed line services.

10.2 Draft decision

The ACCC's March draft decision on accounting for the impact of the NBN is summarised in section 4.2 of the June 2015 further draft decision.

⁴⁷⁹ Formally the Per Subscriber Address Amount (PSAA).

⁴⁸⁰ CCA, section 152AB(1)

In the further draft decision, the ACCC considered that users of the fixed line network should not bear the costs associated with the loss of economies of scale that will occur as a result of NBN migration.⁴⁸¹ The reasons for this draft decision are summarised below.

The ACCC noted that, as services are disconnected from the fixed line network during NBN migration, certain fixed line assets will become redundant and certain assets will become progressively under-utilised and exhibit excess capacity.⁴⁸² The ACCC noted that, if the costs associated with NBN-induced asset redundancy and under-utilisation are reflected in regulated revenues, then the unit costs of services supplied using these assets would rise.⁴⁸³ The ACCC also noted that, under the Telstra-NBN arrangements, Telstra has undertaken to only provide fixed line services over the NBN where the NBN is deployed. The ACCC noted that remaining users of the fixed line network are not causing this redundancy and excess capacity and, as a result of the Telstra-NBN arrangements, will not use it.⁴⁸⁴

The ACCC noted the payments Telstra is receiving under the DAs for the migration of customers to the NBN. Telstra is receiving these payments specifically in respect of the disconnection of customers from its fixed line network. Given that Telstra has undertaken to only provide fixed line services over the NBN where the NBN is deployed, Telstra will be receiving a financial benefit in return for the permanent loss of wholesale and retail customers on its fixed line network.⁴⁸⁵

The ACCC noted Telstra's submission to the March draft decision in relation to Telstra's assessment of the sufficiency of the payments it receives. However, the ACCC considered that such arguments were not relevant to its draft decision and reiterated that, in accounting for the Telstra-NBN arrangements, it had not considered the quantum of the payments, but rather had regard to the NBN arrangements and to the regulatory value of relevant assets.⁴⁸⁶ The ACCC considered that Telstra was provided with an opportunity to ensure that it would receive consideration through the DAs for the impact of the NBN on its fixed line assets. Telstra was aware that NBN migration would cause asset redundancy and under-utilisation, and that unit costs would rise as a result. In addition, the ACCC considered that Telstra possessed significant bargaining power in negotiations with NBN Co and the government—notably, if Telstra had not cooperated in the NBN rollout, NBN Co would have been required to bypass the fixed line network and unnecessarily duplicate costly infrastructure.⁴⁸⁷

The ACCC discussed the implementation of its draft decision for the purposes of the FLSM. In particular, the ACCC noted that it had made two types of adjustment:

- A proportion of the regulatory value of assets made redundant by NBN migration would be treated as an asset disposal in the roll-forward of the RAB. This proportion would be based on the forecast rate of the NBN rollout.
- For assets that become progressively under-utilised as a result of NBN migration, adjustments would be made to cost allocation factors to ensure that the increased unit costs associated with this under-utilisation are not allocated to fixed line services.⁴⁸⁸

The ACCC noted that the adjustments to allocation factors were made using an 'incremental costing' approach, whereby the cost of spare capacity within an asset is measured as the

⁴⁸¹ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms – Further draft decision*, June 2015, p. 71.

⁴⁸² *ibid.*, p. 72.

⁴⁸³ *ibid.*

⁴⁸⁴ *ibid.*, p. 71.

⁴⁸⁵ *ibid.*, p. 72.

⁴⁸⁶ *ibid.*, pp. 72-73.

⁴⁸⁷ *ibid.*, p. 73.

⁴⁸⁸ *ibid.*, p. 71.

difference between the total cost of the assets with spare capacity and the cost of the assets if there were no spare capacity.⁴⁸⁹

Finally, the ACCC discussed its views on the implementation of its further draft decision.⁴⁹⁰

10.3 Submissions

Submissions on the issue of accounting for the impacts of the NBN were received from Telstra, the Department of Communications (the Department), Optus, iiNet, Macquarie Telecom (Macquarie), TPG, NBN Co and the CCC.

Telstra submitted that the ACCC's NBN-related adjustments will lead to under-recovery of costs and will not be in the LTIE—if Telstra is deprived of a reasonable opportunity to recover efficient costs, this will not promote competition or efficient investment.⁴⁹¹ Telstra submitted that the adjustments breach the fixed principles, which were adopted to provide the industry with certainty about how the ACCC would implement the BBM.⁴⁹² Telstra submitted that the adjustments base prices on hypothetical (that is, without-NBN) costs, which contradicts the intent of the BBM.⁴⁹³ Telstra submitted that the ACCC's approach is arbitrary and does not provide a reasoned basis for why a change in unit costs caused by NBN migration should be treated separately from other causes under the fixed principles.⁴⁹⁴

Telstra submitted that under a BBM, where an exogenous event occurs which alters demand (and therefore unit costs), there is no scope to ignore this on the basis of its cause. In any event, Telstra submits that the cause of declining demand was a government policy. Telstra submitted that while the decline in demand was not caused by access seekers, this does not provide a basis for ignoring it in the determination of access prices.⁴⁹⁵

Telstra submitted that the question of any opportunity to recover costs associated with NBN-induced loss of economies of scale is irrelevant. The question is whether Telstra has in fact recovered these costs. In any event, Telstra submitted that it did not have such an opportunity, and was not able to achieve an outcome that fully compensated it for all the impacts of the NBN rollout.⁴⁹⁶

Telstra submitted that the ACCC's NBN adjustments are not necessary to avoid 'absurd' price levels for some customers. If, at the time of the next FAD, forecasts of costs and demand suggest significant price increases, the ACCC is able to address this with mechanisms within the regulatory framework, such as accelerating depreciation.⁴⁹⁷

Telstra submitted that even if the ACCC's adjustments were allowed under the fixed principles, their implementation in the FLSM does not reflect reasonable outcomes that may occur under a credible 'counterfactual'. Telstra submitted that, while the ACCC has made adjustments based on a 'no-NBN counterfactual', they should be based on a 'no deal counterfactual' where: there

⁴⁸⁹ Analysys Mason, *Assessment and verification of inputs into Telstra's Cost Allocation Framework*, June 2015, p. 17.

⁴⁹⁰ ACCC, *Further draft decision*, June 2015, pp. 74-76.

⁴⁹¹ Telstra, *Response to ACCC further draft decision*, July 2015, p. 10.

⁴⁹² *ibid.*, p. 11.

⁴⁹³ *ibid.*, p. 13.

⁴⁹⁴ *ibid.*, p. 27.

⁴⁹⁵ *ibid.*, pp. 22-23.

⁴⁹⁶ *ibid.*, pp. 23-24.

⁴⁹⁷ *ibid.*, pp. 27-28.

is no agreement between Telstra and NBN Co; the NBN is rolled out without Telstra's cooperation; and Telstra competes with NBN Co.⁴⁹⁸

Telstra submitted that the ACCC's NBN-related adjustments are not consistent with the fixed principles because:

- The treatment of assets made redundant by NBN migration is not consistent with the RAB roll-forward fixed principle since Telstra will retain ownership of the assets and no transaction will take place.⁴⁹⁹
- The NBN-related adjustments to cost allocation factors are inconsistent with the fixed principle relating to demand forecasts, since the adjustments are calculated using hypothetical 'no-NBN' demand forecasts.⁵⁰⁰
- The adjustments to cost allocation factors are inconsistent with the cost allocation fixed principle, since a portion of the revenue requirement is removed and is not allocated to a current user or service.⁵⁰¹

In support of its views, Telstra provided a report by Mr Keith Lockey on asset disposals and a report by Mr Jeff Balchin on cost allocation adjustments.⁵⁰²

NBN Co submitted that, subject to maintaining consistency with the fixed principles, the ACCC should seek to deliver price stability in the transition to the NBN as this is likely to promote the LTIE. NBN Co submitted that the ACCC should not adjust for loss of economies of scale and asset redundancy, and that an alternative approach for dealing with this would be to 'levelise' prices during NBN migration. This would provide Telstra with an opportunity to recover its costs and provide end-users with stable pricing.⁵⁰³

NBN Co submitted that the ACCC's proposed approach appears inconsistent with Telstra having the opportunity for cost recovery, consistent with the fixed principles. NBN Co submitted that the ACCC has neither explicitly accepted nor rejected Telstra's submission that the DAs do not compensate Telstra for the costs associated with NBN-induced loss of economies of scale. In the absence of evidence to the contrary, Telstra's submission should be accepted. NBN Co further submitted that on the balance of probabilities the proposed price decrease is expected by NBN Co to lead to a slower rate of migration to the NBN within the 18 month disconnection window.⁵⁰⁴

The Department submitted that it was concerned the ACCC's NBN-related adjustments may prevent appropriate cost recovery by Telstra, which may mean that the decision will not be in the LTIE.⁵⁰⁵ The Department submitted that '[f]or the ACCC to say that the costs should have been recovered through the DA process indicates that the costs are not recovered'.⁵⁰⁶ The Department submitted that the adjustments would also be inconsistent with the fixed principles,

⁴⁹⁸ *ibid.*, p. 28.

⁴⁹⁹ *ibid.*, pp. 16-17.

⁵⁰⁰ *ibid.*, p. 18.

⁵⁰¹ *ibid.*, p. 18-21.

⁵⁰² KPMG, *Independent advice on the basis of accounting for disposals of assets in Telstra's regulatory asset base for fixed line services* (Lockey Report), July 2015; Incenta, *Comment on the ACCC further draft decision in relation to fixed line services* (Balchin Report), July 2015.

⁵⁰³ NBN Co letter to ACCC, 'Public inquiry into final access determinations for fixed line services—primary price terms—Further Draft Decision', July 2015.

⁵⁰⁴ *ibid.*

⁵⁰⁵ Department of Communications, *Final access determinations for fixed line services – primary price terms – Submission to ACCC Further Draft Decision*, July 2015, p. 3.

⁵⁰⁶ *ibid.*, p. 5.

which are meant to provide certainty in the transition to the NBN and were assumed to be fixed during the DA negotiations.⁵⁰⁷

The Department submitted that there will be a loss of economies of scale due to NBN migration, but access seekers are requiring fixed line assets to remain in service and are therefore causing the costs associated with them.⁵⁰⁸ Further, the Department submitted that the ACCC has not adequately considered the importance of price stability in the transition to the NBN, citing recent experience in New Zealand.⁵⁰⁹

The CCC submitted that Telstra's arguments that migration payments are not relevant are not logical. Telstra has argued that the payments compensate for loss of revenue, not for the costs still borne by Telstra; however, that foregone revenue would have been what was used to cover the ongoing costs. If the lost revenue is being compensated, it follows that the costs are being compensated for.⁵¹⁰

TPG submitted that it agrees with the adjustments in the FLSM to ensure that access seekers do not incur higher charges associated with Telstra's loss of economies of scale due to the NBN. TPG submitted that Telstra has been more than sufficiently compensated for this by its agreements with NBN Co for customer migration, and users of the fixed line network should not have to bear such costs.⁵¹¹

Macquarie submitted that it agrees with the ACCC's view, and the reasoning for its view, that the costs associated with NBN-induced loss of economies of scale should not be reflected in regulated revenues. The ACCC's decision is consistent with the fixed principles and the LTIE—it would not be in the LTIE to require users of existing fixed line services to pay higher prices to recover investment costs attributable to the NBN rollout. Telstra is already receiving payments (and had the opportunity to negotiate those payments) under the DAs which cover the costs which Telstra proposes should be borne by access seekers. Macquarie strongly supports the approach set out by the ACCC in relation to loss of economies of scale attributable to the NBN rollout.⁵¹²

Optus submitted that it welcomes the implementation of the October 2014 position statement. Optus submitted that the implementation of this position should not surprise any interested party, and indeed, failure to implement the position may give rise to procedural fairness issues.⁵¹³ The implementation of the position statement is reasonable and consistent with the legislative criteria and procedural fairness considerations.⁵¹⁴

iiNet submitted that the further draft decision has struck a reasonable balance between the competing arguments from Telstra and access seekers and this balance delivers an outcome that is consistent with the statutory criteria.⁵¹⁵ iiNet submitted that the ACCC has sought to provide certainty to industry as soon as possible (with the release of the October 2014 position statement) regarding its approach to NBN impacts on setting prices for the declared services.⁵¹⁶

⁵⁰⁷ *ibid.*, pp. 3-4.

⁵⁰⁸ *ibid.*, p. 4.

⁵⁰⁹ *ibid.*, pp. 5-6.

⁵¹⁰ CCC letter to ACCC, 'Response to the Second Draft FLS FAD', July 2015.

⁵¹¹ TPG Telecom, *Submission to ACCC Fixed line services Final Access Determination inquiry Further Draft Decision*, July 2015, p. 1.

⁵¹² Macquarie, *Public Inquiry into final access determinations for fixed line services – primary price terms, Further Draft Decision – Outstanding Issues*, July 2015, p. 3.

⁵¹³ Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues*, July 2015, p. 9.

⁵¹⁴ *ibid.*, p. 10.

⁵¹⁵ iiNet, *Public inquiry into final access determinations for fixed line services —primary price terms, Further Draft Decision – Outstanding Issues*, July 2015, p. 3.

⁵¹⁶ *ibid.*, p. 7.

iiNet submitted that the ACCC's approach to asset disposals is consistent with the fixed principles. iiNet submitted that the fixed principles only require that the allocation of costs between 'various' services be done on the basis of relative usage, and do not require that all costs be allocated to specific services. iiNet further submitted that the fixed principles require the ACCC to consider causal relationships between supplying services and incurring costs—the ACCC has identified that the costs of excess capacity caused by the NBN should not be allocated to the services that continue to be supplied over Telstra's network because the cause of that excess capacity is not related to supplying those services. iiNet submitted that adjusting allocation factors to avoid access seekers bearing costs they do not cause is entirely consistent with the fixed principles.⁵¹⁷

iiNet submitted that it may be that, as implied by Telstra, the DA payments do not completely compensate Telstra for the loss of incumbent status; however this is irrelevant to the determination of prices for the declared services because it is not the role of access pricing to ensure that Telstra is fully compensated for the loss of incumbent status as a result of the NBN.⁵¹⁸

iiNet submitted that NBN-related costs such as those associated with loss of economies of scale cannot legitimately be attributed to access seekers. iiNet submitted that Telstra had an opportunity to ensure that it would receive consideration through the DAs for the impact of the NBN on its fixed line assets, and that Telstra possessed significant bargaining power in negotiations with NBN Co and the government. iiNet submitted that there is no prospect of the ACCC's approach resulting in Telstra not being able to recover such costs because Telstra is receiving payments that are intended to compensate Telstra for the effects of the NBN, and the amount of those payments is more than sufficient to offset the revenue impact arising from the ACCC's approach. On the contrary, if the ACCC did allocate such costs to access seekers, there would be clear double recovery by Telstra. iiNet submitted that Telstra's submissions on the issue lack merit because they appear to conflate the issue of recovering the cost of lost incumbency with the issue of recovering NBN-related costs.⁵¹⁹

10.3.1 Cross submissions

The ACCC received cross submissions from iiNet, Optus and the CCC in response to the Department's submission. The key points from these cross submissions are as follows:

- iiNet submitted that it is concerned by the notion of the ACCC setting prices above the economic value of the services simply because the Government believes this would encourage faster NBN migration. iiNet submitted that the Department's submission on Telstra's cost recovery should not be considered as otherwise there is a danger that the Department will have usurped a function which by law rests with the ACCC.⁵²⁰
- Optus submitted that it is concerned with the Department's intervention and that the Department is requesting that access prices be kept high so that consumers don't face price changes upon NBN migration.⁵²¹
- The CCC submitted that the Department is proposing that the ACCC allow for over-recovery to facilitate price stability and is concerned that the Department's late intervention could undermine the independence of the ACCC's pricing process.⁵²²

⁵¹⁷ *ibid.*, p. 9.

⁵¹⁸ *ibid.*

⁵¹⁹ *ibid.*, p. 10.

⁵²⁰ *ibid.*, pp. 3-4

⁵²¹ Optus letter to ACCC, 'Submission in response to Department of Communications Submission to Further Draft Decision', July 2015.

Further, Optus submitted a letter to the ACCC which responded to Telstra's submission to the further draft decision. Optus submitted that Telstra has made contradictory claims between 2011 and the current inquiry in relation to DA payments, and that the ACCC should give little weight to claims made during this inquiry if they are inconsistent with previous statements made by Telstra.⁵²³ Optus submitted that Telstra has submitted in this FAD inquiry that the payments would not fully compensate Telstra for the impacts of the NBN. Optus submitted that this is inconsistent with statements made in 2011 by former CEO David Thodey and former CFO John Stanhope that NBN-related revenue loss would be offset by future revenue generated by its networks and the DA payments.⁵²⁴

Optus noted Telstra's claim that it could not have reasonably anticipated that the ACCC would not allow it to recover costs associated with the NBN rollout, and had therefore not factored this into the DA payments. Optus submitted that this is inconsistent with statements made by the ACCC and access seekers during 2010-11.⁵²⁵ For example, Optus notes that the ACCC stated in the September 2010 report that it would take into account any migration payments and the impact that decommissioning the network may have on the RAB in subsequent regulatory periods. Optus further notes that the July 2011 final decision stated that the ACCC will take into account the impacts of the NBN in the next regulatory period.⁵²⁶

Optus submitted that while Telstra may have assumed that access charges would remain stable, it is clear that other parties formed the view that prices were likely to fall in subsequent regulatory periods. Optus noted its submission to the ACCC in July 2010 which stated that fixed line access prices should be expected to fall since, as a result of the financial heads of agreement (FHOA), Telstra will receive additional revenue streams and it will require less revenue from wholesale access prices over time.⁵²⁷ Optus submitted that Telstra is suggesting that, based on the same set of facts, it came to different views on the future path of access prices than Optus and other access seekers. If Telstra made an incorrect assumption it is not the role of the ACCC to compensate Telstra for errors of judgement.⁵²⁸

Finally, Telstra submitted a cross submission in response to access seeker submissions. In response to Optus' submission that the implementation of the October 2014 position statement should not surprise any party, Telstra submitted that the ACCC did not foreshadow any adjustment to allocation factors to account for the effect of NBN-induced loss of economies of scale. Telstra submitted that the October 2014 position statement dealt with the treatment of the three groups of assets that are potentially affected by NBN migration. Telstra submitted the first indication that the ACCC may adjust for the effects of loss of economies of scale came in the March draft decision, however there was no indication of what adjustment it intended to make.⁵²⁹

Telstra submitted that the further draft decision takes a different approach to that taken in the position statement—the position statement focuses on *assets* affected by NBN migration, whereas the further draft decision seeks to adjust the *total costs* that may be recovered (Telstra's emphasis) by adjusting allocation factors. Further, Telstra submitted that with this adjustment the ACCC has moved away from its March draft decision to adopt a fully allocated cost framework. Telstra submitted that by removing costs associated with NBN-induced loss of

⁵²² CCC letter to ACCC, 'Response to the Second Draft FLS FAD', July 2015.

⁵²³ Optus, *Supplementary Submission, Response to Telstra's NBN Claims*, August 2015, p. 1.

⁵²⁴ *ibid.*, p. 2.

⁵²⁵ *ibid.*, pp. 1-2.

⁵²⁶ *ibid.*, p. 3.

⁵²⁷ *ibid.*, p. 4.

⁵²⁸ *ibid.*

⁵²⁹ Telstra, *Public inquiry into final access determinations for fixed line services—primary prices, Response to industry submissions on the ACCC further draft decision*, August 2015, p. 5.

economies of scale, the ACCC disallows recovery of costs the ACCC has accepted are necessary for the prudent and efficient operation of the fixed line network and which are directly associated with the supply of declared services to wholesale customers. This contrasts to the position statement, which in Telstra's view flagged that adjustments would be made only to the RAB.⁵³⁰

Telstra noted iiNet's submission that the costs removed by the ACCC's adjustment to allocation factors are costs of excess capacity caused by the NBN and that these costs are not related to the supply of fixed line services. Telstra submitted that the excluded costs are costs that: need to be incurred to maintain supply of the fixed line services; are not caused by NBN migration or by Telstra's arrangements with NBN Co; and would not disappear in a 'without NBN' world. Telstra submitted that these costs are caused by the supply of fixed line services—were it not for Telstra's obligation to supply fixed line services, it would not incur these costs.⁵³¹

Telstra submitted that iiNet's submission appears to confuse cost causation with the cause of changes in demand and the consequential effects on unit costs. Telstra accepts that the allocation of costs should reflect cost causation; however it is not appropriate or consistent with the fixed principles to allocate costs on the basis of who is deemed to be responsible for particular changes in demand.⁵³² Telstra submitted that cost allocation should ensure that the customers who cause the consumption of economic resources pay a price that reflects the cost of those resources. If costs are allocated on the basis of who causes a change in demand, then some customers will pay less than the cost of the resources they consume, and others more. This would lead to inefficient outcomes which would be inconsistent with the LTIE. Telstra submitted that, in any event, Telstra is not responsible for NBN-induced changes in demand. Therefore it is not appropriate for Telstra to fully bear its impact.⁵³³

Telstra noted iiNet's submission that the ACCC's cost allocation adjustments are consistent with the fixed principles.⁵³⁴ Telstra submitted that iiNet's interpretation of the relative usage fixed principle—that it does not require all costs to be allocated to specific services—would render this principle meaningless. It would imply that costs could be allocated to hypothetical or unspecified services, with the result that cost allocation would not reflect relative usage of the network by each service.⁵³⁵ Further, Telstra submitted that the cost causation fixed principle does not support the ACCC's approach because the costs being excluded through cost allocation adjustments are caused by the provision of fixed line services.⁵³⁶

Telstra noted iiNet's submission that the DA payments will allow Telstra to recover the costs the ACCC has removed from regulated revenues. Telstra submitted that the payments were not intended to (and did not) compensate Telstra for all the effects of the NBN. The fact that Telstra is receiving an amount of revenue elsewhere that is greater than the amount of revenue being excluded through the ACCC's adjustments does not justify the ACCC's approach.⁵³⁷

Telstra noted iiNet's submission that the ACCC's adjustment to cost allocation factors is generous to Telstra since the ACCC has assumed that operating expenditure would be flat in the 'without NBN' scenario and ignores scope for efficiency gains and other factors which may reduce operating expenditure. Telstra submitted that this assumption is not generous, but

⁵³⁰ *ibid.*

⁵³¹ *ibid.*, p. 6.

⁵³² *ibid.*

⁵³³ *ibid.*, p. 7.

⁵³⁴ *ibid.*

⁵³⁵ *ibid.*

⁵³⁶ *ibid.*

⁵³⁷ *ibid.*, p. 8.

rather is arbitrary. It cannot be said with any certainty what opex would be in a 'without NBN' world, and it cannot be assumed that opex would be declining.⁵³⁸

Telstra noted Optus' submission that the uniform price decrease in the further draft decision is largely due to a lower cost of capital, not due to exclusion of costs. Telstra submitted that despite a moderate increase in the rate of return since the March draft decision, the price outcome changed from -0.7 to -9.6 per cent.⁵³⁹ Telstra submitted that it is clear from the modelling behind the further draft decision that the primary driver of the price reduction is the approach for accounting for NBN-induced loss of economies of scale.⁵⁴⁰

10.4 Final decision

The circumstances in which the ACCC makes this final decision are unique. The NBN is replacing Telstra's fixed line network as the infrastructure used to provide fixed line telecommunications services in Australia, with this transition facilitated by commercial arrangements between Telstra and NBN Co. Under these arrangements, Telstra will migrate its customer base to the NBN and will sell and lease certain infrastructure to NBN Co, and will receive corresponding payments for doing so. Further, Telstra has undertaken to only provide fixed line services over the NBN where it is deployed.

These arrangements will significantly impact the way Telstra's fixed line assets are used, and Telstra will receive financial consideration as a consequence. The ACCC, in determining prices for the declared fixed line services for the next regulatory period, has had regard to these important considerations and the complex issues they raise.

Having had regard to the LTIE and the other matters in section 152BCA(1) of the CCA, the ACCC's final decision is to account for the Telstra-NBN Co arrangements using the regulatory values approach set out in the October 2014 position statement, the March 2015 draft decision and the June 2015 further draft decision. As part of this approach, the ACCC has maintained its draft decision to treat assets sold to NBN Co as asset disposals and removed them from the RAB at their regulatory value. To the extent that NBN Co uses fixed line assets that are also used to provide declared services, this is accounted for in the cost allocation framework of the FLSM. All submissions supported these aspects of the ACCC's regulatory values approach.

Further, having had regard to the LTIE and the other matters in section 152BCA(1) of the CCA, the ACCC's final decision is that the costs associated with the loss of economies of scale that will occur as a result of NBN migration should not be reflected in regulated revenues or charges. The ACCC considers that such costs should not be borne by users of the fixed line network. These users are not causing these costs, and Telstra has been provided with an opportunity to ensure that it was compensated for such costs under the DAs. Telstra is receiving ongoing payments that provide replacement revenues which represent an avenue for the recovery of these costs.

The sections below set out the ACCC's reasons for its final decision in relation to NBN-induced loss of economies of scale in further detail. These reasons relate in particular to the issues of:

- cost causation
- Telstra's opportunity for compensation under the Definitive Agreements
- the payments received by Telstra under the Definitive Agreements

⁵³⁸ *ibid.*

⁵³⁹ *ibid.*

⁵⁴⁰ *ibid.*, p. 9.

- the ACCC's pricing framework for the fixed line services
- the ACCC's application of the fixed principles.

The ACCC has taken into account submissions where relevant.

10.4.1 Cost causation

The migration of customers to the NBN under the Telstra-NBN arrangements is causing a loss of economies of scale in the operation of the fixed line network. NBN migration will result in certain fixed line assets becoming redundant, and certain assets becoming progressively under-utilised and exhibiting excess capacity, in the upcoming regulatory period. As a consequence, the unit costs of services supplied using these assets will rise. Therefore, the costs associated with this loss of economies of scale are being caused by NBN migration. Under Telstra's cost allocation proposal (discussed in chapter 11), these additional costs would be borne by remaining users of the fixed line network.

Further, under these arrangements, Telstra has undertaken to only provide fixed line services over the NBN where it is deployed.⁵⁴¹ This means that under the terms of the DAs, fixed line services will not be able to make use of NBN-induced excess capacity in Telstra's network.

The ACCC has considered the Department's submission that while there will be a loss of economies of scale due to NBN migration, access seekers are requiring fixed line assets to remain in service and are therefore causing the costs associated with them.⁵⁴² The ACCC has also considered Telstra's submission that it is government policy that has caused a decline in demand, rather than access seekers or Telstra.⁵⁴³ Telstra submitted that it is facing the resulting costs of supporting the fixed line network and supplying the fixed line services.⁵⁴⁴

The ACCC acknowledges that there is an external event impacting upon costs: the Department identifies this as NBN migration, while Telstra identifies it as government policy. The ACCC considers that the relevant external factor is the migration of customers to the NBN, which is facilitated by commercial arrangements between Telstra and NBN Co. As noted above, the terms of these arrangements also mean that any excess capacity caused by NBN migration will not be able to be used by fixed line services.

The ACCC agrees with the Department's submission and Telstra's cross submission in so far as it is the case that certain fixed line assets are required to remain in service during NBN migration in order for fixed line services to be provided to remaining fixed line customers. However, the ACCC considers that it is necessary to draw a distinction between the total costs of providing access to remaining users and the costs associated with the excess capacity that arises as a result of the migration of customers to the NBN under the Telstra-NBN arrangements—of which it is agreed that no use will be made by remaining fixed line customers. The ACCC considers that this loss of economies of scale, and its associated costs, is being caused by NBN migration. If it were not for NBN migration, these costs would not arise.

The ACCC considers that it would be inappropriate to attribute the cost of this excess capacity to remaining users of the fixed line network given that Telstra has been provided with an opportunity to ensure that it would receive consideration for such costs, and has been provided with an avenue for their recovery. To attribute such costs to those users would be to ignore

⁵⁴¹ Telstra, Media release: *Telstra signs NBN Definitive Agreements*, June 2011, p. 8; Telstra, Media release: *Telstra signs revised NBN Definitive Agreements*, December 2014, p. 12.

⁵⁴² Department of Communications, *Submission to ACCC Further Draft Decision*, July 2015, p. 4.

⁵⁴³ Telstra, *Response to ACCC further draft decision*, July 2015, p. 23.

⁵⁴⁴ *ibid.*, p. 22.

their clear cause and the corresponding consideration being received by Telstra, and would result in an outcome contrary to the LTIE (see chapter 2).

10.4.2 Opportunity for consideration through the Definitive Agreements

The ACCC maintains its view that Telstra has been provided with an opportunity to ensure that it would receive consideration through the DAs for the impact of the NBN on its fixed line assets, including the costs associated with NBN-induced loss of economies of scale.

The DAs provide for migration payments and infrastructure payments to be made by NBN Co to Telstra. NBN Co will make a payment to Telstra for each end-user disconnected from the fixed line network when they are migrated to the NBN, and NBN Co will pay Telstra ongoing infrastructure payments for the lease of certain infrastructure. Telstra is receiving these migration payments specifically in respect of the disconnection of customers from its fixed line network. Under the DAs Telstra has undertaken to only provide fixed line services over the NBN where it is deployed. Therefore, Telstra will be receiving payment in return for the permanent loss of wholesale and retail customers on its fixed line network.⁵⁴⁵

The ACCC considered in the further draft decision that Telstra has been provided with an opportunity to ensure that it would receive consideration through the DAs for the impact of the NBN on its fixed line assets. It was noted that Telstra was aware that the disconnection of fixed line customers during NBN migration would cause unit costs to increase. The ACCC considered that Telstra possessed significant bargaining power in negotiations with NBN Co and the government—notably, absent Telstra’s cooperation, NBN Co would have faced significant costs to duplicate existing infrastructure.⁵⁴⁶

In response, Telstra submitted that it did not have such an opportunity, and was not able to achieve an outcome that fully compensated it for all of the impacts of the NBN.⁵⁴⁷ Telstra submitted that several factors constrained its bargaining power in the DA negotiations, namely:

- First, its infrastructure was not required for the NBN rollout. Telstra quotes former minister Stephen Conroy stating in October 2009 that the NBN would be built ‘with or without Telstra’.
- Second, legislative changes in 2009 meant that if Telstra did not cooperate with the NBN rollout, functional separation would be imposed on Telstra and it would be prevented from acquiring spectrum necessary to provide 4G services.⁵⁴⁸

In support of its submission, Telstra attached a statement by [c.i.c start] [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c end]

The ACCC acknowledges the statement made by the former communications minister, but considers that little weight can be given to a statement made in a politically sensitive policy area at a time when the legislative and regulatory framework underpinning the NBN was evolving and not yet finalised.

⁵⁴⁵ ACCC, *Further draft decision*, June 2015, p. 72.

⁵⁴⁶ *ibid.*, p. 73.

⁵⁴⁷ Telstra, *Response to ACCC further draft decision*, July 2015, p. 24.

⁵⁴⁸ *ibid.*

⁵⁴⁹ Statement of [c-i-c start] [REDACTED] [c-i-c end], p. 3.

As to Telstra's cooperation, the ACCC does not accept Telstra's submission that the proposed imposition of functional separation and the prospective prevention of Telstra acquiring spectrum altered the bargaining position of Telstra to such an extent that it did not have an opportunity to seek compensation for the costs associated with NBN-induced loss of economies of scale. This is because it is evident that Telstra's cooperation in the NBN rollout was integral to NBN Co's long term business model and, as a result, the NBN rollout was heavily reliant on reaching agreement with Telstra. The ACCC considers that this is a key reason that Telstra was in a strong position in the DA negotiations to ensure that it was compensated for the impacts of the NBN on its fixed line assets. As noted in the further draft decision, the ACCC considers that, in the absence of Telstra's cooperation in the NBN rollout, NBN Co would have been required to bypass the fixed line network and unnecessarily duplicate costly infrastructure.⁵⁵⁰

NBN Co's reliance on Telstra's cooperation is evident from NBN Co's initial Corporate Plan (2011-2013). NBN Co noted that this Corporate Plan was 'an integral part of NBN Co's 30-year business model', and was 'developed to assess the long term viability of the Company'.⁵⁵¹ NBN Co stated that the Corporate Plan was 'based on the premise that the Government's intention is to build the NBN as the sole fixed line network...and on the assumption that Telstra will structurally separate and migrate its customer base to the NBN'.⁵⁵² The Corporate Plan was 'predicated on the assumption that a deal is finalised and approved between NBN Co and [Telstra] in accordance with the Financial Heads of Agreement'.⁵⁵³ NBN Co stated that '[c]ritically, the deployment schedule is predicated on the availability to NBN of existing infrastructure. It specifically assumes that...[e]xisting Telstra infrastructure will be available for use by NBN Co'.⁵⁵⁴ NBN Co noted that the deal with Telstra as agreed under the FHOA 'substantially mitigates' a number of key risks, including the risk to revenue projections of lower take up of NBN services.⁵⁵⁵

The ACCC does not have a view in relation to [c-i-c start] [REDACTED] [c-i-c end] However, given the information before it, the ACCC considers that the circumstances did provide Telstra with an opportunity to ensure that it would be compensated for the impacts of the NBN. In arriving at this conclusion, the ACCC has not formed a view as to whether Telstra achieved an outcome in its negotiations that fully compensated it for all of the impacts of the NBN. The nature of the payments, and the question of their sufficiency, is discussed in the next section.

The ACCC notes Telstra's submission to the March draft decision that:

The fact of the NBN rollout would be faced by Telstra in either the cooperate or the compete scenario, and therefore Telstra did not seek to be compensated for the effects of the NBN rollout through payments for cooperation.⁵⁵⁶

As noted above, Telstra had full knowledge of the impact that NBN migration would have on its fixed line assets and the unit costs of providing fixed line services, and the ACCC considers that it had the opportunity to ensure that it would receive consideration. If Telstra did not seek to be compensated for these impacts, the ACCC considers that it should not fall on remaining users of the fixed line network to bear any consequential costs.

⁵⁵⁰ ACCC, *Further draft decision*, June 2015, p. 73.

⁵⁵¹ NBN Co, *Corporate Plan 2011–2013*, December 2010, p. 22.

⁵⁵² *ibid.*, p. 13.

⁵⁵³ *ibid.*, p. 51.

⁵⁵⁴ *ibid.*, p. 78.

⁵⁵⁵ *ibid.*, p. 51; p. 148.

⁵⁵⁶ Telstra, *Response to Draft Decision*, May 2015, p. 47.

10.4.3 Payments received under the Definitive Agreements

This section discusses the ACCC's views in relation to the payments Telstra is receiving under the Definitive Agreements.

Replacement revenue

The ACCC considers that the payments Telstra is receiving under the DAs provide Telstra with replacement revenues which represent an avenue for recovery of the costs associated with the rollout of the NBN. This includes the costs associated with NBN-induced asset redundancy and under-utilisation that results from the migration of fixed line customers to the NBN.

In the March draft decision the ACCC noted that the migration payments received from NBN Co under the DAs provide replacement revenues to Telstra.⁵⁵⁷ The ACCC referred to Telstra's June 2011 media release in which it announced the signing of the original DAs, in which Telstra stated the following:

The agreements provide Telstra with replacement revenue, through disconnection payments as the rollout of the NBN occurs, and new revenues, through access payments for the use of Telstra's infrastructure over an assumed average 30 year period.⁵⁵⁸

In the first statement of [c-i-c start] [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c end]

In its submission to the March draft decision, Telstra stated that the DA payments do not compensate Telstra for NBN-induced loss of economies of scale.⁵⁶¹ Telstra submitted that the extent to which the DA payments operate as replacement revenue reflects an assessment of the overall value loss to Telstra associated with losing control of its own business model as an integrated operator of local access copper and HFC networks.⁵⁶²

The ACCC considers that its view in relation to the DA payments is consistent with public statements made by Telstra since the execution of the original agreements in June 2011 and information provided by Telstra in the course of this FAD inquiry. The parts of the first statement of [c-i-c start] [REDACTED] [c-i-c end]. Further, in response to the further draft decision Telstra submitted the following:

The payments Telstra receives from NBN Co occur and relate to compensation for the period after customers disconnect from Telstra's network. Those payments do not relate to the costs the ACCC has estimated for the supply of regulated fixed line services.⁵⁶³

The ACCC accepts Telstra's submission that the payments relate to the period after disconnection. The ACCC considers that this accounts for lost revenue that would otherwise have been generated by the fixed line network in the absence of the NBN. A portion of this revenue would be regulated revenue, comprised of a return on and of capital, operating

⁵⁵⁷ ACCC, *Draft Decision*, March 2015, p. 140.

⁵⁵⁸ Telstra, Media release: *Telstra signs NBN Definitive Agreements*, June 2011.

⁵⁵⁹ Statement of [c-i-c start] [REDACTED] [c-i-c end], pp. 13-14.

⁵⁶⁰ *ibid.*, p. 15.

⁵⁶¹ Telstra, *Response to Draft Decision*, May 2015, p. 49.

⁵⁶² *ibid.*

⁵⁶³ Telstra, *Response to ACCC further draft decision*, July 2015, p. 4.

expenditure and a tax allowance. After disconnection from the fixed line network, a wholesale customer's share of regulated revenues (comprised of the aforementioned building blocks) that would have existed in the absence of the NBN is foregone. Since the DA payments occur and relate to compensation for the period after customers are disconnected, the DA payments therefore provide a source of recovery of this revenue. The CCC reached a similar conclusion in its submission to the further draft decision. The CCC noted that Telstra has argued that migration payments compensate for loss of revenue, not for the costs still borne by Telstra. The CCC submitted that such foregone revenue is what would have been used to recover ongoing costs—if the payments compensate for lost revenue, it follows that the payments compensate for costs.⁵⁶⁴

The ACCC accepts that the payments are not specifically tied to the costs estimated for the supply of regulated fixed line services; however the payments do relate to customer disconnection. This disconnection results in a loss of economies of scale that would not have arisen otherwise, and the DA payments replace the foregone revenue that would have been generated by the network in the absence of the NBN and the continuation of Telstra's integrated business model. Under the ACCC's pricing framework for the declared fixed line services, prices are set so as to allow revenue received from these services to recover the efficient costs of supply. Given the ACCC's view that the DA payments provide replacement revenue which represent a source of recovery of the costs associated with the loss of economies of scale that has resulted from the change in Telstra's business model, the ACCC considers that the prices set as a result of this final decision will allow recovery of the efficient costs of supplying the declared fixed line services net of the costs the ACCC has attributed to NBN-induced loss of economies of scale.

The conclusion that the DAs provide replacement revenue is supported by the shareholder FAQ which was attached to Telstra's June 2011 media release. In this document, Telstra provided a response to the question of what would happen if NBN migration takes longer than originally assumed:

The approximately \$11 billion of post-tax NPV has been assessed on the basis of a 10 year rollout. If the NBN rollout is delayed, the present value of the disconnection, infrastructure access and other payments may reduce. However, it is expected that the value of these payments would be offset by the additional value from revenue received on Telstra's copper Customer Access Network.⁵⁶⁵

This statement provided Telstra's assurance to its shareholders that, in Telstra's view, the value of the DA payments is equal, in present value terms, to the revenue Telstra would have expected to receive through the fixed line network in areas yet to be covered by the NBN. The ACCC considers that this statement indicates Telstra's view that there is an offsetting relationship between, on one hand, the DA payments received as the NBN is rolled out; and on the other hand, the revenues it would expect to receive through the operation of the fixed line network in the absence of the NBN.

Further, in its annual report for 2015, Telstra notes that the results of its financial impairment testing show that its discounted expected future cash flows 'support the carrying amount of the (fixed line and HFC) networks'.⁵⁶⁶ This is based on, firstly, the forecast cash flows from continuing to operate both networks, and secondly:

the consideration we expect to receive under the National Broadband Network (NBN) Definitive Agreements (DAs) for:

- the progressive disconnection of copper-based Customer Access Network services and broadband services on our HFC cable network (excluding Pay TV services on the HFC cable network) provided to premises in the NBN fibre footprint

⁵⁶⁴ CCC letter to ACCC, 'Response to the Second Draft FLS FAD', July 2015.

⁵⁶⁵ Telstra, Media release: *Telstra signs NBN Definitive Agreements*, June 2011, p. 27.

⁵⁶⁶ Telstra, *Annual Report 2015*, August 2015, p. 141.

- providing access to certain infrastructure, including dark fibre links, exchange rack spaces and ducts
- the sale of lead-in conduits.

The ACCC considers that Telstra's assessment of the consideration it expects to receive indicates that the DA payments provide replacement revenue. The statement suggests that Telstra does not expect its networks to be financially impaired given, firstly, the revenues expected to be generated by the fixed line and HFC networks, and in addition, expected DA payments. Given that the annual report acknowledges the ACCC's June further draft decision and estimates its impact on Telstra's cash flows,⁵⁶⁷ it would be reasonable to assume that the expected revenue from the operation of the fixed line network accounts for this impact.

The ACCC notes that in Telstra's annual report for 2014, Telstra included an almost identical discussion. However, in that report, which preceded the ACCC's further draft decision, Telstra noted that its discounted expected future cash flows 'more than support the carrying amount of the (fixed line and HFC) networks' (emphasis added).⁵⁶⁸

Finally, the ACCC notes Optus' cross submission which refers to statements made in 2011 by former Telstra CEO David Thodey and former CFO John Stanhope that NBN-related revenue loss would be offset by future revenue generated by its networks and the DA payments.⁵⁶⁹ The ACCC considers that these statements also support its conclusion that the DA payments provide replacement revenue.

Quantum of the payments

The ACCC considers that Telstra's submissions about the sufficiency or otherwise of the DA payments do not impact upon the ACCC's decision to remove the costs associated with NBN-induced lost economies of scale from regulated revenues. Rather, the ACCC has considered the existence of the DA payments and their purpose.

In its submission Telstra reiterated its argument that Telstra was not fully compensated for the impact of the NBN through the DAs. Telstra submitted that it anticipated that the DA payments it would receive would not be sufficient to compensate for the loss of value caused by the government's NBN policy.⁵⁷⁰

The ACCC reiterates its position established in the October 2014 position statement and repeated in the March draft decision and further draft decision.⁵⁷¹ That is, in accounting for the Telstra-NBN Co arrangements in determining prices for the declared services, the ACCC has not considered the quantum of the payments received by Telstra, but rather has had regard to the Telstra-NBN Co arrangements and to the regulatory value of affected assets. Telstra is receiving migration payments specifically in respect of the disconnection of customers from its fixed line network. Under the DAs, Telstra has undertaken to only provide fixed line services over the NBN where it is deployed. Therefore, Telstra will be receiving payment in return for the permanent loss of wholesale and retail customers on its fixed line network.⁵⁷²

In any event, an assessment of the sufficiency of the payments based on comparisons with Telstra's projections of the revenue it would have received as a vertically integrated monopoly infrastructure owner would not be a relevant consideration to the ACCC, and accordingly, the

⁵⁶⁷ Telstra, *Annual Report 2015*, August 2015, p. 7.

⁵⁶⁸ Telstra, *Annual Report 2014*, August 2014, p. 150.

⁵⁶⁹ Optus, *Supplementary Submission, Response to Telstra's NBN Claims*, August 2015, p. 2.

⁵⁷⁰ Telstra, *Response to ACCC further draft decision*, July 2015, pp. 24-25.

⁵⁷¹ ACCC October 2014 Position Statement, p. 10; ACCC March 2015 Draft Decision, p. 136; ACCC June 2015 Further Draft Decision, p. 73.

⁵⁷² ACCC, *Further draft decision*, June 2015, p. 72.

ACCC would give little weight to any assertions of the inadequacy of the payments made on this basis. iiNet reached a similar conclusion in its submission, which stated that it may be the case that DA payments do not completely compensate Telstra for the loss of its incumbent status; however this is irrelevant to the determination of prices for the declared services because it is not the role of access pricing to ensure that Telstra is fully compensated for the loss of incumbent status as a result of the NBN.⁵⁷³

The ACCC notes iiNet's submission that, given the migration payments Telstra is receiving under the DAs, if the ACCC were to allocate the costs associated with NBN-induced loss of economies of scale to access seekers, there would be double recovery by Telstra.⁵⁷⁴ While the ACCC has not considered the quantum of the payments in reaching its final decision, the ACCC agrees that, without adjustments to remove the costs associated with NBN-induced asset redundancy and under-utilisation, there would be a degree of double recovery by Telstra. That is, given that the DA payments provide a source of the revenue that would have been generated by the fixed line network in the absence of the NBN—and given that some of this revenue would be from regulated charges calculated to recover the efficient costs of providing declared services—without adjustment, regulated revenues in the next regulatory period would include some of these costs.

The ACCC also notes the cross submissions (summarised in section 10.3.1 above) by access seekers in response to the Department's submission to the further draft decision. These submissions expressed concern that the Department is proposing that access prices not be lowered—and therefore, as submitted by the CCC, allow Telstra to over-recover—to keep prices stable in the transition to the NBN. The ACCC acknowledges that the smooth transition to the NBN is a factor that is relevant to the ACCC's decision. However, as discussed in section 10.4.4 below, the ACCC does not consider that this decision will adversely impact this transition.

Finally, the ACCC notes the Department's submission which stated that '[f]or the ACCC to say that the costs should have been recovered through the DA process indicates that the costs are not recovered' and this would not be in the LTIE.⁵⁷⁵ To clarify, in its further draft decision the ACCC stated the following:

While not entering into the merits of Telstra's arguments regarding the sufficiency or otherwise of the payments it receives under its arrangements with NBN, the ACCC considers that such arguments are not relevant to its draft decision to make adjustments to remove the costs associated with NBN-induced lost economies of scale from regulated revenues...

The ACCC considers that Telstra has been provided with an opportunity to ensure that it would receive consideration through the Definitive Agreements for the impact of the NBN on its fixed line assets.⁵⁷⁶

The further draft decision stated the ACCC's view that Telstra has been provided with an opportunity to be compensated for the impact of the NBN. The ACCC did not discuss the sufficiency or otherwise of the payments Telstra receives under the DAs, and therefore did not imply that there will be under-recovery.

10.4.4 ACCC pricing framework for the fixed line services

This section sets out the ACCC's views in relation to this final decision in the context of the pricing framework for the fixed line services established during the 2011 FAD inquiry, and its views on the implications of the decision on price stability in the transition to the NBN.

⁵⁷³ iiNet, *Public inquiry into final access determinations for fixed line services —primary price terms, Further Draft Decision – Outstanding Issues*, July 2015, p. 9.

⁵⁷⁴ *ibid.*

⁵⁷⁵ Department of Communications, *Submission to ACCC Further Draft Decision*, July 2015, p. 5.

⁵⁷⁶ ACCC, *Further draft decision*, June 2015, p. 73.

Establishment of the BBM pricing framework and fixed principles

In response to the March draft decision, Telstra submitted that the value of the payments did not contemplate that the ACCC would depart from the fixed principles or operate as replacement revenue for 'future substantial regulatory asset write-downs'.⁵⁷⁷ Telstra also submitted that the current pricing framework for fixed line services and the fixed principles were established during the 2011 FAD inquiry to provide certainty to industry (a concern also expressed by the Department).⁵⁷⁸

Telstra submitted that the ACCC appears to be suggesting in its further draft decision that Telstra could and should have expected that the ACCC would act in a way in which it (the ACCC) said it would not.⁵⁷⁹ Telstra submitted that at the time it was negotiating the DAs with NBN Co, Telstra could not have reasonably anticipated that the ACCC would not allow it to recover costs associated with NBN-induced loss of economies of scale, and that such an approach is contrary to the fixed principles, the building block approach, and the ACCC's public statements on the need for pricing certainty.⁵⁸⁰

The ACCC considers that the fixed principles were not relevant in the negotiation of the DAs. The ACCC did not adopt the fixed principles until after the DA negotiations had concluded. The fixed principles were not introduced for the purpose of guiding the DA negotiations or for specifying how NBN impacts would be accounted for. The primary reason for the adoption of the fixed principles was to provide a building block framework for estimating prices for the declared services, and to provide certainty with respect to the value of regulated assets used to provide fixed line services.

The ACCC notes that in the context of the establishment of the BBM pricing framework during the 2011 FAD inquiry, the ACCC had expressed a clear view that the NBN payments reflected the revenue recoverable under such a framework, and had clearly stated its intention to account for this in subsequent regulatory periods.

The ACCC sets out below the timing and substance of its key messages to the industry during and since the 2011 FAD inquiry, and how this relates to the negotiation of the DAs.

- The negotiation of the DAs began in 2009, with the non-binding Financial Heads of Agreement being announced in June 2010.
- In the September 2010 draft report on its review of pricing principles for the fixed line services, the ACCC stated that:
 - In the process of reviewing prices for subsequent regulatory periods, the ACCC would take into account any migration payments received by Telstra and any impact that decommissioning the network may have on the RAB.⁵⁸¹
 - NBN Co's payments to Telstra under the FHOA (comprised of payments for the leasing of Telstra's infrastructure and migration payments as the fixed line network is decommissioned) reflect recovery of operating expenditure and a return on and of capital.⁵⁸²

⁵⁷⁷ Telstra, *Response to Draft Decision*, May 2015, pp. 49-50.

⁵⁷⁸ *ibid.*, p. 51.

⁵⁷⁹ Telstra, *Response to ACCC further draft decision*, July 2015, pp. 26-27.

⁵⁸⁰ *ibid.*, p. 26.

⁵⁸¹ ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services – Draft report*, September 2010, p. 29.

⁵⁸² *ibid.*

- The ACCC first proposed preliminary fixed principles in its April 2011 discussion paper on prices for the fixed line services. In this document the ACCC repeated that the payments under the proposed deal between Telstra and NBN Co were expected to compensate Telstra for unrecovered depreciation on assets no longer used to provide fixed line services following the rollout of the NBN.⁵⁸³
- The DAs were executed in June 2011.
- The ACCC released its final FAD decision in July 2011, in which it adopted the fixed principles. The ACCC stated that it would take into account the impacts of the NBN rollout in determining the inputs to the FLSM in the next regulatory period, and that it would consult if any modifications to the design of the FLSM were required.⁵⁸⁴
- In the March 2015 draft decision on the current FAD inquiry, the ACCC stated that the loss of economies of scale in the provision of fixed line services is likely to be predominantly incremental to the NBN, and that access seekers should not incur higher charges for fixed line services as a consequence of the decision by Telstra regarding the future of its network. In addition, the ACCC stated that it agreed with the report by WIK-Consult on the issue of NBN-induced loss of economies of scale. The ACCC stated that any costs reflected in expenditure forecasts that were incremental to the NBN should not be included in the FLSM.⁵⁸⁵

The ACCC notes that the approach to cost allocation adopted for the 2011 FADs was such that forecast changes in demand during the regulatory period would not directly affect prices for the declared services. That is, all else being equal, unit costs would not be allowed to increase if demand for the declared services was forecast to fall. This approach gave effect to the ACCC's decision to not allow recovery of costs associated with declines in demand attributed to loss of market share to infrastructure-based competition and fixed-to-mobile substitution. If carried forward, this approach would have resulted in prices that were invariant to changes in demand for fixed line services regardless of the source, including NBN migration.

The ACCC considers that its statements during the 2011 FAD inquiry regarding the establishment of the current pricing framework, including the adoption of the fixed principles, should not be considered in isolation. The ACCC, despite not having made a decision on how to account for NBN impacts, made unequivocal statements about how it viewed the NBN payments, its intention to account for the impacts of the NBN in subsequent regulatory periods, and the effects of its allocation framework on regulated revenues and unit costs. Concurrently, the ACCC adopted a set of fixed principles with the specific intent of locking in a building block model pricing framework. The ACCC considered that this would contribute to continuity and predictability between regulatory periods, and would avoid the uncertainty associated with a periodic revaluation of the asset base.⁵⁸⁶ The ACCC considers that its treatment of the impacts of the NBN in this final decision is consistent with an holistic view of the ACCC's 2011 decision—that is, taking all elements together as intended.

The ACCC notes Optus' cross submission which states that Telstra's claim that it could not have reasonably anticipated that the ACCC would not allow it to recover the costs associated with the NBN rollout (and had therefore not factored this into DA payments) is inconsistent with statements made by the ACCC during 2010-11.⁵⁸⁷ For example, Optus noted the ACCC's statements in its September 2010 report and in the July 2011 final decision regarding its

⁵⁸³ ACCC, *Public inquiry to make final access determinations for the declared fixed line services – Discussion paper*, April 2011, p. 105.

⁵⁸⁴ ACCC, *Inquiry to make final access determinations for the declared fixed line services – Final report*, July 2011, p. 29.

⁵⁸⁵ ACCC, *Draft Decision*, March 2015, p. 141.

⁵⁸⁶ ACCC, *Final report*, July 2011, p. 149.

⁵⁸⁷ Optus, *Supplementary Submission, Response to Telstra's NBN Claims*, August 2015, pp. 1-2.

intention to account for the impacts of the NBN in subsequent regulatory periods (as discussed above). Further, Optus submitted that, while Telstra may have assumed that access charges would remain stable, it is clear that other parties formed the view that access prices were likely to fall in subsequent regulatory periods. Optus supported this by noting its July 2010 submission to the ACCC which stated that access prices should be expected to fall since, as a result of the FHOA, Telstra will receive additional revenue streams and will require less revenue from wholesale access prices over time. Optus submitted that, if Telstra made an assumption about future prices that was inconsistent with access seekers' stated expectations, it is not the role of the ACCC to compensate Telstra.⁵⁸⁸

The method by which the ACCC has accounted for the impacts of the NBN in this final decision is consistent with the pricing framework established during the 2011 FAD inquiry and the ACCC's statements on pricing certainty and accounting for the impacts of the NBN. Moreover, as discussed in chapter 2, the ACCC considers that this decision appropriately balances the interests of Telstra (as the access provider) and access seekers as users of the fixed line network, having regard to the LTIE and the matters specified in section 152BCA(1) of the CCA, and having regard to the unique circumstances of the transition to the NBN. The way in which Telstra factored the ACCC's foreshadowed regulatory approach into its approach to negotiating the DAs is not a relevant consideration for the ACCC.

Price stability

The ACCC notes the Department's submission (summarised in section 10.3 above) that the ACCC has not adequately considered the importance of price stability in the transition to the NBN. These concerns were also expressed by Telstra and NBN Co. The ACCC notes that these submissions were made in response to the ACCC's further draft decision to apply a uniform price decrease of 9.6 per cent across all declared services. The ACCC's final decision is to apply a uniform price decrease of 9.4 per cent.

The ACCC considered that the further draft decision price decrease of 9.6 per cent would be unlikely to materially influence NBN migration or to give rise to the type of concerns raised in New Zealand about the implications of a price differential between legacy and next generation telecommunications networks. The ACCC considers that a price decrease of 9.4 per cent is similarly unlikely to impact migration. This is for the following reasons.

Regarding the comparison with the experience in New Zealand, the ACCC notes, first, that its final decision for a price decrease of 9.4 per cent is one-third less than the draft price decrease of 14.7 per cent set by the New Zealand Commerce Commission for Chorus' ULL and bitstream access services. Second, unlike in New Zealand, disconnection from Telstra's fixed line network is mandatory, and as a result any price differentials would be expected to be less consequential for migration. Third, such a price decrease would be unlikely to adversely affect NBN migration as there is evidence of increasing competition in both the legacy fixed line and NBN market as retail service providers seek to acquire the scale necessary to compete effectively on the NBN. Such competition in the legacy market may serve to reduce the rate of mobile substitution and result in a greater number of customers being migrated to the NBN.

In response to the further draft decision, TPG submitted that carriage service providers will not have an incentive to not promote migration to the NBN. TPG submitted that the migration event is an important one and all carriage service providers are competing heavily to make sure that they get their share of NBN migrations. TPG submitted that if the draft pricing is confirmed, competitive forces should result in a price reduction for fixed line services.⁵⁸⁹ Similarly, Macquarie submitted that it does not accept that access seekers have the ability or incentive to delay migration to the NBN. Macquarie submitted that the deployment of the NBN and

⁵⁸⁸ *ibid.*, p. 4.

⁵⁸⁹ TPG Telecom, *Submission to ACCC Further Draft Decision*, July 2015, p. 1.

subsequent decommissioning of legacy networks is a matter within the control of NBN Co and Telstra and is a process over which access seekers have no control.⁵⁹⁰

Further, the ACCC notes that the largest supplier of retail fixed line services is Telstra, which does not pay regulated prices. Therefore, any change in the prices of declared services will not have any direct effect on the migration of Telstra's retail customers (or any HFC customers) to the NBN. Given the evidence of increased competition noted above, other retail service providers that actively attempted to defer migrating its customers so as to maintain increased margins on the provision of legacy services would risk having those customers move to the NBN with another provider and losing the entirety of those customers' contribution to its revenues.

10.4.5 Application of the fixed principles

Fixed principles for the declared fixed line services (apart from wholesale ADSL) were made in the 2011 FADs. Identical fixed principles were subsequently included in the 2013 wholesale ADSL FAD. The fixed principles provisions for all declared fixed line services apply until 30 June 2021. The new FADs for the declared fixed line services will come into force before the nominal termination date specified in the fixed principles. Therefore, the ACCC must include the same fixed principles provisions in the new FADs. The fixed principles are set out in Appendix D of this final decision.

As noted in section 10.3, in response to the further draft decision, Telstra and the Department have submitted that the ACCC's treatment of redundant assets as disposals and the adjustments to the cost allocation factors to account for NBN-induced under-utilisation are inconsistent with the fixed principles.

The ACCC's views in relation to its application of the fixed principles, and its response to submissions on this issue, are discussed further below.

RAB roll-forward fixed principle

The RAB roll-forward mechanism is set out in clause 6.7 of the fixed principles. Clause 6.7 specifies the following:

6.7 Roll-forward mechanism

- (a) The RAB is to be rolled forward each year according to the formula below:

$$RAB_{t+1} = RAB_t + capex_t - depreciation_t - asset\ disposals_t$$

where RAB_{t+1} = opening RAB for the next regulatory year

RAB_t = opening RAB for the current year

$capex_t$ = forecast capital expenditure during the current year

$depreciation_t$ = regulatory depreciation during the current year

$asset\ disposals_t$ = asset disposals during the current year

- (b) Land asset values will be indexed by the Consumer Price Index (CPI) where it is available or by the forecast for the CPI used in the Fixed Line Services Model

⁵⁹⁰ Macquarie, *Further Draft Decision – Outstanding Issues*, July 2015, p. 3.

(FLSM) where actual CPI is not available. This will account for appreciation over time in land values.

- (c) To roll forward RAB values in nominal terms, any variables that are specified in real terms will be indexed by the actual CPI where it is available or by the forecast for the CPI used in the FLSM where the actual CPI is not available.
- (d) Any variables that are specified in nominal terms will not be indexed, with the exception of land values as specified above.
- (e) In these fixed principles provisions 'the FLSM' means the FLSM as it may be varied from time to time or similar model used by the ACCC for the calculation of prices for the relevant declared services.

The Department submitted that 'the ACCC's proposal to treat a proportion of the regulatory value of assets made redundant by NBN migration as an asset disposal at a realised price equivalent to their RAB value in the roll-forward mechanism for the RAB is not consistent with the fixed principles'.⁵⁹¹ The Department submitted that 'removing a proportion of the regulatory value of assets that are made redundant but remain with Telstra does not enable Telstra to recover its costs for these assets'. The Department also submitted that as 'Telstra is not receiving any consideration for the decommissioning of these assets, they should not be removed from the RAB through the disposal mechanism, and rather these assets should be depreciated in an accelerated manner, in order to allow Telstra to recover its costs'.⁵⁹²

In Telstra's submission to the further draft decision, it stated its view that the ACCC's removal of assets from the RAB is inconsistent with the RAB roll-forward fixed principle.⁵⁹³ Telstra submitted that the ACCC seeks to justify its adjustment for 'redundant' assets on the basis that it treats these assets as 'disposals', and Telstra submits that this is incorrect.

Telstra submitted further advice from Mr Keith Lockey of KPMG in relation to the ACCC's view in the further draft decision that assets which become commercially obsolete or reach the end of their useful lives can be properly accounted for as disposals. Mr Lockey's further report states that the adoption of Accounting Standards as the relevant framework for determining accounting treatments is appropriate.⁵⁹⁴ The advice states that the further draft decision's treatment of assets which are made redundant by NBN migration but remain under Telstra's ownership or control as disposals is inconsistent with Australian Accounting Standards, for reasons that include that the ACCC has incorrectly concluded that under Australian Accounting Standards an asset is disposed of at the end of its useful life. Mr Lockey states that:

the ACCC's view...that commercial obsolescence is a relevant factor in determining whether an asset has been disposed of is inconsistent with Accounting Standards. Commercial obsolescence is relevant to the derecognition of value through impairment or depreciation, but does not fall within the ambit of a disposal under Accounting Standards.⁵⁹⁵

Mr Lockey's advice also states that a disposal transaction is necessary for a disposal.⁵⁹⁶ Telstra also submitted that a report that was submitted with Telstra's response to the March draft decision expressed a similar view from a regulatory economics perspective. The report of Mr Jeff Balchin stated that the 'core ingredient' for a disposal is that there has been a transaction in

⁵⁹¹ Department of Communications, *Final access determinations for fixed line services – primary price terms – Submission to ACCC Further Draft Decision*, July 2015, p. 4.

⁵⁹² *ibid.*

⁵⁹³ Telstra, *Response to ACCC further draft decision*, July 2015, p. 16.

⁵⁹⁴ KPMG, *Independent advice on the basis of accounting for disposals of assets in Telstra's regulatory asset base for fixed line services* (Lockey Report), July 2015, p. 2.

⁵⁹⁵ *ibid.*, p. 4.

⁵⁹⁶ *ibid.*

relation to the assets in question. This view is affirmed in a further report from Mr Balchin submitted in response to the further draft decision.⁵⁹⁷

The term 'asset disposals' is not defined in the fixed principles. The ACCC considers that the term 'disposals' has an ordinary meaning, and that this ordinary meaning is to be considered in the context of the building block model approach, and in particular, the RAB roll-forward mechanism. The ACCC considers that 'disposal' is capable of broad interpretation. The ACCC notes that iiNet submitted that it agreed with the ACCC's view that the term 'disposal' should be given its ordinary meaning, given that the fixed principles do not provide a definition.⁵⁹⁸

The ACCC has applied the fixed principles having regard to the matters in subsection 152BCA(1) of the CCA, including Telstra's legitimate business interests and the overarching objective of the LTIE. The ACCC's treatment of assets made redundant by the migration to the NBN ensures that users of the fixed line network will not bear the costs of assets they do not use. It also ensures that those costs which Telstra had an opportunity to recover (and for which Telstra has been provided with an avenue of recovery) through the DAs are not allocated to remaining users of the fixed line network.

The ACCC has had regard to the Australian Accounting Standards Board (AASB) approach to disposals in forming its view on the meaning of 'disposals' for the purposes of the RAB roll-forward mechanism. In particular, the ACCC considered the AASB's statement that the term 'disposal' is not defined in the Australian Accounting Standards and that the Board has referred to the common definition of that term.⁵⁹⁹ The ACCC has also taken into account the non-exhaustive manner in which a 'disposal' is described in AASB 116 as occurring, which included by sale, by entering into a finance lease or by donation.⁶⁰⁰

Mr Lockey's advice states that a condition that must be met for a disposal to be recognised is the transfer of the risks and rewards of ownership and discontinuation of management involvement to the degree usually associated with ownership or effective control of an asset.⁶⁰¹ While the ACCC has had regard to the AASB's approach to disposals which is discussed in Mr Lockey's advice, the ACCC does not consider that this is a condition that must be met in the context of the RAB roll-forward mechanism. The ACCC agrees that 'disposal' includes circumstances in which there is a transaction in relation to the asset. However, the ACCC also considers that whether or not an asset has been disposed of for the purposes of the building block model approach in the fixed principles should not be limited to a transaction whereby the asset has been sold and there has been a transfer of the risks and rewards of ownership and discontinuation of management involvement. The ACCC considers that 'disposal' for the purposes of the RAB roll-forward mechanism can include circumstances in which an asset has ceased to be used.

In reaching this view, the ACCC also had regard to the AASB's approach to determining an asset's useful life. The ACCC has had particular regard to technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset as a factor to be considered in determining the useful life of an asset. iiNet has submitted that 'Telstra unreasonably restricts the definition of asset disposal to a situation where the asset has been sold' and that 'the accepted meaning of the term disposal is broader than this and comfortably includes the

⁵⁹⁷ Incenta, *Comment on the ACCC further draft decision in relation to fixed line services* (Balchin Report), July 2015, p. 3.

⁵⁹⁸ iiNet, *Further Draft Decision – Outstanding Issues*, July 2015, p. 8.

⁵⁹⁹ Australian Accounting Standards Board, *Issues Paper Definition and application of residual value*, AASB meeting 3-4 September 2014, Agenda Paper 17.2 (M140), paragraph 6.

⁶⁰⁰ AASB 116, [69].

⁶⁰¹ Lockey Report, July 2015, p. 9.

situation of commercial and technical obsolescence that arises from the move from Telstra's legacy network to the NBN'.⁶⁰²

The ACCC considers that all assets that become redundant as a result of NBN migration will become commercially obsolescent, as each of these assets will no longer be required after customers are disconnected from the fixed line network. In relation to commercial obsolescence, Mr Lockey's advice refers to an asset reaching the end of its economic life but not its useful life if the asset remains available for use by the entity.⁶⁰³ The ACCC considers that assets made redundant by NBN migration will not remain available for use by Telstra because Telstra has agreed not to use those assets where the NBN has rolled out.

Cost allocation fixed principle

Clause 6.14 of the fixed principles relates to cost allocation factors. Clause 6.14 specifies the following:

6.14 Cost allocation factors

- (a) The allocation of the costs of operating the PSTN should reflect the relative usage of the network by various services.
- (b) Direct costs should be attributed to the service to which they relate.
- (c) The cost allocation factors for shared costs should reflect causal relationships between supplying services and incurring costs.
- (d) No cost should be allocated more than once to any service
- (e) The determination of cost allocation factors should reflect the principles in 6.14 (a) – (c) above except where reliable information is not available to support the application of the principles.

In Telstra's submission to the further draft decision, it stated its view that the ACCC's adjustments to allocation factors are inconsistent with the cost allocation fixed principle.⁶⁰⁴ Telstra submitted that the adjustments lead to an allocation of costs that does not reflect the relative usage of the network by various services or the causal relationships between supplying services and incurring costs. The result, in Telstra's view, is a set of allocation factors that do not provide for a full allocation of the revenue requirement among users of the fixed line network: a portion of the revenue requirement (that is, the portion attributed to NBN-induced loss of scale economies) is not allocated across current users of the fixed line network. Telstra submitted that the ACCC has not explained how it reconciles this approach with its draft decision to adopt a fully allocated cost framework.⁶⁰⁵ Telstra also submitted that the ACCC is making an exception to the fixed principles and that the ACCC is treating the loss of economies of scale due to NBN migration as a 'special case' requiring exceptional treatment, as compared to any other factor which might affect unit costs, such as fixed-to-mobile substitution or changes in input costs.⁶⁰⁶

Telstra has submitted a further report by Mr Jeff Balchin in relation to the ACCC's treatment of the impact of the NBN. Mr Balchin states that:⁶⁰⁷

the outcome of the cost allocation factors that the ACCC proposes to apply is that a material share of the revenue requirement will not be allocated to a service or user for which there is a corresponding

⁶⁰² iiNet, *Further Draft Decision – Outstanding Issues*, July 2015, p. 9.

⁶⁰³ Lockey Report, July 2015, p. 7.

⁶⁰⁴ Telstra, *Response to ACCC further draft decision*, July 2015, pp. 18-21.

⁶⁰⁵ *ibid.*

⁶⁰⁶ *ibid.*, p. 27.

⁶⁰⁷ Balchin Report, July 2015, p. 10.

revenue stream being generated. Rather, a share of the revenue requirement will simply be unrecoverable.

Mr Balchin concludes that the ACCC's proposed cost allocation adjustments do not meet the fixed principles.

The ACCC has applied the fixed principles having regard to the matters in subsection 152BCA(1) of the CCA, including Telstra's legitimate business interests and the overarching objective of the LTIE. The ACCC's allocation of costs ensures that those costs which Telstra had an opportunity to recover—and for which Telstra has been provided with an avenue of recovery—through the DAs are not allocated to remaining users of the fixed line network.

The ACCC's treatment of the costs attributed to NBN-induced loss of economies of scale is consistent with an application of the fixed principles that appropriately has regard to the overarching LTIE objective of Part XIC. The unique circumstances of NBN migration, as noted in section 10.1, centre on the Telstra-NBN arrangements: Telstra is migrating its customer base to the NBN and selling and leasing infrastructure to NBN Co and receiving corresponding payments. The ACCC considers that the migration of customers to the NBN under these arrangements is causing the under-utilisation of certain assets and that Telstra has been provided with the opportunity to ensure that it would receive consideration through the DAs for the impact of the NBN on its fixed line assets, including the costs associated with such under-utilisation as a result of NBN migration. The ACCC also considers that the payments Telstra receives under the DAs represent an avenue for the recovery of costs including those associated with NBN-induced loss of economies of scale. Further, under the DAs, Telstra will only provide fixed line services over the NBN where it is deployed, and as a result, any excess capacity caused by NBN migration will not be put to future use by remaining users of the fixed line network.

The ACCC considers that these factors distinguish this type of excess capacity from other types of excess capacity such as that caused by fixed-to-mobile substitution. The ACCC considers that it would be contrary to the LTIE to apply the fixed principles in such a way that costs could be allocated to users of the fixed line network who do not cause them when Telstra has been provided with the opportunity to be compensated for such costs, and when Telstra is receiving ongoing revenues that represent an avenue for their recovery.

The ACCC's cost allocations reflect the relative usage of Telstra's network by various services that continue to be supplied. The ACCC's adjustments to cost allocation factors are made on a per asset class basis using per asset class estimates of the higher unit costs caused by NBN-induced excess capacity. Since the allocations for a given asset class for a given year are all adjusted by a single corresponding adjustment factor, the relativities between service allocations are unaffected. Therefore, for all services that continue to be supplied, cost allocations remain reflective of each service's usage of the fixed line network relative to other services.

The ACCC's approach is consistent with a fully allocated cost framework. The ACCC has not, as Telstra has submitted, reverted to a 'partially allocated' approach⁶⁰⁸ or moved away from the March draft decision to adopt a fully allocated cost framework.⁶⁰⁹ In this FAD inquiry, Telstra proposed that a fully allocated cost framework be adopted which takes into account all services supplied over the fixed line network, including both regulated and unregulated. The ACCC's March draft decision was to adopt this approach. In doing so, the ACCC explained that the framework adopted in 2011 was a 'partially allocated' approach in that it took into account demand for declared services but not for other services supplied over the fixed line network. The ACCC's final decision reflects a cost allocation framework that takes into account demand for both regulated and other services supplied over the fixed line network. This removes any

⁶⁰⁸ Telstra, *Response to ACCC further draft decision*, July 2015, pp. 19.

⁶⁰⁹ Telstra, *Response to industry submissions on the ACCC further draft decision*, August 2015, p. 5.

potential distortion in the allocations that may arise from considering the demand for regulated services in isolation. The ACCC's adjustments to cost allocation factors do not change that approach.

Beyond this, the ACCC does not accept that the adoption of the fully allocated cost framework in the FLSM requires that all costs attributed to the declared services must be exclusively recovered through regulated charges. A share of total costs may be allocated to the declared services, and a share may be allocated to other services. The ACCC's cost allocations reflect this. Given the unique circumstances in which this final decision is made, the ACCC's cost allocations also ensure that the costs attributed to NBN-induced under-utilisation are not allocated to these services. Telstra had an opportunity to ensure that it would be compensated under the DAs for such costs, and is receiving payments that provide an avenue for their recovery. Therefore, the ACCC's cost allocations result in a full allocation of the total revenue requirement.

Demand fixed principle

Clause 6.11 relates to demand forecasts. This clause specifies the following:

6.11 Demand forecasts should:

- (a) be based on an appropriate forecasting methodology;
- (b) be based on reasonable assumptions about the key drivers of demand;
- (c) be determined utilising the best available information before the ACCC, including historical data that can identify trends in demand; and
- (d) be determined taking into account current demand and economic conditions.

In its submission to the further draft decision, Telstra stated that the ACCC's adjustment to cost allocation factors is inconsistent with the demand fixed principle. Telstra submitted that the demand fixed principle requires that demand forecasts reflect current demand and economic conditions, and does not allow for hypothetical forecasts of demand.⁶¹⁰ Telstra submitted that the ACCC's adjustments are based on a hypothetical view of demand for the fixed line services in the absence of the NBN.⁶¹¹

Telstra referred to the report by Mr Balchin, in which he concludes that the ACCC's cost allocation adjustments do not meet the demand fixed principle because it will result in access prices being driven by hypothetical forecasts of demand.⁶¹²

Telstra is correct to note that these adjustments are based on a hypothetical view of demand for the fixed line services in the absence of the NBN. However, the ACCC notes that these ex-NBN demand forecasts are not intended to reflect real world forecasts of demand for the fixed line services. They are intended to reflect the best estimate of demand that would occur in the absence of the NBN (using Telstra's ex-NBN forecasts) for the specific purpose of estimating the unit costs that would result if NBN-induced under-utilisation did not occur. These are then compared to unit costs expected to result with NBN-induced under-utilisation. The proportionate difference between the two estimates of unit costs then forms the basis of the adjustments applied to cost allocations. The ACCC considers that this is an appropriate method to assess the impact of NBN migration on demand—and, in turn, unit costs—based on Telstra's ex-NBN forecasts of demand combined with NBN Co's most recent rollout forecasts.

⁶¹⁰ Telstra, *Response to ACCC further draft decision*, July 2015, pp. 18.

⁶¹¹ *ibid.*

⁶¹² *ibid.*

The demand forecasts in the parts of the FLSM where they are typically used—that is, in the determination of cost allocation factors and in the calculation of service prices—reflect Telstra’s forecasts of demand for the fixed line services taking into account NBN migration. As noted above, the circumstances in which the ACCC makes this final decision are not typical. The ACCC considers that the methodology it has applied to remove the costs attributed to NBN-induced asset under-utilisation is appropriate and robust, and uses the best information available. That this methodology uses hypothetical forecasts of demand does not cause an inconsistency with the fixed principles to arise.

The demand fixed principle provides the basis for determining forecasts of demand. Mr Balchin’s conclusion appears to be based on a characterisation of the fixed principles such that they require demand forecasts to reflect ‘the sales of the fixed line services over the regulatory period ahead’ and require revenue requirements to be divided by actual demand to determine prices.⁶¹³ The fixed principles do not state this. Further, Mr Balchin considers that the ACCC’s adjustments will mean that there is ‘little or no relationship between the access prices and the forecasts of actual demand’. The ACCC notes that the fixed principles do not require the ACCC to determine individual access prices, much less require that access prices correlate with forecasts of demand—nor do the matters the ACCC must take into account in making an access determination.⁶¹⁴ The fixed principles as a whole prescribe a methodology to be followed in determining revenue requirements and assessing forecasts—individual access charges are calculated, based on these revenue requirements, in the FLSM.

10.4.6 Implementation

This section discusses the implementation of the ACCC’s final decision in the FLSM, and provides a response to submissions on implementation issues.

10.4.6.1 Adjustments in the FLSM

The ACCC has maintained its adjustments in the FLSM to give effect to its decision to remove assets sold to NBN Co from the RAB. The ACCC has treated a proportion of the RAB value of the copper cables asset class as an asset disposal in each year, with that proportion being based on the expected rate of the NBN rollout. The ACCC has also maintained the adjustments within Telstra’s allocation framework to reflect NBN Co’s leasing of ducts, exchange rack space and dark fibre links. The adjustments are made to the ‘ducts and pipes’, ‘other communications plant and equipment’, and ‘inter-exchange cables’ assets classes, respectively.

Further, the ACCC has maintained its adjustments in the FLSM to give effect to its decision to remove the costs associated with NBN-induced asset redundancy and under-utilisation from regulated revenues. Under these adjustments:

- A proportion of the regulatory value of assets made redundant by NBN migration is treated as an asset disposal in the roll-forward of the RAB. This proportion is determined based on the expected rate of the NBN rollout.⁶¹⁵
- For assets that become progressively under-utilised as a result of NBN migration, adjustments are made to cost allocation factors to ensure that the costs associated with this under-utilisation are not allocated to fixed line services.⁶¹⁶

⁶¹³ Balchin Report, July 2015, p. 10.

⁶¹⁴ Section 152BC(8) specifies that an access determination must include terms and conditions relating to a price or a method of ascertaining price.

⁶¹⁵ The disposals adjustment applies to the following asset classes: CA02 Copper cables, CA03 Other cables, CA04 Pair gain systems, CA05 CAN radio bearer equipment, CA06 Other CAN assets, and CO01 Switching equipment – Local (proportion of costs relating to assets whose costs are SIO-driven).

These adjustments to cost allocation factors are intended to give effect to the ACCC's final decision that the costs associated with NBN-induced under-utilisation should not be allocated to fixed line services. The adjustments are based on what Analysys Mason refers to in its report as an 'incremental costing' approach, whereby the cost of spare capacity within an asset is measured as the difference between the total cost of the assets with spare capacity and the cost of the assets if there were no spare capacity.⁶¹⁷

The adjustments in the FLSM involve the following steps:

- Step 1: Estimate unit costs for each relevant asset class that would result if NBN-induced under-utilisation did not occur. These unit costs are estimated by replacing FLSM expenditure and demand inputs with ones that do not account for the impact of the NBN. For demand, Telstra's ex-NBN demand forecasts are used. For capital expenditure, Telstra's forecast model is used to estimate a pre-NBN level that is applied throughout the forecast period (this is discussed further below). For operating expenditure, the impacts of the NBN rollout are removed from the forecast model. In addition, adjustments are made to cost allocations to remove NBN impacts.
- Step 2: Calculate the proportionate difference between, firstly, unit costs calculated by the FLSM (using final decision inputs and (pre-scale adjustment) cost allocation factors and, secondly, the unit costs estimated under Step 1. This difference represents the per asset class cost of NBN-induced excess capacity as a proportion of total unit costs.
- Step 3: Scale down allocation factors for each relevant asset class by the proportionate cost of excess capacity calculated under Step 2. That is, multiply allocation factors by 1 minus the proportionate difference in unit costs arising from NBN-induced excess capacity.

As noted in the further draft decision, the intended effect of these adjustments is that unit costs for each asset class do not rise as a result of under-utilisation caused by NBN migration.

10.4.6.2 Telstra's submission on implementation

In its response to the further draft decision, Telstra submitted that it disagreed with the ACCC's implementation of its cost allocation adjustments. Telstra submitted that it had two main concerns in relation to the ACCC's methodology:

- First, Telstra submitted that the ACCC had used the wrong 'counterfactual'.⁶¹⁸ Telstra submitted that the issue identified by the ACCC is that there will be a loss of economies of scale caused by Telstra entering into the DAs, while the cost allocation adjustments seek to remove the effect of lost economies of scale due to the NBN rollout. Telstra submitted that there would be a loss of economies of scale associated with the NBN rollout regardless of Telstra's cooperation, and that it would be inappropriate for Telstra to bear the entirety of the costs given that Telstra is no more responsible for the NBN than other users of the fixed line network. Telstra submitted that it would be more appropriate to base the adjustment on a 'no deal' scenario in which it is assumed that the NBN continues to be rolled out but without Telstra's cooperation. Under this scenario, Telstra would compete with the NBN. Telstra submitted modelling with forecasts of expenditure and demand under such a scenario.

⁶¹⁶ The cost allocation adjustment applied to all other asset classes, and the proportion of local switching costs relating to assets whose costs are traffic-driven.

⁶¹⁷ Analysys Mason, *Assessment and verification of inputs into Telstra's Cost Allocation Framework*, June 2015, p. 17.

⁶¹⁸ Telstra, *Response to ACCC further draft decision*, July 2015, pp. 28-29.

- Second, Telstra submitted that the ACCC's cost allocation adjustments appear to have the objective of ensuring that access prices reflect the unit cost of providing services in a hypothetical 'without NBN' world, rather than real world unit cost.⁶¹⁹ Telstra submitted that the ACCC's estimation of 'without-NBN' unit costs is based on inconsistent assumptions.⁶²⁰ Telstra submitted that the ACCC uses a hypothetical view of 'without NBN' demand, while it takes the RAB as it is today (that is, the real world RAB). Further, Telstra submitted that the ACCC has not accounted for the fact that, while demand may have been higher without the NBN, Telstra's costs would also have been higher (both forecast and historic). Telstra submitted that a 'no deal' scenario would involve Telstra facing higher capital costs and higher operating expenditure.

The ACCC provides its response to Telstra's submission below.

ACCC response to Telstra's submission

The ACCC notes that the premise of Telstra's conclusion that the ACCC has employed the wrong 'counterfactual' is incorrect. The ACCC's further draft decision was not made on the basis that a loss of economies of scale is being caused by Telstra having entered into the DAs. The ACCC clearly stated that NBN migration—which is occurring under the Telstra-NBN arrangements⁶²¹—is causing the loss of economies of scale. The further draft decision stated the following:⁶²²

The ACCC's draft decision is that users of the fixed line network should not bear the costs associated with the loss of economies of scale that will occur as a result of NBN migration.

Further, throughout chapter 4 of the further draft decision, the ACCC referred to the issue as 'NBN-induced loss of economies of scale'. It is clear from Telstra's submission to the further draft decision that Telstra has understood this aspect of the further draft decision as intended by the ACCC. In the first paragraph of the section of Telstra's submission dealing with NBN impacts, Telstra stated the following:

The ACCC states in the Further Draft Decision that costs associated with NBN-induced loss of scale economies should not be reflected in regulated revenues. The ACCC considers that these costs are caused by the migration of services to the NBN and not by users of the fixed line services.

Telstra also refers to the issue as 'NBN-induced loss of economies of scale' throughout its submission.

Therefore there can be no doubt as to the ACCC's draft decision on the cause of NBN-related loss of economies of scale, or Telstra's interpretation of it. In light of this, it is clear that the costs the ACCC seeks to remove from regulated revenues correspond to the issue the ACCC has identified. That is, there will be a loss of economies of scale caused by NBN migration, with adjustments to cost allocation intended to remove the costs associated with this loss of economies of scale from regulated revenues. There is no disconnect between the issue identified and the method proposed to address it, as submitted by Telstra.⁶²³

As discussed in the sections above, it is not appropriate for users of the fixed line network to bear costs they do not cause, which are associated with assets they will not use, and in respect of which Telstra has been provided with an avenue of recovery. Therefore, the ACCC confirms its intention that adjustments to allocation factors to prevent the costs attributed to NBN-induced under-utilisation, as calculated using the methodology described above, from being

⁶¹⁹ Telstra, *Response to ACCC further draft decision*, July 2015, p. 29.

⁶²⁰ *ibid.*, pp. 29-30.

⁶²¹ ACCC, *Further draft decision*, June 2015, p. 72.

⁶²² *ibid.*, p. 71.

⁶²³ Telstra, *Response to ACCC further draft decision*, July 2015, p. 29.

allocated to fixed line services. This means that, when estimating the proportionate unit costs associated with NBN-induced under-utilisation, estimated unit costs over the regulatory period should be compared to estimates of unit costs that would result if this under-utilisation did not occur—that is, estimates of unit costs that would arise in the absence of the NBN.

Estimation of unit costs without NBN-induced under-utilisation

The ACCC notes that Telstra's interpretation of the cost allocation adjustments as having the objective of ensuring that access prices reflect unit costs in a 'without NBN' world is not correct. The ACCC stated in the further draft decision that the intention of the cost allocation adjustments is to ensure that the increased unit costs associated with NBN-induced asset under-utilisation should not be allocated to fixed line services.⁶²⁴ As noted above, these adjustments have been maintained in order to give effect to the ACCC's final decision that users of the fixed line network should not bear the costs associated with NBN-induced loss of economies of scale. Therefore, it is not intended that access prices reflect the unit cost of providing services in a 'without NBN' world; rather, it is intended that access prices should not reflect unit cost in excess of what would be expected if NBN-induced under-utilisation did not occur.

The ACCC's response to Telstra's submissions on the assumptions behind the ACCC's estimation of unit costs without NBN-induced under-utilisation is set out below.

Capital expenditure for the regulatory period

As noted above, Telstra submitted to the further draft decision that the level of capital expenditure assumed by the ACCC in estimating unit costs without NBN-induced under-utilisation would underestimate capital expenditure in the absence of the NBN. This is because current levels of capital expenditure (on which the further draft decision assumptions were based) are lower than in earlier years, reflecting the fact of the NBN.

The ACCC accepts that the forecasts of capital expenditure used for the further draft decision to estimate unit costs that would result without NBN-induced under-utilisation may underestimate capital expenditure that would be expected to occur in the absence of the NBN. This is because, as Telstra submitted, current levels of capital expenditure (on which the forecasts are based) are lower than in pre-NBN years, which reflects the fact of the NBN in Telstra's current expenditure levels.⁶²⁵ The ACCC agrees, and has revised the estimates of capital expenditure that would occur in the absence of the NBN accordingly.

For the final decision, the ACCC has used Telstra's forecast model to estimate the level of capital expenditure relevant to the FLSM asset classes immediately before Telstra began to factor the NBN into its investment planning for the fixed line network. The ACCC has used Telstra's actual capital expenditure for 2011-12 to 2014-15, combined with forecasts accepted by the ACCC for 2015-16 to 2018-19, to determine an overall trend of capital expenditure for these years. The ACCC has used this trend to 'backcast' capital expenditure to the financial year in which the previous government's NBN policy was announced—that is, 2008-09. This produces an estimated pre-NBN level of capital expenditure of [cic] [REDACTED] [cic]. This level of capital expenditure is assumed to remain constant over the forecast period for the purposes of estimating unit costs in the absence of NBN-induced under-utilisation.

Figure below demonstrates this 'backcast' method. The solid line shows Telstra's actual capital expenditure for the FLSM asset classes between 2011-12 and 2014-15, and the forecasts accepted by the ACCC between 2015-16 and 2018-19. The dotted line represents the trend of capital expenditure over these years. The levels of 'backcast' capital expenditure for 2008-09 to 2010-11 are the levels that lie on this trend line. As noted, the ACCC has used the 'backcast'

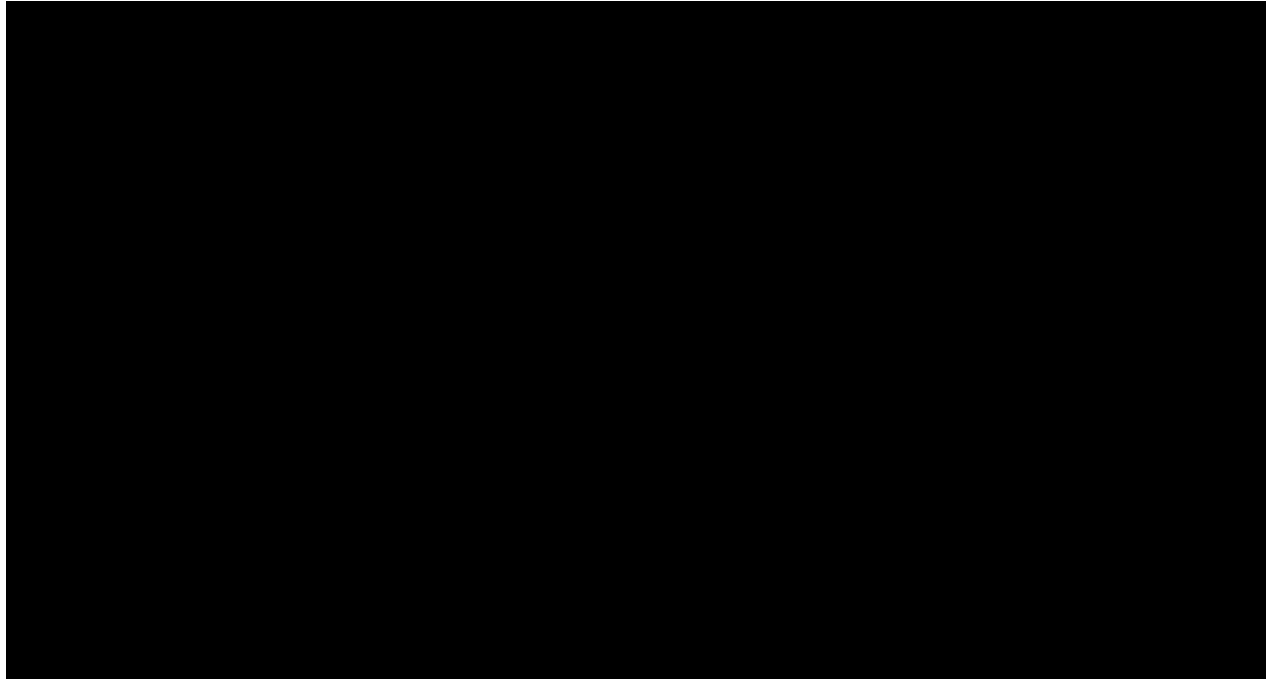
⁶²⁴ ACCC, *Further draft decision*, June 2015, p. 73.

⁶²⁵ Telstra, *Response to ACCC further draft decision*, July 2015, p. 30.

level from 2008-09 for the purposes of estimating unit costs without NBN-induced under-utilisation. The ACCC has used the 'backcast' level for 2008-09 as an estimate of Telstra's immediate pre-NBN level of capital expenditure relevant to the FLSM asset classes, and has held this level constant over the regulatory period to estimate unit costs in the absence of NBN-induced under-utilisation.

Figure 10.1: 'Backcast' capital expenditure

[c-i-c start]



[c-i-c end]

The ACCC considers that this method produces a reasonable estimate of Telstra's pre-NBN level of capital expenditure relevant to the FLSM asset classes. As noted, the level of capital expenditure estimated for 2008-09 using the 'backcast' method is [cic] [redacted] [cic]. Over the 4-year forecast period and 2014-15 this gives a total of [cic] [redacted] [cic], which is [cic] [redacted] [cic] than the total capital expenditure used to estimate unit costs without NBN-induced under-utilisation for the further draft decision. This method has the advantage of making use of the bottom-up forecasting methodology Telstra has employed for the FLSM asset classes for 2015-16 to 2018-19, as well as Telstra's actual levels of capital expenditure for 2011-12 to 2014-15, over which the impact of the NBN can be inferred. Given the unresponsiveness of Telstra's capital expenditure forecasts to non-NBN changes in demand over the forecast period, the ACCC considers that it is reasonable to assume that the downward trajectory of capital expenditure over this eight year period is attributable to the NBN. Using this trend to 'backcast' allows for a reversal of the impacts of the NBN on actual and forecast capital expenditure, and therefore provides a reasonable estimate of the level of capital expenditure at the point in time where the NBN became a reality—that is, to 2008-09—which can then be used over the forecast period.

In Telstra's modelling of its 'no deal' (or 'compete') scenario, it assumed that annual capital expenditure over the forecast period would be [cic] [redacted] [cic] on average. Telstra determined this on the basis of the internal Telstra modelling of 'cooperate' and 'compete' NBN scenarios used to assess deal valuations during the negotiation of the DAs—referred to by Telstra as the 'NBN value analysis'.⁶²⁶ Telstra calculated the proportion of NBN value analysis

⁶²⁶ Telstra, *Response to ACCC further draft decision*, July 2015, p. 55.

capital expenditure in the compete scenario that is relevant to FLSM asset classes by taking the ratio of FLSM and Telstra Group capital expenditure in 2009-10—calculated as [cic] [redacted] [cic]—and applying this to the NBN value analysis compete scenario capital expenditure forecasts in each year. As explained above, a compete scenario is not appropriate for the purposes of an adjustment to allocation factors with the intention of removing costs associated with a loss of economies of scale that is due to NBN migration. However, for the purposes of comparison it is possible to adjust Telstra’s modelling to estimate forecasts of FLSM capital expenditure under Telstra’s ‘baseline’ or ‘without NBN’ scenario. This is done by removing (from NBN value analysis ‘compete’ scenario capital expenditure) the forecast FLSM savings and additional spending that are specific to the compete scenario.

However, the ACCC considers that it is not appropriate to base its cost allocation adjustments on the information and modelling submitted by Telstra. This is because, firstly, the NBN value analysis capital expenditure forecasts are hardcoded, and no supporting material has been provided to explain the assumptions and methods used to derive them. Secondly, the FLSM-to-Telstra Group capital expenditure ratio is based on 2009-10 figures for FLSM capital expenditure. Telstra did not explain the source of the FLSM-related capital expenditure for this year, however it broadly aligns with the amount rolled into the RAB in the FLSM.

The use of 2009-10 FLSM capital expenditure to determine this ratio would not be appropriate as it is based on an out-dated method of mapping Telstra Group capital expenditure to the FLSM asset classes. For this inquiry, Telstra has derived its capital expenditure forecasts based on a revised, bottom-up methodology which ensures the inclusion of only relevant expenditure and which is consistent with Telstra’s internal business systems and forecasting processes.⁶²⁷ As such, if the ACCC were to follow Telstra’s methodology, it would be more appropriate and consistent with the other information used to determine prices to use the actual levels of capital expenditure for 2011-12 to 2014-15 (that are used to derive the forecasts) as a proportion of Telstra Group capital expenditure for these years.⁶²⁸ Calculating the FLSM-to-Telstra Group capital expenditure ratio for 2011-12 to 2014-15 using these actuals results in a roughly constant ratio of between [cic] [redacted] [cic]. Taking the average ([cic] [redacted] [cic]) and applying this in Telstra’s modelling (and removing incremental compete scenario FLSM savings and additional spending to arrive at a ‘without NBN’ forecast) results in a lower level of capital expenditure for all years of the FLSM compared to the levels used by the ACCC.

However, the issue of the lack of transparency into Telstra’s NBN value analysis capital expenditure forecasts remains. In any case, the ACCC considers that its ‘backcast’ methodology provides the most reasonable estimate of a pre-NBN level of capital expenditure relevant to the FLSM asset classes which makes the greatest possible use of Telstra’s bottom-up forecasting methodology, thereby maintaining consistency with the mapping process used to determine capital expenditure forecasts in the FLSM. Further, compared to the level of capital expenditure determined when using Telstra’s modelling to estimate a ‘without NBN’ level, as discussed above, it is a conservative assumption.

Value of the opening RAB as at 2014-15

Telstra also submitted that the ACCC has incorrectly used the ‘real world’ value of the RAB as at the start of the regulatory period in estimating unit costs that would occur without NBN-induced under-utilisation. Telstra submitted that the NBN policy was implemented in 2007 and then redesigned in 2009. From this point Telstra’s capital expenditure decisions have been impacted by the knowledge that the NBN would be rolled out—therefore, ‘the real world’ RAB

⁶²⁷ Telstra, *FAD Inquiry – Confidential response to information request under the BBM RKR*, November 2013, p. 3-4.

⁶²⁸ That the numerator in the ratio—Telstra Group capex—is similarly influenced by the NBN. In any case, as noted, the ratio calculated is roughly constant (and in fact increasing slightly) over the relevant years.

reflects the fact that Telstra has reduced capital expenditure below what otherwise would have been required had the NBN not been rolled out.⁶²⁹

For the reasons outlined above, the ACCC considers that a reasonable estimate of Telstra's capital expenditure as at 2009, which makes use of Telstra's bottom-up forecasting methodology and reverses NBN impacts, is [cic] [redacted] [cic]. However, the level of capital expenditure used in the FLSM for the 2011 FADs for 2009-10 is [cic] [redacted] [cic], falling to [cic] [redacted] [cic] by 2013-14. The opening RAB as at 2014-15 is based on these levels. The ACCC has taken a conservative approach and maintained this opening RAB value at the start of the regulatory period to estimate unit costs that would arise without NBN-induced under-utilisation.

The ACCC considers that Telstra's modelling of past levels of capital expenditure in the FLSM for a 'compete' scenario supports the conservatism of maintaining the current levels in the FLSM for the purposes of the ACCC's cost allocation adjustments. As discussed above, adjustments to this modelling to reflect a 'without NBN' scenario, and attributing NBN value analysis capital expenditure forecasts to FLSM assets in a way that is more consistent with Telstra's RKR forecasting methodology, results in a lower level of capital expenditure for all years of the FLSM except 2010-11. Consequently, the value of the opening RAB in 2014-15 for this scenario would be significantly lower than that used by the ACCC—that is, using unaltered levels of capital expenditure in the FLSM between 2009-10 and 2013-14.

Operating expenditure for the regulatory period

To estimate unit costs without NBN-induced under-utilisation for the further draft decision, the ACCC held Telstra's forecast model base year (that is, actual 2013-14) operating costs constant throughout the forecast period. The ACCC noted that this was a conservative approach as it ignores any efficiency gains achieved over the forecast period, as well as any reduction in operating costs that may result from the forecast fall in demand for fixed line services that is unrelated to NBN migration.⁶³⁰ Telstra submitted that the basis of this assumption was not clear.⁶³¹

The ACCC has reviewed this assumption and considers that a more appropriate estimate of Telstra's operating expenditure in the absence of the NBN is produced by removing the direct impacts of the NBN rollout from Telstra's forecast model. The forecast model identifies how the NBN rollout directly impacts forecast operating expenditure. For example: it impacts SIOs which then impacts total CSD and Networks operating expenditure; it impacts capital expenditure forecasts which then impacts 'propex'; and it causes a fall in power consumption as a result of the decommissioning of DSLAMs. The ACCC considers that the removal of the NBN rollout from the forecast model, including setting annual DSLAM removal to zero, increases Telstra's operating expenditure forecasts by the costs it would not avoid in the absence of the NBN and therefore provides a reasonable estimate of forecast operating expenditure incurred in the absence of the NBN.

In addition, given that the 'backcast' methodology applied to estimate a level of pre-NBN capital expenditure does not allow for the automatic estimation of propex in Telstra's forecast model, the ACCC has estimated a 'without NBN' level of propex. To do this, the ACCC has (using Telstra's forecast model) calculated Telstra's historical (that is, 2011-12 to 2014-15) propex-capex ratios and applied them to the nominal 'backcast' levels of capital expenditure for these years. Telstra's forecast model then generates forecasts of propex, for a given year, based on the average propex-capex ratio for the preceding 4 years and the level of forecast capital expenditure for that year.

⁶²⁹ Telstra, *Response to ACCC further draft decision*, July 2015, p. 30.

⁶³⁰ ACCC, *Further draft decision*, June 2015, p. 76.

⁶³¹ Telstra, *Response to ACCC further draft decision*, July 2015, p. 30.

Total assumed operating expenditures over the forecast period under this approach are higher than that assumed in the further draft decision by 3.7 per cent. The ACCC maintains the view that this is a conservative approach. This is because, as discussed in chapter 4, Telstra's forecast model does not estimate or adjust for the trade-off between capital and operating expenditure. In the absence of the NBN, capital expenditure would necessarily be higher than what is forecast in the regulatory period, and as a result, operating expenditure would be expected to be lower. However, since Telstra's forecasts of operating expenditure do not respond to changes in forecast capital expenditure, the forecast operating costs remain indirectly influenced by considerations of the NBN rollout. That is, despite the direct impacts of the NBN rollout being removed from the model, operating expenditure forecasts would exceed 'truer' estimates of operating costs in the absence of the NBN by the undetermined amount of the capital and operating expenditure trade-off.

10.4.6.3 Response to submissions on the ACCC's implementation of the October 2014 position statement

As noted in section 10.3, Optus submitted in response to the further draft decision that it supports the implementation of the October 2014 position statement, and that the implementation of this position should not surprise any interested party.

Telstra submitted in response that the ACCC did not foreshadow any adjustment to allocation factors to account for the effect of NBN-induced loss of economies of scale. Telstra submitted that the October 2014 position statement dealt with the treatment of the three groups of assets that are potentially affected by NBN migration. Telstra submitted the first indication that the ACCC may adjust for the effects of loss of economies of scale came in the March draft decision, however there was no indication of what adjustment it intended to make.⁶³²

Telstra submitted that the further draft decision takes a different approach to that taken in the position statement—the position statement focuses on *assets* affected by NBN migration, whereas the further draft decision seeks to adjust the *total costs* that may be recovered (Telstra's emphasis) by adjusting allocation factors. This contrasts to the position statement, which in Telstra's view flagged that adjustments would be made only to the RAB.⁶³³

The ACCC notes that it did not indicate an intention to adjust allocation factors to account for under-utilisation in the October 2014 position statement. Nor did the ACCC indicate that it would only make adjustments to the RAB. The ACCC did not rule out the use of allocation factors to account for under-utilisation in the October 2014 position statement, nor did the ACCC indicate that it intended to do so. The ACCC released the position statement to indicate that it intended to adopt a regulatory values approach to accounting for the Telstra-NBN arrangements. The position statement also indicated how it intended to implement such an approach.⁶³⁴

The ACCC discussed the treatment of 'assets' in accounting for the Telstra-NBN arrangements; however this is not indicative of adjustments only to the RAB. This is evident from the ACCC's stated intention to account for NBN Co's leasing of Telstra's assets by making adjustments to cost allocation factors—and therefore total costs—within the context of the regulatory values approach. The ACCC stated the following:

The ACCC's position on leased assets is that, to the extent that NBN Co uses assets that are also used to provide declared services, this should be accounted for in the cost allocation framework of the FLSP...

⁶³² Telstra, *Response to industry submissions on the ACCC further draft decision*, August 2015, p. 5.

⁶³³ *ibid.*

⁶³⁴ ACCC, October 2013 Position Statement, p. v.

This approach, like that described above in relation to sold assets, constitutes a regulatory values treatment of leased assets, as the allocation of asset costs to declared services in the FLSM is based on the values assigned to those assets in the RAB.⁶³⁵

While the ACCC discussed ‘assets’ affected by the arrangements, the method by which the ACCC intended to account for these effects explicitly included both RAB adjustments (for sold assets) and cost allocation adjustments (for leased assets).⁶³⁶ Indeed, the further draft decision maintained this terminology by referring to NBN-induced asset under-utilisation—and its impact on total costs—in the section discussing the ACCC’s cost allocation adjustments. For example, the ACCC noted that certain assets will become progressively under-utilised as NBN migration continues, and that if the costs associated with such under-utilisation are reflected in regulated revenues then the unit costs of services supplied using these assets will rise.⁶³⁷

Therefore, the position statement did not propose that adjustments only be made to the RAB, or that adjustments would not be made to cost allocation factors as part of the ACCC’s regulatory values approach for accounting for the impacts of the NBN. In Telstra’s response to the draft decision it acknowledged and supported the ACCC’s approach to leased assets.⁶³⁸ Given Telstra’s acknowledgement of and support for the ACCC’s approach to leased assets, it is evident that the position statement was not understood by Telstra as only proposing adjustments to the RAB.

Further, in the ACCC’s discussion of assets affected by NBN migration in the position statement, it noted that some assets would be decommissioned and some assets would be utilised to a lesser extent. The ACCC’s position on accounting for this was that assets decommissioned, and an appropriate share of assets utilised to a lesser extent, should be removed from the regulated cost base.⁶³⁹ This is not indicative of adjustments exclusively to the RAB, particularly when read in conjunction with the ACCC’s proposal to treat assets sold to NBN Co as disposals and remove them from the RAB.

⁶³⁵ ACCC, October 2013 Position Statement, p. 11.

⁶³⁶ ACCC, October 2013 Position Statement, p. 11.

⁶³⁷ ACCC, *Further draft decision*, June 2015, p. 72.

⁶³⁸ Telstra, *Response to Draft Decision*, May 2015, p. 37.

⁶³⁹ ACCC, October 2013 Position Statement, p. 11.

11 Cost allocation

Key Points

- The ACCC's final decision is to implement a fully allocated cost framework for determining the prices of fixed line services. The ACCC has utilised the detailed cost allocation framework (CAF) and allocation factors developed by Telstra as the starting point for allocating Telstra's costs to declared fixed line services. The costs allocated to declared services form the basis for setting prices of the declared services.
- The CAF results in the cost impacts of declining demand for fixed line services being shared proportionally across all users of the network. However, as discussed in chapter 10, the ACCC has adjusted cost allocation factors in order to prevent costs attributed to loss of economies of scale caused by NBN-induced declining demand from being allocated to fixed line services. This is necessary because Telstra has been provided with an opportunity to be compensated for these costs under the DAs, and is receiving replacement revenues which provide an avenue for their recovery. This is not the case for other sources of declining demand such as fixed-to-mobile substitution.
- In addition to the NBN adjustment to cost allocation factors, the ACCC has implemented a number of specific adjustments to certain allocation factors in the final decision. These adjustments largely reflect the assessment and recommendations provided by Analysys Mason in its report for the ACCC and are made before the adjustments to remove the loss of economies of scale effect of migration of services to the NBN.
- The Analysys Mason assessment included a review of inputs into the Telstra model to verify that the proposed CAF and factors were based on accurate information, had been developed using reasonable methods and assumptions, and appropriately reflected forecast relative use by relevant services.
- In making its final decision on the allocation factors to be used in setting primary price terms the ACCC has considered the Analysys Mason analysis as well as comments provided by access seekers and Telstra in response to that analysis and the ACCC's proposed adjustments as detailed in the further draft decision.

11.1 Introduction

Telstra's fixed line network is used to provide both declared and non-declared services. Cost allocation factors are used in the FLSM to allocate a share of each asset class's total revenue requirement to individual declared services to estimate the costs of providing these services. Prices for declared services are then calculated based on costs allocated to these services.

The majority of cost allocation factors for the 2011 FADs were based on a model previously developed by Analysys Mason (the Analysys model).⁶⁴⁰ The ACCC modified the Analysys model's allocation factors to reflect that the model assumed an optimised network and did not include all asset classes making up the FLSM to determine the allocation framework for the 2011 FADs. This framework was a 'partially allocated' approach in that it considered changes in demand for only declared services and did not take into account demand for other services that

⁶⁴⁰ The Analysys model was a Total Service Long Run Incremental Cost, plus indirect costs (TSLRIC+) model, developed in 2007-08 before the building block model was adopted by the ACCC.

use fixed line assets. The 2011 framework thus accounted for the relative use of the fixed line network as between the declared services but not relative to other uses of the network.

Telstra proposed that a fully allocated cost framework for setting prices should be adopted in the FADs for the next regulatory period. A fully allocated approach considers all uses of the network when allocating the costs of the fixed line assets. In the CAF proposed by Telstra, costs are explicitly allocated to non-declared services as well as declared services that use the fixed line network, taking into account relative usage of the network by all services.⁶⁴¹

Following the release of the draft decision, the ACCC engaged Analysys Mason to undertake a further assessment of Telstra's proposed cost allocation framework (CAF).⁶⁴² This chapter sets out the ACCC's final decision on key aspects of the CAF used to determine primary price terms for the declared fixed line services as proposed in the ACCC's further draft decision. It focuses on Analysys Mason's findings and recommendations and the ACCC's position on the inputs, assumptions and methodologies used in Telstra's proposed model to reflect usage by various services (the ACCC's adjustments to cost allocation factors to account for the loss of economies of scale caused by migration of services to the NBN are discussed in chapter 4).

11.2 Draft decision

The ACCC's March draft decision on cost allocation and declining demand is summarised in section 10.4 of the June further draft decision.

In its further draft decision the ACCC reiterated its position from the draft decision that a fully allocated approach was an appropriate approach for allocating the costs of Telstra's fixed line network. It maintained its view that a fully allocated approach was compatible with the building block methodology; was likely to result in prices that reflect the relative cost of supplying declared fixed line services; and formed an appropriate basis for accounting for NBN related impacts.

Prior to reaching its further draft decision the ACCC engaged Analysys Mason to undertake the further assessment and verification of Telstra's CAF and to advise on assumptions and methodologies used in the calculation of cost allocation factors. Analysys Mason provided a final report on its findings and recommendations on 16 June 2015.⁶⁴³

The Analysys Mason report proposed some broad principles for assessing Telstra's proposed CAF in the context of the roll-out of the NBN as well as several specific recommendations with respect to cost allocation factors for individual asset classes. These are outlined below.

Analysys Mason's principles for assessment

Analysys Mason's framework for assessing Telstra's proposed CAF with the rollout of the NBN took into account the ACCC's fixed principles and the long-term interests of end-users (LTIE) objective of Part XIC of the CCA, as well as Ofcom's cost allocation principles.⁶⁴⁴ Accordingly, Analysys Mason proposed that:

⁶⁴¹ Telstra, Cost Allocation Framework for the ACCC Fixed Line Services Model - Framework and Model Guide, Version 1, July 2014

⁶⁴² A summary of the ACCC's draft decision on cost allocation is contained within section 5.2 of the July 2015 further draft decision.

⁶⁴³ Analysys Mason, Assessment and verification of inputs into Telstra's Cost Allocation Framework, 16 June 2015. A public version of Analysys Mason's report is available on the ACCC website. Access seekers that entered confidentiality arrangements with Telstra were provided with access to the confidential version.

⁶⁴⁴ Ofcom, http://www.ofcom.org.uk/static/archive/oftel/ind_info/numbering/mnpdetre.pdf, pp. 5-6.

- *Scalable assets that progressively become redundant* as the NBN is rolled out should be removed from the RAB through the asset disposal mechanism.
- *Efficiently incurred costs and assets that are not made progressively redundant* as the NBN is rolled out but that become progressively underutilised even for an efficient operator should remain in the RAB, but the CAF should allocate the overcapacity appropriately.⁶⁴⁵

For the second of these, it was proposed that the efficiently incurred costs be included in the CAF and allocated across appropriate services in line with the principles of cost causation, distribution of benefits, cost minimisation, effective competition and practicality.

In the case of overcapacity caused by the NBN, Analysys Mason considered that the party (or service) could be 'Telstra Corporate' or 'NBN-Telstra agreement' cost centre rather than to Telstra fixed line services, on the basis that the fixed line services cannot use the overcapacity.

Analysys Mason's recommendations on specific asset classes.

Analysys Mason also provided an assessment for each of the 22 asset classes. Analysys Mason's specific recommendations on each asset class related to the verification of inputs into Telstra's proposed CAF and assumptions and methodologies used to determine forecast usage by the various services that use Telstra's fixed line assets.

For 10 of the 22 FLSM asset classes, Analysys Mason found that the inputs into the calculation of cost allocation factors could be verified as being reasonable. For the remaining 12 asset classes, Analysys Mason recommended the following adjustments:

- *CA01: Ducts and pipes* – It was proposed that fixed line duct usage should be reduced by [c-i-c starts] [c-i-c ends] for every 1m of duct usage by NBN Co in FTTP/dp, FTTN or HFC to reflect the relatively larger duct usage requirement for the fixed line network compared to the NBN. Telstra had only made allowance for a reduction in CAN duct and pipe usage with the rollout of the NBN in relation to FTTN and on a 1 for 1 distance basis. FTTP/dp and HFC duct use was also treated as additive, rather than substitutive to CAN usage.
- *CA08: Network land and CA09: Network buildings/support* – Analysys Mason noted that Telstra applies a land value modification to asset classes CO07, CO08 and CO09 to reflect the higher value of exchange space in urban areas than in outlying areas and recommended that these should also be applied to asset classes CA08 and CA09.⁶⁴⁶
- *CO01: Switching equipment (local)* – Reflecting that the port component of local switching assets is scalable while the remaining traffic-driven component is not scalable Analysys Mason proposed that the port-related costs be removed entirely from this asset class via the asset disposal mechanism and that the remaining traffic component of costs be allocated on the basis of SIOs and the costs of overcapacity be progressively allocated to the NBN in proportion to SIO migration or across all services as an EPMU. It also proposed recalculating the allocation between the port and traffic components by ignoring an item of negative \$4.9 million for 'Local Switch – Credit') which it could not attribute to either port or traffic driven components.
- *CO02: Switching equipment (trunk) and CO03: Switching equipment (other)* - As the legacy switching equipment can be reused by subscribers who have been migrated to the NBN access network with the use of trunk gateways, Analysys Mason

⁶⁴⁵ Analysys Mason, *op.cit.*, pp.13-14.

⁶⁴⁶ *ibid*, pp. 42-44.

recommended allocation of a portion of these costs to the NBN or maintaining the use of Minutes of Use (MOU) as the basis for the allocation and modifying the forecast used to keep the volume of PSTN traffic broadly constant (e.g. pre NBN forecast).⁶⁴⁷

- *CO04: Inter-exchange cables* – Analysys Mason recommended that the platform allocation should be updated using March 2015 NDS platform allocation data. This would enable the extrapolation from a one-year period rather than a six-month period.
- *CO05: Transmission equipment* – Analysys Mason recommended rebasing the transmission technology distribution in order to keep the ‘other’ transmission platform category constant, whilst the remaining categories be allowed to vary as per the current approach.
- *CO07: Other communications plant and equipment/ CO08: Network land/ CO09: Network buildings/support* – Analysys Mason recommended reviewing the rack usage forecasts when the CAF is updated to ensure that it takes account of the latest available information. It also suggested keeping the TEBA rack forecast static at 2013/14 levels.
- *CO12: Data equipment* – Analysys Mason recommended allocating subscriber and throughput driven components separately. It was argued this would be more in line with principles of cost causation. It also proposed making a distinction between scalable and non-scalable equipment for the purposes of modelling the impact of migration to the NBN.

Summary of ACCC further draft decision

Taking into account stakeholder submissions and the Analysys Mason recommendations the ACCC’s further draft decision on costs allocations was:

- Subject to a number of specific changes recommended by Analysys Mason, the ACCC would accept Telstra’s proposed CAF as the starting point for allocating costs to declared services over the next regulatory period.
- To make adjustments to cost allocation factors to account for the loss of economies of scale caused by the migration of customers to the NBN for the 17 affected asset classes. These adjustments scaled down allocation factors for each asset class by the proportionate cost of NBN induced excess capacity to ensure that higher costs associated with the migration to the NBN are not borne by remaining users of fixed line services. This is described further in chapter 10.
- To make a series of proposed additional modifications to allocations factors for specific asset classes to improve the integrity of these allocations. These covered 8 of the 12 asset classes for which Analysys Mason proposed changes. For the remainder no changes were proposed.

11.3 Submissions to further draft decision

There were only a small number of comments in submissions in response to the ACCC’s cost allocation approach proposed in the further draft decision. While Telstra submitted extensively on the loss of economies of scale adjustments related to the NBN, its submission did not comment on adjustments to specific cost allocation factors.

⁶⁴⁷ *ibid*, pp. 50-51.

iiNet indicated that it had not been able to undertake a detailed assessment of Analysys Mason's findings on the costs allocations to verify whether they were correct. However, it stated it was broadly satisfied that the recommendations as implemented by the ACCC in the June Draft Decision were based on appropriate objectives (including consistency with the Fixed Principles and promotion of the LTIE) and sound reasoning.⁶⁴⁸

Optus was the only stakeholder providing comments on the adjustments to the specific asset classes in the further draft decision. It was broadly supportive of the ACCC's approach in the further draft decision for cost allocation adjustment to ducts and pipes (CA01)⁶⁴⁹, Network land and buildings (CA08, CA09, CO08, CO09)⁶⁵⁰ and for Local switching asset classes (CO01) and trunk switching asset class (CO02),

For Inter-exchange cables (CO04), Optus submitted that whilst it disagrees with the ACCC's approach not to make adjustments to this class in the further draft decision, given the likely magnitude of the impact, the ACCC approach can be accepted on a pragmatic basis.⁶⁵¹

For the Transmission equipment (CO05) asset class, Optus notes that the further draft decision did not address the concerns raised in Optus' response to the draft decision about the use of an SIO-based allocator and the possible use of a traffic-based allocator as an alternative. However it noted that the decision not to alter Telstra's approach may be a practical one given the long timeframes of the inquiry.⁶⁵²

For the Data equipment (CO12) asset class, Optus stated it disagreed with the ACCC's acceptance in the further draft decision that SIO-based NBN adjustments were adequate. Optus submitted that the growth in NBN traffic is likely to be much greater than the growth in NBN SIOs. Optus also notes that the advice of Analysys Mason is consistent with Optus' response to the draft decision. However, Optus concluded that the further draft decision may be a practical outcome given information available to the ACCC and the already long timeframe of the inquiry.⁶⁵³

Telstra wrote to the ACCC on 28 August 2015 to express concern at Analysys Mason's (and the ACCC's) proposed adjustments to the allocations for the ducts and pipes asset class (CA01). It was concerned that Analysys Mason's proposed duct usage factor of [start c-i-c] [c-i-c end] used to reduce the amount of CAN duct for a given distance of NBN network deployed was based on the incorrect assumption that Telstra's duct is only used by the CAN; that it was not correct to assume fibre usage of duct length will be on a 1 for 1 basis; and that sufficient consideration was not taken that the NBN will be made up of range of access technologies with different duct usage. Telstra proposed that it would be more reasonable for the ACCC to assume that NBN and fixed line usage of the duct network was equivalent on a per service basis.⁶⁵⁴

Telstra also expressed concerns with the application of the economies of scale adjustment, both for the ducts and pipes asset class and other asset classes more generally including trunk and other switching equipment (CO02 and CO03). In relation to ducts and pipes, it proposed that the reduction in duct usage by the CAN in FTTP/dp and HFC areas as proposed by

⁶⁴⁸ Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues*, July 2015, iiNet, *Submission by iiNet Limited*, July 2015, p. 11.

⁶⁴⁹ Optus, *Submission in response to ACCC Further Draft Decision – Outstanding Issues*, July 2015, p. 10.

⁶⁵⁰ *Ibid.*, p. 11.

⁶⁵¹ *Ibid.*, p. 11.

⁶⁵² *Ibid.*, p. 11.

⁶⁵³ *Ibid.*, p. 12.

⁶⁵⁴ Telstra, *Response to Analysis Mason/Further Draft Decision*, 28 August 2015, pp. 3-4.

Analysys Mason and the ACCC in its further draft decision should only occur if the proposed adjustment for loss of economies of scale was not made.⁶⁵⁵

Telstra stated it supported changes in the allocation factors for the asset classes network land (CA08) and network buildings and support (CA09) to account for land value differences across ULLS bands, recalculating the share of port and traffic shares for local switching equipment (CO01) and for the ACCC not to adjust the allocator for inter-exchange cables (CO04).⁶⁵⁶ It was silent on the adjustments the ACCC proposed to make to the other asset classes in the further draft decision.

11.4 ACCC final decision

The ACCC's final decision is to implement a fully allocated cost (FAC) framework for determining the prices of fixed line services. The ACCC has used the detailed cost allocation framework (CAF) and allocation factors developed by Telstra as the starting point for allocating Telstra's costs to declared fixed line services. This framework allows the impact of falling demand for fixed services to be shared proportionally by all services using the PSTN. However, as discussed in chapter 10, the ACCC has adjusted allocation factors to ensure that the costs attributed to the loss of economies of scale caused by NBN migration are not allocated to users of the fixed line network. This is because Telstra has been provided with an opportunity to be compensated for these costs under the DAs, and is receiving replacement revenues which provide an avenue for their recovery. This is not the case for other sources of declining demand such as fixed-to-mobile substitution.

In addition, in its final implementation of the FAC framework the ACCC has made a number of adjustments to Telstra's proposed cost allocation factors to better reflect how costs are incurred and shared with the declared fixed line services. These adjustments implement the changes to allocations proposed in the further draft decision following the report by Analysys Mason.

Assessment of approach against section 152BCA matters

As noted in section 2.6, the prices calculated as a result of the ACCC's adjustments to cost allocation factors to reflect NBN-induced under-utilisation will allow Telstra to recover the efficient costs of providing access to the declared services net of the costs attributed to NBN-induced loss of economies of scale. The ACCC's assessment against the 152BCA matters in this section relate to the adoption of Telstra's CAF and the adjustments made by the ACCC as a result of the report by Analysys Mason. That is, this assessment is made against the allocation factors which are determined before adjustments to reflect NBN-induced under-utilisation are applied.

The FAC approach facilitates the recovery of only the efficient costs of the supply of the declared fixed line services. The ACCC considers that this will encourage the economically efficient investment in the fixed line network.⁶⁵⁷ The ACCC also considers that this is also in Telstra's legitimate business interests.⁶⁵⁸

Use of the FAC as adjusted by the ACCC to more accurately reflect relative use by declared fixed line services means that prices for declared fixed line services are based on the prudent and efficient costs of providing access. This will allow access seekers to obtain access to the

⁶⁵⁵ Ibid. pp. 2, 5.

⁶⁵⁶ Ibid. pp. 4-5.

⁶⁵⁷ Sections 152BCA(1)(a) and 152AB(2)(e).

⁶⁵⁸ Sections 152BCA(1)(b) and 152AB(6)(b).

declared fixed line services on reasonable price terms for the purpose of providing downstream services and thereby promote competition in downstream markets.⁶⁵⁹

Determining cost allocations and pricing of services through a transparently determined FAC framework and cost-based pricing model (implemented using the FLSM) will provide regulatory certainty for both the access provider and access seekers about the way in which the ACCC will set prices for declared fixed line services over time. Such certainty encourages the economically efficient investment in the infrastructure and will promote competition in the markets for carriage services.⁶⁶⁰

The cost allocations as adjusted by the ACCC are designed to ensure that the regulated fixed line services contribute an appropriate share of Telstra's costs in supplying the regulated fixed line services in combination with other services. The resulting costs allocated to the regulated fixed line services are expected to promote competition in the markets for carriage services and encourage the economically efficient use of, and the economically efficient investment in, the infrastructure.⁶⁶¹

The ACCC considers that adopting the costs allocations in the final decision is in the access provider's legitimate business interests as it means that access seekers will contribute fully to the costs of the services that they use, thereby enabling Telstra to recover the cost of efficient investments and the efficient costs of supplying the declared fixed line services.⁶⁶²

The adjusted cost allocations will also better ensure that only the costs of providing the declared fixed line services are included in the revenue requirement used to estimate prices. This will help ensure access prices allow for the recovery of only the efficient costs of supplying the declared fixed line services and promote competition in the supply of listed services.⁶⁶³

The adjustments to cost allocation factors in the FLSM ensure that the costs associated with providing other services over the PSTN are not included in the revenue requirement for declared fixed line services, thereby ensuring the efficient supply of other eligible communications services.⁶⁶⁴

Use of fully allocated costs

The ACCC's final decision is to adopt Telstra's CAF as the basis from which costs are allocated to the declared services. This maintains the ACCC's position as detailed in section 10.4 of the draft decision and section 5.4 of the further draft decision. The ACCC reiterates the reasoning in these decisions that the use of a FAC framework provides a transparent method of identifying and allocating costs to all services that utilise Telstra's fixed network, helps to ensure that services contribute to the costs of the fixed line service assets based on their relative use of these assets, and enables fixed network assets leased by the NBN to be accounted for explicitly.

In addition to the migration of fixed line customers to the NBN, the evolution of services offered by mobile network operators and changes in consumer preferences have resulted in declining demand for fixed line services due to substitution of mobile services. The declining demand for fixed line services results in reduced utilisation of fixed line assets and network costs being shared across a smaller number of users.

⁶⁵⁹ Sections 152BCA(1)(a), 152AB(2)(c) and 152AB(4).

⁶⁶⁰ Sections 152BCA(3), 152BCA(1)(a) and 152AB(2)(c) and (e).

⁶⁶¹ Sections 152BCA(1)(a) and 152AB(2)(c) and (e).

⁶⁶² Sections 152BCA(1)(b), 152BCA(6)(b), 152BCA(1)(a) and 152AB(2)(e).

⁶⁶³ Sections 152BCA(1)(c), 152BCA(1)(a), 152AB(2)(c) and 152AB(4).

⁶⁶⁴ Section 152BCA(2).

Under the FAC framework, the cost impacts of declining demand are shared proportionally across all users of the network. However, as discussed in chapter 10, the ACCC has adjusted allocation factors to ensure that the costs attributed to the loss of economies of scale caused by NBN migration are not allocated to users of the fixed line network. The cause of this decline in demand is the migration of fixed line customers to the NBN, facilitated by the arrangements between Telstra and NBN Co. Telstra has been provided with an opportunity to be compensated for the costs associated with the resulting loss of economies of scale under the DAs, and is receiving replacement revenues which provide an avenue for their recovery.

This is not the case for other sources of declining demand such as fixed-to-mobile substitution. The ACCC considers that it is appropriate for all users of the network to bear the effects of declining demand due to mobile substitution because they are due to changing conditions in the retail markets in which both Telstra and access seekers operate. Unlike in the case of the cost impacts of NBN-related declining demand, Telstra does not have another avenue to recover these costs.

Adjustments to cost allocations

The ACCC has made adjustments to certain asset classes following the Analysys Mason assessment of the methods and assumptions of Telstra's proposed CAF and verification of inputs to the model.

As noted in the further draft decision, in the case of the 10 asset classes for which Analysys Mason did not recommend any specific changes, the ACCC has adopted Telstra's proposed cost allocation factors without modification as a starting point for allocating costs to declared services.

In relation to the 12 asset classes where Analysys Mason made specific recommendations, the ACCC's final decision is to implement the adjustments to cost allocation factors for the asset classes as proposed in the further draft decision with the exception of a change to the method by which Analysys Mason's recommendation for ducts and pipes is made. Details of the ACCC approach with respect to each of these asset classes are detailed below. Responses are also provided to specific issues with the cost allocations raised in submissions to the further draft decision.

CA01: Ducts and pipes

The ACCC's final decision is to implement the Analysys Mason recommendations as proposed by the ACCC in its June 2015 further draft decision, but with modifications. Analysys Mason made two recommendations in respect of the ducts and pipes cost allocation:

- Telstra's proposed in its forecast model that the NBN Co's use of ducts and pipes in FTTN areas is substitutive to fixed line use but that it is additive in FTTP/dp and HFC areas. Analysys Mason considered that usage of ducts and pipes by NBN Co is substitutive for fixed line use in FTTP/dp and HFC areas as well as in FTTN areas; and
- Fixed line services are more intensive users of ducts and pipes than the NBN. For each additional kilometre of use by NBN, fixed line use should be reduced by [c-i-c] [c-i-c] kilometres.

In the further draft decision, the ACCC agreed with Analysys Mason that NBN use is substitutive for fixed line use in all areas of the MTM.⁶⁶⁵ However, the ACCC notes that NBN use of ducts and pipes in an area begins when the area is ready for service but that fixed line use does not cease until services are migrated off Telstra's network. During the period between

⁶⁶⁵ Further Draft Decision, p. 84.

ready for service and service migration, NBN use and fixed line use co-exist in the ducts and pipes. Therefore there is a period during which NBN usage of ducts and pipes is additive to fixed line use before becoming substitutive.

On the second point, the ACCC also agreed in the further draft decision with Analysys Mason that fixed line usage of ducts and pipes is more intensive than is NBN's usage.⁶⁶⁶ However, following Telstra's submission on this issue,⁶⁶⁷ the ACCC has reviewed the estimation of the usage ratio to be applied when fixed line use of the ducts and pipes ceases. The Analysys Mason calculation is based on the ratio of total duct usage to actual duct length. Following its review the ACCC considers that the correct utilisation rate to apply when fixed line usage of ducts and pipes ceases is [c-i-c] [c-i-c] based on the ratio of Telstra's fixed network duct length to the fixed network route length and using data supplied by Telstra as part of Analysys Mason's assessment.

The ACCC' final decision is to implement Analysys Mason's recommendations for ducts and pipes in a modified form as follows:

- Step 1: as the NBN is rolled out, its ducts and pipes use will be accounted for in the FAC based on the assumed rate of rollout for each NBN technology. Each technology's assumed rate of rollout is based on the 'ready for service' forecasts in NBN Co's August 2015 rollout plan and schedule.
- Step 2: as services are activated on the NBN and disconnected from Telstra's network, fixed line use of ducts and pipes is subtracted within the forecast model. This adjustment is done using the NBN activation numbers from NBN Co's August 2015 rollout plan and schedule and using the ducts and pipes utilisation ratio calculated for fixed line services ([c-i-c] [c-i-c]).

The ACCC rejects Telstra's argument that the duct adjustment for FTTP/dp and HFC should only occur if the economies of scale adjustment is not made. Telstra's argument appears to be based on the assumption that the economies of scale adjustment is made first, but in fact it is made after the other adjustments have been made, and only corrects for the loss of economies of scale due to NBN migration that is subsequently calculated. This means that the magnitude of the adjustment made to ducts and pipes to reflect NBN-induced under-utilisation will respond commensurately with any separate adjustments that have the effect of changing unit costs of ducts and pipes.

CA08: Network land and CA09: Network buildings and support

Land value modifications are made in the same way as Telstra had applied for the similar core asset classes CO08 and CO09 (and also to CO07). This adjustment reflects the higher land value that applies to exchange space in urban areas compared to other areas.⁶⁶⁸ This is achieved by weighing the proportion of access seeker SIO usage by ULLS band by the proportion of asset value (for combined land and building valuation) for each ULLS band as done for rack usage by band for CO07, CO08 and CO9.⁶⁶⁹

CO01: Local switching equipment

The ACCC has modified the FLSM so that the port-related (scalable) component of local switching equipment is reduced as the NBN roll-out progresses via the asset disposal

⁶⁶⁶ *Ibid.*

⁶⁶⁷ Telstra, Submission on cost allocators, 28 August 2015.

⁶⁶⁸ *Ibid.*, p. 43.

⁶⁶⁹ Telstra, Telstra Cost Allocation Framework for the ACCC Fixed Line Services Model, Framework and Model Guide Version 1 July 2014, pp. 48-51.

mechanism with the rate of disposal of these components determined by the rate of SIO migration to the NBN. The traffic driven components of local switching equipment are maintained in the RAB on the basis they are unscalable. However, the traffic driven costs are made subject to the ACCC's loss of economies of scale adjustment.

These modifications differ somewhat from the Analysys Mason recommendation that all port costs be removed from the asset class up-front via the asset disposal mechanism and the remaining traffic-driven component of costs be reduced in proportion to the number of SIOs cut over to the NBN.⁶⁷⁰ The ACCC considers that the disposal of the port related components of the local switching equipment should occur progressively in line with the NBN rollout. This modification more accurately reflects the expected means by which costs for this asset class are incurred and distributed.

In accordance with the Analysys Mason recommendation, the ACCC recalculated the allocation by ignoring the amount of [start c-i-c] [c-i-c end] for 'Local Switch – Credit') which could not be attributed to either port or traffic driven components.

CO02: Switching equipment – trunk and CO03 Switching equipment – other

Given these assets will be used by NBN-based voice services, the ACCC agreed with Analysys Mason's proposal that a proportion of these costs be allocated to the NBN or alternatively, that a pre-NBN forecast of traffic be used to unitise these costs.⁶⁷¹ In the application of the loss of economies of scale adjustment to these asset classes, the ACCC has effectively implemented the first of Analysys Mason's proposals, as this adjusts for the excess costs of the assets due to reduced utilisation. It was therefore not necessary to alter Telstra's traffic forecasts to pre-NBN levels as well.

The ACCC rejects Telstra's argument that no loss economies of scale adjustment should be made to this asset class on the basis of its overall reasoning to apply the loss of economies of scale adjustment as is discussed in chapter 10.

CO04: Inter-exchange cable

Analysys Mason proposed to update the platform allocation using March 2015 data, so as to extrapolate from a one-year period rather than a six-month period.⁶⁷² Although inter-exchange cables is a material asset class, the ACCC observes that only a small proportion is allocated to fixed line services. The ACCC also ascertained that the inclusion of one additional data point to determine platform allocations would not result in a material change to the proportion of costs allocated to declared fixed line services and therefore did not consider it necessary to make the adjustment proposed by Analysys Mason.

CO05: Transmission equipment

The ACCC has modified the cost allocations to keep the allocation percentage of 'other' transmission to platforms constant over the regulatory period. This is designed to prevent the proportion of the 'other' transmission equipment category increasing over time as the transmission technology mix changes given that there should not be a particularly strong relationship between these variables as implied.⁶⁷³ This is achieved by re-allocating, the excess share for the 'other' category to the SDH and xWDM transmission platforms in proportion to their respective shares of the total over time.

⁶⁷⁰ Analysys Mason, *op.cit.*, p. 49.

⁶⁷¹ *ibid.*, p. 51.

⁶⁷² *ibid.*, p. 56.

⁶⁷³ *ibid.*, p. 63.

The ACCC has not made the adjustments to the costs allocations for transmission assets suggested by Optus given that Analysys Mason did not express concerns with Telstra's methodology and that an adjustment is made to this asset class to account for the loss of economies of scale due to the NBN.

CO07: Other communications plant and equipment, CO08: Network land and CO09: Network buildings and support

The ACCC has modified the FLSM to maintain access seeker TEBA racks constant at base year levels rather than decreasing during the course of the forecast period. This change makes access seeker's demand for racks consistent with Telstra's constant demand for its own racks during the period, and follows an Analysys Mason recommendation.⁶⁷⁴

CO12: Data equipment

Analysys Mason proposed that the forecasts be modified to account for other measures of volume in addition to the number of data SIOs and scalable and non-scalable equipment. Telstra was unable to provide throughput data for Other DSL services and there was little difference in throughput between Wholesale DSL and Retail DSL which meant that Analysys Mason concluded an SIO-based cost allocation was not unreasonable.⁶⁷⁵ The ACCC agrees with this recommendation and has not made a change to the SIO-based cost allocation for this asset class.

⁶⁷⁴ *ibid.*, p. 71.

⁶⁷⁵ *ibid.*, pp.74-75.

12 Term of the final access determinations

Key Points

- The ACCC's final decision is that the FAD price terms (including wholesale ADSL) will apply for the period from 1 November 2015 to 30 June 2019.
- The ACCC's final decision is also to remove its draft decision intention to include a 'trigger and review' mechanism at the mid-point of the FAD term.
- In the Draft Decision, the mid-point trigger and review mechanism was considered because the uncertainty of the NBN rollout and migration introduced the risk that declared service prices may deviate from cost reflective levels.
- The ACCC considers that the trigger and review mechanism is now unnecessary. This is because the ACCC's final decision to adjust declared service unit costs for the loss of economies of scale has mitigated the effect of the NBN rollout uncertainty on the cost reflectivity of declared service prices.

12.1 Introduction

Access determinations must have an expiry date which aligns with the expiry date of the declaration for the relevant service unless there are circumstances that warrant a different expiry date.⁶⁷⁶ The current declarations for the fixed line services expire on 31 July 2019, and the current declaration for the wholesale ADSL service expires on 13 February 2017.⁶⁷⁷

For the 2011 FADs, the ACCC determined a regulatory period of three years. While the ACCC's preference at the time was for a five year regulatory period, it had regard to industry submissions that a regulatory period of no more than three years would be preferred. It also recognised the difficulties of developing sufficiently reliable forecasts for a five year period.

In determining an expiry date for the wholesale ADSL FAD in 2013, the ACCC decided to align the expiry of that FAD with the expiry of the 2011 FADs. The ACCC considered that aligning the expiry of these FADs would: allow wholesale ADSL prices to be reviewed at the same time as the prices for the other declared fixed line services; ensure consistency between the pricing approach used in setting prices; and reduce the risk of the access provider over or under-recovering its costs of supplying those services.

The ACCC discussion paper and draft decision considered that in addition to the desirability of an alignment between the expiry of these FADs, the term of these FADs should continue to balance the need to provide longer term pricing stability and certainty to support industry investment planning with flexibility to review prices and price structures when there are changes to industry circumstances.⁶⁷⁸

⁶⁷⁶ Subsection 152BCF(6) of the CCA.

⁶⁷⁷ ACCC, *Public inquiry into the fixed line services declarations final report*, April 2014, pp.66-75; ACCC, *Wholesale ADSL service declaration*, February 2012, p.1

⁶⁷⁸ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms*, Draft Decision, p. 156; ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms*, July 2014, p. 85.

12.2 ACCC draft decision

The ACCC's draft decision was that the FAD price terms (including ADSL) will apply for a four year period from 1 July 2015 to 30 June 2019. The ACCC also stated its intent to initiate a 'trigger and review' process at the mid-point of the FAD term. Under this process, the ACCC may decide to review FAD prices if the rate of the NBN rollout differs by at least 20 per cent from that expected at the time of making the FADs.⁶⁷⁹

The ACCC's reasons for its draft decision on the FAD term, and the design of the 'trigger and review' process are provided below.

Length of the regulatory period

In the draft decision, the ACCC considered that a regulatory period of four years, and the relative price stability that results, will promote the efficient use of, and investment in, the infrastructure used to provide the declared fixed line services. A longer regulatory period of four years would mean that annual changes to declared service prices as a result of changes to realised inputs and volumes are effectively smoothed out. The smoothing of prices would result in relative price stability between the current and subsequent regulatory periods.⁶⁸⁰

Dealing with NBN rollout uncertainty

In the draft decision, the ACCC acknowledged stakeholders concerns that Telstra's expenditure and demand forecast largely depend on the forecast NBN rollout rate. Adopting a longer regulatory period raised the risk that declared service prices may deviate from cost reflective levels if the NBN rollout rate differed significantly from the forecast in the FAD decision.⁶⁸¹

The ACCC considered that the circumstances of its decision on the fixed line FAD price terms for the next regulatory period are not typical. This was because Telstra's forecast expenditures, demand forecasts and (unit) revenue requirements were closely linked to expectations about the NBN rollout—an exogenous variable which is outside Telstra's control and highly uncertain—but for which better information is likely to be available well before the end of the four year regulatory period. The ACCC considered that it should have regard to such information and, if appropriate, vary the FADs. This is because, if the NBN rollout deviates significantly from what is assumed at the time of making the FADs, prices for the declared fixed line services could significantly diverge from cost reflective levels and no longer encourage the efficient use of and investment in infrastructure.⁶⁸²

To deal with this uncertainty, in the draft decision the ACCC stated its intent to initiate a 'trigger and review' process at the mid-point of the FAD term. Under this process, the ACCC would, before the mid-point of the FAD term, review the most up-to-date information about the rollout of the NBN, both realised and forecast. If this information indicated that the assumptions made about the rollout at the time of making the FADs were significantly inaccurate, the ACCC would make a decision on whether to commence a variation inquiry to review the FAD prices. In deciding whether to commence an inquiry, the ACCC would have regard to this information and its impact on expenditure and demand forecasts. The ACCC considered that any variation to FAD prices arising from this process would be forward-looking, and that any changes to prices

⁶⁷⁹ ACCC (2015), *Public inquiry into final access determinations for fixed line services – primary price terms, Draft Decision*, pp. 157-158.

⁶⁸⁰ *ibid.*, p. 158.

⁶⁸¹ *ibid.*, pp. 158-159.

⁶⁸² *ibid.*, pp. 158-159.

would only apply from the date on which the variation comes into force, which would be no earlier than 1 July 2017.⁶⁸³

The NBN rollout metric used as an input in determining Telstra's expenditure and demand forecasts is the cumulative number of premises passed by the NBN fixed line network in a given year. As noted above, before the mid-point of the FAD term, it was proposed that the ACCC would use the most up-to-date rollout information to determine whether a variation of FAD prices may be triggered if either:

- the actual cumulative number of premises passed by the mid-point of the FAD term, or
- the forecast cumulative number of premises passed by the expiry of the FAD term⁶⁸⁴

is at least 20 per cent above or below the level used as an input to determine FAD prices, the ACCC would make a decision on whether to commence a variation inquiry to review the FAD price having regard to this new information and its impact on expenditure and demand forecasts.

Finally, the ACCC noted in the draft decision that it is able to initiate an inquiry to vary an access determination at any time if it considers this is necessary. However, to improve regulatory certainty, the ACCC stated how it intended to respond should the NBN rollout deviate significantly from current expectations, and the metrics it intended to use to decide whether to hold an inquiry to vary the FADs.⁶⁸⁵

The ACCC's draft and further draft decision: economies of scale adjustment

In the draft decision, the ACCC noted that the loss of economies of scale and density caused by the NBN migration is incremental to NBN and was considering its approach on this issue.⁶⁸⁶

In the June 2015 further draft decision, the ACCC proposed to make adjustments to forecast unit revenue requirements and declared prices for the loss of economies of scale caused by the NBN migration. The effect of this proposal was that the rollout and the migration to NBN would have a substantially reduced impact on declared service prices.⁶⁸⁷ Therefore, any unanticipated changes to NBN's actual or forecast rollout rate during the regulatory period will have a reduced effect on the overall cost reflectivity of declared service prices.

⁶⁸³ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms*, Draft Decision, pp. 158-159.

⁶⁸⁴ The threshold of 20 per cent was chosen as a result of scenario modelling by the ACCC. The assumptions made about the speed of the NBN rollout, which are used to determine expenditure and demand forecasts, were adjusted to determine the likely impact on the uniform price change. The ACCC considers that a movement in the uniform price change, either upwards or downwards, would be material if it exceeded 1 per cent. The ACCC estimates that the rate of the NBN rollout would need to deviate by at least 20 per cent from what is currently expected for the impact on the uniform price change to exceed 1 per cent.

⁶⁸⁵ ACCC (2015), *Public inquiry into final access determinations for fixed line services – primary price terms*, Draft Decision, pp. 158-159.

⁶⁸⁶ *ibid.*, p. xi.

⁶⁸⁷ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms*, Further Draft Decision – Outstanding Issues, June 2015, pp. 61–85.

12.3 Submissions to the draft decision

Telstra

Telstra submitted that the expiry dates for each of the replacement FADs should be 30 June 2019 and that the FAD should not contain a mid-term review. It submitted the absence of a mid-term review offers all industry participants certainty and predictability which is important during the early period of transition to the NBN.⁶⁸⁸

Optus

Optus recommended that the ACCC adopt a short-term FAD for two years while it addresses the substantial flaws in the current set of forecasts.⁶⁸⁹

12.4 Final decision

The ACCC considers that the length of the regulatory period of close to four years promotes price stability and efficiency. The ACCC's final decision is that the FAD price terms (including wholesale ADSL) will apply for almost a four year period from 1 November 2015 to 30 June 2019.

The ACCC has now reconsidered the need for a mid-point trigger and review process since, in the final decision, the ACCC has retained the further draft decision proposal to adjust declared service prices for the loss of economies of scale caused by the NBN migration.

The effect of this proposal is that the impact of an unanticipated change to the NBN rollout will have a considerably reduced effect on the cost reflectivity of declared services during the regulatory period. As a result, the ACCC considers that the trigger and review mechanism is no longer necessary. Therefore, the ACCC's final decision is that it removes its draft decision intention to include a 'trigger and review' mechanism at the mid-point of the FAD term.

Assessment of approach against section 152BCA matters

The ACCC considers that the length of the regulatory period of close to four years promotes regulatory certainty.

The ACCC considers that a regulatory period of close to four years, and the regulatory certainty it provides, will promote competition in markets for listed services and will promote the achievement of any-to-any connectivity in relation to carriage services that involve communication between end-users.⁶⁹⁰ The ACCC considers that the regulatory certainty of the close to four year regulatory period will remove obstacles to users gaining access to listed services.⁶⁹¹

⁶⁸⁸ Telstra, *Public inquiry into the final access determinations for fixed line services – primary prices, Response to Draft Decision*, Confidential Version, 1 May 2015, p. 31.

⁶⁸⁹ Optus, *Submission in response to ACCC Draft Decision, Public inquiry into final access determinations for fixed line services – primary price terms*, Confidential Version, April 2015, p. 11.

⁶⁹⁰ Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE; Paragraph 152AB(2)(c) – the objective of promoting competition in markets for listed services; Paragraph 152AB(2)(d) – the objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users.

⁶⁹¹ Paragraph 152AB(4) – In determining the extent to which a particular thing is likely to result in the achievement of the objective referred to in paragraph (2)(c), regard must be had to the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services.

The ACCC considers that a regulatory period of close to four years, and the regulatory certainty it provides, will promote economically efficient use of, and economically efficient investment in the infrastructure by which listed services are supplied and any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁶⁹²

The ACCC considers that the regulatory certainty of a close to a four year regulatory period is likely to result in the achievement of the objective in subsection 152AB(2)(e) (economically efficient use of, and the economically efficient investment in, infrastructure).⁶⁹³ This is because in the consideration of the term of the FADs, the ACCC had regard to the following matters:

- (a) the technology that is in use, available or likely to become available and its influence on the supply and charging for listed services
- (b) the costs that would be involved in supplying and charging for the listed services are reasonable or likely to become reasonable,
- (c) the effects, or likely effects, that supply, and charging for, the listed services would have on the operation or performance of telecommunications networks.
- (d) the legitimate commercial interests of the supplier of the listed services, including the ability of the supplier to exploit economies of scale and scope;
- (e) the incentives for investment in infrastructure by which the listed services are supplied and any other infrastructure by which the services are, or are likely to become, capable of being supplied.⁶⁹⁴

The ACCC is also of the view that considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs.⁶⁹⁵

⁶⁹² Paragraph 152BCA(1)(a) – whether the determination will promote the LTIE; Paragraph 152AB(2)(e) – the objective of encouraging the economically efficient use of, and economically efficient investment in: (i) the infrastructure by which listed services are supplied; (ii) any of infrastructure by which listed services are, or are likely to become, capable of being supplied.

⁶⁹³ Paragraph 152AB(6) – the extent to which a particular thing is likely to result in the objective referred to in Paragraph 152AB(2)(e).

⁶⁹⁴ Paragraph 152AB(6) – the extent to which a particular thing is likely to result in the objective referred to in Paragraph 152AB(2)(e).

⁶⁹⁵ Paragraph 152BCA(3) – This subsection states the ACCC may take into account any other matters that it thinks are relevant when making a FAD.

13 Revenue requirement and primary prices

Key Points

- The ACCC's final decision is for a uniform fall in the primary prices of the declared fixed line services of 9.4 per cent from their current levels. This also applies to the AGVC/VLAN service. The new regulated charges will apply to all declared services on 1 November 2015, with prices then remaining constant for the remainder of the regulatory period (until 30 June 2019).
- The uniform price decrease is based on the change in the total revenue requirement needed to recover the costs of the declared fixed line services over the period 1 July 2015 to 30 June 2019 compared to the revenue requirement that would be realised with the current fixed services prices and forecast demand levels over the same period.
- In reaching its decision to apply a uniform price change, the ACCC has balanced the benefits of stability in relative prices with the potential short-term efficiency losses from prices diverging from their underlying costs in order to produce an outcome in the LTIE.
- The ACCC considers that its final decision on prices will not cause instability during the transition to the NBN or impact the rate of service migration to the NBN. Rather, the ACCC considers that its decision will promote efficiency and competition during the transition and is in the LTIE.
- The ACCC has decided not to adopt its August 2015 proposal for a larger price reduction for the AGVC/VALN service and a lesser uniform change for the remaining regulated charges.
- The ACCC has not made any changes to the geographic price structures for ULLS, Wholesale ADSL or FOAS and FTAS.
- The ACCC has not taken account of costs incurred and revenue received by Telstra in the 2014-15 financial year in determining the prices to apply from 1 November 2015. This provides Telstra with a substantial financial windfall compared to the prices that would result from including this year's revenue requirement in determining the uniform price change.

13.1 Introduction

After revenue requirements for each asset class are calculated in the FLSM and a share of these costs has been allocated to declared services, prices for each declared service must then be determined. The approach to setting prices for individual declared services has important implications for efficient use of declared services, efficient investment in fixed line assets and for competition in downstream markets. The approach to setting prices for individual services was therefore an important consideration in this inquiry and for this final decision.

In the 2011 final access determinations (FADs), prices for individual declared services were based directly on the revenue requirement allocated to respective declared services, so that the expected revenue to be recovered from each declared service was equal to the revenue requirement allocated to that service by the cost allocation factors. For ULLS prices, an

adjustment was made to determine a price for ULLS bands 1 to 3 and a price for ULLS band 4 using geographic cost relativities that were adopted from the Analysys model. For the 2013 FAD, the wholesale ADSL service prices were structured to comprise port charges for Telstra's two ADSL pricing zones and a single charge for the AGVC/VLAN service. This maintained the price structure applied by Telstra prior to declaration of the wholesale ADSL service.

In its submission to the price terms discussion paper, Telstra proposed a one-off nominal price increase of 7.2 per cent, applied uniformly across all declared services. This increase was to ensure that the expected revenue to be recovered from the declared services equalled the total revenue requirement allocated to the declared services (given Telstra's assumptions about expenditure, demand, cost allocation and other matters). This differed from the approach adopted in 2011, in that the price for each declared service would not be based directly on the costs allocated to that service.

This chapter sets out the ACCC's final decision on the revenue requirement for the declared services, prices for individual declared services and the reasons for adopting these prices. It also provides an overview of the ACCC's discussion paper, draft and further draft decisions and further consultations as well as stakeholder submissions on revenue and pricing issues in relation to these earlier stages of the FAD inquiry.

13.2 ACCC final decision on the revenue requirement

Overview

The FLSM calculates the aggregate revenue required by Telstra to recover its costs of supplying access services. As such, the aggregate revenue requirement calculated in the FLSM includes the estimated costs incurred in providing the declared fixed line services, other declared services and non-regulated services.

The aggregate revenue requirement is calculated according to the following formula:

$$RR_t = E(OPEX_t) + (RAB_{t-1} * WACC) + E(DEP_t) + E(TAX_t)$$

where RR_t = the aggregate revenue requirement for the year

$E(OPEX_t)$ = the forecast operating expenditure for the year

RAB_{t-1} = the RAB at the beginning of the year, which equals the closing value of the RAB for the previous year

WACC = the regulatory WACC, which is multiplied by the RAB to calculate the required return on capital for the year

$E(DEP_t)$ = the forecast depreciation expensed for the period, which represents the return of capital for the year

$E(TAX_t)$ = the tax liabilities forecast to be incurred during the year

The methodology and assumptions used to estimate each cost block are discussed in chapters 4 to 7 and 9 of this final decision.

Assessment of approach against section 152BCA matters

The RAB places a value on the network assets used by the access provider in providing the declared services. The RAB is rolled forward each year to determine the opening value of the RAB for the next year. The roll-forward process updates the RAB to reflect forecasts for capital expenditure, depreciation and asset disposals for each year.

The allowance for regulatory depreciation in the BBM that recovers investment costs over the lives of relevant assets promotes price stability, which encourages efficient use of and

investment in infrastructure, promotes the legitimate interests of the access provider⁶⁹⁶, and promotes regulatory certainty. The ACCC is of the view that regulatory certainty and consistency are important when setting the terms and conditions of the FADs.⁶⁹⁷

The ACCC considers that rolling forward the RAB fosters predictable revenues and price paths, thereby minimising the likelihood of windfall gains and losses. This certainty promotes efficient use of and investment in infrastructure.⁶⁹⁸

The ACCC considers that the predictable allowance for regulatory depreciation in the BBM promotes regulatory certainty. The ACCC is of the view that considerations of regulatory certainty and consistency are important for setting the terms and conditions of the FADs.⁶⁹⁹

The calculation of the revenue requirement

The ACCC's final decision on the aggregate revenue requirement for each year (in real terms) and each component of the revenue requirement is set out in Table 13.1. The aggregate revenue requirement shown in the table represents the estimated total revenue required to recoup the costs the CAN and core fixed line services network.

Table 13.1: Aggregate revenue requirement (\$million, 2009)

	2015-16	2016-17	2017-18	2018-19	Total
Aggregate revenue requirement	[cic starts] [redacted]	[redacted]	[redacted]	[redacted]	[redacted] [cic ends]

Source: ACCC analysis.

To determine the revenue to be recovered from specific services, the aggregate revenue requirement must be allocated to the different services that make use of the fixed network. The ACCC has applied the cost allocation factors discussed in Chapter 10 (adjusted to reflect NBN-induced loss of economies of scale) to estimate the share of the total revenue requirement to be recovered from declared fixed line services.

The ACCC's final decision on the revenue requirements (in real terms) allocated to the declared fixed line is set out in Table 13.2.

Table 13.2: Regulated revenue requirement (\$million, 2009)

	2015-16	2016-17	2017-18	2018-19	Total
Operating expenditure	[cic starts] [redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Return on capital (RAB*WACC)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Return of capital (regulatory depreciation)	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Tax payments	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Estimated revenue requirement	[redacted]	[redacted]	[redacted]	[redacted]	[redacted] [cic ends]

Source: ACCC analysis.

⁶⁹⁶ Sections 152BCA(1)(a) and (b), 152AB(e) and 152AB(6)(b)

⁶⁹⁷ Section 152BCA(3) – regard to other matters.

⁶⁹⁸ Sections 152BCA(1)(a) and 152AB(e).

⁶⁹⁹ Section 152BCA(3) – regard to other matters.

Treatment of 2014-15 forecasts and revenue requirement

As explained in the draft decision, the ACCC considered that the revenue requirement for 2014-15 should not be accounted for in determining prices that will apply from 2015-16.⁷⁰⁰ This was on the basis that the regulatory framework within which the ACCC makes access determinations for the declared fixed line services is forward-looking. Revenue requirements are calculated using forecasts of demand and expenditure and forward-looking assumptions on matters such as the cost of capital and depreciation for only the regulatory period in which the prices are to apply. Without explicit provisions to take into account revenue requirements or revenues received in years outside the regulatory period (for example, a revenue cap or other 'unders and overs' mechanisms), these are generally not taken into account.

It is noted that this provides Telstra with a financial windfall compared to the prices that would result from including the 2014-15 revenue requirement in determining the one-off uniform price change over the regulatory period.

Notwithstanding the exclusion of the 2014-15 revenue requirement, the ACCC used capital expenditure forecasts and depreciation for 2014-15 to establish the opening RAB for 2015-16, consistent with the standard process for rolling forward the RAB (and as required under the fixed principles).

Other issues

In response to the draft decision, Frontier Economics in its report for the Competitive Carriers Coalition, iiNet and Optus proposed that the annual revenues earned by the fixed line services under the uniform price adjustment be set so they equalled the annual revenue requirement in NPV terms. Frontier noted that the ACCC's failure to do this in the calculation of the price change meant that Telstra would over-recover revenues by around \$10 million in net present value terms.⁷⁰¹

The ACCC has not adopted the Frontier Economics proposal for the final decision as the existence of differences between the estimated annual revenues earned and the annual revenue requirements occurs because the uniform price change adopted in the final decision (see section 13.3.7) is derived from revenues equalling the revenue requirement over the entire four year regulatory period. Moreover, based on the application of the uniform price change of the final decision of 9.4 per cent, the ACCC considers that any under- or over-recovery in NPV terms would be negligible.

13.3 Prices and price structures

13.3.1 Discussion paper

In the discussion paper, the ACCC raised a potential alternative approach to setting prices for individual services based on the costs allocated to them in the FLSM. This alternative approach, which was initially proposed by Telstra with its cost allocation proposal, involved setting prices for declared services so that they would be expected collectively to recover the total revenue requirement allocated to all declared services, subject to the condition that the

⁷⁰⁰ ACCC Draft Decision, March 2015, pp. 168-169.

⁷⁰¹ Frontier Economics, Submission to Draft Decision, p. 31.

price for each declared service is set between the avoidable cost and standalone cost of providing that service.⁷⁰²

The ACCC sought stakeholder views about the merits of the existing and alternative approaches to individual price setting as well as specific pricing structures applicable for ULLS, wholesale ADSL and FOAS and FTAS charges. A summary of stakeholder submissions made in response to the discussion paper is contained in section 13.3 of the March 2015 draft decision.

13.3.2 ACCC draft and further draft decisions

The ACCC's draft decision on the setting of individual fixed services prices was that a uniform nominal price change should be applied once to all declared services on 1 July 2015, with prices then remaining constant for the four-year regulatory period. Based on the ACCC's draft decision on all other underlying pricing elements, this equated to a one-off nominal price decrease of 0.7 per cent. This price decrease was interim as the ACCC was still considering a number of issues at the time of the draft decision. The effect of applying this price change uniformly to all declared services was that the relative prices of the declared services did not change and that the current price structures for the declared fixed line services set in previous FADs would continue to apply.

The ACCC did not specifically address issues in relation to the structure of prices for the fixed line prices in the further draft decision. It did, however, publish a revised schedule of prices using an amended uniform price adjustment across the fixed services. This revised uniform price adjustment and revised schedule of prices reflected the ACCC draft decision on issues outstanding from the March draft decision, including to remove the effect of the loss of economies of scale due to the NBN, changes to the WACC parameters and revisions to Telstra's forecast operating expenditures.⁷⁰³

The further draft decision schedule of prices for the period commencing on 1 October 2015 and finishing on 30 June 2019 is reproduced in Table 13.3 below. These prices were based on a uniform price reduction of 9.6 per cent based on the change in the total revenue requirement needed to recover the costs of the declared fixed services over the period 1 July 2015 to 30 June 2019 compared to the revenue requirement that would be realised with the current fixed services prices and demand levels over the same period.

Table 13.3 Further draft decision charges for the declared fixed line services

Service	Unit	Current charges	Further draft decision
ULLS Bands 1 to 3	\$ per line per month	16.21	14.65
ULLS Band 4	\$ per line per month	48.19	43.56
WLR	\$ per line per month	22.84	20.65
LSS	\$ per line per month	1.80	1.63
LCS	¢ per call	8.90	8.05
FOAS & FTAS	¢ per minute	0.95	0.86
Wholesale ADSL Zone 1	\$ per port per month	24.44	22.09

⁷⁰² ACCC, *Public inquiry into final access determination for fixed line services – primary price terms: discussion paper*, July 2014, p. 51-52

⁷⁰³ ACCC, *Further Draft Decision – Outstanding Issues*, June 2015, pp. 8-9.

Wholesale ADSL Zone 2/3	\$ per port per month	29.66	26.81
Wholesale AGVC/VLAN	\$ per Mbps per month	32.31	29.21

The ACCC considered that applying a uniform price change to all declared services would provide a degree of stability to the industry in the lead up to and during the transition to the NBN. The ACCC considered that stability in price relativities for declared services would maintain efficient use of declared services and investment in fixed line assets by Telstra and provide a more stable environment for service providers as customers migrated to the NBN.

The ACCC considered that a significant change in price relativities could give access seekers incentives to change the way they supply services to end-users over Telstra's fixed line network. It was concerned that this would not promote efficient investment in infrastructure or efficient use of declared services, particularly in the lead up to the transition to the NBN.

The ACCC also considered that maintaining the existing price relativities with a uniform price change would minimise any undesirable consequences of setting prices for individual services using the current approach.

In response to views raised by stakeholders in relation to specific price structure issues, the ACCC made the following comments:

- Separate prices for ULLS bands 1-3 and ULLS bands 4, and the ratio between the two prices, should be retained to promote price stability. The ACCC considered that Telstra's proposed approach for reflecting geographic cost differences between ULLS bands directly through cost allocation factors was more likely to accurately reflect these differences, compared to the existing approach (which relied on geographic cost ratios adopted from the Analysys model). The ACCC indicated it would adopt this approach as part of the cost allocation framework.
- The existing two part tariff for wholesale ADSL, including the separate port charges for different zones, should be retained to promote price stability. It was also considered that applying a different price change to wholesale ADSL services could create some adverse consequences and create disruption in the lead up to the transition to the NBN.
- Although geographically de-averaged prices for FOAS and FTAS are more likely to reflect cost differences between areas, the ACCC considered that a uniform price for these services should be retained in the interests of price stability. The ACCC considered that a move to de-average FOAS and FTAS prices could create some of the adverse consequences of non-uniform price changes discussed above.⁷⁰⁴

13.3.3 Submissions on draft and further draft decisions

Draft decision submissions

In response to the draft decision Telstra supported the ACCC's draft decision to maintain existing price relativities for services and to apply any required price change as a one-off uniform price reduction across all services. It also supported a four year FAD term with no mid-year review.⁷⁰⁵

⁷⁰⁴ ACCC Draft Decision, March 2015, pp. 168.

⁷⁰⁵ Telstra, Submission to Draft Decision, p. 184.

While Telstra supported a nationally averaged price for the FOAS and FTAS, it was keen to retain its ability to commercially negotiate geographically de-averaged rates, particularly for its access to non-dominant networks without national coverage and having the availability of other ACCC regulatory mechanisms to ensure this if the need arose.⁷⁰⁶

Telstra also raised concerns about ACCC errors in the FLSM model in relation to the calculation of tax liabilities and the application of inflation indices which had a bearing on pricing outcomes.⁷⁰⁷ These have been addressed for the final decision (see chapters 7 and 9).

Optus detailed a range of concerns about the ACCC's proposed pricing of the wholesale ADSL service. The first of these concerns was that the cost of the wholesale ADSL service had not been suitably allocated in the FLSM, both with other data services and between the port and VLAN components of the service.⁷⁰⁸ Another concern was that in order to utilise the declared wholesale ADSL service, it was necessary to purchase other services and allowance for redundancy outside the service description that add to the costs actually faced by access seekers.⁷⁰⁹

Optus also presented evidence to suggest that at the proposed VLAN prices in the draft decision it would not be able to replicate the service offerings of Telstra Retail and noted that the wholesale ADSL prices proposed in the draft decision would substantially over-recover the cost of the service as modelled in the FLSM.⁷¹⁰

In relation to other fixed line services pricing, Optus was supportive of the ACCC's draft decision not to propose changes to the pricing structure of the ULLS and FOAS and FTAS.⁷¹¹

Frontier Economics, in its report for the Competitive Carriers Coalition, iiNet and Optus, proposed a series of changes to the modelling approach and parameters that would lead to a 9.7 per cent uniform price fall across all the fixed line services.⁷¹²

In its response to the draft decision, iiNet submitted that the overall pricing outcome should be a decrease in prices, referring to the findings of the Wik report to support this view.⁷¹³

Further draft decision submissions

The ACCC's further draft decision did not explicitly consider issues of pricing structure beyond that of the draft decision. Nevertheless a number of submissions raised issues that could have a bearing on the structure and level of the fixed service prices.

Telstra, in focusing on the impact of the loss of economies of scale adjustment on the size of the uniform price reduction proposed by the ACCC, submitted that the proposed price reduction would affect the incentives of access seekers to migrate to the NBN because it would lead to large subsequent price increases when services were cut over to the NBN. This was considered to be inconsistent with the objective of price stability to facilitate a smooth industry migration to the NBN.⁷¹⁴

⁷⁰⁶ Telstra, Submission to Draft Decision, pp. 183-184.

⁷⁰⁷ Telstra, Submission to Draft Decision, p. 185.

⁷⁰⁸ Optus, Submission to Draft Decision, pp. 89-95.

⁷⁰⁹ *ibid.*, pp. 95-97.

⁷¹⁰ *ibid.*, pp. 99-100.

⁷¹¹ *ibid.*, pp. 101-103.

⁷¹² Frontier Economics, Submission to Draft Decision, pp. 33-35.

⁷¹³ iiNet, Submission to Draft Decision, p. 3

⁷¹⁴ Telstra, Submission to Further Draft Decision, p. 5.

The Department of Communications submitted that the FLS FAD pricing outcome should give the highest priority to price stability, including the price of the services relative to the prices of NBN services. In this context it expressed concern about the impact of the magnitude of the price reduction proposed in the further draft decision on migration to the NBN.⁷¹⁵

NBN Co submitted that the ACCC's final decision on fixed line service pricing should seek to deliver price stability during migration to the NBN network, not make adjustments for loss of economies of scale and asset redundancy and to 'levelise' pricing over the migration to the NBN to address the last customer problem. It provided results of analysis which it had undertaken indicating that the ACCC's proposed price reduction of 9.6 per cent for the fixed line services would delay migration to the NBN [start NBN Co c-i-c] [redacted] [end NBN Co c-i-c] over the 18 month disconnection time window [start NBN Co c-i-c] [redacted] [end NBN Co c-i-c].⁷¹⁶

The Competitive Carriers Coalition considered that the further draft decision to reduce access prices by 9.6 percent was on balance in the LTIE, reasonably reflected the direct costs to Telstra of providing access and appropriately dealt with NBN-related costs. It rejected that the ACCC should be influenced by the cost of providing future services over the NBN in setting prices for the fixed line services.⁷¹⁷

iiNet stated in its submission that it considered the uniform 9.6 per cent price reduction in the further draft decision was justified.⁷¹⁸ In its supplementary submission in response to the submission from the Department of Communications, iiNet rejected the idea that concerns about price stability and price shock with the transition to the NBN should lead the ACCC to set prices in excess of costs. It claimed that rational consumers will have no problems with being charged prices that reflect the economic value of the services they use.⁷¹⁹

TPG supported the ACCC's one-off reduction in prices of the fixed line services by 9.6 per cent. It claimed that lower prices for the fixed line services would help service providers to win more customers prior to the migration to the NBN and did not believe that they would prompt a delay in migration to the NBN.⁷²⁰

Macquarie Telecom stated it was generally supportive of the further draft decision's 9.6 per cent uniform price reduction, although it considered a further reduction could be justified given ongoing concerns about the prudence and efficiency of Telstra's expenditure. It stated that it did not consider that maintaining higher prices in the interests of maintaining price stability with NBN services would promote the long term interests of end users or a competitive outcome. Nor did it accept that access seekers would have the ability or incentive to delay migration onto the NBN.⁷²¹

Optus, in its submission responding to the submission by the Department of Communications, stated it did not support keeping fixed access prices higher to smooth the transition to the NBN.⁷²²

⁷¹⁵ Department of Communications, Submission to Further Draft Decision, pp. 5-6.

⁷¹⁶ nbn, Submission to Further Draft Decision, pp.1-3.

⁷¹⁷ CCC, Submission to Further Draft Decision, p. 1.

⁷¹⁸ iiNet, Submission to Further Draft Decision, p. 3

⁷¹⁹ iiNet, Supplementary Submission to Further Draft Decision, p. 3.

⁷²⁰ TPG, Submission to Further Draft Decision.

⁷²¹ Macquarie Telecom, Submission to Further Draft Decision. pp.1-4.

⁷²² Optus, Supplementary Submission to Further Draft Decision, pp. 1-2.

13.3.4 Other information supplied to the ACCC

In addition to the formal submission process for the draft and further draft decisions, the ACCC was provided with further information from Telstra and access seekers verbally and in response to an ACCC information request in July 2015 relating specifically to the acquisition of the wholesale ADSL service.

In summary, some access seekers expressed concerns that:

- They are currently operating at very high AGVC/VLAN utilisation levels per SIO for the wholesale ADSL service and that further requirements for increased bandwidth at the proposed price for the AGVC/VLAN charge in the further draft decision could render the service uneconomic to purchase.
- They are finding it necessary to acquire substantially more AGVC/VLAN capacity as a direct consequence of markedly increased consumption of video and streaming content in recent months.
- They are required to purchase other services from Telstra in addition to the port and AGVC/VLAN service that constitute the declared wholesale ADSL service which adds significantly to the costs of supplying a retail ADSL service.
- The forecasts of wholesale ADSL demand used within the FLSM were not an accurate indication of the demand for the services because access seekers purchase capacity in excess of what they use.

Telstra recognised that rebalancing of the AGVC/VLAN and port charges could be warranted to address access seeker and ACCC concerns about the structure of the wholesale ADSL charges under the uniform price change for the fixed services proposed in the draft decision. It acknowledged that the AGVC/VLAN charge determined on the basis of a proposed uniform price change would recover a much higher share of wholesale ADSL revenues than the [c-i-c start] [redacted] [c-i-c end] and a solution would be to lower the AGVC/VLAN charge and increase the port charges to restore this percentage revenue split. It indicated this could be achieved [c-i-c start] [redacted] [c-i-c end].⁷²³

13.3.5 Consultation on proposed changes to the pricing of the AGVC/VLAN and other fixed services

In response to the concerns of access seekers about the price of the AGVC/VLAN service and Telstra's suggested change to the structure of wholesale ADSL charges, the ACCC released a consultation paper on proposed changes to the pricing of the AGVC/VLAN in August 2015.

This consultation paper proposed that the price of the AGVC/VLAN be set to recover its notional cost of [start c-i-c] [redacted] [end c-i-c] of the costs of the wholesale ADSL service as determined by the FLSM for the four year forecast period. This followed the suggestion for setting the AGVC/VLAN charge put forward by Telstra. The price derived was \$17.90 per Mbps/month, a reduction of 45 per cent on the existing AGVC/VLAN price.

The paper also proposed that the prices of the other fixed line services, including the wholesale ADSL port charges be set by applying a uniform price change to these services. This uniform price change was determined from the change in the current and forecast aggregate revenue requirement for services excluding the revenue obtained from the AGVC/VLAN services, for the

⁷²³ Telstra, Response to request for further information, 28 July 2015, p. 4.

level of forecast demand over the period 2015-16 to 2018-19. The resulting proposed uniform price change for these other services was a 5.8 per cent decrease from current levels, assuming all other inputs to determining prices were held at the levels of the further draft decision.

The ACCC's proposal reflected concerns about the extent to which the wholesale ADSL service was over-recovering its allocated costs under the proposed uniform price change relative to other services and that this could be exacerbated over time given the expected growth in AGVC/VLAN capacity required to meet increased uptake of video streaming services that was not reflected in the demand forecasts used in the FLSM. There were concerns that this would lead to Telstra over recovering its fixed line services costs as a whole and competition being distorted in the transition to the NBN. Separating the AGVC/VLAN charges from the uniform price change was therefore considered to better encourage efficient investment, promote competition and be in the LTIE.⁷²⁴

13.3.6 Response to the consultation paper on the proposed changes to the pricing of the AGVC/VLAN and other fixed services

M2 responded that it would prefer the larger uniform price reduction of the further draft decision to the ACCC's revised proposal put forward in the consultation paper. This was on the basis that access seekers relying more heavily on the ULLS and other fixed services (such as itself and many other second and third tier access seekers) would be more disadvantaged rather than advantaged by the proposal.⁷²⁵

iiNet did not favour the proposal to reduce the AGVC/VLAN charge at the expense of a lower reduction in other charges put forward in the consultation paper. It was concerned the ACCC proposal would lead to excessive use of the wholesale ADSL service compared to ULLS and LSS. It favoured keeping the uniform charge reduction proposal of the June 2015 further draft decision and updating the demand forecast in the FLSM to reflect the increased usage from streaming services, but also stated it did not support any further delay in the finalisation of the FAD.⁷²⁶

Optus submitted that it did not support setting the prices of WDSL differently from the other fixed line services and was concerned that the ACCC's pricing proposal would alter price relativities to the detriment of access seekers that have invested in competitive infrastructure. It was also worried that the change in the pricing of the VLAN by the magnitude proposed would likely lead to a substantial growth in demand for wholesale ADSL services which Telstra may not be able to accommodate in a timely manner. Optus considered that many of the issues it had previously raised about the pricing of the VLAN had been addressed via the prices proposed in the ACCC's further draft decision.⁷²⁷ However, the ACCC notes that Optus did not comment to that effect in its submission to the further draft decision.

TPG expressed a preference for keeping the uniform price reduction for all services as proposed in the draft decision. It was concerned that applying a larger reduction for the

⁷²⁴ ACCC, *Proposed change to the pricing of AGVC/VLAN and implications for the prices of other fixed services*, August 2015, pp. 2-3

⁷²⁵ M2 Group, *Response to proposed change to the pricing of the AGVC/VLAN and other fixed services*, 21 August 2015.

⁷²⁶ iiNet, *Response to proposed change to the pricing of the AGVC/VLAN and other fixed services*, 24 August 2015.

⁷²⁷ Optus, *Response to proposed change to the pricing of the AGVC/VLAN and other fixed services*, 24 August 2015.

wholesale ADSL price would advantage competitors that had not made investments in their own infrastructure and disadvantage competitors that had done so in the lead up to the NBN.⁷²⁸

Foxtel supported the proposed change to the setting of the AGVC/VLAN charge independently from the uniform price reduction applied to other services as proposed in the ACCC's consultation paper. It considered that the pricing change would help new entrants like Foxtel to quickly and effectively compete in the national market for bundled telephony, broadband and video streaming/subscription TV services in the transition to the NBN. However, it also proposed there be an adjustment mechanism introduced for the AGVC/VLAN charge over the course of the FAD period that took account of traffic demand and prevented over-recovery of costs by Telstra.⁷²⁹

Telstra did not support the pricing changes proposed in the consultation paper. Telstra's reasons included that it would distort the use of resale and infrastructure based inputs, impede migration to the NBN, prompt an increase in demand for AGVC/VLAN services that could lead to an increase in network congestion and reduced service quality and impact expenditure and other demand variables that would affect the revenue requirements in the FLSM. It was concerned that the ACCC had not provided sufficient time for these impacts to be considered in detail by stakeholders and saw greater virtue in the ACCC providing for ongoing price stability across the fixed line services via the adoption of the uniform price change.⁷³⁰

The ACCC notes that Telstra did not take the opportunity to affirm its proposed change to the pricing of port and AGVC/VLAN services that it outlined in response to the ACCC's July 2015 information request.

13.3.7 Final decision on prices and price structures

Overview

The ACCC's final decision is for a uniform fall in the primary prices of the declared fixed line services of 9.4 per cent from their current levels. This also applies to the AGVC/VLAN service. The new regulated charges will apply to all declared services on 1 November 2015, with prices then remaining constant for the remainder of the regulatory period (until 30 June 2019). The adoption of the uniform price change differs from past approaches where the price of each service reflected the costs, the associated revenue requirement and level of demand for each service.

Assessment of approach against section 152BCA matters

The uniform pricing reduction has been directed at minimising industry disruption in the supply of different fixed line services in the transition to the NBN which is considered to be important for helping to promote continued competition in the markets for carriage services and to continue to support Telstra and access seekers' investments in a full range of access services.⁷³¹

In addition, the ACCC considers that the final decision prices and price structures will fulfil the subsection 152BCA matters for the following reasons:

⁷²⁸ TPG, Response to proposed change to the pricing of the AGVC/VLAN and other fixed services, 25 August 2015.

⁷²⁹ Foxtel, Response to proposed change to the pricing of the AGVC/VLAN and other fixed services, 24 August 2015.

⁷³⁰ Telstra, Response to proposed change to the pricing of the AGVC/VLAN and other fixed services, 24 August 2015.

⁷³¹ Sections 152BCA(1)(a) and 152AB(c) and (e).

- The prices and price structures ensure that the access provider is adequately compensated for the overall cost of providing the declared service over time. This ensures that Telstra's legitimate business interests are met.⁷³²
- Using a uniform pricing approach that allows an overall revenue requirement to be met will ensure that prices for declared fixed line services are based on the prudent and efficient costs of providing access services overall. This will allow access seekers to obtain access to the declared fixed line services on reasonable price terms for the purpose of providing downstream services and thereby promote competition in markets for listed services.⁷³³
- The ACCC considers that the uniform price reduction and the retention of the existing price structures provides for consistency with the ACCC's previous FAD for the fixed services, minimises the scope for the ACCC's decision to unduly advantage some access seekers over others and provides for regulatory certainty in the lead-up to the NBN.⁷³⁴

The uniform price change and the structure of charges

The final decision provides for a uniform 9.4 per cent fall in the prices of all the declared fixed line services from their existing levels. This reflects the decline in Telstra's overall revenue requirement for all of the fixed line services compared to the revenue requirement that would be realised under current prices.

Changes in a number of input parameters between the further draft decision and the final decision mean that the prices and price changes are not the same as specified in the August 2015 consultation paper.

The final decision prices are based on the costs incurred and revenues required to recover these costs in nominal terms over the four year period 1 July 2015 to 30 June 2019. This means the prices are smoothed so that users of the network in years with lower unit costs bear some of the burden of the higher unit costs and prices otherwise faced by users in other years of the period.

The new prices are to apply to all declared services on 1 November 2015, with prices then remaining constant for the remainder of the regulatory period (until 30 June 2019).

The final decision prices are shown in Table 1.3 below.

Table 13.4 *Final decision charges for the declared fixed line services*

Service	Unit	Current charges	Final decision charges
ULLS Bands 1 to 3	\$ per line per month	16.21	14.68
ULLS Band 4	\$ per line per month	48.19	43.65
WLR	\$ per line per month	22.84	20.69
LSS	\$ per line per month	1.80	1.63

⁷³² Sections 152BCA(1)(b) and 152AB(6)(b)

⁷³³ Sections 152BCA(a) and (c) and 152AB(c)

⁷³⁴ Section 152BCA(3) – regard to other matters.

LCS	¢ per call	8.90	8.06
FOAS & FTAS	¢ per minute	0.95	0.86
Wholesale ADSL Zone 1	\$ per port per month	24.44	22.14
Wholesale ADSL Zone 2/3	\$ per port per month	29.66	26.87
Wholesale AGVC/VLAN	\$ per Mbps per month	32.31	29.27

The ACCC has decided to maintain its draft decision not to make any changes to the existing price structures for ULLS or FOAS and FTAS given that all stakeholders are satisfied with the existing structures.

The ACCC has had regard to the views of access seekers and Telstra in their submissions in response to the consultation paper which proposed to introduce a large change in the price of the AGVC/VLAN charge and a lesser change in the prices of other fixed line services. Having had regard to those views and the matters in section 152BCA(1) of the CCA that it must take into account, the ACCC has decided to maintain the position proposed in the March 2015 draft decision and the June 2015 further draft decision to apply a uniform price change across all regulated fixed line charges, including for the AGVC/VLAN service.

The ACCC accepts that further analysis would be required to understand the full implications of applying a larger price reduction for the AGVC/VLAN on the demand for the wholesale ADSL and other fixed line services and the associated network cost implications for Telstra. This is not considered appropriate at the late stage of the inquiry and absent support from stakeholders for further delay.

The ACCC further acknowledges that working within the parameters established via the final decision uniform price change, that it may be feasible and desirable for Telstra and access seekers to commercially negotiate changes to AGVC/VLAN, port and other charges that are mutually beneficial.

On adopting the uniform price change more broadly, the ACCC notes that it requires the balancing of considerations, notably maintaining relative price stability against responding to changes in demand and cost relativities between services in order to produce an outcome in the LTIE. The ACCC also recognises that changes in relative prices that reflect changes in relative costs may best promote efficient use of, and investment in, infrastructure. However the ACCC also notes the unique circumstances of the compulsory migration to the NBN and the now limited period before the transition is completed. Therefore any efficiency losses as a consequence of not allowing price relativities to move with the costs relativities will be of relatively short duration and that the benefits of price stability in promoting competition in the lead up to the NBN are expected to outweigh any efficiency losses.

The size of the price change and the transition to the NBN

The ACCC rejects the proposition that the level of the price reduction should be moderated to smooth the transition of fixed services to the NBN as was argued in a number of submissions. Rather, the ACCC considers that its final decision on primary price terms for the fixed line services will promote competition in the transition to the NBN and will be in the LTIE. The ACCC holds this view for a number of reasons.

On the issue of concerns raised by the Department of Communications, Telstra and NBN Co that access seekers will delay migration of services to the NBN in response to reduced costs of supplying services on the legacy copper network, the ACCC notes that migration is compulsory for access seekers and that it is customer driven. There is a prospect that an access seeker

would lose customers to competitors if it attempted to delay migration of customers wanting the speed and reliability benefits of an NBN-based service. Also relevant is that the regulated charges are not the same as the variable costs that Telstra faces to supply its retail customers on the fixed network or the HFC, so that any impact that may occur would only apply to a part of the market.

In regard to the prospect that retail customers may be discouraged by subsequent price increases from taking up an NBN-based service when cut-over to the NBN occurs, the ACCC notes that there is an implicit assumption regarding the extent to which lower regulated fixed line charges will flow through to retail charges. Access seekers have an interest in ensuring that they do not lose customers as a result of such price shocks. This is supported by evidence that service providers, both access seekers and Telstra, are structuring prices to smooth the retail prices between fixed network and NBN services.

Further in regard to declining demand for fixed line services, it seems more plausible that imposing higher fixed network access prices now and over time would be more likely to exacerbate the mobile substitution that has been occurring for some time. The ACCC considers it significant that access seekers that submitted on this issue were unanimously of the view that lower prices now for fixed services are more likely to result in them retaining fixed customers in the transition to services provided over the NBN.

The price reduction for fixed line services will facilitate access to the infrastructure services required by access seekers to provide a range of communications services to end-users and enable them to provide lower retail prices to end-users.

The ACCC considers that the prices and price structures reflect the overall costs of providing the declared fixed line services. This ensures that access prices only recover the efficient costs of supplying the declared fixed line services and helps to ensure the efficient supply of other eligible communications services.

The ACCC considers that setting prices for the fixed line services with regard to the efficient costs of supplying these services overall will allow access seekers to compete effectively in downstream markets where each of the declared fixed line services is an input to supplying services in the downstream (e.g. retail) markets. This serves the interests of all persons who have rights to use the declared service and is sufficient to meet Telstra's legitimate business interests.

Other pricing issues

The ACCC has also given consideration to other issues concerning the wholesale ADSL service raised by access seekers in response to the draft decision and July 2015 information request.

The ACCC notes concerns raised by Optus regarding services purchased ancillary to the wholesale ADSL declared service. These services are outside the description of the declared wholesale ADSL service and hence not covered by the standard access obligations. The ACCC has not consulted on setting charges for these services, however there will be an opportunity for stakeholders to raise concerns regarding the scope of the service description when the ACCC considers re-declaration of the wholesale ADSL service prior to the expiration of the current declaration in February 2017.

The ACCC's final decision on the demand metrics for the wholesale ADSL service are discussed in Chapter 8.

Part B: Pricing approach – supplementary price terms

14 Connection charges for fixed line services

Key Points

- The ACCC's final decision is to set connection charges for three of the fixed line services. The ACCC's final decision is not to allow a separate disconnection charge for the unconditioned local loop service (ULLS) and an early termination charge for the wholesale asymmetric digital subscriber line (ADSL) services.
- Based on technical advice provided by UXC Consulting the ACCC's final decision is to set a regulated disconnection charge for the line sharing service (LSS), to be applied in certain circumstances. This is a departure from the ACCC's draft decision.
- The ACCC's final decision is not to change the scope of its regulation on connection charges from those set out in the 2011 FAD.
- The ACCC considers connection charges are unavoidable costs in providing voice and broadband services to customers using the declared services.
- Following the release of the draft decision, the ACCC reengaged its consultant, UXC, to update the connection charges model using revised information provided in Telstra's submission to the draft decision.
- UXC was also asked to consider a number of issues raised in submissions from stakeholders. These issues related to the ACCC's draft decision not to allow separate disconnection charges for the ULLS and LSS.

Fixed line connection charges are one-off charges imposed by Telstra for services associated with connecting an end-user to an access seeker's network using either the unconditioned local loop service (ULLS), line sharing service (LSS) or wholesale asymmetric digital subscriber line (ADSL) service. The ACCC considers connection charges are unavoidable costs in the provision of voice and broadband services to customers using the declared fixed line services.

There are a range of connection charges currently regulated in the final access determinations (FADs) for the ULLS, LSS and wholesale ADSL services. Connection charges for ULLS and LSS are set outside the fixed line services model (FLSM) used to determine the monthly access and usage prices for these services.

This chapter sets out the ACCC's final decision on fixed line connections charges and is structured as follows

- Section 14.1 provides an overview of the ACCC's draft decision on fixed line connection charges, as set out in its non-price terms and conditions draft decision released on 25 March 2015.
- Section 14.2 provides an overview of key issues raised in submissions to the draft decision in relation to fixed line connection charges.
- Section 14.3 provides an overview of the ACCC's consultant's key findings and considerations in its updated and final report.

- Section 14.4 sets out the ACCC's final decision on fixed line connections charges.

14.1 Draft decision on connection charges

On 25 March 2015, the ACCC released its draft decision on connection charges for fixed line services, alongside the draft decision on non-price terms and conditions. The ACCC's draft decision sets regulated connection charges for the ULLS, LSS and wholesale ADSL services using a simple bottom-up costs model. To update this cost model for the purposes of the ACCC's draft decision, the ACCC engaged an external consultant, UXC Consulting (UXC), to provide technical advice on Telstra costs in providing these services and to extend the cost model to estimate connection charges for the wholesale ADSL service. The ACCC also wrote to Telstra seeking updated information on its third party subcontracting rates and information on its current connection charges processes for the purpose of engaging UXC to update the model.

The existing connection model was originally developed by Telstra as part of its 2004 undertaking for the ULLS and LSS. This model has been modified by independent technical advice provided to the ACCC in 2006, 2007 and 2008 as part of previous arbitrations on these services. This existing connection charges model seeks to estimate the two main types of costs Telstra incurs in providing these services:

- Costs associated with technicians performing the physical jumpering work inside a Telstra exchange. These costs were estimated using third party contractor rates.
- Costs related to Telstra back of house costs, which primarily related to system based work undertaken by Telstra staff. These costs were estimated using a time and motion study, which was originally provided by Telstra in support of its December 2004 undertakings and which the ACCC made modifications to as the result of independent technical advice.

Wholesale ADSL connection charges were first set in the 2013 FAD (following declaration of the wholesale ADSL service for the first time in February 2012). The 2013 FAD set wholesale ADSL connection charges at Telstra's then commercial rate. These charges were set without the benefit of independent technical advice and with limited information about the basis for Telstra's existing commercial charges.

The ACCC used UXC's updated and extended connection charges model in determining the regulated connection charges set out in the ACCC's draft decision. UXC's updated model estimated significantly lower charges than the charges set in the 2011 and 2013 FADs (with the exception of one type of charge).⁷³⁵ As discussed in the ACCC's draft decision, the fall in connection charges resulted from efficiencies achieved by Telstra due to new contractual arrangements it put in place in 2010. Under these new arrangements Telstra moved away from engaging a range of contractors to perform its installation and maintenance work to partnering with a single supplier. UXC update to the connection charge model also estimated significantly lower connection charges for the wholesale ADSL services, which for the first time, estimated the costs involved in these activities.

In addition to setting connection charges significantly lower than charges set in the 2011 and 2013 FADs, the ACCC's draft decision also proposed not to allow Telstra to impose a separate disconnection charge for the ULLS and LSS or impose an early termination charge for a wholesale ADSL service. The draft decision also made the decision not to extend the scope of the regulated connection charges, as suggested by some stakeholders.

⁷³⁵ The fixed component of the MNM charge for the LSS and ULLS increase slightly.

14.2 Submissions

The ACCC received three submissions to the ACCC's draft decision on connection charges. Submissions were received from Telstra, iiNet and Macquarie. Views presented in the submissions on connection charges are summarised below and grouped into three main themes; connection charges, disconnection and early termination charges and the scope of regulation.

Connection charges for ULLS, LSS and wholesale ADSL

In general, submissions supported the ACCC's approach to setting connection charges for the ULLS, LSS and wholesale ADSL as set out in the ACCC's draft decision. iiNet and Macquarie welcomed the update to the cost model which was last updated in 2007 and 2008. Similarly, Telstra welcomed the update and submitted that third party contractor rates are appropriate inputs to the model and remain a good proxy for the efficient cost.⁷³⁶

Regarding the modelling of connection charges, Telstra's submission provided updated information for some of the model's inputs and identified one minor error in the cost model. The updated information included the geographic distribution of LSS and ULLS and the proportion of single and multiple jumpering for ULLS. Telstra also provided more accurate estimates of subcontractor rates which excluded general maintenance work [c-i-c starts] [redacted] [c-i-c ends]. While Telstra provide these revised subcontractor rates it retained its view that excluding general maintenance work was not required as these activities are normally undertaken when making connections and disconnections and as such should be accounted for in determining the regulated charge.⁷³⁷

Regarding the ACCC's decision to extend the cost model to wholesale ADSL, Telstra generally agreed with the ACCC's approach. Specifically, Telstra supported differentiating between the different types of connections ('Type A', 'Type B' and/or 'all other'). Telstra also accepted UXC's reasoning that a 'Type B' and 'all other' wholesale ADSL connections were analogous to a single LSS connection. However, Telstra did raise concerns with the ACCC's draft decision to set wholesale ADSL prices based on ULLS geographic bands rather than the geographic zones currently used in Telstra's billing system. Telstra submitted that such a change would require changes to its internal billing system.⁷³⁸

iiNet and Macquarie both supported the ACCC's proposed approach to setting connection charges. However, iiNet and Macquarie raised concerns that UXC updated cost model did not reflect changes to Telstra's back of house costs.⁷³⁹ Macquarie submitted that Telstra should be requested to provide additional information to clarify and justify its back of house costs.⁷⁴⁰

Disconnection charges for the ULLS and LSS and early termination charges for a wholesale ADSL service

The ACCC's draft decision was to not allow a separate disconnection charges for the ULLS and LSS. The ACCC's draft decision was to also not allow an early termination charge for wholesale ADSL. iiNet⁷⁴¹ and Macquarie⁷⁴² supported these decisions and suggested that the ACCC

⁷³⁶ Telstra, *Response to the ACCC's Draft Decision on non-price terms and conditions*, 8 May 2015, p.14

⁷³⁷ Ibid., pp.15-18

⁷³⁸ Ibid., 8 May 2015, p.18

⁷³⁹ iiNet, *Submission to ACCC Draft Decision on non-price terms and conditions and connection charges for fixed line services*, 8 May 2015, p.10

⁷⁴⁰ Macquarie, *Response to the ACCC's Draft Decision on non-price terms and conditions*, 5 June 2015, p.6

⁷⁴¹ iiNet, *Submission to ACCC Draft Decision on non-price terms and conditions and connection charges for fixed line services*, 8 May 2015, p.11

should consider backdating these decisions at the earliest date possible. However, Telstra raised concerns with these decisions.

Telstra strongly disagreed with the ACCC's draft decision to not allow a separate disconnection charge for the LSS. Telstra submitted that it does not charge for disconnection where a service is migrating to another provider or the NBN, and that the ACCC's draft decision would restrict Telstra's ability to recover its legitimate costs.⁷⁴³

Telstra noted that the ACCC's reasoning to not allow a separate disconnection charges for the ULLS was made on the basis that disconnection work can be combined with connection work. However, Telstra submitted information indicating that the number of ULLS disconnections increased between 2007 and 2015 and that the aggregate number of disconnections is greater than the number of 'in place' ULLS connections. Furthermore, the number of 'in place' connections decreased between 2009 and 2015. Telstra concluded that if this trend continues, there are likely to be some circumstances where Telstra is entitled to recover the direct costs associated with a disconnection.⁷⁴⁴

Similarly Telstra disagreed with the ACCC's draft decision to not allow an early termination charge. Telstra submitted that removing this charge could lead to disruptive changes to end-user or access seeker behaviour. Telstra warned that without this charge, end-users could switch between providers more frequently which would require more billing adjustments and resourcing requirements for Telstra and access seekers. Telstra further submitted that early termination charges are a contractual issue between Telstra and access seekers.⁷⁴⁵

iiNet⁷⁴⁶ and Macquarie⁷⁴⁷ supported the ACCC's draft decision to not set disconnection charges for the ULLS and LSS or an early termination charge for wholesale ADSL. However, both submitters raised concerns that the draft FAD did not include specific operative terms to prevent Telstra from imposing a separate disconnection charges and recommended that the ACCC amend the draft determination to explicitly prohibit disconnection charges or include zero priced disconnection charges.

Scope of regulation

The ACCC draft decision was to not extend the scope of regulation to cover connection charges for the Wholesale Line Retail (WLR) service. iiNet was the only submitter to comment on WLR. iiNet's submission recommended that the ACCC reconsider its draft decision and set a connection charge for WLR. iiNet claimed that in coming to its draft decision on WLR, the ACCC had considered the wrong test and not given due regard to whether the regulation would promote the long term interest of end-user (LTIE).

Telstra also suggested that the ACCC should reduce the scope of regulated connection charges by not setting regulated charges for Managed Network Migration (MNM) for the ULLS and LSS. Telstra noted that no access seekers has utilised the MNM service [c-i-c starts] [REDACTED]

⁷⁴² Macquarie, *Response to the ACCC's Draft Decision on non-price terms and conditions*, 5 June 2015, p.6

⁷⁴³ Telstra, *Response to the ACCC's Draft Decision on non-price terms and conditions*, 8 May 2015, p.19

⁷⁴⁴ *Ibid.*, p.20

⁷⁴⁵ *Ibid.*, p.18

⁷⁴⁶ iiNet, *Submission to ACCC Draft Decision on non-price terms and conditions and connection charges for fixed line services*, 8 May 2015, p.11

⁷⁴⁷ Macquarie, *Response to the ACCC's Draft Decision on non-price terms and conditions*, 5 June 2015, p.6

[c-i-c ends] and does not expect there to be any significant demand for MNMs during the next FAD.⁷⁴⁸

14.3 UXC Consulting final report on connection charges for the ULLS, LSS and wholesale ADSL service

Following the ACCC's assessment of submissions to its March 2014 draft decision, the ACCC reengaged UXC to undertake further work on connection charges. Specifically, UXC were reengaged to update the cost model and its final report to reflect information provided by Telstra in its submission of 8 May 2015 and subsequent information provided by Telstra on 14 June 2015. Revisions to the model included incorporating:

- Telstra revised third party sub-contractor rates relating to the physical jumpering work undertaken at Telstra's exchanges. These new sub-contractor rates removed any reference to maintenance activities.
- Updated information provided by Telstra on its geographical band distributions for ULLS and LSS connections. This information is used to calculate the single connection charges for the ULLS, LSS and wholesale ADSL.
- Updated information provided by Telstra on the proportion of single versus multiple jumpering used in calculating single ULLS connection.

The ACCC requested technical advice from UXC regarding the appropriateness of separate disconnection charges for the ULLS and LSS. This request was made in response to comments made by Telstra in its submission to the ACCC's draft decision.

UXC provided the ACCC with its final report on connection charges for the ULLS, LSS and wholesale ADSL services on 25 July 2015. A public version of UXC's final report is available on the ACCC's website.⁷⁴⁹ This section sets out UXC's finding in its final report regarding the consideration of revised third party contractor rates as well as UXC view on disconnection charges for the ULLS and LSS. The UXC update also included calculating a ULLS call diversion and ULLS MNM cancellation charge in its connection charges model.

Telstra revised third party sub-contractor rates

UXC's final report re-estimated the full suite of connections charges set out in the ACCC's draft decision—using, where appropriate, the revised information provided by Telstra in its submission of 8 May 2015. UXC's revised cost model re-estimated slightly higher connection charges than those estimated in its initial report of 2 March 2015. However, as shown in table 14.1 at the end of this chapter the revised charges are still considerably lower than the current regulated charges, with the exception of one type of charge. This charge related to the fixed component of the LSS and ULLS connection charges for a MNM.

As discussed in UXC's final report and as set out in the ACCC's draft decision, the reduction in connection charges estimated by UXC mainly reflects efficiencies achieved by Telstra due to new contractual arrangements put in place in 2010. Under these new arrangements Telstra moved away from engaging a range of contractors to perform its installation and maintenance work to partnering with a single supplier. UXC has used Telstra's revised contractor rates as provided in its submission of 8 May 2015 to re-estimate the full suite of connections charges set out in the ACCC's draft decision. UXC has again found that the third party sub-contractor rates

⁷⁴⁸ Telstra, *Response to the ACCC's Draft Decision on non-price terms and conditions*, 8 May 2015, p.20

⁷⁴⁹ UXC Technical Advice on connection charges for the ULLS, LSS and WADSL services: Final Report, 25 June 2015

relating to these new contractual arrangements were the main driver in the fall in connection charges for the ULLS and LSS.

As discussed in UXC's initial report, UXC sought to exclude certain third party rates relating to maintenance activities from the updated connection charges model. As according to UXC, these activities related to general maintenance work rather than connection activities. As Telstra at the time could not provide a further breakdown of its third party contractor rates to remove these maintenance activities, UXC reduced Telstra's subcontractor rates by [c-i-c starts] [redacted] [c-i-c ends]. However, following the release of the ACCC's draft decision, Telstra in its submission of 8 May 2015 provided a more detailed breakdown of its third party rates to remove costs associated with the maintenance activities. As such UXC has used these updated subcontracting rates in its final update to the connection charges model. In addition to the other updated information provided by Telstra such as the revised geographic distribution of LSS and ULLS and the proportion of single and multiple jumpering for ULLS connections.

Separate disconnection charges for the ULLS and LSS

In regards to disconnection charges for the ULLS and LSS, UXC has reviewed the ACCC's draft decisions on these charges and has considered Telstra's response in its submission of 8 May 2015. For the reasons set out below, UXC has concluded that there are technical grounds for Telstra levying a separate disconnection charge for the LSS but was unable to find any compelling reasons to allow Telstra to impose a separate disconnection charges for the ULLS.

As stated in its submission, Telstra disagreed with the ACCC's draft decision to not allow a separate disconnection charge for the ULLS. Telstra cited the large and growing gap between ULLS connections and 'in-place' ULLS connections and its need to recover the direct costs associated with these disconnections. UXC in its final report did not agree that the growing number of ULLS connections (performed outside a churn) in and of itself meant that Telstra should be unable to recover the direct costs associated with a ULLS connection. Rather UXC agreed with the reasoning set out in the ACCC's draft decision that Telstra could align its disconnection with connections, saving the need for a two-step jumpering process. In support of its position UXC concluded that while it would be technically possible for an access seeker to continue to use a ULLS following its cancellation, such practice was unlikely because an access seeker would not be able to ensure a satisfactory quality of service. That is, an access seeker would not be able to report and repair faults on the line, which in turn could jeopardise the quality of service it could offer its end-users. UXC therefore considered there was no compelling reason for Telstra to remove the jumper and charge a separate disconnection charge following the cancellation of a ULLS.

UXC came to a different conclusion regarding a separate disconnection charge for the LSS. UXC concluded that unlike ULLS it was not appropriate to leave the LSS wires in place until a new service was installed. This was because unlike a ULLS line, the continued provisioning of the underlying PSTN (voice) service prevents the access seeker from experiencing any risk that the rest of the copper path will eventually be disconnected or may experience a fault.

UXC conclude that based on this analysis Telstra should be allowed to impose a separate disconnection charge for the LSS in certain circumstances. However, UXC noted that this need not be scheduled immediately, and disconnections could be batched with other tasks undertaken in the exchange. In light of its conclusion UXC updated its connection charges model to estimate a charge for a separate LSS disconnection, performed outside a churn.

14.4 ACCC final decision

In setting the regulated connection charges for the ULLS, LSS and wholesale ADSL services, the ACCC has had regard to the findings of UXC's final report and submissions made to the ACCC's draft decision.

The ACCC's final decision is to set connection charges for the ULLS, LSS and wholesale ADSL service, using the revised charges estimated by UXC in its final report. The ACCC's final decision is not to allow a separate disconnection charge for the ULLS and an early termination charge for the wholesale ADSL service. The ACCC, based on technical advice provided by UXC has decided to set a regulated disconnection charge for the LSS, to be applied in certain circumstances. This is a departure from the draft decision. Further details regarding the ACCC's considerations informing its final decision are set out below, in addition, to the ACCC's reasons not to extend the scope of regulation for connection charges.

Assessment of approach against section 152BCA matters

The ACCC confirms its draft decision to include price terms for connection services for the ULLS, LSS and wholesale ADSL in the respective FADs. The ACCC considers these connection charges are unavoidable costs in the provision of voice or broadband services to end-users using the declared fixed line services. As such, the ACCC considers that when determining the price for the ULLS, LSS or wholesale ADSL services it is also appropriate to determine the regulated connection charges for these services. The ACCC considers that the proposed charges for connection and disconnection will allow the access provider to recover the direct costs of providing those services.

As noted in the ACCC's draft decision, in the absence of regulated connection charges, Telstra would have the ability and incentive to set connection charges above costs which would have the effect of creating a cost barrier for access seekers to supply end-users with broadband and/or voice services. This in turn may reduce competition in the retail market. The ACCC considers that the connection and disconnection charges for the LSS, ULLS and wholesale ADSL promote the LTIE.⁷⁵⁰ Setting the charges to reflect the estimated costs involved in providing these services will promote competition.⁷⁵¹ The charges passed on to end-users who change service providers will therefore be able to reflect the costs incurred in churning to another service provider. As such, the ACCC's final decision is that setting price terms for a selection of fixed line connection charges will promote the LTIE. The ACCC also notes that Telstra (nor any other submitter) has not argued that the connection charges should not be regulated. Submitters to the ACCC's draft decision were generally supportive of the approach used to determine connections charges and the approach used to update the connection charges model.

The final decision on connection and disconnection charges for the ULLS, LSS and wholesale ADSL services is based on the best available estimates of the costs incurred to efficiently supply these services. The ACCC considers UXC's final report and the updated modelling provide the best available information about Telstra's costs for connections and disconnection work for the ULLS and LSS. The ACCC considers that UXC's approach to estimating connection charges for the wholesale ADSL service will result in connection charges that reflect the efficient costs of providing these services. These regulated charges will in turn encourage the economically efficient use of, and the economically efficient investment in, the infrastructure.⁷⁵² Access seekers will be able to acquire the listed services at prices that reflect

⁷⁵⁰ Paragraphs 152BCA(1)(a) and 152AB(2)

⁷⁵¹ Paragraph 152AB(2)(c)

⁷⁵² Paragraph 152AB(2)(e) and 152BCA(1)(g)

the efficient and prudent costs of supply which will promote access to the LSS, ULLS and wholesale ADSL service.⁷⁵³

In setting the connection charges, the ACCC has had regard to the technical feasibility of the listed services to be supplied and charged for.⁷⁵⁴ The ACCC considers that the final decision for connection and disconnection charges would contribute the efficient and prudent cost of supply (which will allow access seekers to equally and efficiently compete with Telstra on their own merits), promote access to the relevant listed services (ULLS, LSS and wholesale ADSL services), and promote the efficient operation of Telstra's fixed line network.

The ACCC considers that the final decision on connection and disconnection charges are in the legitimate business interests of the access provider as it is based on the efficiently incurred cost of supplying connections and disconnections for the ULLS, LSS and wholesale ADSL services.

The ACCC considers that the final decision reflects the efficient cost of supplying the connection and disconnection services for the ULLS, LSS and wholesale ADSL services. This is likely to have a positive effect on the acquisition of the relevant declared services and would have flow-on benefits to downstream services as the costs of supplying retail voice and broadband services would likely decrease.

14.4.1 Regulated connection charges

The ACCC has used the outputs from UXC's updated model to inform the ACCC's final decision on the regulated connection charges for the ULLS, LSS and wholesale ADSL services. These charges are set out in table 14.1 at the end of this chapter.

The ACCC notes that while UXC's report has considered Telstra's back of house costs in relation to providing these services, the updated UXC model provided both in its initial report and final report did not seek to re-estimate Telstra's back-of-house costs by revising the underlying time and motion study. The original time and motion study used to estimate Telstra's back-of-house costs was provided by Telstra in relation to its 2004 undertaking and has been revised over the years by independent technical advice provided to the ACCC in 2006, 2007 and 2008 in relation to previous arbitrations. In making revisions to Telstra's original time and motion study, the ACCC's previous consultant visited Telstra sites and was taken through the various processes and systems to ensure that the allocation of time and the processes undertaken were appropriate for each connection activity.

As noted in UXC's reports, Telstra has since renamed its back-of-house costs centres and at the time of preparing its reports, UXC had not been provided with further information regarding these processes. The ACCC notes concerns raised by iiNet and Macquarie in their submissions to the draft decision that UXC has not taken into consideration changes to Telstra's back-of-house costs in its update and that the ACCC should require Telstra to provide additional information to clarify the extent of these changes. The ACCC notes that it has sought further clarification from Telstra on its changes to its back of house costs. However, [c-i-c starts]

[redacted] [c-i-c ends]. Given the time and costs to both Telstra and the ACCC of revising the back-of-house costs in the model, the small quantum of these charges, and small gains expected from the revision, the ACCC has not requested Telstra to reconstruct a time and motion study on its new connection and disconnection processes. Furthermore, the ACCC notes that while it has not required Telstra to reconstruct its time and motion study, UXC as part of its initial update did review time estimates included in the existing study and made some adjustments to the time

⁷⁵³ Paragraph 152AB(4)

⁷⁵⁴ Paragraph 152AB(6)(a)

allocated for certain activities. These adjustments are discussed in more detail in the ACCC's draft decision and UXC initial and final reports.

Telstra's submission to the draft decision also raises the issues about whether or not the ACCC needs to set a regulated price for the MNM charges as set out in the draft decision. Telstra's submission notes that no access seekers have utilised the MNM service since [c-i-c starts] [redacted] [c-i-c ends] and Telstra does not anticipate that there will be any significant demand for MNMs over the life of the FAD. Following Telstra's submission and comments regarding the lack of demand for MNM process, the ACCC wrote to a selection of access seekers seeking information on their current and future use of MNM services for the ULLS and LSS.

While most access seekers agreed with Telstra's comments that there had been limited use of MNM process in recent years, some access seekers noted that they are in fact using these services or may use them in the near future. While other access seekers noted that the FAD terms on MNM services act as a benchmark in their commercial negotiations for similar services.

In light of access seekers' comments, the ACCC considers it is appropriate to retaining regulated charges for the MNM connections as they may be used during the life of the ULLS and LSS FADs. The ACCC's confirms its draft decision and has set out regulated charges for MNM services for both the ULLS and LSS in table 14.1 at the end of this chapter.

14.4.2 ULLS, LSS disconnection and wholesale ADSL early termination charge

The ACCC's draft decision was to not allow Telstra to impose a separate disconnection charge for the ULLS and LSS or impose an early termination charge for the wholesale ADSL service.

Disconnection charges

Following submissions to the draft decision the ACCC sought technical advice from UXC on the implication of imposing a separate disconnection charges for the ULLS and LSS. In consideration of this matter, UXC has concluded that there are technical grounds for Telstra levying a separate disconnection charges for the LSS but was unable to find any compelling reasons to allow Telstra to impose a separate disconnection charge for the ULLS.

The ACCC has considered the technical advice provided by UXC as well as submissions to the draft decision in making its final decision. The ACCC agrees with advice provided by UXC on disconnection charges for the ULLS and LSS. As such the ACCC has decided to retain its draft decision to not allow a separate disconnection charge for the ULLS. The ACCC considers that a separate disconnection activity and charge for the ULLS is avoidable. The ACCC agrees with UXC that Telstra is able to provision a new service using the copper pair circuit of a cancelled ULLS connection and that when required the disconnection of the jumper wires can be undertaken at the same time as a new connection. The ACCC considers that Telstra is able to leave its jumping wires in place with minimal risk that the access seeker could continue to use the ULLS.

However, the ACCC has decided, based on the evidence presented by UXC, that it will depart from its draft decision and set a regulated disconnection charge for the LSS, to be applied in certain circumstances. UXC has estimated a regulated charge for a separate disconnection charge similar to the approach it has taken in estimating other connections charges. The ACCC has adopted UXC's estimated charge for a separate disconnection charges for the LSS, as it provides the best available information about Telstra's costs for this disconnection work, allowing Telstra to recover its direct costs associated with a disconnection. The regulated disconnection charge for the LSS is set out in table 14.1 at the end of this chapter.

The ACCC agrees with UXC view that a separate disconnection charge should only be applied in certain circumstances. Specifically, the ACCC's final decision is that Telstra can only apply a separate disconnection charge for the LSS when a disconnection is performed outside of Telstra's churn process. That is, an end-user is not transferring over to another service provider or being disconnected because the end-user's premise is NBN serviceable at the time of the disconnection. A separate disconnection is only applicable where an end-user is cancelling the services and not transferring to another provider or in relation to the rollout of the NBN.

In regards to suggestions raised by iiNet and Macquarie, the ACCC does not consider it necessary to include an operative term in the FAD to prevent Telstra from imposing a separate disconnection charge for the ULLS. The ACCC notes that the decision to not allow a separate disconnection charge for the ULLS is not new and has been in place since the 2011 FAD took effect.

Early termination charges for the wholesale ADSL service

The ACCC's confirms its draft decision to not allow an early termination charges for the wholesale ADSL service. The ACCC has not been provided with any evidence to warrant a change to its draft decision. In particular, Telstra's submission to the draft decision does not provide any information about what cost its early termination charges is seeking to recover. Rather, Telstra submission raises concerns that the removal of early termination charges could lead to disruption in the market. Telstra claims that without requiring a minimum term it is feasible that, in certain circumstances, this could lead to an increasing number of end-users churning between providers leading to the requirement for more billing adjustments and additional resourcing requirements for both Telstra and access seekers to accommodate this increased churn.

The ACCC notes Telstra's concerns but does not agree with its conclusions that the removal of an early termination charge would increase the number of end-users churning between providers. If, as Telstra suggests, there is an increase in billing and associated resourcing costs for both Telstra and access seekers in accommodating an increase in end-user churn, there would be nothing preventing an access seeker or Telstra seeking to recover these costs from its end-user. Furthermore, the ACCC notes that the costs associated with connecting an end-user is already covered through the regulated connection charge. The ACCC notes that by not allowing an early termination charge to be imposed will allow access seekers to differentiate their retail offering by offering contracts without lock-in terms, which in turn promotes the LTIE.

The ACCC's final decision is to not allow an early termination charges for the wholesale ADSL service as Telstra has not provided any evidence to suggest that this charge is required to recover its efficient costs of providing a wholesale ADSL service. To give effect to this decision and for the avoidance of doubt, the ACCC has included a regulatory charge of zero in the FAD.

14.4.3 The scope of regulated charges

The ACCC confirms its draft decision to not increase the scope of its regulation of connection charges. The ACCC has not been provided with any evidence to warrant a change to its draft decision.

iiNet was the only submitter to provide comments on the ACCC's draft decision not to set a regulated charge for WLR. Specifically, iiNet suggested that the ACCC has appeared to consider the wrong test in its draft decision and that the ACCC must consider whether regulation would promote the LTIE not a cost and benefit test.

The ACCC reiterates comments made in its draft decision that no evidence was provided to suggest that the current charges for the WLR connection create a significant barrier to entry or cause competition concerns in the supply of the regulated service. The ACCC further notes that

a high price in and of itself is not justification for regulatory intervention and agrees with iiNet that demonstrating how the regulation of this charge furthers the LTIE is the key consideration.

Table 14.1 Final FAD connection and disconnection charges for regulatory period

	Current regulated charges	November 2015 to June 2016	July 2016 to June 2017	July 2017 to June 2018	July 2018 to June 2019
LSS charges					
LSS single connections*					
Band 1	\$47.55	\$42.63	\$43.66	\$44.72	\$45.80
Band 2	\$47.55	\$43.65	\$44.70	\$45.78	\$46.89
Band 3	\$47.55	\$44.66	\$45.74	\$46.85	\$47.98
Band 4		\$45.79	\$46.89	\$48.03	\$49.20
LSS single disconnections**					
Band 1	\$42.69	\$20.49	\$20.98	\$21.49	\$22.01
Band 2	\$42.69	\$19.28	\$19.75	\$20.23	\$20.72
Band 3	\$42.69	\$19.72	\$20.20	\$20.69	\$21.19
Band 4		\$21.41	\$21.93	\$22.46	\$23.00
LSS MNM connection charges – where the service is to be connected on a line Telstra is using to supply a wholesale ADSL service					
Fixed amount (per MNM)	\$154.56	\$168.14	\$172.21	\$176.38	\$180.64
Variable amount (per connection)	\$35.52	\$23.99	\$24.57	\$25.16	\$25.77
LSS MNM minimum exchange charge (excluding Band 4)					
Per exchange	\$865.04	\$647.85	\$663.53	\$679.59	\$696.04
ULLS charges					
ULLS single connection charges – in use ULLS, transfer ULLS and enhanced vacant ULLS connections***					
Band 1	\$55.60	\$51.62	\$52.87	\$54.15	\$55.46
Band 2	\$58.58	\$50.75	\$51.98	\$53.23	\$54.52
Band 3	\$63.66	\$55.63	\$56.98	\$58.36	\$59.77
Band 4		\$65.37	\$66.95	\$68.58	\$70.23
Charges for ULLS MNM – involving the transfer of end-user data services from a Telstra wholesale PSTN and/or ADSL service, or from a line that Telstra is using to supply a ULLS to another access seeker					
Fixed amount (per MNM)	\$152.25	\$168.14	\$172.21	\$176.38	\$180.64

	Current regulated charges	November 2015 to June 2016	July 2016 to June 2017	July 2017 to June 2018	July 2018 to June 2019
Variable amount (per connection)	\$27.58	\$20.18	\$20.66	\$21.16	\$21.68
ULLS MNM minimum exchange charge					
Per exchange	\$703.86	\$571.65	\$585.48	\$595.65	\$614.16
ULLS call diversion charge					
Fixed amount (per ULLS call diversion)	\$10.26	\$11.34	\$11.62	\$11.90	\$12.19
Variable amount (pro rata per month)	\$13.79	\$14.95	\$15.31	\$15.68	\$16.06
ULLS cancellation charges					
Per service where pre-jumping has occurred	\$22.06	\$15.09	\$15.46	\$15.83	\$16.21
Where entire MNM is cancelled	\$152.25	\$168.14	\$172.21	\$176.38	\$180.64
Wholesale ADSL					
Completed Type A connection					
Per connection	\$22.50	\$20.66	\$21.16	\$21.68	\$22.20
Completed Type B and all other wholesale ADSL connections					
Per connection	\$80.00	\$44.02	\$45.08	\$46.17	\$47.29
Early termination charge	\$50.00	\$0.00	\$0.00	\$0.00	\$0.00

* Note: the single LSS connection charge does not apply where the line on which the LSS is connected was being used to supply a ULLS.

** Note: These charges are not payable for: a disconnection made pursuant to the Telstra churn process by which services can be transferred between LSS, and between LSS and DSL services, or any period in which the Access Seeker was participating in the Telstra LSS churn process and Telstra (Bigpond) was not participating in the Telstra LSS churn process.

*** Note: No price is set for a Vacant ULLS connection.

15 Internal interconnection cable (IIC)

Key Points

- The ACCC's final decision is to include an IIC charge of \$0.051 (excluding GST) per month per pair installed, in the FAD price terms. This charge is determined by applying the same uniform price decrease as for the primary price terms to the current IIC charge.
- The IIC service is essential for access seekers that supply services to end-users using the ULLS and LSS.
- In June 2014, the ACCC varied the existing ULLS and LSS FADs to include price terms for the IIC charge. The varied FADs specified an IIC charge of \$0.056 (excluding GST) per month. This charge is the same as that set in the 2012 arbitral final determinations (FDs). This variation commenced on 1 July 2014 (the day after the existing arbitral determinations expired).
- The ACCC's draft decision was to retain the pricing methodology used for the arbitral decisions for the FAD as the FLSM has insufficient disaggregation of costs to enable a price to be set on a standalone basis for the IIC. The ACCC therefore proposed in the draft decision to apply the same uniform price change as determined for other regulated fixed line charges to the IIC charge.
- The final decision on the IIC charge confirms the pricing approach proposed for the IIC charge in the draft decision.

15.1 Introduction

The internal interconnection cable (IIC) is a twisted copper pair cable connecting an access seeker's equipment to Telstra's customer access network (CAN) and is required for an access seeker being able to obtain an Unconditioned Local Loop Service (ULLS) or Line Sharing Service (LSS) from Telstra. Specifically, the IIC connects a point of interconnection (POI) in the relevant access seeker's equipment space to Telstra's main distribution frame (MDF) (or its equivalent). It is installed by the relevant access seekers but is then owned and operated by Telstra.

The ACCC currently regulates the IIC charge via the ULLS and LSS final access determinations (FADs) varied on 30 June 2014. The price terms (\$0.056 per month per pair installed) in the ULLS and LSS FADs are the same as those set out in the final arbitral determination made in November 2012 under the previous Part XIC regime. The ACCC's view when it varied the ULLS and LSS FADs was that the IIC FAD price terms should remain the same as those determined in the final arbitral determinations until the ACCC makes new FADs for these services.

The ACCC set the current IIC charge of \$0.056 per copper pair installed per month in the 2012 IIC final determinations (FD) by adjusting Telstra's IIC cost model to more closely align the model with the pricing approach from the Fixed Line Services Model (FLSM).⁷⁵⁵

This chapter provides the ACCC's final decision on the IIC charge. In reaching its final decision, the ACCC has considered Telstra's and access seekers' submissions in response to the draft decision.

15.2 March 2015 ACCC draft decision

The ACCC commenced consulting on IIC charges in the non-price terms and conditions (NPTC) FAD position paper in May 2014.⁷⁵⁶ The position paper sought views on the approach for pricing IIC and (any) alternative approach to pricing the IIC. Access seekers submitted that the IIC charge should either be \$0 or be maintained at the previous \$0.056 charge until the ACCC determines new charges.⁷⁵⁷ Telstra submitted that the IIC charge needed to be considered as part of the inquiry into primary prices to ensure consistency and minimise the risk of over or under recovery of costs.⁷⁵⁸ The ACCC's March 2015 draft decision was to set an IIC charge of \$0.056 (excluding GST) per month per pair installed in the FAD price terms.⁷⁵⁹

The ACCC considered using the FLSM for setting the IIC charge. However, the draft decision was unable to adopt this approach for a number of reasons including that the level of information currently available to the ACCC does not allow estimation of a stand-alone IIC charge within the FLSM. In particular, there is insufficient granularity within the FLSM to enable an allocation of costs separately to the IIC service [c-i-c starts] [c-i-c ends].

The ACCC also considered Telstra's proposal for setting the IIC charge within the FLSM but did not proceed with the proposal for a number of reasons including:

- Information submitted by Telstra does not [c-i-c starts] [c-i-c ends].
- Telstra's approach is based on a number of assumptions [c-i-c starts] such as the number of TEBA racks at the end of the NBN rollout. [c-i-c ends] Telstra has not provided evidence or justification for these assumptions.
- Telstra's approach appeared to suggest a [c-i-c start] [c-i-c end].⁷⁶⁰

The ACCC considered that it should use an alternative approach to that proposed by Telstra and that the approach taken in the 2012 FDs to determine IIC price terms could be a useful starting point to determine an IIC charge. The draft decision IIC charge was estimated by adopting the previous IIC charge of \$0.056 per pair installed per month and adjusting for the

⁷⁵⁵ ACCC, *ULLS and LSS Access Disputes - Chime Communication Pty Ltd/Telstra Reasons for Final Determination*, November 2012, p 16.

⁷⁵⁶ ACCC, *Telecommunications Final Access Determination inquiries – non-price terms and conditions and supplementary prices*, Position paper, May 2014, p. 17.

⁷⁵⁷ Submissions to the non-price terms and conditions discussion paper is discussed in more detail in the ACCC's March draft decision, pp. 172-173.

⁷⁵⁸ Telstra, *Final Access Determination inquiry on supplementary pricing, Response to ACCC position paper*, 15 July 2014, pp. 3–14.

⁷⁵⁹ ACCC, Draft Decision, p. 171.

⁷⁶⁰ ACCC, Draft Decision, p. 175.

same uniform change in prices (-0.7 per cent in the draft decision)⁷⁶¹ across all declared services over the regulatory period.

15.3 Submissions to the draft decision

Frontier commented [c-i-c starts] [REDACTED]
[REDACTED]
[REDACTED] [c-i-c ends] Frontier also stated that the ACCC's reasoning for setting prices to IIC services also applies to the TEBA services.⁷⁶³ [c-i-c starts] [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] [c-i-c ends]⁷⁶⁵

iiNet agreed with the ACCC's draft decision that IIC charges should be included in the FADs for ULLS and LSS. However, iiNet noted that Telstra treats the IIC as part of Telstra's TEBA service, with the other two main components of that service being power and TEBA racks. For this reason, iiNet submitted that TEBA racks and power charges should also be included as a combined charge with IIC.⁷⁶⁶

15.4 ACCC final decision

The ACCC's final decision is to include an IIC charge of \$0.051 (excluding GST) per month per pair installed in the FAD price terms. The ACCC's final decision is to set the IIC charge by applying the uniform price change determined for the primary price terms using the FLSM to the IIC charge of \$0.056 per pair installed per month as set for the 2012 final arbitral determinations.

⁷⁶¹ Uniform changes refers to applying the same proportion of change in IIC charges as that for other declared services that were calculated within the FLSM.

⁷⁶² Frontier Economics, *Submission on the ACCC's draft decision on fixed line prices – A report prepared for the Competitive Carriers Coalition, iiNet and Optus*, May 2015, p. 40.

⁷⁶³ The ACCC stated in the draft decision that even though the IIC is not part of the ULLS or LSS, access seekers are unable to provide ULLS or LSS based services to end users without the IIC service. Therefore, when determining prices for ULLS and LSS, IIC prices must also be determined.

⁷⁶⁴ Frontier Economics, *Submission on the ACCC's draft decision on fixed line prices – A report prepared for the Competitive Carriers Coalition, iiNet and Optus*, May 2015, p. 41.

⁷⁶⁵ Ibid, p. 41.

⁷⁶⁶ iiNet, *Submission by iiNet Limited*, May 2015, p. 7

The ACCC continues to consider that the methodology used for the 2012 FDs to determine IIC price terms is an appropriate starting point for the IIC charge given limitations of the FLSM in this regard:

- The asset classes used in the FLSM continue to be insufficiently disaggregated to readily derive IIC costs based on specific assets used to provide the IIC service. Telstra has been unable to provide further detailed information on assets used to supply the IIC service compared to those provided in the 2012 FDs.
- [c-i-c starts] [c-i-c ends] does not allow a standalone IIC charge to be estimated.

The ACCC notes Frontier's and iiNet's submissions for including other TEBA charges (TEBA power and TEBA rack space) in the FAD. The ACCC maintains its draft decision to only set the IIC charge in these FADs as the ACCC has not consulted on setting regulated charges for the TEBA power and TEBA rack services and further consultation would delay the FSR FAD inquiry.

15.5 Assessment of approach against section 152BCA matters

In making an access determination, the ACCC is required to take into account matters in section 152BCA(1), (2) and 152AB(2), (4) and (6) of Part XIC of the CCA.

The ACCC considers that the IIC charge included in the final decision setting prices for the declared fixed line services promotes the LTIE⁷⁶⁷ for the following reasons:

- Promoting competition in markets for the declared services⁷⁶⁸ – the final decision IIC charge is based on the current charge which was set in the 2012 arbitral decisions. The pricing approach in the 2012 arbitral decision allowed a reasonable estimate of the efficiently incurred costs of supplying the IIC services which will promote competition in the relevant markets for the supply of voice and/or broadband services.⁷⁶⁹ Access seekers will be able to acquire the listed services at prices that reflect efficient and prudent cost of supply which will promote access to the IIC service, the LSS and the ULLS.⁷⁷⁰
- Encouraging the economically efficient investment in, and the economically efficient use of, infrastructure⁷⁷¹ – the final decision IIC charge is based on a reasonable estimate of the efficiently incurred cost of supplying the IIC service. In setting the IIC charge, the ACCC has had regard to the technical feasibility of the listed services to be supplied and charged for.⁷⁷² The ACCC considers that the final decision IIC charge would contribute the efficient and prudent cost of supply (which will allow equally efficient access seekers to compete with Telstra on their own merits), promote access to the relevant listed services (ULLS and LSS), and promote the efficient operation of Telstra's fixed line network.

⁷⁶⁷ Paragraphs 152BCA(1)(a) and 152AB(2).

⁷⁶⁸ Paragraph 152AB(2)(c).

⁷⁶⁹ ACCC, *ULLS and LSS Access Disputes - Chime Communication Pty Ltd/Telstra Reasons for Final Determination*, November 2012, p. 56.

⁷⁷⁰ Paragraph 152AB(4).

⁷⁷¹ Paragraphs 152AB(2)(e) and 152BCA(1)(g).

⁷⁷² Paragraphs 152AB(6)(a)

The ACCC considers that the final decision IIC charge is in the legitimate business interests of the access provider as it is based on the efficiently incurred cost of supplying the IIC service.⁷⁷³

The ACCC considers that the final decision IIC charge reflects the efficient cost of supplying the IIC service. This is likely to have a positive effect on the acquisition of the relevant declared services and would have flow on benefits to downstream services as the costs of supplying retail voice and broadband services would likely decrease.⁷⁷⁴ In determining this charge, costs that are already being sufficiently recovered through other services have been removed.⁷⁷⁵

The ACCC has stated in its *access pricing principles – Telecommunications 1997* that if an access seeker enhances the facility to provide the required services, the access provider should not attempt to recover any costs related to this enhancement for themselves. Equally, if an access provider must enhance a facility to provide the service, it is legitimate for the access provider to incorporate some proportion of the cost of doing so in the access price.⁷⁷⁶ The ACCC has previously noted that the costs for installing equipment relating to the IIC have been borne by the access seekers or Telstra depending on the circumstances of a particular exchange.⁷⁷⁷

The ACCC is of the view that the value to parties of these installations is confined to the provision of the IIC service by Telstra to the access seekers. The ACCC notes that the current IIC charge appropriately accounts for the costs borne by the different parties.⁷⁷⁸

In basing the final decision IIC charge on the current charge, the ACCC has considered the value of extensions or enhancements whose cost has been borne by someone else regarding the provision of the IIC service.⁷⁷⁹

The ACCC considers that the final decision IIC charge is based on an estimate of the efficiently incurred costs of supplying the IIC service. The ACCC considers that this will not compromise the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility.⁷⁸⁰

The ACCC considers that this cost-based charge for the IIC service will encourage the economically efficient operation of the relevant declared services, the downstream services provided through the declared services and the telecommunications networks and infrastructure used to supply these services.⁷⁸¹

The ACCC notes that the IIC service is generally acquired by access seekers of ULLS and LSS. The ACCC considers that setting an IIC charge that reflects the efficiently incurred cost of supply will facilitate and promote the supply of the ULLS and LSS where appropriate.⁷⁸²

⁷⁷³ Paragraph 152BCA(1)(b).

⁷⁷⁴ Paragraphs 152BCA(1)(c) and 152AB(2)(c).

⁷⁷⁵ ACCC, *ULLS and LSS Access Disputes - Chime Communication Pty Ltd/Telstra Reasons for Final Determination*, November 2012, p. 59. Paragraph 152BCA(1)(d).

⁷⁷⁶ ACCC, *Access pricing principles-telecommunications*, July 1997, p.11.

⁷⁷⁷ ACCC, *ULLS and LSS Access Disputes - Chime Communication Pty Ltd/Telstra Reasons for Final Determination*, November 2012, p. 59.

⁷⁷⁸ ACCC, *ULLS and LSS Access Disputes - Chime Communication Pty Ltd/Telstra Reasons for Final Determination*, November 2012, p. 59.

⁷⁷⁹ Paragraph 152BCA(1)(e).

⁷⁸⁰ Paragraph 152BCA(1)(f).

⁷⁸¹ Paragraphs 152BCA(1)(g); 152AB(2)(c) and (e).

⁷⁸² Paragraph 152BCA(2).

Part C: Scope of the application of the SAOs

16 Geographic exemption

Key points

- The ACCC's final decision is that the SAOs and the FADs for WLR and LCS should apply to all geographic areas, including CBD areas.

16.1 Introduction

While the preceding chapters in this report on the FAD price terms discuss the application of the FLSM and key issues in that application, this Chapter and Chapter 17 set out the ACCC's decision on the scope of the application of the SAOs in respect of the supply of the declared fixed line services.

The ACCC can make terms and conditions in FADs which provide that any or all of the SAOs do not apply to a carrier or carriage service provider either unconditionally or subject to such conditions and limitations as are specified in the FAD.⁷⁸³

In the past, access providers have sought from the ACCC two types of exemptions from regulation:

- geographic exemptions, which would exempt an access provider from the application of the SAOs when it supplies services in specific geographic areas. There are currently no geographic exemptions included in the fixed line services FADs.
- carrier-specific exemptions, which would exempt specific carriers/CSPs from the application of the SAOs. There is an exemption in the existing wholesale ADSL FAD, which limits the application of the category A SAOs to Telstra only. Carrier-specific exemptions are discussed in further detail in chapter 17.

In April 2014, the ACCC decided to continue to declare the fixed line services for a period of five years. In respect of WLR and LCS, the ACCC decided that the SAOs would apply to all access providers nationally, extending the declaration to WLR and the LCS supplied in CBD areas (where previously, the service descriptions for these declarations excluded CBD areas).⁷⁸⁴ From 1 August 2014, the regulated terms and conditions in the relevant FADs (including regulated prices) applied to Telstra when supplying the WLR service and LCS in CBD areas. That is, there are no geographic exemptions for services supplied in CBD areas in the current WLR and LCS FADs.

In October and November 2014, Telstra, iiNet and Macquarie Telecom made submissions to the ACCC's discussion paper to the fixed line services FAD inquiry about exempting WLR and LCS services supplied in CBD areas from the application of the SAOs. In response to the March Draft Decision, Telstra submitted that, in making new FADs, the ACCC should provide that the SAOs do not apply in the CBD areas unconditionally.⁷⁸⁵ Telstra also submitted in response to a request for information that if the ACCC does not believe an unconditional

⁷⁸³ See section 152BC(3)(h)(ii) of the CCA.

⁷⁸⁴ Section 152AR of the CCA. In the past, the ACCC exempted CBD areas from WLR and LCS regulation. Between 2002 and before the change in 2014, the service description for the LCS exempted the CBD areas of Sydney, Melbourne, Adelaide, Brisbane and Perth from the declarations. Similarly, the service description for WLR also exempted CBD areas when it was first separately declared in 2006 until the change in 2014. Therefore, in the past, access providers were not obliged to supply these services when requested in CBD areas.

⁷⁸⁵ Telstra, submission to ACCC March draft decision, public version, 1 May 2015, p. 3.

exemption is appropriate for whatever reason, the ACCC should also consider making an exemption subject to conditions or limitations.⁷⁸⁶

In March 2015, the ACCC published its draft decision on the fixed line services FAD. In that decision, it set out its view that the SAOs and the WLR and LCS FAD terms should apply to the supply of WLR and LCS services in CBD areas. In reaching this view, the ACCC found that exempting the supply of WLR and LCS in CBD areas would not promote the LTIE. This is consistent with the ACCC's decision in the 2014 declaration inquiry to regulate CBD areas.

16.2 ACCC March Draft Decision

In its draft decision, the ACCC identified the relevant markets for the WLR and LCS and considered that these markets were the:

- retail and wholesale markets for the supply of fixed voice services
- retail market for the supply of a bundle of fixed voice and fixed broadband services.

The ACCC expressed draft views on substitution, including views on substitution in respect of the product dimension. Specifically, the ACCC's draft view was that at the retail level, some end-users may be reluctant to switch from a traditional voice service to IP-based services (supplied over the ULLS or an alternate network) or a mobile service for a range of reasons. Further, the ACCC's draft view was that at the wholesale level, self-supply of fixed voice services via the ULLS and the resale of or self-supply of fixed voice services over alternative networks are not close substitutes for traditional voice services.⁷⁸⁷

With regard to the above markets, the ACCC's draft view was that Telstra remained the dominant wholesale and retail provider of fixed voice services in the CBD areas and that this dominance was likely to enable Telstra to exploit economies of scale and scope.

In its section 152BCA assessment, the ACCC considered whether including the exemptions for the supply of WLR and LCS in the CBD areas would promote competition in the relevant markets. The ACCC's Draft Decision was that as there was still significant demand for traditional voice only services and Telstra's pricing of WLR services had had a flow on effect on retail prices for voice services, the inclusion of CBD exemptions would not promote the LTIE.⁷⁸⁸

Also, the ACCC's Draft Decision was that applying the SAOs and the FADs to WLR and the LCS supplied in CBD areas would promote the economically efficient use of, and economically efficient investment in, infrastructure.⁷⁸⁹ The ACCC also assessed the CBD exemptions against the relevant matters in section 152BCA and found that its assessment supported applying the SAOs and FADs to WLR and LCS supplied in CBD areas (i.e. no exemption for CBD areas).⁷⁹⁰

Lastly, in the March 2015 Draft Decision, the ACCC also noted its decision in the declaration inquiry in relation to LCS.⁷⁹¹ Specifically, while the ACCC did not receive evidence during the declaration inquiry that Telstra was supplying the LCS at a rate that was well above the economically efficient cost price, the ACCC considered that given the lack of effective competition in supplying voice-only services in CBD areas, Telstra would have an incentive and ability to raise the LCS price in CBD areas in the event that the CBD exemptions were removed

⁷⁸⁶ Telstra, response to ACCC request for further information, public version, 11 August 2015, p. 6.

⁷⁸⁷ ACCC, March draft decision, public version, March 2015, p 189

⁷⁸⁸ Ibid., p 194

⁷⁸⁹ Ibid., p 197

⁷⁹⁰ Ibid., p 198

⁷⁹¹ Ibid., p 182

only from the WLR service description.⁷⁹² The ACCC therefore found that removing the CBD exemptions from the LCS service description would lead to lower retail prices, greater innovation and choice and so would promote the LTIE.⁷⁹³ The ACCC maintains this view on LCS in this final decision.

16.3 Submissions to Draft Decision

Market structure and market definition

In its submission to the ACCC discussion paper and the March Draft Decision, Telstra submitted that competition is effective in the CBD areas due to the availability of multiple substitutes.⁷⁹⁴ Telstra disagreed with the ACCC's view that the ULLS is not a substitute for WLR at the wholesale level in cases where only a small number of services are required due to a lack of economies of scale. Further, Telstra also repeated its arguments and argued that IP-based services and fibre-based DTCS tails offer alternative wholesale inputs for the supply of fixed voice services at the retail level.⁷⁹⁵ Telstra provided an example of the Optus Evolve product suite which contains the access option of Ethernet over Managed Leased Line Ethernet (a transmission service).⁷⁹⁶

In response to the ACCC discussion paper and request for further information, **[c-i-c starts**

[REDACTED]

c-i-c ends].

State of competition

Telstra suggested that the ACCC appears to believe that for competition to be effective, the commercial price of the WLR should be driven down to at least the regulated price (if not a cost-based price). Telstra claims that the ACCC's view is that Telstra's prices are above the regulated prices due to market power and that this fails to explain why Telstra has not changed its prices since 2005. Telstra referred to a report from Castalia to support its view that because Telstra has not changed its long term prices for WLR and LCS, this would suggest that Telstra does not have market power.⁷⁹⁹ Telstra submitted that the likely cause for the price difference between CBD and other areas is that Telstra's loss of market share (owing to an increase in ULLS based competition) is resulting in increasing average costs of supply for WLR.⁸⁰⁰

⁷⁹² ACCC, Public Inquiry into the fixed line services declarations: Final report, April 2014, p. 44.

⁷⁹³ ACCC, Public Inquiry into the fixed line services declarations: Final report, April 2014, p. 44.

⁷⁹⁴ Telstra, submission to ACCC discussion paper, public version, 13 October 2014, p. 15; Telstra, submission to ACCC March draft decision, public version, p. 188.

⁷⁹⁵ Telstra, submission to ACCC March draft decision, public version, 1 May 2015, p. 186.

⁷⁹⁶ Telstra, submission to ACCC request for further information, public version, 11 August 2015, p. 13.

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⁷⁹⁹ Telstra commissioned an expert report by Castalia in support of its submission to the fixed line services discussion paper, available at: <https://www.accc.gov.au/system/files/Telstra%20Submission%20to%20the%20fixed%20services%20FAD%20inquiry%20on%20price%20and%20non-price%20terms%20-%20Expert%20report%20for%20SAOs%20submission.PDF>, October 2015.

⁸⁰⁰ Telstra, submission to the ACCC March draft decision, public version, 1 May 2015, p. 187.

16.4 Consideration of the LTIE

Promoting competition

In its submissions to the ACCC discussion paper and March Draft Decision, Telstra submitted that any ex-ante regulation should be limited to areas where there is an essential bottleneck facility to be regulated and WLR is not such a bottleneck.⁸⁰¹ Telstra argued that if the ACCC were to undertake a proper evidence-based market review (rather than relying on an imputation or margin analysis), this review would show that there are multiple substitutes to WLR which allow competitors to provide the final product (i.e. a standard telephone call) at a cost comparable to Telstra.⁸⁰²

Economically efficient use of, and investment in, infrastructure

Telstra submitted that there is [c-i-c starts █████ c-i-c ends] per cent spare capacity on DSLAMs and that it is a more economically efficient for access seekers to use the already installed infrastructure through ULLS/LSS based service offerings, rather than encouraging the use of WLR (through 'low regulated prices set by regulation').⁸⁰³

16.5 ACCC final assessment and decision

Consistent with the ACCC's Draft Decision, the ACCC's final decision is to not exempt the supply of WLR and LCS in CBD areas from the SAOs, for the reasons set out in this section. This reflects the present approach under the current FADs for the WLR and LCS, and the ACCC's position in the declaration inquiry.

Market definition

In making an access determination, the ACCC is required to take into account a number of matters. In particular, in considering whether to exempt the supply of WLR and LCS in CBD areas from the SAOs, the ACCC must consider whether its decision will promote competition in markets for listed services. This involves identifying the relevant markets for the services in question and assessing the state of competition in those markets. Consistent with its March 2015 Draft Decision, the ACCC's final view is that the relevant markets are:

- the retail and wholesale markets for the supply of fixed voice services, and
- the retail market for the supply of a bundle of fixed voice and fixed broadband services.

In its declaration decision, the ACCC decided to declare WLR and LCS on a national basis (by removing the CBD exemptions from the WLR and LCS service descriptions). In doing this, consistent with the ACCC's approach in the past, the ACCC considered the implications for competition within the CBD areas in undertaking its LTIE assessment.

Substitution is the key to market definition. Substitution involves switching from one product to another in response to a change in the relative price, service or quality of the product that is the subject of the inquiry. There are two types of substitution at different functional levels which are relevant to this decision on geographic exemptions:

⁸⁰¹ Telstra, *submission to the ACCC discussion paper, public version, 13 October 2014, p. 25*; Telstra, *submission to the ACCC March draft decision, public version, 1 May 2015, p. 188*.

⁸⁰² Telstra, *submission to the ACCC discussion paper, public version, 13 October 2014, p. 11*; Telstra, *submission to the ACCC March draft decision, public version, 1 May 2015, p. 188*.

⁸⁰³ Telstra, *submission to the ACCC discussion paper, confidential version, 13 October 2014, p. 16*; Telstra, *submission to the ACCC March draft decision, confidential version, 1 May 2015, p. 189*.

- substitution at the retail level, which involves end-user-switching by end-users; and
- substitution at the wholesale level, which involves switching by suppliers (ie. access seekers).

The ACCC has focused on demand-side substitution at both levels in its analysis in this section. There may be associated switching costs or difficulties which, if significant, can impede the substitutability of products. When considering whether a product is substitutable, the ACCC may consider customer attitudes, the function or end-use of the technology, past behaviours of buyers, relative price levels, and physical and technical characteristics of a product.⁸⁰⁴

Typically, the ACCC considers the product, geographic and temporal dimensions of a market. The ACCC discusses substitution at the retail and wholesale levels below.

Product dimension

Retail level substitutability

Wholesale line rental (WLR) is a wholesale input that is used in combination with LCS to supply traditional fixed voice services, and the fixed voice part of a bundle of fixed voice and fixed broadband services in retail markets. WLR is also used as an input to provide special services such as point of sale EFTPOS solutions, facsimile, and security alarms.

On balance, and for the reasons set out below, the ACCC considers that there are limited retail substitutes which end-users currently buying a WLR-based fixed voice service or special service can switch to in the event of a SSNIP in WLR-based services.

Retail fixed voice services

Defining the relevant markets for fixed voice services involves considering services for retail customers or end-users which are substitutes for retail voice services (supplied through WLR). The ACCC notes that from an end-user's perspective there are the following alternative means by which voice services can be acquired by them:

- VoIP services which are purchased as part of broadband services
- Voice services provided over other alternative and non-copper networks such as mobile networks and fixed wireless networks.

In this FAD inquiry, Telstra submitted that at the retail level, end-users can switch to alternative voice products in the event of a rise in the prices of WLR-based fixed voice services, specifically:

- IP-based voice services (VoIP) such as those supplied over fibre networks or via the ULLS⁸⁰⁵
- Fixed wireless voice services.⁸⁰⁶

In its response to the further request for information, Telstra reiterated that the industry has increasingly accepted VoIP as a legitimate alternative to PSTN-based voice. Telstra also indicated that the barriers of providing VoIP to end-users are low and the costs of providing and

⁸⁰⁴ See ACCC, *Merger Guidelines*, November 2008, p.19 for a useful list of information the ACCC may consider when identifying close substitutes to the relevant product.

⁸⁰⁵ Telstra, *submission to the ACCC discussion paper*, public version, 13 October 2014, p. 14

⁸⁰⁶ *Ibid.*, p. 14

obtaining VoIP are not prohibitive.⁸⁰⁷ Further, Telstra submitted that perceptions of VoIP quality have changed.⁸⁰⁸

Consistent with its March Draft Decision, the ACCC considers that some end-users may be reluctant to switch from a PSTN-based voice service to an IP-based service supplied over a fibre network or via ULLS, or a mobile service, for a range of reasons.

While the ACCC recognises that some VoIP services such as POTS-emulation VoIP⁸⁰⁹ are a good substitute because they offer higher quality service assurance and do not require an end-user to upgrade their customer equipment (low or no barriers to switching), there are technical limitations because these VoIP services cannot perform some functions which PSTN based services can. These services are special services like EFTPOS, which are discussed more below, facsimile and security alarms. Further, while POTS-emulation VoIP may be a demand side substitute for end-users in the retail market, the availability of POTS-emulation VoIP depends on whether access seekers are offering it at the retail level (and whether access seekers consider it a viable substitute at the wholesale level). This is discussed in further detail below.

Other VoIP services such as carrier-grade⁸¹⁰ and application layer VoIP⁸¹¹ (provided over fibre networks or ULLS) have reduced substitutability in view of the switching costs for end-users which arise because they would have to buy a VoIP enabled router and handset, and/or would require end-users to enter in to a minimum contract term for the underlying internet service or pay a set-up fee if the end-user does not sign up to a contract. The ACCC maintains its draft view that end-user perception as to the quality of these VoIP services may also be a reason for a reluctance to switch. Further, as noted in the March 2015 Draft Decision, and as is the case with POTS-emulation VoIP, carrier-grade and application layer VoIP are limited in functionality as they cannot supply special services.

In view of the above, the ACCC maintains its draft view that VoIP services are not a strong substitute for traditional PSTN-based voice services from a retail end-user perspective.

Telstra submitted that mobile services offer an effective alternative for end-users who only need a voice service. Telstra submitted that information obtained from the ACMA reports indicates that end-users are increasingly moving away from fixed line telephony services. Telstra submitted that the mobile markets in the CBD are highly competitive.⁸¹²

The ACCC maintains that in line with the reasons set out in its Draft and Final Decisions in the 2014 declaration inquiry, mobile services are not a close substitute for traditional voice-only services. For a significant proportion of retail end-users, mobile voice services are not substitutable for traditional fixed-voice services due to switching costs, technical and pricing limitations. As the ACCC noted in its 2013-2014 Telecommunications Report, for most

⁸⁰⁷ Telstra, submission to ACCC request for further information, confidential version, August 2015, p. 7.

⁸⁰⁸ Ibid., p. 7.

⁸⁰⁹ The access seeker uses the normal voice band of the copper line to connect a standard (POTS) telephone to a Multi-Service Access Node (MSAN) installed in Telstra exchanges that can terminate both DSL and voice-band traffic

⁸¹⁰ The end-user connects to an internet access device (such as internet phone or modem with handset adapter) that converts the voice call to VoIP at the end-user premises. The call is transferred to the exchange and the access seeker's equipment over the broadband connection.

⁸¹¹ The access seeker provides a voice service through a full IP solution over the broadband connection, using either a VoIP handset or software on a computer to emulate a telephone, for example, Skype or other non-prioritised VoIP service.

⁸¹² Telstra, submission to ACCC further request for information, public version, August 2015, p.10.

consumers, mobile services continue to complement fixed line telephone services, rather than be a complete substitute.⁸¹³

Telstra has submitted that fixed wireless has become a viable alternative for the supply of voice services.⁸¹⁴ The ACCC maintains its view that fixed wireless networks are a limited substitute for PSTN-based fixed voice only services due to their limited availability in CBD areas. The ACCC also notes that some special services cannot currently be supplied over fixed wireless networks.

Special services (such as EFTPOS)

As noted above, there are retail special services which have historically been provided over a copper line (using WLR) including EFTPOS machines, facsimile, security alarms, elevator telephones and back-up telephones.

For the reasons set out below, the ACCC considers that there are limited retail substitutes for WLR-based special services.

The ACCC understands that businesses requiring EFTPOS typically require two line rental services, one for an EFTPOS machine and another for either a voice-only or a bundled voice and broadband service.

In its submission to the discussion paper and its response to the ACCC's request for further information, Telstra submitted that:

- the use of WLR-based EFTPOS is being subsumed by the use of mobile EFTPOS machines and the use of mobile services as a platform for EFTPOS transactions has increased year on year.⁸¹⁵
- IP EFTPOS terminals are widely available for use where a fixed solution is preferred over a mobile solution, and these IP EFTPOS terminals can be used over a ULLS or fibre based connection⁸¹⁶ and such IP connections can be used to supply voice, broadband and EFTPOS over the single IP access line.⁸¹⁷

The ACCC sought more information on the take up and substitutability of mobile and IP EFTPOS for WLR-based 'dial-up' EFTPOS from access seekers and financial institutions.

One non-Telstra mobile network operator [c-i-c starts [REDACTED] c-i-c ends] confirmed that it provides mobile EFTPOS.⁸¹⁸ Another mobile operator noted the possibility of financial institutions purchasing a SIM card from it and on-selling that mobile connection with an EFTPOS device to create an EFTPOS solution.

From inquiries with financial institutions, it appears most financial institutions offer all three types of EFTPOS and some institutions are encouraging new customers to transition from WLR-based or 'dial-up' EFTPOS to mobile EFTPOS using 2G or 3G, with little or no price differential between fixed and mobile EFTPOS solutions.

⁸¹³ ACCC, ACCC telecommunication reports 2013-2014, p. 15 (available at: <https://www.accc.gov.au/publications/accc-telecommunications-report/accc-telecommunications-report-2013-14>)

⁸¹⁴ Telstra, submission to the ACCC discussion paper, 13 October 2014, public version, p. 15

⁸¹⁵ Telstra, submission to the ACCC discussion paper, public version, 13 October 2014, p. 19; Telstra, response to ACCC request for further information, public version, 11 August 2015, p. 11.

⁸¹⁶ Telstra, submission to the ACCC discussion paper, public version, 13 October 2014, public version, p. 19

⁸¹⁷ Ibid., p. 19

⁸¹⁸ [REDACTED]

However, information from another financial institution indicates that mobile EFTPOS might not be a practical option for some customers, especially retail outlets. This advice indicated that for these customers, a WLR-based fixed EFTPOS solution would appear to be a practical choice, as customers come to a fixed point of sale to make purchases and fixed EFTPOS may be perceived to be more reliable and less susceptible to mobile dropouts. In response to this, Telstra submitted that retailers would consider fit-for-purpose options and price rather than connectivity when selecting an EFTPOS supplier. Telstra submitted that the ACCC should not assume that some customers not switching to IP/mobile EFTPOS is evidence that there is not a more appropriate solution available to them.⁸¹⁹

The ACCC also notes that one financial institution also offered a (40 per cent) lower terminal rental price for its WLR-based EFTPOS solution compared to its rental price for mobile EFTPOS terminals. Telstra submitted that variation in different EFTPOS providers' pricing, service levels and technical capability is expected in a competitive market.⁸²⁰

The ACCC also understands from its inquiries with financial institutions that IP-based EFTPOS, while being a fixed-line EFTPOS solution, would only be suitable for some businesses such as supermarkets and fast food restaurants, which have high foot traffic, and that they may not be a close substitute due to switching costs associated with buying the systems and software to support IP-based EFTPOS.

Considering the available information, the ACCC's final view is that mobile and IP-based EFTPOS may not be a substitute for WLR-based EFTPOS for certain retailers, and is therefore not a fully effective substitute.

The ACCC understands that for other complex services, other than EFTPOS (such as facsimile, elevator telephones, back up telephones and security alarms), there are limited effective substitutes. While Telstra has submitted that significant work is underway to ensure that all services can be supplied using the NBN (that is, there has been progress in developing IP-based alternatives), the ACCC maintains its view that work for new IP-based solutions is not yet complete⁸²¹ and it would require end-user investment in customer equipment which may be a further barrier to customer switching.

Wholesale level substitutability

Access seekers (being retail service providers) use resale services, WLR and the LCS, acquired at the wholesale level to provide retail fixed voice-only services (and special services) either on a standalone basis or as part of a bundle to end-users. At the wholesale level, the potential alternatives to WLR and LCS available to access seekers are:

- self-supply of fixed voice services via the ULLS (e.g. POTS emulation VoIP),
- self-supply of fixed voice services over a non-copper end-to-end network such as HFC or other fibre network, or
- a resale fixed voice service supplied by a non-Telstra wholesale provider using the ULLS or an alternative network.

⁸¹⁹ Telstra, response to ACCC additional inquiry on EFTPOS services, public version, 21 August, p. 2. submission to request for further information, confidential version, 21 August 2015, p. 2

⁸²⁰ Telstra, response to ACCC additional inquiry on EFTPOS services, public version, 21 August, p. 2., Telstra, submission to ACCC request for further information, confidential version, 21 August 2015, p. 2

⁸²¹ For example, the Communications Alliance NBN OTT Services Transition Working Group (NOST) is continuing work to be undertaken to assess the implications for over the top device transition arising from the introduction of FTTN to the range of access technologies to be used during the roll-out of the NBN. See: <http://www.commsalliance.com.au/Activities/committees-and-groups/nost-wg>

During this FAD inquiry, Telstra made submissions rejecting the ACCC's view that the above alternatives were not effective substitutes for WLR or copper based services in CBD areas.⁸²² In addition to self-supply of ULLS (using DSLAMs),⁸²³ and the use of non-copper fibre networks,⁸²⁴ Telstra also submitted that the use of commercial or regulated DTCS tails,⁸²⁵ provide alternatives to WLR at the wholesale level which can be used to provide fixed voice services at the retail level.

The ACCC maintains its March Draft Decision that the above wholesale inputs are not effective alternatives which access seekers could use, in the event that there was a SSNIP in WLR prices, to supply fixed voice only services to retail end-users.

Self-supply of ULLS

The ACCC considers self-supply of ULLS is not an alternative to WLR and LCS which access seekers can use to provide fixed voice services. As discussed in the draft⁸²⁶ and final declaration decisions⁸²⁷, and the March Draft Decision for the fixed line services FADs,⁸²⁸ the ACCC considers that using ULLS would require investment in DSLAMs or MSANs at the Telstra exchange, and in the case of supplying a POTS-emulation VoIP service it would also require investment in soft switching equipment.

In the transition period to the NBN, there is a greater potential that such equipment might be stranded and therefore access seekers are unlikely to consider self-supply via ULLS as an effective substitute to WLR. The ACCC accepts that this risk of asset stranding may be higher under the new technology mix for the NBN, because the NBN is likely to be rolled out faster.⁸²⁹

Further, in relation to a particular subset of retail (business and residential) customers in CBD areas that require a small number of voice-only lines to a premises, self-supply of ULLS is not an economically viable substitute to WLR due to the higher unit costs of self-supplying ULLS. Macquarie Telecom [c-i-c starts [REDACTED]

[REDACTED] c-i-c ends].⁸³⁰ [REDACTED], Optus in its submission to the March Draft Decision noted that [c-i-c starts [REDACTED] c-i-c ends].⁸³¹

Telstra has not commented on the higher-unit costs that access seekers face by self-supplying ULLS for a small number of lines to a premises. Rather, Telstra has argued that CBD ESAs contain a significantly larger addressable market than other ESAs in terms of the number of active PSTN SIOs in Band 1 ESAs and that this would indicate scale economies.⁸³² However

⁸²² Telstra, submission to the ACCC March Draft Decision, public version, 1 May 2015, p. 188.

⁸²³ Telstra, submission to the ACCC discussion paper, public version, 13 October 2014, p. 16.

⁸²⁴ Ibid., p. 14.

⁸²⁵ Ibid., p. 14.

⁸²⁶ ACCC, *Fixed Services Review – Declaration Inquiry*, draft report, December 2015, p. 20.

⁸²⁷ ACCC, *Public inquiry into the fixed line services declarations*, final report, April 2014, pp. 36-37.

⁸²⁸ ACCC, March Draft Decision, public version, March 2015, p.189.

⁸²⁹ Macquarie Telecom submitted [c-i-c [REDACTED] c-i-c]. See Macquarie Telecom, submission to the discussion paper, confidential version, 19 December 2014, p. 4.

⁸³⁰ Macquarie Telecom, submission to the ACCC discussion paper, confidential version, 19 December 2014, p. 4.

⁸³¹ Optus, response to ACCC request for further information, confidential version, 19 June 2015, p 3

⁸³² Telstra, submission to the ACCC March Draft Decision, public version, 1 May 2015, p. 188.

the ACCC understands that in this context the issue of lack of scale is relevant at a premises basis rather than at an ESA level.

In line with the ACCC's draft view, the ACCC accepts information submitted by access seekers which indicates that [c-i-c] [redacted] [c-i-c], and therefore where end-users demand [c-i-c] [redacted] [c-i-c] voice only services to a particular premise, ULLS-based supply is not an effective substitute for the WLR service. The ACCC also considers that self-supply of ULLS is not a close substitute for WLR at the wholesale level given that further investment in ULLS equipment to supply fixed voice services may be stranded.

Further, the ACCC does not consider that alternative non-copper networks, such as HFC and other fibre networks, are effective substitutes for WLR for access seekers. This is because they have been and are currently limited by their geographic footprint and/or lack of availability of a suitable wholesale product for voice-only services. Also, consistent with the ACCC's March draft decision, as there is a class of end-users that continue to require functionality that can only be supplied using Telstra's PSTN, alternative networks are not an effective substitute for the WLR service.

DTCS tails

In Telstra's submission to the March Draft Decision, Telstra reiterated that it provides fibre-based DTCS tails to CBD premises and that these DTCS tails, starting at 2Mbps, can supply multiple voice channels using protocols ranging from SIP trunks through to ISDN emulation.⁸³³ Telstra has clarified that it was only putting DTCS forward as a substitute service where DTCS is already being used to supply a data access service and the voice service is being supplied in addition to that data service.⁸³⁴

In light of the material difference in costs of WLR and DTCS tails, [c-i-c starts] [redacted] [c-i-c ends],⁸³⁵ and the need for customers to commit to a fixed contract term, the ACCC considers that DTCS tails are not a substitute for WLR at the wholesale level for access seekers that seek to supply end-users requiring a small number of lines.

The ACCC sought information from access seekers about whether DTCS tails could be used as a substitute to WLR and LCS as a wholesale input to provide fixed voice only services. The ACCC maintains that this is the relevant line of inquiry, as the ACCC is particularly concerned about the supply of fixed voice only services in considering this exemptions issue. While most of these stakeholders did not use DTCS tails to supply retail fixed voice services, some access seekers did. However these providers, [c-i-c starts] [redacted]

[c-i-c ends].⁸³⁶ The ACCC also understands that the retail customer would also face switching costs in buying a PBAX phone system (VoIP enabled handset), and would have to commit to a fixed contract term.⁸³⁷ Access seekers also noted the material difference in the cost of WLR and DTCS tails.⁸³⁸ The ACCC also notes that there are significant connection charges for regulated DTCS.

Resale services

⁸³³ Telstra, submission to the ACCC March Draft Decision, public version, 1 May 2015, p. 188.

⁸³⁴ Telstra, response to ACCC request for further information, public version, 11 August 2015, p. 15.

⁸³⁵ [redacted]

⁸³⁶ [redacted]

⁸³⁷ AAPT, response to ACCC request for further information, confidential version, 30 June 2015

⁸³⁸ Optus, response to ACCC request for further information, confidential version, 19 June 2015, p. 2; AAPT, response to ACCC request for further information, confidential version, 30 June 2015

Separately, based on the available information, the ACCC remains of the view that obtaining resale fixed voice services from a non-Telstra wholesale provider using an alternative network is not a substitute for WLR for access seekers. The ACCC maintains its reasons set out in the draft decision on the declaration inquiry⁸³⁹, that, among other things, alternative networks have limited substitutability for WLR because, as noted above, they are limited by their geographic footprint and/or lack of wholesale voice-only services.

The ACCC also understands that a resale fixed voice service supplied via ULLS by a non-Telstra provider is not an effective substitute to WLR. The higher unit costs of using the ULLS to provide a wholesale fixed voice service alternative to WLR means that providers of such resale services often impose conditions on supplying wholesale voice services. These conditions mean that a resale fixed voice service using ULLS is not an effective substitute for access seekers that seek to supply an end-user who requires a small number of lines at their premises.

Geographic dimension

As noted above, the ACCC has declared WLR and LCS on a national basis. However, consistent with the ACCC's March Draft Decision, the ACCC has considered the implications for competition within CBD areas in undertaking its LTIE assessment.

16.6 State of competition

Telstra remains the dominant provider of fixed voice services

Consistent with its draft decision, the ACCC considers that on a national level, Telstra remains the dominant provider of retail fixed voice services with a market share of 61 per cent (although its market share has declined by 5 per cent from the previous year).⁸⁴⁰ Further, the ACMA noted that Telstra accounted for 68 per cent of retail and resale (wholesale) fixed line telephone services in operation nationally at June 2014.⁸⁴¹ These figures support a conclusion that there are barriers to effective competition in retail markets for fixed voice services, including the cost to end-users in switching retail suppliers and information asymmetry about prices and products. Telstra is also likely to have a competitive advantage owing to its economies of scale and scope, vertical integration and ownership of the ubiquitous copper network.

Similarly, the ACCC also considers that Telstra is the dominant wholesale provider of fixed voice services nationally. The ACMA reported that Telstra supplied 80 per cent of wholesale fixed-line telephone services (as at June 2013).⁸⁴² The ACCC maintains its view that Telstra is the dominant provider of wholesale fixed voice services (including via its supply of WLR), and that the wholesale market does not display the characteristics of an effectively competitive market. This suggests the presence of barriers to alternative wholesale providers providing substitutes to WLR, including lack of economies of scale and the limited geographic footprint of alternative networks (discussed above).

⁸³⁹ ACCC, *Fixed Services Review – Declaration inquiry, draft report*, December 2013, p. 21.

⁸⁴⁰ ACCC, *ACCC telecommunication reports 2013-2014*, p 12 (available at: <https://www.accc.gov.au/publications/accc-telecommunications-report/accc-telecommunications-report-2013-14>)

⁸⁴¹ This reflects market share including PSTN and other fixed-line telephone services. It also reflects total resale (retail services directly connected via another network) and retail services in operation are reported. See ACMA, *Communications Report 2013-2014*, p 14 (available at: http://www.acma.gov.au/~media/Research%20and%20Analysis/Publication/Comms%20Report%202013%2014/PDF/Communications%20report%20201314_LOW-RES%20FOR%20WEB%20pdf.pdf)

⁸⁴² Wholesale relates to services provided for resale. See ACMA, *Communications Report 2012-2013*, p. 19. (available at: <http://www.acma.gov.au/theACMA/Library/Corporate-library/Corporate-publications/communications-report-2012-13>)

The ACCC also considers that in respect of CBD areas, Telstra is the dominant provider of retail and wholesale fixed voice services, particularly for end-users that require a fixed voice only service and a small number of lines per premises. In its submission (December 2014), Macquarie Telecom referred to data it had previously provided which suggested that Telstra has a significant market share of [c-i-c starts ██████████ c-i-c ends] in retail voice only services in CBD areas, compared to a lower [c-i-c starts ██████████ c-i-c ends] market share for retail voice and data customers.⁸⁴³

16.7 Consideration of the LTIE

Section 152AB of the CCA provides that in determining whether a particular decision will promote the LTIE, the ACCC must have regard to the extent to which the decision is likely to:

- promote competition in markets for listed services
- encourage the economically efficient use of infrastructure and
- encourage efficient investment in infrastructure.

Consistent with its March Draft Decision, the ACCC considers that the information and analysis undertaken in making its 2014 declaration decision, is relevant to its consideration of the CBD exemptions in this FAD inquiry, and the ACCC has had regard to this information and analysis in this final decision.

The ACCC considers that making a decision that the FADs for WLR and LCS will apply in all areas, including CBD areas (that is, not including CBD exemptions in the WLR and LCS FADs) would promote the LTIE. The ACCC has also decided not to make a FAD term which would exempt CBD areas subject to further conditions. The ACCC considers that regulating all CBD services in the same way provides for consistent regulation of WLR and LCS in CBD areas and other areas which allows for efficiencies in contract management for the access provider and access seekers, and will promote competition in downstream markets – both in CBD areas and the broader national market – between retail service providers on their relative merits.

In its submission to the March Draft Decision, Telstra submitted that the ACCC's Draft Decision is not based on an evidence-based review of market structure in CBD areas.⁸⁴⁴ Telstra argued that WLR and LCS cannot reasonably be considered an essential facility or enduring bottleneck in CBD areas as there are multiple alternative wholesale inputs within CBD areas, and a wide range of alternative end-user services to WLR-based services.⁸⁴⁵ Telstra also submitted that the ACCC has relied on an inappropriate linkage between the Building Block Model pricing outputs and market prices to infer market failure.⁸⁴⁶

The ACCC has, in assessing the LTIE and other matters in subsection 152BCA(1), undertaken a market structure and substitution analysis. For the reasons set out below, the ACCC considers that in respect of a significant subset of retail CBD customers requiring fixed voice services only, there are limited or no effective wholesale and retail level substitutes to WLR and WLR-based retail services, and therefore exempting CBD areas from regulation will not promote the LTIE.

In response to Telstra's comments about a linkage between the Building Block Model prices and market prices, the ACCC rejects that characterisation of the ACCC's decision. The ACCC

⁸⁴³ Macquarie Telecom, submission to the ACCC discussion paper, confidential version, 19 December 2014, p 4.

⁸⁴⁴ Telstra, submission to the ACCC March Draft decision, public version, 1 May 2015, p. 186.

⁸⁴⁵ Telstra, submission to the ACCC March Draft Decision, public version, 1 May 2015, p. 187.

⁸⁴⁶ Telstra, submission to the ACCC March Draft Decision, public version, 1 May 2015, p. 186.

would expect that market WLR prices in exempt CBD areas would have reflected the costs of supplying these services, as is typically the case over time in effectively competitive markets. The ACCC's nationally averaged price for WLR from the FLSM reflects a conservative measure of such costs, given that the costs of supplying WLR in Band 1 areas (CBD areas) would likely be lower than the nationally-averaged WLR price, which includes the costs of supplying WLR services in higher-cost Bands 2-4 areas.⁸⁴⁷ The ACCC has assessed the likely effects of an unregulated WLR price on retail competition below.

Demand for traditional voice services in CBD areas

In its submission to the March Draft Decision, Telstra submitted that one of the reasons for the ACCC's decision is that there is a large pool of voice-only customers in CBD areas and that the ACCC should re-examine how significant this demand is.⁸⁴⁸ Telstra's arguments during this FAD inquiry are that the ACCC has over-stated demand for copper based voice only services (by using WLR and Telstra retail basic access figures) as:

- It does not account for customers who buy a PSTN based voice service along with a non-copper data service.⁸⁴⁹
- It does not account for customers who buy a non-copper based data service over which an IP based voice service can be provided.⁸⁵⁰

In its submission to the March Draft Decision, Telstra repeated that the more appropriate metric to use to reflect demand for copper based voice only services would be premises that only have a single PSTN line which is [c-i-c starts ██████████ c-i-c ends] premises in CBD areas, or [c-i-c starts ██████████ c-i-c ends] of total "voice only" SIOs.⁸⁵¹

The ACCC maintains its draft view that the relevant metric is the number of 'voice only SIOs' which includes Telstra Retail basic access and WLR SIOs (and may involve multiple PSTN lines). This metric reflects that while the ACCC considers that ULLS may be used to effectively supply multiple voice services to a single premises, this is not the case for premises that require less than a certain number of voice services.⁸⁵²

According to new data provided by Telstra there were at least [c-i-c starts ██████████ c-i-c ends] of these 'voice only SIOs' as at June 2015.⁸⁵³ Telstra notes that since the ACCC's declaration decision in 2014, the number of voice only SIOs has declined from [c-i-c starts ██████████ c-i-c ends], while the number of bundles of PSTN and broadband services over the same copper line has increased.⁸⁵⁴ Despite this decrease in the number of voice only SIOs, the ACCC maintains its view that there is still a significant number of affected voice-only SIO customers in CBD areas. Further, the ACCC notes that the decline is principally due to a decline in the use of

⁸⁴⁷ In its submission to the declaration inquiry, Frontier Economics, commissioned by Macquarie Telecom, submitted that the fact that prices are higher in CBD areas where costs of supply are much lower than average appears inimical to competitive pricing. See Frontier Economics, second supplementary submission to the ACCC discussion paper on behalf of Macquarie Telecom, public version, November 2013, p 5, available at: <https://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fixed-line-services-declaration-inquiry-2013/consultation-on-discussion-paper>

⁸⁴⁸ Telstra, submission to the ACCC March Draft Decision, public version, 1 May 2015, p. 187.

⁸⁴⁹ Telstra, response to ACCC request for further information, public version, 11 August 2015, p. 7.

⁸⁵⁰ Telstra, response to ACCC request for further information, public version, 11 August 2015, p. 7.

⁸⁵¹ Telstra, submission to the ACCC March Draft Decision, public version, 1 May 2015, p. 187.

⁸⁵² This is consistent with the ACCC's view in the declaration inquiry: See ACCC, *Public inquiry into the fixed line services declarations, final report*, public version, April 2014, p. 42.

⁸⁵³ Telstra, response to ACCC request for further information, public version, 11 August 2015, p. 18.

⁸⁵⁴ Telstra, response to ACCC request for further information, public version, 11 August 2015, p. 8.

Telstra retail basic access and not WLR which indicates that WLR usage is occurring at relatively constant levels.

Promoting competition

In line with the ACCC's Draft Decision, the ACCC maintains its view that the application of the SAOs to WLR and LCS supplied in CBD areas will promote competition in the relevant markets. As noted above, there is still significant demand for fixed voice-only services, and the ACCC considers that this decision will have a competitive impact for these end-users.⁸⁵⁵ These end-users may be residential voice only customers, and small, medium and large businesses.

In this FAD inquiry, Telstra argued that the ACCC mischaracterised the needs of these customers. Telstra submitted that medium-sized and large business end-users have a variety of needs beyond requiring two access lines, and for medium sized businesses, access seekers would prefer to use an IP-based connection instead of WLR.⁸⁵⁶ Telstra asserted that larger organisations would have complex needs, and even if those needs are not complex, the size of the customer would mean that it is more attractive to supply the customer using fibre-based or ULLS infrastructure.⁸⁵⁷

In line with the March Draft Decision, the ACCC acknowledges that certain businesses may be served by technologies that are not WLR-based. However, the ACCC accepts information submitted by access seekers, that in respect of residential and business end-users requiring a small number of lines to a premises, at a wholesale level:

- self-supply through the use of ULLS,
- using alternative non-copper networks such as HFC or other fibre networks (including DTCS tails), or
- obtaining resale fixed voice services

would not be full and/or effective supply substitutes for WLR. Additionally, as discussed above in section 16.5, the ACCC has also concluded that from an end-user perspective there are limited substitutes to which an end-user could switch from WLR-based services at the retail level.

The ACCC therefore considers that regulating the supply of WLR and LCS in CBD areas is likely to promote competition.

The ACCC considers that in the absence of regulation, the high commercial WLR prices in CBD areas are likely to impede efficient entry by access seekers or reduce access seekers ability to effectively compete in CBD areas. A lack of entry and higher WLR prices for CBD areas would also likely affect the ability of access seekers to offer competitively-priced 'whole of business' packages of voice and broadband services to corporate and business end-users that have nationally-distributed operations. Further, where access seekers do not enter in to or remain in CBD areas, CBD end-users would have reduced choice of retail services to choose from and potentially reduced differentiation among retail plans.

In contrast, regulating the supply of WLR and LCS in CBD areas will promote retail competition in CBD areas and nationally. The application of the SAOs to CBD areas will mean that the ACCC's FAD terms on prices and non-price terms of access will be applicable to WLR and LCS supplied in CBD areas. This would ensure that access seekers can obtain WLR and LCS on

⁸⁵⁵ ACCC, March Draft Decision, public version, March 2015, p. 194.

⁸⁵⁶ Telstra, *submission to the ACCC discussion paper*, public version, 13 October 2014, pp. 18-21

⁸⁵⁷ *Ibid.*, p. 21.

rental) component of PSTN accounts for 63 per cent of the total cost of PSTN expenditure.⁸⁶⁴ The ACCC also considers that there would still be a significant difference between access seekers' and Telstra's retail margins which would affect the capacity of access seekers to enter in to or compete with Telstra in CBD areas.⁸⁶⁵

Economically efficient use of, and investment in, infrastructure

The ACCC maintains its draft view that the application of the SAOs to WLR and the LCS in CBD areas will promote the economically efficient use of, and economically efficient investment in, infrastructure. Exempting the CBD areas with or without further conditions would likely mean higher commercial WLR prices in CBD areas, which could lead to inefficient (over) investment in copper-based equipment in CBD areas, at a time when industry is transitioning to the NBN.

In its submission to the March Draft Decision, Telstra noted that the amount of spare capacity in installed DSLAMs shows that installing additional DSLAMs would not be rational for access seekers. Rather, access seekers could use the spare capacity in already installed DSLAMs in combination with ULLS and LSS to supply retail fixed voice services, and this would be economically efficient. Telstra notes DSLAMs in CBD ESAs have [c-i-c starts ██████████ c-i-c ends] spare capacity.⁸⁶⁶ Telstra also remarked that it seems counter-intuitive that as PSTN services are moving beyond maturity and increasingly substituted by IP based telephony as the market migrates to the NBN, the ACCC has decided to re-regulate PSTN services in CBD areas.⁸⁶⁷

The ACCC recognises that CBD areas are characterised by a higher level of DSLAM based investment compared to non-CBD areas and that there may be spare capacity in existing DSLAMs at CBD exchanges. However, the ACCC understands that to use this spare capacity to self-supply fixed line voices services using ULLS may require further investment by access seekers or require a minimum number of lines at a particular premises. For instance, supplying POTS emulation VoIP services would require access seekers to make further investments in soft-switching equipment at the exchange.

Further, given that the regulated Band 1-3 ULLS price is lower than the regulated WLR price, the ACCC would expect access seekers to have utilised existing spare capacity on their DSLAMs or installed new DSLAMS to provide voice only services if it was economic to do so. As discussed above, the ACCC also notes that self-supplying fixed voice services using ULLS for a small number of lines and any related investment would likely be inefficient. In view of the above, the ACCC considers that applying the SAOs to WLR and LCS supplied in CBD areas will promote the efficient investment in infrastructure.

The remaining matters in s 152BCA

The ACCC did not receive any submissions which specifically addressed the remaining matters in section 152BCA. The ACCC affirms its views in the March draft decision for its assessment against the remaining matters in section 152BCA.⁸⁶⁸

⁸⁶⁴ ACCC, March Draft Decision, public version, March 2015, p. 196.

⁸⁶⁵ Ibid., p. 196.

⁸⁶⁶ Telstra, *submission to the March Draft Decision*, public version, 1 May 2015, p. 189.

⁸⁶⁷ Ibid., p. 189.

⁸⁶⁸ ACCC, March Draft Decision, March 2015, pp 198-199.

17 Carrier specific exemptions

Key points

- The ACCC's final decision is to include a term in the wholesale ADSL FAD which limits the application of the SAOs and the FAD to Telstra in relation to the supply of wholesale ADSL.
- The ACCC's final decision is that the SAOs and the FADs for all remaining fixed line services should apply to all carriers and carriage service providers.

17.1 Introduction

In its 2013 FAD inquiry decision for wholesale ADSL, the ACCC decided that only Telstra should be required to comply with the SAOs in respect of the wholesale ADSL service, and other carriers and carriage service providers should be exempted from these obligations.⁸⁶⁹ The ACCC considered that access seekers self-supplying wholesale ADSL with their own DSLAMS, but not supplying existing wholesale customers, should not be required to undertake significant investments to supply those customers without a business case that provided a commercial risk-adjusted rate of return.

The ACCC also concluded that giving a carrier specific exemption to non-Telstra providers in respect of wholesale ADSL was likely to promote competition. The ACCC considered that not imposing the category A SAOs on access seekers would allow them to differentiate their wholesale ADSL product offerings and attract more customers to offset factors that reduce their ability to compete against Telstra.⁸⁷⁰

In its 2014 declaration inquiry for fixed line services, the ACCC considered whether to include carrier specific exemptions in the service descriptions for the other fixed line services.⁸⁷¹ The ACCC decided that it would not promote competition or be in the LTIE if it were to exempt non-Telstra providers from the application of the SAOs for the supply of the other declared fixed line services. The ACCC was aware that non-Telstra service providers had been supplying the other fixed line services for some time and the ACCC did not believe that there would be significant additional costs for non-Telstra providers to supply those services.

17.2 Draft decision

The ACCC's March 2015 Draft Decision was to maintain a term in the wholesale ADSL FAD which limits the application of the SAOs to Telstra for the supply of wholesale ADSL. The ACCC noted that it had not received any submissions which indicated that Telstra's market share in the supply of wholesale ADSL had decreased. The ACCC also noted that it has not received any submissions that access seekers have invested in their billing and provisioning systems to be able to offer Wholesale ADSL services to other access seekers.

The ACCC's Draft Decision was that the SAOs and the FADs for all the remaining fixed line services should apply to all carriers and carriage service providers. The ACCC noted that the remaining fixed line services have been declared and covered by access determinations for many years.

⁸⁶⁹ ACCC, *Wholesale ADSL Final Access Determination*, Final Report, May 2013, p. 70.

⁸⁷⁰ *Ibid.*, p. 72.

⁸⁷¹ ACCC, *Fixed Line Services Declaration Inquiry*, Final Report, April 2014, pp. 62-63.

17.3 Submissions to Draft decision

The ACCC has not received any submissions to the March Draft Decision regarding carrier specific exemptions. In June 2015, the ACCC requested further information on the total number of wholesale ADSL services Telstra and other access seekers currently supply nationally. Telstra and a number of access seekers responded with the requested information.

17.4 ACCC final assessment and decision

Wholesale ADSL

Consistent with the ACCC's draft views, the ACCC's final decision is that the wholesale ADSL FAD and SAOs will only apply to Telstra and will not apply to other carriers or carriage service providers. Accordingly, the ACCC has maintained a term in the wholesale ADSL FAD, exempting all non-Telstra providers from category A SAOs for the supply of wholesale ADSL.

The ACCC considers that Telstra remains the dominant provider of wholesale ADSL with an approximate market share of [c-i-c starts] [c-i-c ends] per cent.⁸⁷² The ACCC notes that non-Telstra providers may face barriers to increasing their market share because they face the incremental costs of acquiring wholesale ADSL services from multiple providers to supply wholesale ADSL nationally, and non-Telstra access providers are unable to supply wholesale ADSL services on lines affected by LPGS. In contrast, Telstra has significantly larger network coverage for wholesale ADSL. The ACCC considers that there are unlikely to be significant benefits from applying the SAOs to non-Telstra service providers, as they are already effectively constrained in the supply of the wholesale service through competition with Telstra.

Consistent with its view in the wholesale ADSL FAD inquiry⁸⁷³, the ACCC maintains that non-Telstra access providers seek to attract wholesale customers by differentiating their wholesale ADSL product offerings in order to offset factors that reduce their ability to compete with Telstra. The ACCC therefore considers that giving effect to carrier-specific exemptions is likely to promote competition as it will provide them the flexibility to differentiate.

Further, the ACCC considers that imposing the SAOs on non-Telstra providers could potentially lead to the inefficient investment in infrastructure. Many owners of competitive DSLAM infrastructure do not have the current capacity to offer a wholesale ADSL service and would need to undertake significant investment in their billing and provisioning systems to be able to do so. The ACCC has not received information from non-Telstra providers indicating that they have made these investments. To require non-Telstra providers to make these investments now, may result in over investment in infrastructure that may be stranded in the relatively near future as the industry transitions to the NBN and other superfast broadband networks.

Remaining fixed line services

As the ACCC did not receive any submissions on whether there should be carrier exemptions for other fixed line services, it confirms its decision that all the remaining FADs for the fixed line services should apply to all carriers and carriage service providers.

⁸⁷² Current number of services in operation obtained from Telstra and access seekers from an ACCC information request issued in June 2015, available at <https://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fixed-line-services-fad-inquiry-2013/request-for-further-information>

⁸⁷³ ACCC, *Public inquiry to make a FAD for Wholesale ADSL service*, final report, May 2013, p. 72.

Part D: Non-price terms and conditions

18 Non-price terms and conditions

On 24 August 2015, the ACCC released a combined report in respect of non-price terms and conditions for the final access determinations for the fixed line services, the DTCS and the MTAS (the combined report).⁸⁷⁴ The ACCC attached schedules of non-price terms and conditions to the combined report.

The combined report set out the ACCC's views (at that time) on the non-price terms and conditions for the fixed line services. The ACCC maintains and now adopts those views in the combined report as its final decision on the non-price terms and conditions for the fixed line services.

Together, the relevant parts of the combined report, and this report on the final price terms for the fixed line services, constitute the ACCC's report under section 505(1) of the *Telecommunications Act 1997* for the FAD inquiry on the fixed line services.

The final FAD instrument for the fixed line services containing all price and non-price terms for the services is attached to this report.

⁸⁷⁴ Available at: <https://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fad-inquiries-non-price-terms-conditions-supplementary-prices>.

Appendices

A Appendix A: Relevant legislative framework for final access determinations

This section sets out the relevant legislative framework in relation to final access determinations (FADs).

A.1 Content of final access determinations

Section 152BC of the CCA specifies what an FAD may contain. It includes, among other things, terms and conditions on which a carrier or carriage service provider (CSP) is to comply with the SAOs and terms and conditions of access to a declared service.

An FAD may make different provisions with respect to different access providers or access seekers.⁸⁷⁵

A.2 Fixed principles provisions

An FAD may contain a fixed principles provision, which allows a provision in an FAD to have an expiry date after the expiry date of the FAD.⁸⁷⁶ Such a provision allows the ACCC to 'lock-in' a term so that it would be consistent across consecutive FADs.

A.3 Varying final access determinations

Section 152BCN allows the ACCC to vary or revoke an FAD, provided that certain procedures are followed.

A fixed principles provision cannot be varied or removed unless the FAD sets out the circumstances in which the provision can be varied or removed, and those circumstances are present.⁸⁷⁷

A.4 Commencement and expiry provisions

Section 152BCF of the CCA sets out the commencement and expiry rules for FADs.

An FAD must have an expiry date, which should align with the expiry of the declaration for that service unless there are circumstances that warrant a different expiry date.⁸⁷⁸

A.5 Matters to consider when making FADs

The ACCC must have regard to the matters specified in subsection 152BCA(1) of the CCA when making an FAD. These matters are:

- (a) whether the determination will promote the LTIE of carriage services or services supplied by means of carriage services

⁸⁷⁵ Subsection 152BC(5) of the CCA.

⁸⁷⁶ Section 152BCD of the CCA.

⁸⁷⁷ Subsection 152BCN(4) of the CCA.

⁸⁷⁸ Subsection 152BCF(6) of the CCA.

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

The subsection 152BCA(1) matters reflect the repealed subsection 152CR(1) matters that the ACCC was required to take into account in making a final determination (FD) in an access dispute. The ACCC interprets the subsection 152BCA(1) matters in a similar manner to the approach taken in access disputes.

Subsection 152BCA(2) sets out other matters that the ACCC may take into account in making FADs in certain circumstances.

Subsection 152BCA(3) allows the ACCC to take into account any other matters that it thinks are relevant.

The ACCC's views on how the matters in section 152BCA should be interpreted for the FAD process are set out below.

A.5.1 Paragraph 152BCA(1)(a)

The first matter for the ACCC to consider when making an FAD is 'whether the determination will promote the long-term interests of end-users of carriage services or of services supplied by means of carriage services'.

The ACCC has published a guideline explaining what it understands by the phrase 'long-term interests of end-users' in the context of its declaration responsibilities.⁸⁷⁹ This approach to the LTIE was also used by the ACCC in making determinations in access disputes. The ACCC considers that the same interpretation is appropriate for making FADs for the declared fixed line services.

In the ACCC's view, particular terms and conditions promote the interests of end users if they are likely to contribute towards the provision of:

- goods and services at lower prices
- goods and services of a high quality, and/or
- a greater diversity of goods and services.⁸⁸⁰

The ACCC also notes that the Australian Competition Tribunal (Tribunal) has offered guidance in its interpretation of the phrase 'long-term interests of end-users' (in the context of access to subscription television services):

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

⁸⁷⁹ ACCC, *Telecommunications services – declaration provisions: a guide to the declaration provisions of Part XIC of the Trade Practices Act*, July 1999, in particular pp. 31–38.

⁸⁸⁰ *ibid.*, p. 33.

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

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

* Long-term: the long-term will be the period over which the full effects of the ... decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the ... industry) to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit – strategies.⁸⁸¹

To consider the likely impact of particular terms and conditions on the LTIE, the CCA requires the ACCC to have regard to whether the terms and conditions are likely to result in:

- promoting competition in markets for carriage services and services supplied by means of carriage services
- achieving any-to-any connectivity, and
- encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied, and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁸⁸²

Promoting competition

In assessing whether particular terms and conditions will promote competition, the ACCC analyses the relevant markets in which the declared services are supplied (retail and wholesale) and considers whether the terms set in those markets remove obstacles to end-users gaining access to telephony and broadband services.⁸⁸³

Obstacles to accessing these services include the price, quality and availability of the services and the ability of competing providers to provide telephony and broadband services.

The ACCC is not required to precisely define the scope of the relevant markets in which the declared services are supplied. The ACCC considers that it is sufficient to broadly identify the scope of the relevant markets likely to be affected by the ACCC's regulatory decisions.

The ACCC's view is that the relevant markets for the purpose of making FADs for the declared fixed line services are:

- the market for the retail and wholesale supply of voice services (excluding Voice over Internet Protocol (VoIP) and mobile originated calls)
- the market for the retail and wholesale supply of broadband, and
- the market for the retail supply of a bundle of voice and broadband services.

⁸⁸¹ *Seven Network Limited (No 4)* [2004] ACompT 11 at [120].

⁸⁸² Subsection 152AB(2) of the CCA.

⁸⁸³ Subsection 152AB(4) of the CCA. This approach is consistent with the approach adopted by the Tribunal in *Telstra Corporations Limited (No 3)* [2007] A CompT 3 at [92]; *Telstra Corporation Limited* [2006] A CompT at [97], [149].

Any-to-any connectivity

The CCA gives guidance on how the objective of any-to-any connectivity is achieved. It is achieved only if each end-user who is supplied with a carriage service that involves communication between end-users is able to communicate, by means of that service, with each other end-user who is supplied with the same service or a similar service. This must be the case whether or not the end-users are connected to the same telecommunications network.⁸⁸⁴

The ACCC considers that this matter is relevant to ensuring that the terms and conditions contained in FADs do not create obstacles for the achievement of any to any connectivity.

Efficient use of and investment in infrastructure

In determining the extent to which terms and conditions are likely to encourage the economically efficient use of and investment in infrastructure, the ACCC must have regard to:

- whether it is, or is likely to become, technically feasible for the services to be supplied and charged for, having regard to:
 - the technology that is in use, available or likely to become available
 - whether the costs involved in supplying and charging for, the services are reasonable or likely to become reasonable, and
 - the effects or likely effects that supplying and charging for the services would have on the operation or performance of telecommunications networks
- the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope
- incentives for investment in the infrastructure by which services are supplied; and any other infrastructure (for example, the NBN) by which services are, or are likely to become, capable of being supplied, and
- the risks involved in making the investment.⁸⁸⁵

The objective of encouraging the 'economically efficient use of and economically efficient investment in ... infrastructure' requires an understanding of the concept of economic efficiency. Economic efficiency consists of three components:

- productive efficiency – this is achieved where individual firms produce the goods and services that they offer at least cost
- allocative efficiency – this is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e. those that provide the greatest benefit relative to costs), and
- dynamic efficiency – this reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.

On the issue of efficient investment, the Tribunal has stated that:

⁸⁸⁴ Subsection 152AB(8) of the CCA.

⁸⁸⁵ Subsections 152AB(6) and (7A) of the CCA.

An access charge should be one that just allows an access provider to recover the costs of efficient investment in the infrastructure necessary to provide the declared service.⁸⁸⁶

...efficient investment by both access providers and access seekers would be expected to be encouraged in circumstances where access charges were set to ensure recovery of the efficient costs of investment (inclusive of a normal return on investment) by the access provider in the infrastructure necessary to provide the declared service.⁸⁸⁷

...access charges can create an incentive for access providers to seek productive and dynamic efficiencies if access charges are set having regard to the efficient costs of providing access to a declared service.⁸⁸⁸

A.5.2 Paragraph 152BCA(1)(b)

The second matter requires the ACCC to consider ‘the legitimate business interests’ of the carrier or CSP when making an FAD.

In the context of access disputes, the ACCC considered that it was in the access provider’s legitimate business interests to earn a normal commercial return on its investment.⁸⁸⁹ The ACCC is of the view that the concept of ‘legitimate business interests’ in relation to FADs should be interpreted in a similar manner, consistent with the phrase ‘legitimate commercial interests’ used elsewhere in Part XIC of the CCA.

For completeness, the ACCC notes that it would be in the access provider’s legitimate business interests to seek to recover its costs as well as a normal commercial return on investment having regard to the relevant risk involved. However, an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.⁸⁹⁰

The Tribunal has taken a similar view of the expression ‘legitimate business interests’.⁸⁹¹

A.5.3 Paragraph 152BCA(1)(c)

The third matter requires the ACCC to consider ‘the interests of all persons who have the right to use the service’ when making an FAD.

The ACCC considers that this matter requires it to have regard to the interests of access seekers. The Tribunal has also taken this approach.⁸⁹² The access seekers’ interests would not be served by higher access prices to declared services, as it would inhibit their ability to compete with the access provider in the provision of retail services.⁸⁹³

People who have rights to currently use a declared service will generally use that service as an input to supply carriage services, or a service supplied by means of carriage service, to end-users.

⁸⁸⁶ Telstra Corporation Ltd (No. 3) [2007] ACompT 3 at [159].

⁸⁸⁷ *ibid.*, at [164].

⁸⁸⁸ *ibid.*

⁸⁸⁹ ACCC, *Resolution of telecommunications access disputes – a guide*, March 2004 (revised) (Access Dispute Guidelines), p. 56.

⁸⁹⁰ ACCC, *Access pricing principles—telecommunications*, July 1997 (1997 Access Pricing Principles), p. 9.

⁸⁹¹ Telstra Corporation Limited [2006] ACompT 4 at [89].

⁸⁹² Telstra Corporation Limited [2006] ACompT 4 at [91].

⁸⁹³ *ibid.*

The ACCC considers that this class of persons has an interest in being able to compete for the custom of end-users on the basis of their relative merits. This could be prevented from occurring if terms and conditions of access favour one or more service providers over others, thereby distorting the competitive process.⁸⁹⁴

However, the ACCC does not consider that this matter calls for consideration to be given to the interests of the users of these 'downstream' services. The interests of end users will already be considered under other matters.

A.5.4 Paragraph 152BCA(1)(d)

The fourth matter requires the ACCC to consider 'the direct costs of providing access to the declared service' when making an FAD.

The ACCC considers that the direct costs of providing access to a declared service are those incurred (or caused) by the provision of access.

The ACCC interprets this matter, and the use of the term 'direct costs', as allowing consideration to be given to a contribution to indirect costs. This is consistent with the Tribunal's approach in an undertaking decision.⁸⁹⁵ A contribution to indirect costs can also be supported by other matters.

However, the matter does not extend to compensation for loss of any 'monopoly profit' that occurs as a result of increased competition.⁸⁹⁶

The ACCC also notes that the Tribunal (in another undertaking decision) considered the direct costs matter 'is concerned with ensuring that the costs of providing the service are recovered.'⁸⁹⁷ The Tribunal has also noted that the direct costs could conceivably be allocated (and hence recovered) in a number of ways and that adopting any of those approaches would be consistent with this matter.⁸⁹⁸

A.5.5 Paragraph 152BCA(1)(e)

The fifth matter requires that the ACCC consider 'the value to a party of extensions, or enhancements of capability, whose cost is borne by someone else' when making an FAD.

In the 1997 Access Pricing Principles, the ACCC stated that this matter:

...requires that if an access seeker enhances the facility to provide the required services, the access provider should not attempt to recover for themselves any costs related to this enhancement. Equally, if the access provider must enhance the facility to provide the service, it is legitimate for the access provider to incorporate some proportion of the cost of doing so in the access price.⁸⁹⁹

The ACCC considers that this application of paragraph 152BCA(1)(e) is relevant to making FADs.

⁸⁹⁴ *ibid.*

⁸⁹⁵ Application by Optus Mobile Pty Limited and Optus Networks Pty Limited [2006] ACompT 8 at [137].

⁸⁹⁶ See Explanatory Memorandum for the *Trade Practices Amendment (Telecommunications) Bill 1996*, p. 44: [T]he 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.

⁸⁹⁷ Telstra Corporation Limited [2006] ACompT 4 at [92].

⁸⁹⁸ *ibid.* at [139].

⁸⁹⁹ ACCC, 1997 Access Pricing Principles, p. 11.

A.5.6 Paragraph 152BCA(1)(f)

The sixth matter requires the ACCC to consider ‘the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility’ when making an FAD.

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

The ACCC has previously stated in the context of model non-price terms and conditions, it is of the view that:

...this consideration supports the view that model terms and conditions should reflect the safe and reliable operation of a carriage service, telecommunications network or facility. For instance, the model non-price terms and conditions should not require work practices that would be likely to compromise safety or reliability.⁹⁰⁰

The ACCC considers that these views will apply in relation to paragraph 152BCA(1)(f) for the making of FADs.

A.5.7 Paragraph 152BCA(1)(g)

The final matter of subsection 152BCA(1) requires the ACCC to consider ‘the economically efficient operation of a carriage service, a telecommunications network facility or a facility’ when making an FAD.

The ACCC noted in the Access Dispute Guidelines (in the context of arbitrations) that the phrase ‘economically efficient operation’ embodies the concept of economic efficiency as discussed earlier under the LTIE. That is, it calls for a consideration of productive, allocative and dynamic efficiency. The Access Dispute Guidelines also note that in the context of a determination, the ACCC may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated efficiently.⁹⁰¹

Consistent with the approach adopted by the Tribunal, the ACCC considers that in applying this matter, it is relevant to consider the economically efficient operation of:

- retail services provided by access seekers using the access provider’s services or by the access provider in competition with those access seekers, and
- the telecommunications networks and infrastructure used to supply these services.⁹⁰²

A.5.8 Subsection 152BCA(2)

Subsection 152BCA(2) provides that, in making an AD that applies to a carrier or CSP who supplies, or is capable of supplying, the declared services, the ACCC may, if the carrier or provider supplies one or more eligible services,⁹⁰³ take into account:

- the characteristics of those other eligible services
- the costs associated with those other eligible services

⁹⁰⁰ ACCC, Final Determination – Model Non-price Terms and Conditions, November 2008, p. 8.

⁹⁰¹ ACCC, Access Dispute Guidelines, p. 57.

⁹⁰² *Telstra Corporation Limited* [2006] ACompT at [94]–[95].

⁹⁰³ ‘Eligible service’ has the same meaning as in section 152AL of the CCA.

- the revenues associated with those other eligible services, and
- the demand for those other eligible services.

The Explanatory Memorandum states that this provision is intended to ensure that the ACCC, in making an AD, does not consider the declared service in isolation, but also considers other relevant services.⁹⁰⁴ As an example, the Explanatory Memorandum states:

...when specifying the access price for a declared service which is supplied by an access provider over a particular network or facility, the ACCC can take into account not only the access provider's costs and revenues associated with the declared service, but also the costs and revenues associated with other services supplied over that network or facility.⁹⁰⁵

The ACCC proposes to consider the costs and revenues associated with other services—whether declared or not declared—that are provided over Telstra's network when making FADs for the declared fixed line services.

A.5.9 Subsection 152BCA(3)

This subsection states the ACCC may take into account any other matters that it thinks are relevant when making an FAD.

The ACCC is of the view that considerations of regulatory certainty and consistency will be important when setting the terms and conditions of the FADs.

The ACCC also considers that it should have regard to:

- its previous decisions in relation to the fixed line services (both arbitrations and access determinations)
- consultation documents and submissions in response to those documents
- information provided to the ACCC by Telstra under RKR.

These considerations and documents do not limit the matters that the ACCC may have regard to when making the FADs for the declared fixed line services.

⁹⁰⁴ Explanatory Memorandum, Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010, p. 178.

⁹⁰⁵ *ibid.*

B Appendix B: Description of the declared fixed line services

The following are service descriptions to the seven declared fixed line services. Declaration to ULLS, LSS, WLR, LCS, FOAS and FTAS took effect on 1 August 2014 and expires on 31 July 2019.⁹⁰⁶ Declaration to wholesale ADSL took effect on 14 February 2012 and expires on 13 February 2017.⁹⁰⁷

More information on service declarations are available from the ACCC's website www.accc.gov.au.

B.1 Unconditioned local loop service

The unconditioned local loop service is the use of unconditioned communications wire between the boundary of a telecommunications network at an end-user's premises and a point on a telecommunications network that is a potential point of interconnection located at or associated with a customer access module and located on the end-user side of the customer access module.

B.2 Line sharing service

The line sharing service is the use of the non-voiceband frequency spectrum of unconditioned communications wire (over which wire an underlying voiceband PSTN service is operating) between the boundary of a telecommunications network at an end-user's premises and a point on a telecommunications network that is a potential point of interconnection located at, or associated with, a customer access module and located on the end-user side of the customer access module.

B.3 Wholesale line rental

The wholesale line rental service is a line rental telephone service which allows an end-user to connect to a carrier or carriage service provider's public switched telephone network, and provides the end-user with:

- (a) an ability to make and receive any 3.1kHz bandwidth calls (subject to any conditions that might apply to particular types of calls), including, but not limited to, local calls, national and international long distance calls; and
- (b) a telephone number

however, the wholesale line rental service does not include services where the connectivity between the end-user and the carrier or carriage service provider's network is provided in whole or in part by means of a Layer 2 bitstream service that is supplied by an NBN corporation.

B.4 Local carriage service

The local carriage service is a service for the carriage of telephone calls from customer equipment at an end-user's premises to separately located customer equipment of an end-user in the same standard zone, however, the local carriage service does not include services where

⁹⁰⁶ ACCC, *Public Inquiry into the fixed line services declarations*, Final Report, April 2014, pp 66-79.

⁹⁰⁷ ACCC, *Declaration under section 152AL(3) of the Competition and Consumer Act 2010*, Wholesale ADSL service declaration.

the connectivity between the end-user and the carrier or carriage service provider's network is provided in whole or in part by means of a Layer 2 bitstream service that is supplied by an NBN corporation.

B.5 Fixed originating access service

(The fixed originating access service is) an access service for the carriage of telephone calls (i.e. voice, data over the voice band) to a Point of Interconnect (POI) from end-customers assigned numbers from the geographic number ranges of the Australian Numbering Plan and directly connected to the access provider's network.

For the avoidance of doubt, the service also includes a service for the carriage of telephone calls from customer equipment at an end-user's premises to a POI, or potential POI, located at or associated with a local switch (being the switch closest to the end-user making the telephone call) and located on the outgoing trunk side of the switch.

B.6 Fixed terminating access service

(The fixed terminating access service) is an access service for the carriage of telephone calls (i.e. voice, data over the voice band) from a POI to end-customer assigned numbers from the geographic number ranges of the Australian Numbering Plan and directly connected to the access provider's network.

For the avoidance of doubt, the service also includes a service for the carriage of telephone calls from a POI, or potential POI, located at or associated with a local switch and located on the incoming trunk side of the switch to customer equipment at an end-user's premises.

B.7 Wholesale asymmetric digital subscriber line

The wholesale asymmetric digital subscriber line service is an internet-grade, best efforts point to point service for the carriage of communications in digital form between a point of interconnection and an end-user network boundary that:⁹⁰⁸

- (a) is supplied by means of Asymmetric Digital Subscriber Line (ADSL) technology over a twisted metallic pair that runs from the end-user network boundary to the nearest upstream exchange or remote integrated multiplexer or customer multiplexer; and
- (b) uses a static layer 2 tunnelling protocol (L2TP) over a transport layer to aggregate communications to the point of interconnection.

⁹⁰⁸ ACCC, *Declaration of the wholesale ADSL service*, Final decision, February 2012, p 60.

C Appendix C: Submissions received

Telstra submission documentation

Telstra, <i>Confidential undertaking agreements</i> , November 2013
Telstra, <i>Final Access Determination (FADs) Inquiry – confidential response to information request under BBM RKR</i> , Commercial in Confidence, November 2013
Telstra, <i>Draft submission of cost allocation model documentation, cost allocation model, routing factor model (confidential version)</i> , May 2014
Telstra, <i>letter expressing concern regarding CBD exemption issues</i> , June 2014
Telstra, <i>Revised draft cost allocation model, revised cost allocation framework model documentation</i> , June 2014
Telstra, <i>Cost Allocation Framework for the ACCC Fixed Line Services Model, Framework and Model Guide</i> , Versions 1, July 2014
Telstra, <i>Submission to the NPTC and supplementary prices position paper</i> , July 2014
Telstra, <i>presentation to the ACCC Commissioners on response to the ACCC’s discussion paper</i> , September 2014
Telstra, <i>Public inquiry into final access determinations for fixed line services—primary prices—Response to Discussion Paper</i> , Confidential Version, Main Submission and Appendix 1 of Telstra Submission to Discussion Paper, October 2014.
Gilbert + Tobin, <i>Cost allocation for fixed line services</i> , Appendix 2 of Telstra Submission to Discussion Paper, October 2014.
Incenta, <i>Balchin report</i> , October 2014
Telstra, <i>Fixed Services Forecast Model Version 1.05</i> , Appendix 3 of Telstra Submission to Discussion Paper, Confidential, October 2014.
Telstra, <i>Forecast Model v1.05—Framework and Guide to Forecast Assumptions</i> , Appendix 4 of Telstra Submission to Discussion Paper, Confidential,

October 2014.
Sapere Research Group, <i>Review of Telstra's fixed services forecast model—final report</i> , Appendix 5 of Telstra Submission to Discussion Paper, Confidential, October 2014.
Telstra, <i>Fixed Line Services FAD inquiry on price and non-price terms and conditions—Submission on the application of the SAOs for WLR/LCS in CBD areas, Supplementary Submission to Discussion Paper</i> , October 2014.
Castalia Strategic Advisors, <i>Report on ACCC's Findings on the LCS and WLR Exemptions— Report to Gilbert + Tobin</i> , Supporting Documentation of Telstra Supplementary Submission, October 2014.
Incenta, <i>Balchin report</i> , December 2014
Telstra, <i>Public inquiry into final access determinations for fixed line services—primary prices—Response to industry submissions</i> , December 2014.
Gilbert + Tobin, <i>Cost allocation and declining demand for fixed line telecommunications services: comments on submissions and the ACCC proposal paper</i> , December 2014.
Telstra, <i>Updating the Fixed Line Services Model—Amendments to allow for determination of new FAD prices</i> , December 2014.
Telstra, <i>Fixed Services Model v1.1</i> , January 2015
Telstra, <i>FAD inquiry on non-price terms and conditions—Response to the ACCC's proposed non-price draft terms</i> , January 2015
Telstra, <i>Amendments to the Fixed Line Services Model</i> , February 2015.
Telstra, <i>FAD inquiry on non-price terms and conditions Response to the ACCC's consultation on Other Matters</i> , February 2015.

Telstra, <i>Public inquiry into final access determinations for fixed line services—primary prices</i> (confidential version), 12 March 2015.
Telstra, <i>Public inquiry into final access determinations for fixed line services – primary prices, Response to Draft Decision</i> , 1 May 2015.
Telstra, <i>Fixed Services Forecast Model</i> , v1.2, May 2015.
Telstra, <i>Response to the ACCC’s Draft Decision on non-price terms and conditions</i> , 8 May 2015
Telstra, <i>Public inquiry into final access determinations for fixed line services—primary prices, Response to ACCC further draft decision</i> , 17 July 2015.
Incenta, <i>Comment on ACCC further draft decision in relation to fixed line services</i> , Balchin Report, July 2015.
KPMG, <i>Independent advice on the basis of accounting for disposals of assets in Telstra’s regulatory asset base for fixed line services</i> , July 2015.
Telstra, <i>Public inquiry into final access determinations for fixed line services—primary prices, Response to industry submissions on the ACCC further draft decision</i> , August 2015.
Telstra, <i>Public inquiry into final access determinations for fixed line services—primary prices, adjustments to cost allocators</i> , August 2015.

Telstra responses to requests for information

Telstra, <i>Final Access Determinations (FADs) Inquiry – additional information in response to information request under BBM RKR</i> , February 2014 (confidential)
Telstra, <i>Response to ACCC IICTEBA information request</i> , 19 January 2015
Telstra, <i>Response to ACCC information request (14 January)</i> , 30 January 2015
Telstra, <i>Response to ACCC information request</i> , 6 February 2015

Telstra, <i>Calculating the FLSM share of Operations Business Unit Support – Deriving a Mark-up ratio</i> , 23 February 2015.
Telstra, <i>Further explanation of FY2014 operating costs identified as relevant to the FLSM</i> , March 2015.
Telstra, <i>Fixed line services final access determination inquiry: ACCC request for information</i> , 5 March 2015.
NERA, <i>The Comparative Efficiency of Telstra: A Report for Telstra</i> , April 2015.
KPMG, <i>Gilbert and Tobin, The basis for determining Telstra’s base year operating expenditure for fixed line services</i> , April 2015.
Keith Lockey, <i>The basis of accounting for disposals of assets in Telstra’s regulatory asset base for fixed line services</i> , April 2015.
Jeff Balchin, <i>Response to the ACCC Draft Decision on the impact of the NBN for Final Access Determinations for Fixed Line Services</i> , April 2015.
Telstra, <i>Response to request for further information, Consultation on wholesale ADSL</i> , public, July 2015
Telstra, <i>Response to ACCC request for further information—SAO exemptions</i> , public version, August 2015

Other stakeholders

Optus, <i>preliminary submission regarding NBN payments</i> , March 2014
NERA (on behalf of Optus), <i>preliminary submission regarding NBN payments</i> , March 2014
Frontier Economics report (Herbert Geer submission on behalf of TPG), <i>preliminary submission</i> , March 2014
Aussie broadband, <i>Submission to the NPTC and supplementary prices discussion paper</i> , April 2014
TPG, <i>Submission to the NPTC and supplementary prices position paper</i> , May 2014

Macquarie Telecom, <i>Submission to the NPTC and supplementary prices position paper</i> , July 2014
Optus, <i>Submission in response to ACCC Discussion Paper—Public Inquiry into final access determinations for fixed line services —primary price terms, Response to Ministerial Letter</i> , August 2014.
iiNet, <i>Submission to the NPTC and supplementary prices position paper</i> , August 2014
ACCAN, <i>Submission - Public inquiry into Final Access Determinations for fixed line services – primary services</i> , October 2014.
Competitive Carriers' Coalition, <i>Supplementary Submission in Response to Ministers' Letter</i> , October 2014.
Department of Communications, <i>Final access determinations for fixed line services—primary price terms, Department of Communications submission to the Australian Competition and Consumer Commission</i> , October 2014.
Frontier Economics, <i>Submission on the final access determinations for fixed line services – A report prepared for the competitive carriers' coalition</i> , October 2014.
iiNet, <i>Public inquiry into final access determinations for fixed line services — primary price terms</i> , Submission by iiNet Limited, October 2014.
iiNet, <i>Public inquiry into final access determinations for fixed line services — primary price terms, Submission by iiNet Limited</i> , Supplementary Submission, October 2014.
Optus, <i>Submission in response to ACCC Discussion Paper, Fixed Line Services Final Access Determination – Primary Prices</i> , Confidential Version, Main Submission, October 2014.
Optus, <i>Supplementary submission in response to ACCC Discussion Paper, Fixed Line Services Final Access Determination – Primary prices</i> , October 2014,
TPG Telecom, <i>Submission by TPG Telecom Limited (October 2014) to the Australian Competition and Consumer Commission (ACCC), Telecommunications Final Access Determination Inquiries – FLSM</i> , Confidential Version, October 2014
iiNet, <i>Public inquiry into final access determinations for fixed line services — primary price terms, Submission by iiNet Limited, Submission on standard access obligations</i> , November 2014.

Frontier Economics, <i>Submission on the cost allocation methodology and its relationship to the opening regulatory asset base</i> , December 2014.
Frontier Economics, <i>Assessment of Telstra's revised forecasts – A report prepared for the competitive carriers' coalition</i> , December 2014.
iiNet, <i>Amendments to the FLSM, letter to the ACCC</i> , December 2014.
Frontier Economics, <i>Fixed line access prices using the ACCC's fixed line services model</i> , December 2014.
iiNet, <i>Frontier Economics report on behalf of iiNet, Further submission to the ACCC discussion paper</i> , January 2015
iiNet, <i>Telecommunications Final Access Determination inquiries—non-price terms and conditions</i> , January 2015
Vocus, <i>submission—ACCC FAD inquiry: draft non-price terms and conditions</i> , January 2015
Optus, <i>Submission in response to ACCC Draft Clauses, Non-Price Terms and Conditions</i> , January 2015
Vodafone, <i>submission on non price terms and conditions</i> , January 2015
Nextgen, <i>submission on Draft Terms for the —Telecommunications Final Access Determination inquiries — non-price terms and conditions</i> , January 2015
NBN Co, <i>ACCC request for comments on proposed drafting of non-price terms and conditions for inclusion in Final ACCC determinations</i> , February 2015
Telstra, <i>FAD inquiry on non-price terms and conditions Response to the ACCC's consultation on Other Matters</i> , February 2015
iiNet, <i>Public inquiry into final access determinations for fixed line services – primary price terms, Draft Decision</i> , March 2015.
Optus, <i>Submission in response to ACCC Draft Decision, Public Inquiry into final access determinations for fixed line services – primary price terms</i> , April 2015.
iiNet, <i>Submission to ACCC Draft Decision on non-price terms and conditions and connection charges for fixed line services</i> , 8 May 2015
Frontier Economics, <i>Submission on the ACCC's Draft Decision on fixed line prices, A Report Prepared For the Competitive Carriers Coalition, iiNet and</i>

Optus, May 2015.
Macquarie, <i>Response to the ACCC's Draft Decision on non-price terms and conditions</i> , 5 June 2015
UXC Technical Advice on connection charges for the ULLS, LSS and WADSL services: Final Report, 25 June 2015
Department of Communications, <i>Final access determinations for fixed line services—primary price terms</i> , Department of Communications submission to ACCC further Draft Decision, July 2015.
iiNet, <i>Public inquiry into final access determinations for fixed line services —primary price terms</i> , Further Draft Decision – Outstanding Issues, July 2015
Optus, <i>Submission in response to ACCC Further Draft Decision – Outstanding Issues</i> , July 2015
Macquarie, <i>Public Inquiry into final access determinations for fixed line services – primary price terms</i> , Further Draft Decision – Outstanding Issues, July 2015.
TPG Telecom, <i>Submission to ACCC Fixed line services Final Access Determination inquiry Further Draft Decision</i> , July 2015.
Optus, <i>Submission in response to Department of Communications Submission to Further Draft Decision</i> , July 2015.
NBN Co., <i>Public inquiry into final access determinations for fixed line services—primary price terms—Further Draft Decision</i> , July 2015
CCC, <i>Response to the Second Draft FLS FAD</i> , July 2015.
iiNet, <i>Public inquiry into final access determinations for fixed line services —primary price terms, Further Draft Decision – Outstanding Issues, Supplementary Submission</i> , July 2015
Optus, <i>Supplementary Submission, Response to Telstra's NBN Claims</i> , August 2015.
Ian Martin Advisory, <i>Submission to the ACCC Fixed Line Services Inquiry 2013 regarding discount rates</i> , August 2015

Responses to consultation on Wholesale ADSL

Telstra, <i>response to request for information on wholesale ADSL</i> , July 2015
M2, <i>response to request for information on wholesale ADSL</i> , July 2015
TPG Telecom, <i>response to request for information on wholesale ADSL</i> , July 2015.
M2, <i>submission to wholesale ADSL consultation</i> , August 2015.
iiNet, <i>submission to wholesale ADSL consultation</i> , August 2015.
Telstra, <i>submission to wholesale ADSL consultation</i> , August 2015.
Optus, <i>submission to wholesale ADSL consultation</i> , August 2015.
Foxtel, <i>submission to wholesale ADSL consultation</i> , August 2015.
TPG Telecom, <i>submission to wholesale ADSL consultation</i> , August 2015.

Summary of submissions on relevant issues for the final decision

Stakeholders	Issues	Submissions
Telstra	NBN related adjustments	<ul style="list-style-type: none"> The ACCC's NBN-related adjustments will lead to under-recovery and will not be in the LTIE – if Telstra is deprived of a reasonable opportunity to recover efficient costs, this will not promote competition or efficient investment. The adjustments breach the fixed principles, which were adopted to provide the industry with certainty about how the ACCC would implement the BBM. They also base prices on hypothetical (i.e. without-NBN) costs, which contradicts the intent of the BBM. The approach is arbitrary and lacking any reasoned basis – there is no reason why a change in unit costs

		<p>caused by NBN migration should be treated separately from other causes under the fixed principles.</p> <ul style="list-style-type: none"> • Under a BBM, where an exogenous event occurs which alters demand (and therefore unit costs), there is no scope to ignore this on the basis of its cause. In any event, the cause of declining demand was a government policy. While not caused by access seekers, this does not provide a basis for ignoring the costs in setting prices. • The question of any opportunity to recover costs associated with NBN-induced loss of economies of scale (i.e. through the DAs) is irrelevant. The question is whether Telstra has in fact recovered these costs. In any event, Telstra did not have such an opportunity, and was not able to achieve an outcome that fully compensated it for all the impacts of the NBN rollout. • The NBN adjustments are not necessary to avoid “absurd” price levels for some customers. If, at the time of the next FAD, forecasts of costs and demand suggest significant price increases, the ACCC is able to address this with mechanisms within the regulatory framework, e.g. accelerating depreciation. • Even if the ACCC’s adjustments were allowed under the fixed principles, their implementation in the FLSM does not reflect reasonable outcomes that may occur under a credible counterfactual. While the ACCC has made adjustments based on a ‘no-NBN’ counterfactual, they should be based on a ‘no deal’ counterfactual where: there is no agreement between Telstra and NBN Co; the NBN is rolled out without Telstra’s cooperation; and Telstra competes with NBN Co.
	Opex forecasts	<ul style="list-style-type: none"> • Submitted further information and evidence in response to ACCC’s outstanding queries in the further draft decision on the attribution of annual building rental costs and sufficient explanation on the relationship between fault reporting costs and fault rectification costs.
	WACC	<ul style="list-style-type: none"> • WACC in the Draft Decision ‘is significantly lower than in any recent decision of the ACCC in the telecommunications sector’, the ‘lowest WACC set by any Australian regulatory...over the past 2 years’ and ‘recent estimate of Telstra’s cost capital by independent market practitioners’ • A decline in rates of return on risk free assets is often associated with “flight to quality” – that is, investors seeking less risky or risk –free investments, thus pushing down yields on these investments and increasing risk premiums for risky assets. Given this, the MRP and DRP in the draft decisions are unreasonable due to the ‘historically low return’ on risk-free asset.

Market risk premium (MRP)	<ul style="list-style-type: none"> maintaining an MRP of 6 per cent in current market conditions is unreasonable’. estimates of the MRP from the DGM’ must be given significant weight by the ACCC in determining the MRP’. ‘Current estimate of the MRP produced by the AER’s DGM would ‘imply a range for the MRP of 7.65%–8.85%’ based on the risk free rate of 2.5% in the draft decision ‘an estimate of 6.5% is likely to understate the current MRP as current evidence indicates that the MRP is likely to be in excess of 7%’
Equity beta	<ul style="list-style-type: none"> ‘The equity beta should be increased to at least 0.8 to properly compensate for risk exposure’. ‘It would be unreasonable to maintain an equity beta of 0.7 given Telstra’s relatively high exposure to systematic risk compared to other regulated businesses and current empirical evidence. Telstra stated that the adjusted equity beta should be used instead of the raw beta and the Monkhouse formula should not be used for de-levering beta Telstra’s updated equity beta and asset betas continues to support an asset beta of at least 0.5.
Nominal risk free rate	<ul style="list-style-type: none"> Does ‘not propose any changes to the methodology for estimating the risk free rate, provided that other WACC parameters are estimated on a consistent base and that the overall WACC overcome is reasonable’.
Debt risk premium (DRP)	<ul style="list-style-type: none"> ‘A Telstra specific [bond rate] may be appropriate’ and if a Telstra-specific bond rate is to be used, the ACCC can use information from ‘the recent Telstra bond issue and market pricing information periodically collected by Telstra’ There are issues with the ACCC’s use of Telstra Bloomberg Valuation Curve (TBVAL) for estimating the DRP.
Gamma	<ul style="list-style-type: none"> Telstra maintained ‘that the best estimate of gamma is 0.25’ which reflects the ‘best current estimate of the market wide distribution rate (0.7) and ‘the best estimate of theta (0.35) from SFG’s dividend drop off study.
Wholesale ADSL	<ul style="list-style-type: none"> Confirmed verbally that there is potentially an issue with the AGVC/VLAN charge calculated as it currently is due to the potential for access seekers to be faced with a larger than efficient charge for AGVC/VLAN capacity.

		<ul style="list-style-type: none"> Submitted that it was not favour of proposed position detailed by ACCC in consultation on uniform price change
	Term of FADs	<ul style="list-style-type: none"> The expiry dates for each of the replacement FADs should be 30 June 2019 The FADs should not contain a mid-term review – this will offer the industry participants certainty and predictability.
	Connection and disconnection	<ul style="list-style-type: none"> Generally supported the ACCC's approach to setting connection charges Concerns about the ACCC's decision to disallow a separate disconnection charge for the LSS and ULLS, and an early termination charge for Wholesale ADSL.
Optus	NBN related adjustments	<ul style="list-style-type: none"> Supportive of the adjustments made by the ACCC to reflect its position on accounting for NBN impacts.
	Cost allocation framework	<ul style="list-style-type: none"> Transmission assets should be allocated to services on the basis of traffic in Mbps rather than the service usage metrics employed by Telstra (call minutes and SIOs).
	Opex forecasts	<ul style="list-style-type: none"> Expressed concern about the information asymmetries and lack of transparency of Telstra's operating expenditures.
	Market risk premium (MRP)	<ul style="list-style-type: none"> A 6.5 per cent MRP 'is a departure from previous AER decisions which consistently adopted 6%'. The AER's adoption of 6.5% MRP is within the electricity network provider context. 'Supports adopting a MRP of 6%' and 'more weight should be placed on telecommunications specific factors' and 'less weight placed on conclusions which are specific to other industries'
	Equity beta	<ul style="list-style-type: none"> Disagrees with Telstra's approach for equity beta, interpretation of international comparators and Telstra's unique systematic risks over the regulatory period. The ACCC should 'have greater regard to asset betas from Chorus' and other pure-play fixed line operations, as well as 'choose an equity beta below the average identified from its comparator set that includes businesses with non-fixed line operations' 'Asset beta of around 0.3 to 0.35 [is] an appropriate choice in the FLSM, consistent with Telstra's own asset beta and relevant international comparators'.

	<ul style="list-style-type: none"> In its submission to the further draft decision, Optus submitted that the ACCC should set equity beta using actual Telstra values which results in a value of 0.4. Optus also stated that the ACCC should replace Spark NZ with Chorus in its benchmarking table because the fixed line network in New Zealand is owned by Chorus which results in an average equity beta 'around 0.67'.
Nominal risk free rate	<ul style="list-style-type: none"> Supports 'the ACCC's approach for risk-free rate consistent with its previous regulatory decisions'.
Debt risk premium (DRP)	<ul style="list-style-type: none"> 'Supports the approach' to adopt a Telstra specific nominal bond rate in the draft decision
Debt issuance cost	<ul style="list-style-type: none"> 'Supports no change' to the ACCC's approach for debt issuance costs.
Gamma	<ul style="list-style-type: none"> '0.45 is the absolute minimum that should be adopted' 'The ACCC's reluctance to set a value of gamma at 0.65 or more appears to be due to some weight being given to the SFG estimate for theta'. 'Optus' analysis of Telstra's dividend payments over the last 5 years strongly supports' a theta between 0.65 and 1.0' and a gamma 'at the top end of that range'
Gearing	<ul style="list-style-type: none"> 'Supports no change' to the ACCC's 40:60 assumption for gearing ratio.
Demand	<ul style="list-style-type: none"> Concerns raised over the forecast growth of ULLS and band allocations Submitted on call base for PSTN FOAS/FTAS to be expanded to include both Telstra retail and wholesale PSTN and NBN SIOs. Various concerns on wholesale ADSL, submitting on the inclusion of 'backhaul products' in the costs and the validity of faster forecast growth for Telstra retail ADSL peak usage compared to wholesale ADSL peak usage.
Wholesale ADSL	<ul style="list-style-type: none"> Optus submitted general concerns on level of prices of AGVC/VLAN charge and port charge. Submitted that it was not in favour of proposed position detailed by ACCC in consultation on

		uniform price change
	Term of FADs	<ul style="list-style-type: none"> • Supports the proposed 4 year term.
iiNet	NBN related adjustments	<ul style="list-style-type: none"> • Supportive of the adjustments made by the ACCC to reflect its position on accounting for NBN impacts.
	Capex forecasts	<ul style="list-style-type: none"> • Telstra's forecasts are unlikely to be prudent and efficient as they are higher than the ACCC's forecast (4 year average capital expenditure for 2011-12 to 2014-15) which is more likely to represent a higher bound for capital expenditure.
	Opex forecasts	<ul style="list-style-type: none"> • Expressed concern about the information asymmetries and lack of transparency of Telstra's operating expenditures.
	Term of FADs	<ul style="list-style-type: none"> • Supports the proposed 4 year term. • The ACCC should consider backdating the decision to 1 July 2014. • The ACCC's view in the March draft decision on 'trigger and review' mechanism to deal with the uncertainty relating to the NBN rollout is sensible.
	IIC/TEBA	<ul style="list-style-type: none"> • TEBA prices including TEBA racks and power charges should also be set alongside IIC prices in the FADs.
	Wholesale ADSL	<ul style="list-style-type: none"> • Submitted that it was not in favour of proposed position detailed by ACCC in consultation on uniform price change
	Connection and disconnection	<ul style="list-style-type: none"> • Supported the ACCC approach to setting connection charges • Concerns that the update did not reflect changes to Telstra's back of house costs • Welcomed the ACCC's draft decision to not allow Telstra to impose a separate disconnection charge for the LSS and ULLS or early termination charge for the Wholesale ADSL • Suggested that the ACCC should consider backdating these decisions.

		<ul style="list-style-type: none"> The ACCC should set a connection charge for WLR
Macquarie	NBN related adjustments	<ul style="list-style-type: none"> Supportive of the adjustments made by the ACCC to reflect its position on accounting for NBN impacts.
	Opex forecasts	<ul style="list-style-type: none"> Expressed concern about the information asymmetries and lack of transparency of Telstra's operating expenditures.
	Term of FADs	<ul style="list-style-type: none"> Supports the proposed 4 year term. The ACCC should consider backdating the decision to 1 July 2014. Macquarie continues to be concerned that the uncertainty (relating to NBN deployment) may best be dealt with via a shorter term period and/or a review on the occurrence of materially different facts than those on which the present decision is based. This is especially the case if the forecast expenditures of Telstra do not eventuate.
	Connection and disconnection	<ul style="list-style-type: none"> Supported the ACCC approach to setting connection charges Concerns that the update did not reflect changes to Telstra's back of house costs Welcomed the ACCC's draft decision to not allow Telstra to impose a separate disconnection charge for the LSS and ULLS or early termination charge for the Wholesale ADSL Suggested that the ACCC should consider backdating these decisions.
Department of Communications	NBN related adjustments	<ul style="list-style-type: none"> The NBN-related adjustments may prevent appropriate cost recovery by Telstra and the decision will not be in the LTIE. The ACCC's statement that the relevant costs should have been recovered through the Das indicates that cost are not fully recovered. Adjustments would be inconsistent with the fixed principles. The ACCC has not considered the importance of price stability in the transition to the NBN.
Frontier Economics	IIC/TEBA	<ul style="list-style-type: none"> TEBA prices including TEBA racks and power charges should also be set alongside IIC prices in the FADs.

		<ul style="list-style-type: none"> • Telstra's proposed model in relation to TEBA/IIC need to be corrected by taking the following matters into consideration: <ul style="list-style-type: none"> ○ Telstra should provide evidence to the power cost and electricity consumption and the cost of electricity ○ Exchange land and building asset disposals need to be accounted for as a result of NBN migration
	NBN-related propex	<ul style="list-style-type: none"> • Considered the ACCC needs to take further account of WIK-Consult's analysis which includes the removal of NBN-related expenditure from FLSM asset classes
	Revenue Requirement	<ul style="list-style-type: none"> • Proposed that the annual revenues earned by the fixed line services under the uniform price adjustment be set so they equalled the annual revenue requirement in NPV terms
M2	Wholesale ADSL	<ul style="list-style-type: none"> • Submitted that it was not in favour of proposed position detailed by ACCC in consultation on uniform price change
TPG	Wholesale ADSL	<ul style="list-style-type: none"> • Submitted that it was not in favour of proposed position detailed by ACCC in consultation on uniform price change
Foxtel	Wholesale ADSL	<ul style="list-style-type: none"> • Submitted that it was in favour of proposed position detailed by ACCC in consultation on uniform price change and recommended the inclusion of a mechanism to review the charge during the FAD.

D Appendix D: Fixed principles provisions

D.1 Introduction

The ACCC set fixed principles provisions in the 2011 fixed line services FADs.⁹⁰⁹ These fixed principle provisions were updated in the 2013 Wholesale ADSL FAD⁹¹⁰ to reflect the inclusion in the regulatory asset base (RAB) of assets used to supply that service and not included in the RAB at the time of the 2011 FADs.

The ACCC final decision does not include any amendments to the fixed principles provisions it made for the 2011 and 2013 FADs. The fixed principles provisions included in the 2013 Wholesale ADSL FAD are reproduced below.

D.2 Fixed principles provisions

- 6.1 This clause 6 sets out fixed principles provisions that apply to the FAD contained in this document.
- 6.2 The FAD contained in this document must not be varied so as to alter or remove any of the fixed principles provisions in this clause 6 except when the ACCC is satisfied that:
- (a) there is a manifest and material error in these fixed principles provisions;
 - (b) any information on which these fixed principles provisions was based was false or misleading in a material respect; or
 - (c) such amendment or adjustment is necessary or desirable to avoid an unintended consequence of these fixed principles provisions.
- 6.3A The below fixed principles provisions come into force in relation to the Wholesale ADSL service on 29 May 2013.
- 6.4 The nominal termination date for the fixed principles provisions is 30 June 2021.
- 6.5A The opening regulatory asset base (RAB) for the calculation of prices for the Wholesale ADSL service is:
- (a) as per clause 6.5 of the FADs dated 20 July 2011 (as varied from time to time), rolled forward to 1 July 2012 in accordance with clause 6.7 of the FADs dated 20 July 2011; and
 - (b) the asset class data equipment which is \$1,094,008,824 as at 1 July 2012 (in nominal terms).
- 6.6A The opening tax asset value for the calculation of prices for the Wholesale ADSL service is:
- (a) as per clause 6.6 of the FADs dated 20 July 2011 (as varied from time to time), rolled forward to 1 July 2012 in accordance with clause 6.7 of the FADs dated 20 July 2011; and

⁹⁰⁹ ACCC, *Inquiry to make final access determinations for the declared fixed line services*, Final Report, Appendix C: FAD instruments for the declared fixed line services, July 2011, pp. 5-8.

⁹¹⁰ ACCC, *Public inquiry to make a final access determination for the Wholesale ADSL service*, Final Report, Appendix E: Final access determination, May 2013, pp. 2-5.

- (b) the asset class data equipment which is \$1,086,735,207 as at 1 July 2012 (in nominal terms).

6.7 Roll-forward mechanism

- (a) The RAB is to be rolled forward each year according to the formula below:

$$RAB_{t+1} = RAB_t + capex_t - depreciation_t - asset\ disposals_t,$$

where RAB_{t+1} = opening RAB for the next regulatory year

RAB_t = opening RAB for the current year

$capex_t$ = forecast capital expenditure during the current year

$depreciation_t$ = regulatory depreciation during the current year

$asset\ disposals_t$ = asset disposals during the current year

- (b) Land asset values will be indexed by the Consumer Price Index (CPI) where it is available or by the forecast for the CPI used in the Fixed Line Services Model (FLSM) where actual CPI is not available. This will account for appreciation over time in land values.
- (c) To roll forward RAB values in nominal terms, any variables that are specified in real terms will be indexed by the actual CPI where it is available or by the forecast for the CPI used in the FLSM where the actual CPI is not available.
- (d) Any variables that are specified in nominal terms will not be indexed, with the exception of land values as specified above.
- (e) In these fixed principles provisions 'the FLSM' means the FLSM as it may be varied from time to time or similar model used by the ACCC for the calculation of prices for the relevant declared services.

6.8 The annual revenue requirement for each regulatory period will comprise:

- (a) a return on the RAB calculated by multiplying the Weighted Average Cost of Capital (WACC) by the opening RAB for the regulatory year;
- (b) a return of the RAB, that is regulatory depreciation, for that regulatory year;
- (c) operating expenditure forecast to be incurred in that regulatory year; and
- (d) an allowance for tax liabilities.

6.9 Under a building block model (BBM) approach, forecast operating expenditures should reflect prudent and efficient costs. The following matters are relevant to whether forecast operating expenditures reflect prudent and efficient costs:

- (a) the access provider's level of operating expenditure in the previous regulatory period;
- (b) reasons for proposed changes to operating expenditure from one regulatory period to the next regulatory period;
- (c) any relevant regulatory obligations, or changes to such obligations, applicable to providing the relevant declared fixed line services; and

- (d) any other matters relevant to whether forecast operating expenditures reflect prudent and efficient costs.
- 6.10 Under a BBM approach, forecast capital expenditures should reflect prudent and efficient costs. The following matters are relevant to whether capital expenditure forecasts reflect prudent and efficient costs:
- (a) the access provider's level of capital expenditure in the previous regulatory period;
 - (b) reasons for proposed changes to capital expenditure from one regulatory period to the next regulatory period;
 - (c) whether the access provider's asset management and planning framework reflects best practice;
 - (d) any relevant regulatory obligations, or changes to such obligations, applicable to providing the relevant declared fixed line services; and
 - (e) any other matters relevant to whether forecast capital expenditures reflect prudent and efficient costs.
- 6.11 Demand forecasts should:
- (a) be based on an appropriate forecasting methodology;
 - (b) be based on reasonable assumptions about the key drivers of demand;
 - (c) be determined utilising the best available information before the ACCC, including historical data that can identify trends in demand; and
 - (d) be determined taking into account current demand and economic conditions.
- 6.12 Weighted average cost of capital
- (a) A vanilla WACC is used to estimate the return on capital.
 - (b) The cost of equity is estimated using the Capital Asset Pricing Model.
- 6.13 Tax liabilities
- (a) The tax rate used in estimating tax liabilities in the FLSM will be set equal to the corporate tax rate specified in subsection 23(2) of the *Income Tax Rates Act 1986* (Cth) as amended from time to time.
- 6.14 Cost allocation factors
- (a) The allocation of the costs of operating the PSTN should reflect the relative usage of the network by various services.
 - (b) Direct costs should be attributed to the service to which they relate.
The cost allocation factors for shared costs should reflect causal relationships between supplying services and incurring costs.
 - (c) No cost should be allocated more than once to any service
 - (d) The determination of cost allocation factors should reflect the principles in 6.14 (a) – (c) above except where reliable information is not available to support the application of the principles.
- 6.15 The matters set out in the fixed principles provisions at clauses 6.7 – 6.14 inclusive are subject to assessment, calculation, implementation and/or application, as relevant, by the ACCC in making interim and final access determinations for the relevant declared services.

E Appendix E: FAD instruments



Final Access Determination No.2 of 2015 (LSS)
Final Access Determination No.3 of 2015 (LCS)
Final Access Determination No.4 of 2015 (FOAS)
Final Access Determination No.5 of 2015 (FTAS)
Final Access Determination No.6 of 2015 (ULLS)
Final Access Determination No.7 of 2015 (WLR)
Final Access Determination No.8 of 2015 (WADSL)

Competition and Consumer Act 2010

The AUSTRALIAN COMPETITION AND CONSUMER COMMISSION makes these final access determinations under section 152BC of the *Competition and Consumer Act 2010*.

Date of decision: 7 October 2015

1. Application

- 1.1 This instrument sets out final access determinations (FADs) in respect of the declared services ('the relevant declared service') specified in the table below. Each of the FADs replaces a previous access determination specified in the table.

Declared service	Expiry of declaration	Title of final access determination	Previous access determination being replaced
Line Sharing Service ('LSS')	31 July 2019	Final Access Determination – No. 2 of 2015	Final Access Determination No. 1 of 2011
Local Carriage Service ('LCS')	31 July 2019	Final Access Determination – No. 3 of 2015	Final Access Determination No. 2 of 2011
Fixed Originating Access Service ('FOAS')	31 July 2019	Final Access Determination – No. 4 of 2015	Final Access Determination No.3 of 2011
Fixed Terminating Access Service ('FTAS')	31 July 2019	Final Access Determination – No. 5 of 2015	Final Access Determination No. 4 of 2011
Unconditioned Local Loop Service ('ULLS')	31 July 2019	Final Access Determination – No. 6 of 2015	Final Access Determination No. 5 of 2011
Wholesale Line Rental ('WLR')	31 July 2019	Final Access Determination – No. 7 of 2015	Final Access Determination No.6 of 2011

Wholesale ADSL Service (WADSL)	13 February 2017	Final Access Determination – No. 8 of 2015	Final Access Determination No.1 of 2013
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- 1.2 The prices in these FADs are exclusive of tax payable under *the Utilities (Network Facilities Tax) Act 2006* (ACT).
- 1.3 The prices in these FADs are exclusive of Goods and Services Tax (GST).

2. Definitions and interpretation

- 2.1 Schedule 1 applies to the interpretation of this instrument.
- 2.2 The Schedules form part of this instrument.

3. Commencement and duration

- 3.1 These FADs commence on 1 November 2015.
- 3.2 The FADs remain in force up until and including 30 June 2019.

4. Terms and conditions of access

- 4.1 If a carrier or carriage service provider is required to comply with any or all of the standard access obligations as defined in the *Competition and Consumer Act 2010* in respect of the relevant declared service, the carrier or carriage service provider must comply with those obligations on the terms and conditions set out in this clause 4.

Note: The terms and conditions in a final access determination apply only to those terms and conditions where terms and conditions on that matter in an Access Agreement cannot be reached, no special access undertaking is in operation setting out terms and conditions on that matter and no binding rules of conduct have been made setting out terms and conditions on that matter: section 152AY of the *Competition and Consumer Act 2010*.

- 4.2 If the carrier or carriage service provider is required to supply a relevant declared service to a service provider, the carrier or carriage service provider must supply the service at the price specified in the applicable schedule set out in the table below. In relation to each of the relevant declared services, the non-price terms and conditions specified in the applicable schedules for that service as set out in the table below apply to access to that service.

Declared service	Title of final access determination	Applicable schedules	
Line Sharing Service (‘LSS’)	Final Access Determination – No. 2 of 2015	Price	1, 2
		Non price	1,3,4,5,6,7,8,9,10, 11, 13(a), 13(b), 14
Local Carriage Service (‘LCS’)	Final Access Determination – No. 3 of 2015	Price	1,2
		Non price	1,3,4,5,6,7,8,9,10, 11, 14
Fixed Originating Access Service (‘FOAS’)	Final Access Determination – No. 4 of 2015	Price	1,2
		Non Price	1,3,4,5,6,7,8,9,10, 11, 14
Fixed Terminating Access Service (‘FTAS’)	Final Access Determination – No. 5 of 2015	Price	1,2
		Non price	1,3,4,5,6,7,8,9,10, 11, 14
Unconditioned Local Loop Service (‘ULLS’)	Final Access Determination – No. 6 of 2015	Price	1,2
		Non price	1,3,4,5,6,7,8,9,10, 11, 13(a), 13(b), 14
Wholesale Line Rental (‘WLR’)	Final Access Determination – No. 7 of 2015	Price	1,2
		Non price	1,3,4,5,6,7,8,9,10, 11,14
Wholesale ADSL Service (WADSL)	Final Access Determination – No. 8 of 2015	Price	1,2
		Non price	1,3,4,5,6,7,8,9,10, 11, 12,14

4.3 This clause 4 is subject to clause 5.

5. Application of Standard Access Obligations to operators of non-dominant networks

5.1 A carrier or carriage service provider other than Telstra Corporation Limited is not required to comply with any of the standard access obligations as defined in the *Competition and Consumer Act 2010* in respect of the Wholesale ADSL Service.

Note:

1. An access determination may:

- provide that any or all of the standard access obligations are not applicable to a carrier or carriage service provider (either unconditionally or subject to conditions or limitations);

or

- restrict or limit the application to a carrier or carriage service provider of any or all of the standard access obligations: sections 152BC(3)(h) and (i) of the *Competition and Consumer Act 2010*.

6. Fixed principle provisions

- 6.1 This clause 6 sets out fixed principles provisions that apply to the FADs contained in this document.
- 6.2 The FADs contained in this document must not be varied so as to alter or remove any of the fixed principles provisions in this clause 6 except when the ACCC is satisfied that:
- (a) there is a manifest and material error in these fixed principles provisions;
 - (b) any information on which these fixed principles provisions was based was false or misleading in a material respect; or
 - (c) such amendment or adjustment is necessary or desirable to avoid an unintended consequence of these fixed principles provisions.
- 6.3 The nominal termination date for the fixed principles provisions is 30 June 2021.
- 6.4 The opening regulatory asset base (RAB) for the calculation of prices for the relevant declared fixed line services (other than the Wholesale ADSL Service) is \$15,515,621,288 as at 1 July 2011 (in nominal terms).
- 6.5 The opening regulatory asset base (RAB) for the calculation of prices for the Wholesale ADSL service is:
- (a) as per clause 6.5 of the FADs dated 20 July 2011 (as varied from time to time), rolled forward to 1 July 2012 in accordance with clause 6.7 of the FADs dated 20 July 2011; and
 - (b) the asset class data equipment which is \$1,094,008,824 as at 1 July 2012 (in nominal terms).
- 6.6 The opening tax asset value for the calculation of prices for the relevant declared fixed line services (other than the Wholesale ADSL Service) is \$10,144,121,785 as at 1 July 2011 (in nominal terms).
- 6.6A The opening tax asset value for the calculation of prices for the Wholesale ADSL service is:
- (a) as per clause 6.6 of the FADs dated 20 July 2011 (as varied from time to time), rolled forward to 1 July 2012 in accordance with clause 6.7 of the FADs dated 20 July 2011; and
 - (b) the asset class data equipment which is \$1,086,735,207 as at 1 July 2012 (in nominal terms).
- 6.7 Roll-forward mechanism
- (a) The RAB is to be rolled forward each year according to the formula below:
$$RAB_{t+1} = RAB_t + capex_t - depreciation_t - asset\ disposals_t$$
where RAB_{t+1} = opening RAB for the next regulatory year

RAB_t = opening RAB for the current year

$capex_t$ = forecast capital expenditure during the current year

$depreciation_t$ = regulatory depreciation during the current year

$asset\ disposals_t$ = asset disposals during the current year

- (b) Land asset values will be indexed by the Consumer Price Index (CPI) where it is available or by the forecast for the CPI used in the Fixed Line Services Model (FLSM) where actual CPI is not available. This will account for appreciation over time in land values.
- (c) To roll forward RAB values in nominal terms, any variables that are specified in real terms will be indexed by the actual CPI where it is available or by the forecast for the CPI used in the FLSM where the actual CPI is not available.
- (d) Any variables that are specified in nominal terms will not be indexed, with the exception of land values as specified above.
- (e) In these fixed principles provisions 'the FLSM' means the FLSM as it may be varied from time to time or similar model used by the ACCC for the calculation of prices for the relevant declared services.

6.8 The annual revenue requirement for each regulatory period will comprise:

- (a) a return on the RAB calculated by multiplying the Weighted Average Cost of Capital (WACC) by the opening RAB for the regulatory year;
- (b) a return of the RAB, that is regulatory depreciation, for that regulatory year;
- (c) operating expenditure forecast to be incurred in that regulatory year; and
- (d) an allowance for tax liabilities.

6.9 Under a building block model (BBM) approach, forecast operating expenditures should reflect prudent and efficient costs. The following matters are relevant to whether forecast operating expenditures reflect prudent and efficient costs:

- (a) the access provider's level of operating expenditure in the previous regulatory period;
- (b) reasons for proposed changes to operating expenditure from one regulatory period to the next regulatory period;
- (c) any relevant regulatory obligations, or changes to such obligations, applicable to providing the relevant declared fixed line services; and
- (d) any other matters relevant to whether forecast operating expenditures reflect prudent and efficient costs.

6.10 Under a BBM approach, forecast capital expenditures should reflect prudent and efficient costs. The following matters are relevant to whether capital expenditure forecasts reflect prudent and efficient costs:

- (a) the access provider's level of capital expenditure in the previous regulatory period;
- (b) reasons for proposed changes to capital expenditure from one regulatory period to the next regulatory period;

- (c) whether the access provider's asset management and planning framework reflects best practice;
- (d) any relevant regulatory obligations, or changes to such obligations, applicable to providing the relevant declared fixed line services; and
- (e) any other matters relevant to whether forecast capital expenditures reflect prudent and efficient costs.

6.11 Demand forecasts should:

- (a) be based on an appropriate forecasting methodology;
- (b) be based on reasonable assumptions about the key drivers of demand;
- (c) be determined utilising the best available information before the ACCC, including historical data that can identify trends in demand; and
- (d) be determined taking into account current demand and economic conditions.

6.12 Weighted average cost of capital

- (a) A vanilla WACC is used to estimate the return on capital.
- (b) The cost of equity is estimated using the Capital Asset Pricing Model.

6.13 Tax liabilities

- (a) The tax rate used in estimating tax liabilities in the FLSM will be set equal to the corporate tax rate specified in subsection 23(2) of the *Income Tax Rates Act 1986* (Cth) as amended from time to time.

6.14 Cost allocation factors

- (a) The allocation of the costs of operating the PSTN should reflect the relative usage of the network by various services.
- (b) Direct costs should be attributed to the service to which they relate.

The cost allocation factors for shared costs should reflect causal relationships between supplying services and incurring costs.

- (c) No cost should be allocated more than once to any service.
- (d) The determination of cost allocation factors should reflect the principles in 6.14 (a) – (c) above except where reliable information is not available to support the application of the principles.

6.15 The matters set out in the fixed principles provisions at clauses 6.7 – 6.14 inclusive are subject to assessment, calculation, implementation and/or application, as relevant, by the ACCC in making interim and final access determinations for the relevant declared services.

INDEX TO SCHEDULES

Schedule	Schedule	Page	
1	Interpretation and definitions	10	
2	Price	17	
3	Non Price	Billing and notifications	20
4		Creditworthiness and Security	26
5		General dispute resolution procedures	30
6		Confidentiality	34
7		Suspension and Termination	43
8		Liability and Indemnity	48
9		Communications with end-users	50
10		Network modernisation and upgrade provisions	52
11		Changes to operating manuals	57
12		Resale services	58
13 (a)		Ordering and provisioning (Managed Network Migration to the ULLS and the LSS)	59

13 (b)		New ULLS ordering and provisioning processes (LSS to ULLS Transfer processes)	62
14		Recourse to regulated terms	64

Schedule 1 - Interpretation and definitions

Interpretation

In these FADs, unless the contrary intention appears:

- (a) the singular includes the plural and vice versa;
- (b) the words “including” and “include” mean “including, but not limited to”; and
- (c) terms defined in the CCA or the *Telecommunications Act 1997* have the same meaning.

Definitions

ACCC means the Australian Competition and Consumer Commission

Access Agreement has the same meaning as given to that term in section 152BE of the CCA

Access Provider has the same meaning as given to that term in subsection 152AR(2) of the CCA

Access Seeker has the same meaning as given to that term in section 152AG of the CCA

ACDC means the Australian Commercial Disputes Centre Limited

ACDC Guidelines means the mediation guidelines of the ACDC in force from time to time

ACMA means the Australian Communications and Media Authority

AGVC means the aggregating virtual circuit

Band means the geographic classification of exchange service areas (ESAs)

Band 1 means the following ESAs located in central business districts: (a) NSW (City South, Dalley, Haymarket, Pitt, Kent); (b) QLD (Charlotte, Edison, Roma Street, Spring Hill); (c) South Australia (Flinders, Waymouth); (d) Victoria (Batman, Exhibition, Lonsdale); and (e) WA (Bulwer, Pier, Wellington)

Band 2 means an ESA with more than 108.4 services in operation in a square kilometre area at the time this determination is made, which is not a Band 1 ESA

Band 3 means an ESA with 6.56 or more, but less than 108.4, services in operation in a square kilometre area at the time this determination is made

Band 4 means an ESA with 6.55 or less services in operation in a square kilometre area at the time this determination is made.

Billing Dispute means a dispute relating to a Charge or an invoice issued by the Access Provider

Billing Dispute Notice means a notice given pursuant to clause 3.10 in Schedule 3

Billing Dispute Procedures means the procedures set out in clauses 3.10 to 3.30 in Schedule 3

Breach Notice has the meaning set out in clause 7.5 of Schedule 7

Business Hours means 8.00 am to 5.00 pm Monday to Friday, excluding a day which is a gazetted public holiday in the place where the relevant transaction or work is to be performed

Business Day means any day other than Saturday or Sunday or a day which is a gazetted public holiday in the place concerned

Calendar Day means a day reckoned from midnight to midnight

CAN means a customer access network

Capped Exchange means an exchange that is included on a list that the Access Provider has published of exchanges that are subject to capacity constraints

Carriage Service has the same meaning given to that term in section 7 of the *Telecommunications Act 1997 (Cth)*

Central Business District Area means the exchange service areas that are classified as CBD for the purposes of the ordering and provisioning procedures set out in the Telstra Ordering and Provisioning Manual as in force on the date of effect of the renewed declaration.

CCA means the *Competition and Consumer Act 2010 (Cth)*

Charge means a charge for the supply of a Service

Common Infrastructure Works means where an Access Seeker increases the capacity of existing Facilities at an Exchange that could be used by itself and other service providers.

Complex Service means any service which is not a fixed service comprising:

- (a) a connection from a carrier or carriage service provider network boundary to the local exchange;
- (b) a telephone number; and
- (c) access to other kinds of telecommunication services which is indicated by dial-tone

Connect Outstanding process has the meaning set out in clauses 13.23 and 13.24 of Schedule 13.

Confidential Information means all information, know-how, ideas, concepts, technology, manufacturing processes, industrial, marketing and commercial knowledge of a confidential nature (whether in tangible or intangible form and whether coming into existence before or after the commencement of this FAD) relating to or developed in connection with or in support of the Service supplied under this FAD (the “**first mentioned party**”) but does not include:

- (a) information which is or becomes part of the public domain (other than through any breach of this FAD);

- (b) information rightfully received by the other party from a third person without a duty of confidentiality being owed by the other party to the third person, except where the other party has knowledge that the third person has obtained that information either directly or indirectly as a result of a breach of any duty of confidence owed to the first mentioned party; or
- (c) information which has been independently developed or obtained by the other party;
or
- (d) information about Services supplied by the Access Provider (including where that information is generated by the Access Provider) that has been aggregated with other information of a similar or related nature, such that the Access Seeker cannot be identified by the information or any part of it.

Coordinated Capital Works Program means a planned Major Network Modernisation and Upgrade with respect to the Service that extends across more than one ESA but does not include an Emergency Network Modernisation and Upgrade.

Coordinated Capital Works Program Forecast has the meaning set out in clause 10.10 of Schedule 10

Coordinated Capital Works Program Schedule has the meaning set out in clause 10.14 of Schedule 10

Disclosing Party has the meaning set out in clause 6.5 in Schedule 6 of this FAD

Distribution Area has the same meaning as in the Network Deployment Rules

Emergency means an emergency due to an actual or potential occurrence (such as fire, flood, storm, earthquake, explosion, accident, epidemic or war-like action) which:

- a) endangers or threatens to endanger the safety or health of persons or
- b) destroys or damages, or threatens to destroy or damage property, being an emergency which requires a significant and co-ordinated response

Emergency Network Modernisation and Upgrade means a Major Network Modernisation and Upgrade that is required and is reasonably necessary and a proportionate response to address an Emergency

Equivalent Period of Notice means a period of notice commencing at the time that the Access Provider has approved and allocated the capital expenditure or otherwise approved and made a decision to commit to a Major Network Modernisation and Upgrade

ESA means an exchange service area which is a geographic area generally serviced by a single Exchange

Event means an act, omission or event relating to or arising out of this FAD or part of this FAD;

Exchange means a building in which telephone switching or other equipment of an Access Provider or Access Seeker has been installed for use in connection with a telecommunications network

Expert Committee means a committee established under clause 5.11 in Schedule 5

Facility has the same meaning given to that term in section 7 of the *Telecommunications Act 1997* (Cth)

FAD means Final Access Determination

Fault means:

(a) a failure in the normal operation of a Network or in the delivery of a Service; or

(b) any issue as to the availability or quality of a Service supplied to an end-user via the Access Seeker, notified by the end-user to the Access Seeker's help desk, that has been reasonably assessed by the Access Provider as being the Access Provider's responsibility to repair

FOAS means public switched telephone network originating access service

FTAS means public switched telephone network terminating access service

General Notification has the meaning set out in clause 10.1

IIC means the internal interconnection cable which is a twisted copper pair cable connecting an access seeker's equipment to Telstra's customer access network and is essential to an access seeker being able to obtain an unconditioned local loop service or line sharing service.

Indemnifying Party means the Party giving an indemnity under this FAD;

Individual Notification has the meaning set out in clause 10.1 of Schedule 10

Initiating Notice has the meaning as set out in clause 5.11 of Schedule 5

Innocent Party means the Party receiving the benefit of an indemnity under this FAD;

LCS means local carriage service

Liability (of a party) means any liability of that party (whether in contract, in tort, under statute or in any other way and whether due to negligence, wilful or deliberate breach or any other cause) under or in relation to this FAD, or part of this FAD or in relation to any Event or series of related Events;

Limitation Notice has the meaning set out in clause 13.10 of Schedule 13

Listed Carriage Service has the same meaning given to that term in section 7 of the *Telecommunications Act 1997* (Cth)

Loss includes liability, loss, damage, costs, charges or expenses (including legal costs)

LSS means line sharing service

Major Network Modernisation and Upgrade means a modernisation or upgrade that:

- (a) involves the installation of the Access Provider's customer access modules closer to end-users than an Exchange;
- (b) requires the removal/relocation of the Service provided from Exchanges and the establishment of a new POI (or relocation of an existing POI) for the Service; or
- (c) results in a Service no longer being supplied or adversely affects the quality of that Service (or any services supplied by an Access Seeker to their end-users using the Service), but does not mean, or include, an Emergency Network Modernisation Upgrade or an NBN related upgrade

MDF means a main distribution frame

MNM means managed network migration

Month means a period commencing at the beginning of any day of a named month and ending:

- (a) at the end of the day before the corresponding day of the next named month; or
- (b) if there is no such corresponding day – at the end of the next named month

National Broadband Network means a national telecommunications network for the high-speed carriage of communications, where NBN Co has been, is, or is to be, involved in the creation or development of the network. To avoid doubt, it is immaterial whether the creation or development of the network is, to any extent, attributable to:

- (a) the acquisition of assets that were used, or for use, in connection with another telecommunications network; or
- (b) the obtaining of access to assets that are also used, or for use, in connection with another telecommunications network

NBN Co means NBN Co Limited (ACN 136 533 741), as the company exists from time to time (even if its name is later changed).

Network of a party, means that party's system, or series of systems, that carries, or is capable of carrying communications by means of guided or unguided electromagnetic energy

Network Deployment Rules means the industry code entitled "ACIF C559:2012 Unconditioned Local Loop Service (ULLS) – Network Deployment Rules" registered by the ACMA under section 117 of the *Telecommunications Act 1997* (Cth) and as amended from time to time.

Non-Billing Dispute means a dispute other than a Billing Dispute

Ongoing Creditworthiness Information has the meaning as set out in clause 4.8 of Schedule 4 of this FAD

Pair means the twisted pair of copper wires forming the internal interconnection cable

Party means a party to this FAD

People of a party, means each of that party's directors, officers, employees, agents, contractors, advisers and representatives but does not include that party's end-users or the other party;

POI means point of interconnection. A point of interconnection is a physical point of interconnection in Australia between a network operated by a carrier or carriage service provider and another network operated by a service provider

Prohibited Traffic means traffic offered across a POI for which there is no agreement between the Access Provider and the Access Seeker that the Access Provider will carry such traffic or provide a related service to the Access Seeker

Proof of Occupancy means a document that verifies occupancy by the end-user at the service address

PSTN means public switched telephone network

Regulatory Determination means an access determination or a binding rule of conduct.

Representative of a Party means each of that party's directors, officers, employees, agents, contractors, advisers and representatives, but does not include that Party's end-users or the other Party;

Reseller means a person that acquires the Service, or a service derived from the Service, from an Access Seeker, for the purpose of reselling, or transforming and then selling, a service to end- users.

Retail Business Unit has the same meaning given to that term in Schedule 1 of Telstra's Structural Separation Undertaking;

Security means the amount and type of security provided, or required to be provided, to the Access Provider in respect of the provision by the Access Provider of Services, as set out in Schedule 4

Security Deposit means any sum of money deposited by the Access Seeker with the Access Provider, from time to time, for the purposes of fulfilling in whole or in part the requirement under this FAD that the Access Seeker provide Security to the Access Provider;

Service means a service declared under section 152AL of the CCA

Service Number means the Customer's fixed network billing service number which is identifiable by a full national number. For the avoidance of doubt, Service Numbers may be associated with voice and data services.

Service Qualification is a desktop process where the Access Provider checks:

- (a) the availability of the ULLS from the end user side of the customer access module to the end-user's property boundary point; and
- (b) that the use on that ULLS of the Access Seeker nominated deployment class complies with the *Network Deployment Rules Industry Code*

Standard zone has the same meaning as in Part 4 of the *Telecommunications (Consumer Protection and Service Standards) Act 1999*

Structural Separation Undertaking means:

- (a) an undertaking given by Telstra under subsection 577A(1) of the *Telecommunications Act 1997* (Cth) which came into force in accordance with section 577AB, and any amendment to that undertaking which comes into force in accordance with subsection 577B(6); and
- (b) a migration plan approved by the ACCC under Subdivision B of Division 2 of Part 33 of the *Telecommunications Act 1997* (Cth) which, pursuant to subsection 577BE(5), formed part of the undertaking referred to in paragraph (a), and any amendment to that plan which is approved by the ACCC in accordance with section 577BF, and includes all binding schedules, annexures and attachments to such documents;

Suspension Event has the meaning set out in clause 7.2 of Schedule 7

Suspension Notice has the meaning set out in clause 7.2 of Schedule 7

TEBA space means Telstra Exchange Building Access space

Transfer means the transfer of a LSS to a ULLS where there is no change of service provider.

ULL means unconditioned local loop

ULLS means unconditioned local loop service

VLAN means virtual local area network

Wholesale ADSL Service means the wholesale asymmetric digital subscriber service declared under subsection 152AL(3) of the CCA.

WLR means wholesale line rental service

Zone 1 means the Zone of that name (as it stood on 13 May 2013) on the ADSL enabled exchange list that Telstra maintains for the purpose of calculating monthly end-user access charges for a Service, and for the avoidance of doubt includes Zone 1(a).

Zone 2/3 means the amalgam of the zones named Zone 2 and Zone 3 (as they stood on 13 May 2013) on the ADSL enabled exchange list that Telstra maintains for the purpose of calculating monthly end-user access charges for a Service.

Schedule 2 – Price

- 2.1 The primary prices for declared services for the period 1 November 2015 to 30 June 2019 are:

Declared Service	Price
ULLS (bands 1-3)	\$14.68 per line per month
ULLS (band 4)	\$43.65 per line per month
WLR	\$20.69 per line per month
LSS	\$1.63 per line per month
LCS	¢8.06 per local call
FOAS	¢0.86 per minute
FTAS	¢0.86 per minute
Wholesale ADSL Zone 1	\$22.14 per port per month
Wholesale ADSL Zone 2/3	\$26.87 per port per month
Wholesale AGVC/VLAN	\$29.27 per Mbps per month

- 2.2 The following connection charges apply to the LSS, ULLS and wholesale ADSL for the period of 1 November 2015 to 30 June 2019:

	November 2015 to June 2016	July 2016 to June 2017	July 2017 to June 2018	July 2018 to June 2019
LSS charges				
LSS single connections*				
Band 1	\$42.63	\$43.66	\$44.72	\$45.80
Band 2	\$43.65	\$44.70	\$45.78	\$46.89
Band 3	\$44.66	\$45.74	\$46.85	\$47.98
Band 4	\$45.79	\$46.89	\$48.03	\$49.20
LSS single disconnections**				
Band 1	\$20.49	\$20.98	\$21.49	\$22.01
Band 2	\$19.28	\$19.75	\$20.23	\$20.72
Band 3	\$19.72	\$20.20	\$20.69	\$21.19

	November 2015 to June 2016	July 2016 to June 2017	July 2017 to June 2018	July 2018 to June 2019
Band 4	\$21.41	\$21.93	\$22.46	\$23.00
LSS MNM connection charges – where the service is to be connected on a line Telstra is using to supply a wholesale ADSL service				
Fixed amount (per MNM)	\$168.14	\$172.21	\$176.38	\$180.64
Variable amount (per connection)	\$23.99	\$24.57	\$25.16	\$25.77
LSS MNM minimum exchange charge (excluding Band 4)				
Per exchange	\$647.85	\$663.53	\$679.59	\$696.04
ULLS charges				
ULLS single connection charges – in use ULLS, transfer ULLS and enhanced vacant ULLS connections ***				
Band 1	\$51.62	\$52.87	\$54.15	\$55.46
Band 2	\$50.75	\$51.98	\$53.23	\$54.52
Band 3	\$55.63	\$56.98	\$58.36	\$59.77
Band 4	\$65.37	\$66.95	\$68.578	\$70.23
Charges for ULLS MNM – involving the transfer of end-user data services from a Telstra wholesale PSTN and/or ADSL service, or from a line that Telstra is using to supply a ULLS to another access seeker				
Fixed amount (per MNM)	\$168.14	\$172.21	\$176.38	\$180.64
Variable amount (per connection)	\$20.18	\$20.66	\$21.16	\$21.68
ULLS MNM minimum exchange charge				
Per exchange	\$571.65	\$585.48	\$595.65	\$614.16
ULLS call diversion charge				
Fixed amount (per ULLS call diversion)	\$11.34	\$11.62	\$11.90	\$12.19
Variable amount (pro rata per	\$14.95	\$15.31	\$15.68	\$16.06

	November 2015 to June 2016	July 2016 to June 2017	July 2017 to June 2018	July 2018 to June 2019
month)				
ULLS cancellation charges				
Per service where pre-jumpering has occurred	\$15.09	\$15.46	\$15.83	\$16.21
Where entire MNM is cancelled	\$168.14	\$172.21	\$176.38	\$180.64
Wholesale ADSL				
Completed Type A connection				
Per connection	\$20.66	\$21.16	\$21.68	\$22.20
Completed Type B and all other wholesale ADSL connections				
Per connection	\$44.02	\$45.08	\$46.17	\$47.29
Early termination charge				
Per termination	\$0.00			

* Note: the single LSS connection charge does not apply where the line on which the LSS is connected was being used to supply a ULLS.

** Note: These charges are not payable for: a disconnection made pursuant to the Telstra churn process by which services can be transferred between LSS, and between LSS and DSL services, or any period in which the Access Seeker was participating in the Telstra LSS churn process and Telstra (Bigpond) was not participating in the Telstra LSS churn process.

*** Note: No price is set for a Vacant ULLS connection.

2.3 The price for the IIC service for the period 1 November 2015 to 30 June 2019 is \$0.051 per installed pair per month.

Schedule 3 - Billing and notification

- 3.1 The Access Seeker's liability to pay Charges for the Service to the Access Provider arises at the time the Service is supplied by the Access Provider to the Access Seeker, unless the parties agree otherwise.
- 3.2 The Access Seeker must pay Charges in accordance with this FAD, including but not limited to this Schedule 3.
- 3.3 The Access Provider must provide the Access Seeker with an invoice each month in respect of Charges payable for the Service unless the parties agree otherwise
- 3.4 The Access Provider is entitled to invoice the Access Seeker for previously uninvoiced Charges or Charges which were understated in a previous invoice, provided that:
- a) the Charges to be retrospectively invoiced can be reasonably substantiated to the Access Seeker by the Access Provider; and
 - b) subject to clause 3.5, no more than 6 Months have elapsed since the date the relevant amount was incurred by the Access Seeker's customer, except where:
 - i. the Access Seeker gives written consent to a longer period (such consent not to be unreasonably withheld); or
 - ii. to the extent that the Charges relate to services supplied by an overseas carrier and the Access Provider has no control over the settlement arrangements as between it and the overseas carrier, in which case the Access Provider shall invoice such amounts as soon as is reasonably practicable.
- 3.5 The parties must comply with the provisions of any applicable industry standard made by the ACMA pursuant to Part 6 of the *Telecommunications Act 1997 (Cth)* (Standard) and the provisions of any applicable industry code registered pursuant to Part 6 of the *Telecommunications Act 1997 (Cth)* (Code) in relation to billing. Where the effect of a Standard or Code is that an Access Seeker is not permitted to invoice its customers for charges that are older than a specified number of days, weeks or months (the Backbilling Period), the Access Provider must not invoice the Access Seeker for a Charge which was incurred by the Access Seeker's customers that, as at the date the invoice is issued, is older than the Backbilling Period.
- 3.6 Subject to clause 3.12
- a) An invoice is payable in full 30 Calendar Days after the date the invoice was issued or such other date as agreed between the parties.
 - b) The Access Seeker may not deduct, withhold, or set-off any amounts for accounts in credit, for counter-claims or for any other reason or attach any condition to the payment, unless otherwise agreed by the Access Provider.
 - c) All amounts owing and unpaid after the due date shall accrue interest daily from the due date up to and including the date it is paid at the rate per annum of the 90 day

authorized dealers bank bill rate published in the *Australian Financial Review* on the first Business Day following the due date for payment, plus 2.5 per cent.

- 3.7 In addition to charging interest in accordance with clause 3.6 or exercising any other rights the Access Provider has at law or under this FAD, where an amount is outstanding and remains unpaid for more than 20 Business Days after it is due for payment, and is not an amount subject to any Billing Dispute notified in accordance with this FAD, the Access Provider may take action, without further notice to the Access Seeker, to recover any such amount as a debt due to the Access Provider.
- 3.8 Unless the parties otherwise agree, there is no setting-off (i.e. netting) of invoices except where a party goes into liquidation, in which case the other party may set-off. However, in order to minimise administration and financial costs, the parties must consider in good faith set-off procedures for inter-party invoices which may require the alignment of the parties' respective invoice dates and other procedures to allow set-off to occur efficiently.
- 3.9 The Access Provider must, at the time of issuing an invoice, provide to the Access Seeker all information reasonably required by the Access Seeker to identify and understand the nature and amount of each Charge on the invoice, and the service the Charge relates to. Nothing in this clause 3.9 is intended to limit subsections 152AR(6) and 152AR(7) of the CCA.
- 3.10 If the Access Seeker believes a Billing Dispute exists, it may invoke the Billing Dispute Procedures by providing written notice to the Access Provider (Billing Dispute Notice). A Billing Dispute must be initiated only in good faith.
- 3.11 Except where a party seeks urgent injunctive relief, the Billing Dispute Procedures must be invoked before either party may begin legal proceedings in relation to any Billing Dispute.
- 3.12 If a Billing Dispute Notice is given to the Access Provider by the due date for payment of the invoice containing the Charge which is being disputed, the Access Seeker may withhold payment of the disputed Charge until such time as the Billing Dispute has been resolved or otherwise terminated. Otherwise, the Access Seeker must pay the invoice in full in accordance with this FAD (but subject to the outcome of the Billing Dispute Procedures).
- 3.13 Except where payment is withheld in accordance with clause 3.12, the Access Provider is not obliged to accept a Billing Dispute Notice in relation to an invoice unless the invoice has been paid in full.
- 3.14 A Billing Dispute Notice must be given to the Access Provider in relation to a Charge, at the earlier of:
 - a) as soon as reasonably practicable after the Access Seeker becomes aware a Billing Dispute exists, or
 - b) within six Months of the invoice for the Charge being issued in accordance with clause 3.6.

3.15

- a) The Access Provider must acknowledge receipt of a Billing Dispute Notice within two Business Days by providing the Access Seeker with a reference number.
- b) Within five Business Days of acknowledging a Billing Dispute Notice under clause 3.15(a), the Access Provider must, by written notice to the Access Seeker:
 - i. accept the Billing Dispute Notice; or
 - ii. reject the Billing Dispute Notice if the Access Provider reasonably considers that:
 - A. the subject matter of the Billing Dispute Notice is already being dealt with in another dispute;
 - B. the Billing Dispute Notice was not submitted in good faith; or
 - C. the Billing Dispute Notice is incomplete or contains inaccurate information.
- c) If the Access Provider fails to accept or reject the Billing Dispute Notice within five Business Days of acknowledging the Billing Dispute Notice under clause 3.15(a), the Access Provider is taken to have accepted the Billing Dispute Notice.
- d) For avoidance of doubt, if the Access Provider rejects a Billing Dispute Notice under clause 3.15(b)(ii)C, the Access Seeker is not prevented from providing an amended Billing Dispute Notice to the Access Provider relating to the same dispute provided that the amended Billing Dispute Notice is provided within the timeframe under clause 3.14.

3.16 The Access Seeker must, as early as practicable and in any case within five Business Days, unless the Parties agree on a longer period, after the Access Provider acknowledges a Billing Dispute Notice, provide to the other party any further relevant information or materials (which were not originally provided with the Billing Dispute Notice) on which it intends to rely (provided that this obligation is not intended to be the same as the obligation to make discovery in litigation).

3.17 Without affecting the time within which the Access Provider must make the proposed resolution under clause 3.1, the Access Provider may request additional information from the Access Seeker that it reasonably requires for the purposes of making a proposed resolution pursuant to clause 3.18. This additional information may be requested up to 10 Business Days prior to the date on which the Access Provider must make the proposed resolution under clause 3.18. The Access Seeker must provide the requested information within five Business Days of receiving the request. If the Access Seeker fails to do so within five Business Days, the Access Provider may take the Access Seeker's failure to provide additional information into account when making its proposed resolution.

3.18 The Access Provider must try to resolve any Billing Dispute as soon as practicable and in any event within 30 Business Days of accepting a Billing Dispute Notice under clause 3.15 (or longer period if agreed by the parties), by notifying the Access Seeker in writing of its proposed resolution of a Billing Dispute. That notice must:

- a) explain the Access Provider's proposed resolution (including providing copies where necessary of all information relied upon in coming to that proposed resolution); and
- b) set out any action to be taken by:
 - i. the Access Provider (e.g. withdrawal, adjustment or refund of the disputed Charge); or
 - ii. the Access Seeker (e.g. payment of the disputed Charge)

If the Access Provider reasonably considers that it will take longer than 30 Business Days after accepting a Billing Dispute Notice to provide a proposed resolution, then the Access Provider may request the Access Seeker's consent to an extension of time to provide the proposed resolution under this clause 3.18 (such consent not to be unreasonably withheld).

3.19 If the Access Seeker does not agree with the Access Provider's decision to reject a Billing Dispute Notice under clause 3.15 or the Access Provider's proposed resolution under clause 3.17, it must object within 15 Business Days of being notified of such decisions (or such longer time as agreed between the parties). Any objection lodged by the Access Seeker with the Access Provider must be in writing and state:

- a) what part(s) of the proposed resolution it objects to;
- b) the reasons for objection;
- c) what amount it will continue to withhold payment of (if applicable); and
- d) any additional information to support its objection.

If the Access Seeker lodges an objection to the proposed resolution under this clause, the Access Provider must, within 5 Business Days of receiving the objection, review the objection and

- e) provide a revised proposed resolution (Revised Proposed Resolution in this Schedule 3); or
- f) confirm its proposed resolution

3.20 Any:

- a) withdrawal, adjustment or refund of the disputed Charge by the Access Provider; or
- b) payment of the disputed Charge by the Access Seeker (as the case may be),

must occur as soon as practicable and in any event within one Month of the Access Provider's notice of its proposed resolution under clause 3.18 or its Revised Proposed Resolution under clause 3.19 (as applicable), unless the Access Seeker escalates the Billing Dispute under clause 3.23. If the Access Provider is required to make a withdrawal, adjustment or refund of a disputed Charge under this clause but its next

invoice (first invoice) is due to be issued within 48 hours of its proposed resolution under clause 3.18 or its Revised Proposed Resolution under clause 3.19 (as applicable), then the Access Provider may include that withdrawal, adjustment or refund in the invoice following the first invoice notwithstanding that this may occur more than one Month after the Access Provider's notice of its proposed resolution or Revised Proposed Resolution.

3.21 Where the Access Provider is to refund a disputed Charge, the Access Provider must pay interest (at the rate set out in clause 3.6) on any refund. Interest accrues daily from the date on which each relevant amount to be refunded was paid to the Access Provider, until the date the refund is paid.

3.22 Where the Access Seeker is to pay a disputed Charge, the Access Seeker must pay interest (at the rate set out in clause 3.6) on the amount to be paid. Interest accrues daily from the date on which each relevant amount was originally due to be paid to the Access Provider, until the date the amount is paid.

3.23 If

- a) the Access Provider has not proposed a resolution according to clause 3.18 or within the timeframe specified in clause 3.18, or
- b) the Access Seeker, having first submitted an objection under clause 3.19 is not satisfied with the Access Provider's Revised Proposed Resolution, or the Access Provider's confirmed proposed resolution, within the timeframes specified in clause 3.19,

the Access Seeker may escalate the matter under clause 3.24. If the Access Seeker does not do so within 15 Business Days after the time period stated in clause 3.18 or after being notified of the Access Provider's Revised Proposed Resolution under clause 3.19(e) or confirmed proposed resolution under clause 3.19(f) (or a longer period if agreed by the parties), the Access Seeker is deemed to have accepted the Access Provider's proposed resolution made under clause 3.18 or Revised Proposed Resolution under clause 3.19(e) or confirmed proposed solution under clause 3.19(f) and clauses 3.21 and 3.22 apply.

3.24 If the Access Seeker wishes to escalate a Billing Dispute, the Access Seeker must give the Access Provider a written notice:

- a) stating why it does not agree with the Access Provider's Revised Proposed Resolution or confirmed proposed resolution; and
- b) seeking escalation of the Billing Dispute.

3.25 A notice under clause 3.24 must be submitted to the nominated billing manager for the Access Provider, who must discuss how best to resolve the Billing Dispute with the Access Seeker's nominated counterpart. If the Parties are unable to resolve the Billing Dispute within five Business Days of notice being given under clause 3.24 (or such longer period as agreed between the parties) the Billing Dispute must be escalated to the Access Provider's nominated commercial manager and the Access Seeker's nominated counterpart who must meet in an effort to resolve the Billing Dispute.

3.26 If the Billing Dispute cannot be resolved within five Business Days of it being escalated to the Access Provider's nominated commercial manager and the Access Seeker's nominated

counterpart under clause 3.25 (or such longer period as agreed between the parties):

- a) either party may provide a written proposal to the other party for the appointment of a mediator to assist in resolving the dispute. Mediation must be conducted in accordance with the mediation guidelines of the Australian Commercial Disputes Centre (ACDC) and concluded within three Months of the proposal (unless the parties agree to extend this timeframe); or
- b) if the parties either do not agree to proceed to mediation within five Business Days of being able to propose the appointment of a mediator under clause 3.26(a) or are unable to resolve the entire Billing Dispute by mediation, either party may commence legal proceedings to resolve the matter.

3.27 The parties must ensure that any person appointed or required to resolve a Billing Dispute takes into account the principle that the Access Seeker is entitled to be recompensed in circumstances where the Access Seeker is prevented (due to regulatory restrictions on retrospective invoicing) from recovering from its end-user an amount which is the subject of a Billing Dispute (a Backbilling Loss), provided that:

- a) such principle applies only to the extent to which the Billing Dispute is resolved against the Access Provider; and
- b) such principle applies only to the extent to which it is determined that the Backbilling Loss was due to the Access Provider unnecessarily delaying resolution of the Billing Dispute.
- c) Each party must continue to fulfil its obligations under this FAD while a Billing Dispute and the Billing Dispute Procedures are pending.

3.28 Each party must continue to fulfil its obligations under this FAD while a Billing Dispute and the Billing Dispute Procedures are pending.

3.29 All discussions and information relating to a Billing Dispute must be communicated or exchanged between the parties through the representatives of the parties set out in clause 3.25 (or their respective nominees).

3.30 There is a presumption that all communications between the Parties during the course of a Billing Dispute are made on a without prejudice and confidential basis.

3.31 If it is determined by the Billing Dispute Procedures, any other dispute resolution procedure, or by agreement between the parties, that three or more out of any five consecutive invoices for a given Service are incorrect by 5 per cent or more, then, for the purposes of clause 3.21, the interest payable by the Access Provider in respect of the overpaid amount of the invoices in question is the rate set out in clause 3.6, plus 2 per cent. The remedy set out in this clause 3.31 is without prejudice to any other right or remedy available to the Access Seeker.

Schedule 4 - Creditworthiness and Security

4.1 Unless otherwise agreed by the Access Provider, the Access Seeker must (at the Access Seeker's sole cost and expense) provide to the Access Provider and maintain, on terms and conditions reasonably required by the Access Provider and subject to clause 4.2, the Security (as is determined having regard to clause 4.3 and as may be varied pursuant to clause 4.4) in respect of amounts owing by the Access Seeker to the Access Provider under this FAD.

4.2

- a) The Access Seeker acknowledges that unless otherwise agreed by the Access Provider, it must maintain (and the Access Provider need not release or refund) the Security specified in clause 4.1 for a period of six Months following (but not including) the date on which the last of the following occurs:
 - i. cessation of supply of the Service under this FAD, and
 - ii. payment of all outstanding amounts under this FAD.
- b) Notwithstanding clause 4.2(a), the Access Provider has no obligation to release the Security if, at the date the Access Provider would otherwise be required to release the Security under clause 4.2(a), the Access Provider reasonably believes any person, including a provisional liquidator, administrator, trustee in bankruptcy, receiver, receiver and manager, other controller or similar official, has a legitimate right to recoup or claim repayment of any part of the amount paid or satisfied, whether under the laws or preferences, fraudulent dispositions or otherwise.

4.3 The Security (including any varied Security) may only be requested where an Access Provider has reasonable grounds to doubt the Access Seeker's ability to pay for services, and must be of an amount and in a form determined reasonably by the Access Provider taking into account all the relevant circumstances. As a statement of general principle the amount of any Security is calculated by reference to:

- a) the aggregate value of all Services likely to be provided to the Access Seeker under this FAD over a reasonable period; or
- b) the value of amounts invoiced in respect of the Service but unpaid (excluding any amounts in respect of which there is a current Billing Dispute notified in accordance with this FAD).

For the avoidance of doubt, any estimates, forecasts or other statements made or provided by the Access Seeker may be used by the Access Provider in determining the amount of a Security

4.4 Examples of appropriate forms of Security, having regard to the factors referred to in clause 4.3, may include without limitation:

- a) fixed and floating charges;
- b) personal guarantees from directors;
- c) Bank Guarantees;
- d) letters of comfort
- e) mortgages;
- f) a right of set-off;
- g) a Security Deposit; or
- h) a combination of the forms of security referred to in paragraphs (a) to (g) above.

If any Security is or includes a Security Deposit, then:

- i) the Access Provider is not obliged to invest the Security Deposit or hold the Security Deposit in an interest bearing account or otherwise; and
- j) the Access Seeker is prohibited from dealing with the Security Deposit or its rights to that Security Deposit (including by way of assignment or granting of security).

If any security is or includes a Bank Guarantee and that Bank Guarantee (Original Bank Guarantee) has an expiry date which is the last day by which a call may be made under a Bank Guarantee, the Access Seeker must procure a replacement Bank Guarantee for the amount guaranteed by the Original Bank Guarantee no later than two Months prior to the expiry date of the Original Bank Guarantee, such replacement Bank Guarantee to have an expiry date of no less than 14 Months from the date of delivery of the replacement Bank Guarantee.

If the Access Seeker fails to procure a replacement Bank Guarantee, then in addition to any other of the Access Provider's rights under this FAD, the Access Provider may, at any time in the Month prior to the expiry date of the Bank Guarantee, make a call under the Bank Guarantee for the full amount guaranteed. The amount paid to the Access Provider pursuant to a call on the Bank Guarantee will become a Security Deposit.

- 4.5 The Access Provider may from time to time where the circumstances reasonably require, request Ongoing Creditworthiness Information from the Access Seeker to determine the ongoing creditworthiness of the Access Seeker. The Access Seeker must supply Ongoing Creditworthiness Information to the Access Provider within 15 Business Days of receipt of a request from the Access Provider for such information. The Access Provider may, as a result of such Ongoing Creditworthiness Information, having regard to the factors referred to in clause 4.3 and subject to clause 4.7, reasonably require the Access Seeker to alter the amount, form or the terms of the Security (which may include a requirement to provide additional security), and the Access Seeker must provide that altered Security within 20 Business Days of being notified by the Access Provider in writing of that requirement.
- 4.6 The Access Seeker may from time to time request the Access Provider to consent (in writing) to a decrease in the required Security and/or alteration of the form of the Security.

The Access Provider must, within 15 Business Days of the Access Seeker's request, comply with that request if, and to the extent, it is reasonable to do so (having regard to the factors referred to in clause 4.3). The Access Provider may request, and the Access Seeker must promptly provide, Ongoing Creditworthiness Information, for the purposes of this clause 4.6.

4.7 If the Access Seeker provides Ongoing Creditworthiness Information to the Access Provider as required by this Schedule 4, the Access Seeker must warrant that such information is true, fair, accurate and complete as at the date on which it is received by the Access Provider and that there has been no material adverse change in the Access Seeker's financial position between the date the information was prepared and the date it was received by the Access Provider. If there has been a material adverse change in the Access Seeker's financial position between the date the information was prepared and the date it was received by the Access Provider, the Access Seeker must disclose the nature and effect of the change to the Access Provider at the time the information is provided.

4.8 For the purposes of this Schedule 4, **Ongoing Creditworthiness Information** means:

- a) a copy of the Access Seeker's most recent published audited balance sheet and published audited profit and loss statement (together with any notes attached to or intended to be read with such balance sheet or profit and loss statement);
- b) a credit report in respect of the Access Seeker or, where reasonably necessary in the circumstances, any of its owners or directors (Principals) from any credit reporting agency, credit provider or other third party. The Access Seeker must co-operate and provide any information necessary for that credit reporting agency, credit provider or other independent party to enable it to form an accurate opinion of the Access Seeker's creditworthiness. To that end, the Access Seeker agrees to procure written consents (as required under the *Privacy Act 1988* (Cth)) from such of its Principals as is reasonably necessary in the circumstances to enable the Access Provider to:
 - i. obtain from a credit reporting agency, credit provider or other independent party, information contained in a credit report;
 - ii. disclose to a credit reporting agency, credit provider or other independent party, personal information about each Principal; and
 - iii. obtain and use a consumer credit report;
- c) a letter, signed by the company secretary or duly authorised officer of the Access Seeker, stating that the Access Seeker is not insolvent and not under any external administration (as defined in the *Corporations Act 2001* (Cth)) or under any similar form of administration under any laws applicable to it in any jurisdiction; and
- d) the Access Seeker's credit rating, if any has been assigned to it; and
- e) any other information reasonably required to determine the ongoing creditworthiness of the Access Seeker, as agreed between the parties before the request under clause 4.5 is made.

- 4.9 The Access Seeker may require a confidentiality undertaking to be given by any person having access to confidential information contained in its Ongoing Creditworthiness Information prior to such information being provided to that person.
- 4.10 Subject to this Schedule 4, the parties agree that a failure by the Access Seeker to provide the warranties set out in clause 4.7 or to provide Ongoing Creditworthiness Information constitutes:
- a) an event entitling the Access Provider to alter the amount, form or terms of the Security (including an entitlement to additional Security) of the Access Seeker and the Access Seeker must provide that altered Security within 15 Business Days after the end of the period set out clause 4.5; or
 - b) breach of a material term or condition of this FAD.

Any disputes arising out of or in connection with Schedule 4 must be dealt with in accordance with the procedures in Schedule 5. Notwithstanding that a dispute arising out of or in connection with Schedule 4 has been referred to the procedures in Schedule 5 and has not yet been determined, nothing in this clause 4.10 or Schedule 5 prevents the Access Provider from exercising any of its rights to suspend the supply of a Service under Schedule 7.

Schedule 5 - General dispute resolution procedures

- 5.1 If a dispute arises between the parties in connection with or arising from the terms and conditions set out in this FAD for the supply of the Service, the dispute must be managed as follows:
- a) in the case of a Billing Dispute, the dispute must be managed in accordance with the Billing Dispute Procedures; or
 - b) subject to clause 5.2, in the case of a Non-Billing Dispute, the dispute must be managed in accordance with the procedures set out in this Schedule 5.
- 5.2 To the extent that a Non-Billing Dispute is raised or arises in connection with, or otherwise relates to, a Billing Dispute, then unless otherwise determined, that Non-Billing Dispute must be resolved in accordance with the Billing Dispute Procedures. The Access Provider may seek a determination from an independent third party on whether a dispute initiated by the Access Seeker as a Billing Dispute is a Non-Billing Dispute. If the independent third party deems the dispute to be a Non-Billing Dispute, the Access Provider may provide written notice to the Access Seeker to pay any withheld amount to the Access Provider on the due date for the disputed invoice or if the due date has passed, immediately on notification being given by the Access Provider.

For the purposes of this clause 5.2:

- a) the independent third party must be a person who:
 - i. has an understanding of the relevant aspects of the telecommunications industry (or have the capacity to quickly come to such an understanding);
 - ii. have an appreciation of the competition law implications of his/her decisions; and
 - iii. not be an officer, director or employee of a telecommunications company or otherwise have a potential for a conflict of interest;
 - b) the independent third party may include an arbiter from the ACDC.
- 5.3 If a Non-Billing Dispute arises, either party may, by written notice to the other, refer the Non-Billing Dispute for resolution under this Schedule 5. A Non-Billing Dispute must be initiated only in good faith.
- 5.4 Any Non-Billing Dispute notified under clause 5.3 must be referred:
- a) initially to the nominated manager (or managers) for each party, who must endeavour to resolve the dispute within 10 Business Days of the giving of the notice referred to in clause 5.3 or such other time agreed by the parties; and
 - b) if the persons referred to in paragraph (a) above do not resolve the Non-Billing Dispute within the time specified under paragraph (a), then the parties may agree in writing within

a further five Business Days to refer the Non-Billing Dispute to an Expert Committee under clause 5.11, or by written agreement submit it to mediation in accordance with clause 5.10.

5.5 If:

- a) under clause 5.4 the Non-Billing Dispute is not resolved and a written agreement is not made to refer the Non-Billing Dispute to an Expert Committee or submit it to mediation; or,
- b) under clause 5.10(f), the mediation is terminated; and
- c) after a period of five Business Days after the mediation is terminated as referred to in paragraph (b), the parties do not resolve the Non-Billing Dispute or agree in writing on an alternative procedure to resolve the Non-Billing Dispute (whether by further mediation, written notice to the Expert Committee, arbitration or otherwise)

either party may terminate the operation of this dispute resolution procedure in relation to the Non-Billing Dispute by giving written notice of termination to the other party.

5.6 A party may not commence legal proceedings in any court (except proceedings seeking urgent interlocutory relief) in respect of a Non-Billing Dispute unless:

- a) the Non-Billing Dispute has first been referred for resolution in accordance with the dispute resolution procedure set out in this Schedule 5 or clause 5.2 (if applicable) and a notice terminating the operation of the dispute resolution procedure has been issued under clause 5.5; or
- b) the other party has failed to substantially comply with the dispute resolution procedure set out in this Schedule 5 or clause 5.2 (if applicable).

5.7 Each party must continue to fulfil its obligations under this FAD while a Non-Billing Dispute and any dispute resolution procedure under this Schedule 5 are pending.

5.8 All communications between the parties during the course of a Non-Billing Dispute and in connection with that Non-Billing Dispute, are made on a without prejudice and confidential basis.

5.9 Each party must, as early as practicable, and in any case within 14 Calendar Days unless a longer period is agreed between the parties, after the notification of a Non-Billing Dispute pursuant to clause 5.3, provide to the other party any relevant materials on which it intends to rely (provided that this obligation is not intended to be the same as the obligation to make discovery in litigation).

5.10 Where a Non-Billing Dispute is referred to mediation by way of written agreement between the parties, pursuant to clause 5.4(b):

- a) any agreement must include:

- i. a statement of the disputed matters in the Non-Billing Dispute; and
 - ii. the procedure to be followed during the mediation, and the mediation must take place within 15 Business Days upon the receipt by the mediator of such agreement;
- b) it must be conducted in accordance with the mediation guidelines of the ACDC in force from time to time (**ACDC Guidelines**) and the provisions of this clause 5.10. In the event of any inconsistency between them, the provisions of this clause 5.10 prevail;
- c) it must be conducted in private;
- d) in addition to the qualifications of the mediator contemplated by the ACDC Guidelines, the mediator must:
- i. have an understanding of the relevant aspects of the telecommunications industry (or have the capacity to quickly come to such an understanding);
 - ii. have an appreciation of the competition law implications of his/her decisions; and
 - iii. not be an officer, director or employee of a telecommunications company or otherwise have a potential for a conflict of interest;
- e) the parties must notify each other no later than 48 hours prior to mediation of the names of their representatives who will attend the mediation. Nothing in this subclause is intended to suggest that the parties are able to refuse the other's chosen representatives or to limit other representatives from the parties attending during the mediation;
- f) it must terminate in accordance with the ACDC Guidelines;
- g) the parties must bear their own costs of the mediation including the costs of any representatives and must each bear half the costs of the mediator; and
- h) any agreement resulting from mediation binds the parties on its terms.

5.11 The parties may by written agreement in accordance with clause 5.4(b), submit a Non-Billing Dispute for resolution by an Expert Committee (**Initiating Notice**), in which case the provisions of this clause 5.11 apply as follows:

- a) The terms of reference of the Expert Committee are as agreed by the parties. If the terms of reference are not agreed within five Business Days after the date of submitting the Initiating Notice (or such longer period as agreed between the parties), the referral to the Expert Committee is deemed to be terminated.
- b) An Expert Committee acts as an expert and not as an arbitrator.
- c) The parties are each represented on the Expert Committee by one appointee.
- d) The Expert Committee must include an independent chairperson agreed by the parties or,

if not agreed, a nominee of the ACDC. The chairperson must have the qualifications listed in paragraphs 5.10(d)(i), (ii) and (iii).

- e) Each party must be given an equal opportunity to present its submissions and make representations to the Expert Committee.
- f) The Expert Committee may determine the dispute (including any procedural matters arising during the course of the dispute) by unanimous or majority decision.
- g) Unless the parties agree otherwise the parties must ensure that the Expert Committee uses all reasonable endeavours to reach a decision within 20 Business Days after the date on which the terms of reference are agreed or the final member of the Expert Committee is appointed (whichever is the later) and undertake to co-operate reasonably with the Expert Committee to achieve that timetable.
- h) If the dispute is not resolved within the timeframe referred to in clause 5.11(g), either party may by written notice to the other party terminate the appointment of the Expert Committee.
- i) The Expert Committee has the right to conduct any enquiry as it thinks fit, including the right to require and retain relevant evidence during the course of the appointment of the Expert Committee or the resolution of the dispute.
- j) The Expert Committee must give written reasons for its decision.
- k) A decision of the Expert Committee is final and binding on the parties except in the case of manifest error or a mistake of law.
- l) Each party must bear its own costs of the enquiry by the Expert Committee including the costs of its representatives, any legal counsel and its nominee on the Expert Committee and the parties must each bear half the costs of the independent member of the Expert Committee.

5.12 Schedule 5 does not apply to a Non-Billing Dispute to the extent that:

- a) there is a dispute resolution process established in connection with, or pursuant to, a legal or regulatory obligation (including any dispute resolution process set out in a Structural Separation Undertaking)
- b) a party has initiated a dispute under the dispute resolution process referred to in clause 5.12(a), and
- c) the issue the subject of that dispute is the same issue in dispute in the Non-Billing Dispute.

Schedule 6 - Confidentiality provisions

- 6.1 Subject to clause 6.4 and any applicable statutory duty, each party must keep confidential all Confidential Information of the other party and must not:
- a) use or copy such Confidential Information except as set out in this FAD; or
 - b) disclose or communicate, cause to be disclosed or communicated or otherwise make available such Confidential Information to any third person.
- 6.2 For the avoidance of doubt, information generated within the Access Provider's Network as a result of or in connection with the supply of the relevant Service to the Access Seeker or the interconnection of the Access Provider's Network with the Access Seeker's Network (other than information that falls within paragraph (d) of the definition of Confidential Information) is the Confidential Information of the Access Seeker.
- 6.3 The Access Provider must upon request from the Access Seeker, disclose to the Access Seeker quarterly aggregate traffic flow information generated within the Access Provider's Network in respect of a particular Service provided to the Access Seeker, if the Access Provider measures and provides this information to itself. The Access Seeker must pay the reasonable costs of the Access Provider providing that information.
- 6.4 Subject to clauses 6.5 and 6.10, Confidential Information of the Access Seeker may be:
- a) used by the Access Provider:
 - i. for the purposes of undertaking planning, maintenance, provisioning, operations or reconfiguration of its Network;
 - ii. for the purposes of supplying Services to the Access Seeker;
 - iii. for the purpose of billing; or
 - iv. for another purpose agreed to by the Access Seeker; and
 - b) disclosed only to personnel who, in the Access Provider's reasonable opinion require the information to carry out or otherwise give effect to the purposes referred to in paragraph (a) above.
- 6.5 A party (**Disclosing Party**) may to the extent necessary use and/or disclose (as the case may be) the Confidential Information of the other party:
- a) to those of the Disclosing Party's directors, officers, employees, agents, contractors (including sub-contractors) and representatives to whom the Confidential Information is reasonably required to be disclosed in connection with the provision of the Service to which this FAD relates;
 - b) to any professional person for the purpose of obtaining advice in relation to matters arising out of or in connection with the supply of a Service under this FAD;

- c) to an auditor acting for the Disclosing Party to the extent necessary to permit that auditor to perform its audit functions;
- d) in connection with legal proceedings, arbitration, expert determination and other dispute resolution mechanisms set out in this FAD, provided that the Disclosing Party has first given as much notice (in writing) as is reasonably practicable to the other party so that the other party has an opportunity to protect the confidentiality of its Confidential Information;
- e) as required by law provided that the Disclosing Party has first given as much notice (in writing) as is reasonably practicable to the other party, that it is required to disclose the Confidential Information so that the other party has an opportunity to protect the confidentiality of its Confidential Information, except that no notice is required in respect of disclosures made by the Access Provider to the ACCC under section 152BEA of the CCA;
- f) with the written consent of the other party provided that, prior to disclosing the Confidential Information of the other party:
 - i. the Disclosing Party informs the relevant person or persons to whom disclosure is to be made that the information is the Confidential Information of the other party;
 - ii. if required by the other party as a condition of giving its consent, the Disclosing Party must provide the other party with a confidentiality undertaking in the form set out in Annexure 1 of this Schedule 6 signed by the person or persons to whom disclosure is to be made; and
 - iii. if required by the other party as a condition of giving its consent, the Disclosing Party must comply with clause 6.6;
- g) in accordance with a lawful and binding directive issued by a regulatory authority;
- h) if reasonably required to protect the safety of personnel or property or in connection with an emergency;
- i) as required by the listing rules of any stock exchange where that party's securities are listed or quoted;
- j) in accordance with a reporting obligation, or in response to a request from a regulatory authority or any other Government body, in connection with the Access Provider's Structural Separation Undertaking where the party cannot comply with the reporting obligation or request without using or disclosing the Confidential Information, provided that:
 - i. prior to disclosing the Confidential Information of the other party the Disclosing Party informs the relevant person or persons to whom disclosure is to be made that the information is the Confidential Information of the other party; and

- ii. unless prohibited by law, the Disclosing Party informs the other Party in writing as soon as reasonably practicable after receiving the request that the Disclosing Party will disclose Confidential Information to the regulatory authority or any other Government body to fulfil that reporting obligation or respond to that request.
- k) in response to a request from a regulatory authority or any other Government body in connection with interception capability (as that term is used in Chapter 5 of the *Telecommunications (Interception and Access) Act 1979* (Cth)) relating to access to a declared service, where the party cannot comply with the request without using or disclosing the Confidential Information, provided that:
- i. prior to disclosing the Confidential Information of the other party the Disclosing Party informs the relevant person or persons to whom disclosure is to be made that the information is the confidential information of the other party; and
 - ii. unless prohibited by law, the Disclosing Party informs the other Party as soon as reasonably practicable after receiving the request that the Disclosing Party will disclose Confidential Information to the regulatory authority or any other Government body to respond to that request.

6.6 Each party must co-operate in any action taken by the other party to:

- a) protect the confidentiality of the other party's Confidential Information; or
- b) enforce its rights in relation to its Confidential Information.

6.7 Each party must establish and maintain security measures to safeguard the other party's Confidential Information from unauthorised access, use, copying, reproduction or disclosure.

6.8 Confidential Information provided by one party to the other party is provided for the benefit of that other party only. Each party acknowledges that no warranty is given by the Disclosing Party that the Confidential Information is or will be correct.

6.9 Each party acknowledges that a breach of this Schedule 6 by one party may cause another party irreparable damage for which monetary damages would not be an adequate remedy. Accordingly, in addition to other remedies that may be available, a party may seek injunctive relief against such a breach or threatened breach of this Schedule 6.

6.10 If:

- a) the Access Provider has the right to suspend or cease the supply of the Service under:
 - i. Schedule 7 due to a payment breach, or
 - ii. under clause 7.8
- b) after suspension or cessation of supply of the Service under this FAD, the Access Seeker fails to pay amounts due or owing to the Access Provider by the due date for payment,

then the Access Provider may do one or both of the following:

- c) notify and exchange information about the Access Seeker (including the Access Seeker's Confidential Information) with any credit reporting agency or the Access Provider's collection agent; and
- d) without limiting clause 6.10, disclose to a credit reporting agency:
 - i. the defaults made by the Access Seeker to the Access Provider; and
 - ii. the exercise by the Access Provider of any right to suspend or cease supply of the Service under this FAD.

Annexure 1 of Schedule 6

Confidentiality undertaking form

[Amend where necessary]

CONFIDENTIALITY UNDERTAKING

I, _____ of [employer's company name] ([undertaking company]) undertake to [full name of party who owns or is providing the confidential information as the case requires] ([Provider]) that:

- 1 Subject to the terms of this Undertaking, I will keep confidential at all times the information listed in Attachment 1 to this Undertaking (Confidential Information) that is in my possession, custody, power or control.
- 2 I acknowledge that:
 - (a) this Undertaking is given by me to [Provider] in consideration for [Provider] making the Confidential Information available to me for the Approved Purposes (as defined below);
 - (b) all intellectual property in or to any part of the Confidential Information is and will remain the property of [Provider]; and
 - (c) by reason of this Undertaking, no licence or right is granted to me, or any other employee, agent or representative of [undertaking company] in relation to the Confidential Information except as expressly provided in this Undertaking.
- 3 I will:
 - (a) only use the Confidential Information for:
 - (i) the purposes listed in Attachment 2 to this Undertaking; or
 - (ii) any other purpose approved by [Provider] in writing;(the Approved Purposes);
 - (b) comply with any reasonable request or direction from [provider] regarding the Confidential Information.
- 4 Subject to clause 5, I will not disclose any of the Confidential Information to any other person without the prior written consent of [Provider].
- 5 I acknowledge that I may disclose the Confidential Information to which I have access to:
 - (a) any employee, external legal advisors, independent experts, internal legal or regulatory staff of [undertaking company], for the Approved Purposes provided that:
 - (i) the person to whom disclosure is proposed to be made (**the person**) is notified in writing to [Provider] and [Provider] has approved the person as a person who may receive the Confidential Information, which approval shall not be unreasonably withheld;
 - (ii) the person has signed a confidentiality undertaking in the form of this

Undertaking or in a form otherwise acceptable to [Provider]; and

(iii) a signed undertaking of the person has already been served on [Provider];

(b) other persons, if required to do so by law, but then only:

(i) if I notify [Provider] of that request within 7 days of receiving the request;

(ii) to the person(s) to whom I am obliged to provide the Confidential Information;

(iii) to the extent necessary as required by law; and

(iv) if I notify the recipient of the Confidential Information that the information is confidential and is the subject of this Undertaking to the [Provider]; and

(c) any secretarial, administrative and support staff, who perform purely administrative tasks, and who assist me or any person referred to in paragraph 5(a) for the Approved Purpose.

6 I will establish and maintain security measures to safeguard the Confidential Information from unauthorised access, use, copying, reproduction or disclosure and will protect the Confidential Information using the same degree of care as a prudent person in my position would use to protect their own confidential information.

7 Except as required by law and subject to paragraph 10 below, within 14 days after whichever of the following first occurs:

(a) termination of this Undertaking;

(b) my ceasing to be employed or retained by [undertaking company] (provided that I continue to have access to the Confidential Information at that time); or

(c) my ceasing to be working for [undertaking company] in respect of the Approved Purposes (other than as a result of ceasing to be employed by [undertaking company]);

I will destroy or deliver to [Provider] the Confidential Information and any documents or things (or parts of documents or things), constituting, recording or containing any of the Confidential Information in my possession, custody, power or control other than electronic records stored in IT backup system that cannot be destroyed or deleted.

8 Nothing in this Undertaking shall impose an obligation upon me in respect of information:

(a) that is in the public domain; or

(b) that has been obtained by me otherwise than from [Provider] in relation to this Undertaking;

provided that the information has not been obtained by me by reason of, or in circumstances involving, any breach of this Undertaking, any other confidentiality undertaking in favour of [Provider] for the Approved purpose, or by any other unlawful means.

9 I acknowledge that damages may not be a sufficient remedy for any breach of this

Undertaking and that [Provider] may be entitled to specific performance or injunctive relief (as appropriate) as a remedy for any breach or threatened breach of this Undertaking, in addition to any other remedies available to [Provider] at law or in equity.

- 10 The obligations of confidentiality imposed by this Undertaking survive the destruction or delivery to [Provider] of the Confidential Information pursuant to paragraph 7 above.
- 11 I acknowledge that this Undertaking is governed by the law in force in the State of [insert relevant state] and I agree to submit to the non-exclusive jurisdiction of the court of that place.

Signed: _____

Print name: _____

Dated: _____

Witness signature: _____

Witness name: _____

ATTACHMENT 1

Any document, or information in any document provided by [provider] to [undertaking company] which [provider] claims is confidential information for the purposes of this Undertaking.

ATTACHMENT 2

[Approved purpose(s)]

Schedule 7 – Suspension and termination

7.1 The Access Provider may immediately suspend the supply of a Service or access to the Access Provider's Network, provided it notifies the Access Seeker where practicable and provides the Access Seeker with as much notice as is reasonably practicable:

- a) during an Emergency; or
- b) where in the reasonable opinion of the Access Provider, the supply of that Service or access to the Access Provider's Network may pose a threat to safety of persons, hazard to equipment, threat to Network operation, access, integrity or Network security or is likely to impede the activities of authorised persons responding to an Emergency;
- c) where, in the reasonable opinion of the Access Provider, the Access Seeker's Network or equipment adversely affects or threatens to affect the normal operation of the Access Provider's Network or access to the Access Provider's Network or equipment (including for the avoidance of doubt, where the Access Seeker has delivered Prohibited Traffic onto the Access Provider's Network);
- d) where an event set out in clauses 7.8(a) to (i) occurs
- e) and is entitled to continue such suspension until (as the case requires) the relevant event or circumstance giving rise to the suspension has been remedied.

7.2 If:

- a) the Access Seeker has failed to pay monies payable under this FAD;
- b) a Court determines that (and the decision is not subject to an appeal) the Access Seeker's use of:
 - i. its Facilities in connection with any Service supplied to it by the Access Provider;
 - ii. the Access Provider's Facilities or Network; or
 - iii. any Service supplied to it by the Access Providers,is in contravention of any law; or
- c) the Access Seeker breaches a material obligation under this FAD (**Suspension Event**) and:
- d) as soon as reasonably practicable after becoming aware of the Suspension Event, the Access Provider gives a written notice to the Access Seeker:
 - i. citing this clause;
 - ii. specifying the Suspension Event that has occurred;

- iii. requiring the Access Seeker to institute remedial action (if any) in respect of that event; and
 - iv. specifying the action which may follow due to a failure to comply with the notice, (**Suspension Notice**) and:
- e) the Access Seeker fails to institute remedial action as specified in the Suspension Notice within 10 Business Days after receiving the Suspension Notice (in this clause 7.2, the **Remedy Period**), the Access Provider may, by written notice given to the Access Seeker as soon as reasonably practicable after the expiry of the Remedy Period:
- f) refuse to provide the Access Seeker with the Service:
- i. of the kind in respect of which the Suspension Event has occurred; and
 - ii. a request for which is made by the Access Seeker after the date of the breach, until the remedial action specified in the Suspension Notice is completed or the Suspension Event otherwise ceases to exist; and
- g) suspend the provision of the Service until the remedial action specified in the Suspension Notice is completed.

7.3 For the avoidance of doubt, subclause 7.2(a) does not apply to any monies payable that are the subject of a Billing Dispute that has been notified by the Access Seeker to the Access Provider in accordance with the Billing Dispute Procedures set out in this FAD.

7.4 In the case of a suspension pursuant to clause 7.2, the Access Provider must reconnect the Access Seeker to the Access Provider's Network and recommence the supply of the Service as soon as practicable after there no longer exists a reason for suspension and the Access Provider must do so subject to payment by the Access Seeker of the Access Provider's reasonable costs of suspension and reconnection.

7.5 If:

- a) an Access Seeker ceases to be a carrier or carriage service provider; or
- b) an Access Seeker ceases to carry on business for a period of more than 10 consecutive Business Days or
- c) in the case of an Access Seeker, any of the reasonable grounds specified in subsection 152AR(9) of the CCA apply; or
- d) an Access Seeker breaches a material obligation under this FAD, and:
 - i. that breach materially impairs or is likely to materially impair the ability of the Access Provider to deliver Listed Carriage Services to its customers; and
 - ii. the Access Provider has given a written notice to the first-mentioned party within 20 Business Days of becoming aware of the breach (**Breach Notice**); and

- iii. the Access Seeker fails to institute remedial action as specified in the Breach Notice within 10 Business Days after receiving the Breach Notice (in this clause 7.5, the **Remedy Period**), or
 - e) the supply of the Service(s) to the Access Seeker has been suspended pursuant to the terms and conditions of this FAD for a period of three Months or more, the Access Provider may cease supply of the Service under this FAD by written notice given to the first-mentioned party at any time after becoming aware of the cessation, reasonable grounds or expiry of the Remedy Period specified in the Breach Notice (as the case may be).
- 7.5A If an Access Provider ceases to carry on business for a period of more than 10 consecutive Business Days, the other party may cease acquisition of the Service under this FAD by written notice given to the Access Provider at any time after becoming aware of the cessation.
- 7.6 A party must not give the other party both a Suspension Notice under clause 7.2 and a Breach Notice under clause 7.5 in respect of:
- a) the same breach; or
 - b) different breaches that relate to or arise from the same act, omission or event or related acts, omissions or events;
- except:
- c) where a Suspension Notice has previously been given to the Access Seeker by the Access Provider in accordance with clause 7.2 in respect of a Suspension Event and the Suspension Event has not been rectified by the Access Seeker within the relevant Remedy Period specified in clause 7.2; and
 - d) where an Access Seeker has not rectified a Suspension Event, then notwithstanding clause 7.5(d)(ii), the time period for the purposes of clause 7.5(d)(ii) will be 20 Business Days from the expiry of the time available to remedy the Suspension Event.
- 7.7 For the avoidance of doubt, a party is not required to provide a Suspension Notice under clause 7.2 in respect of a breach before giving a Breach Notice in respect of that breach under clause 7.5.
- 7.8 Notwithstanding any other provision of this FAD, either Party may at any time immediately cease the supply of the Service under this FAD by giving written notice of termination to the other Party if:
- a) an order is made or an effective resolution is passed for winding up or dissolution without winding up (otherwise than for the purposes of solvent reconstruction or amalgamation) of the other Party; or
 - b) a receiver, receiver and manager, official manager, controller, administrator (whether voluntary or otherwise), provisional liquidator, liquidator, or like official is appointed over the undertaking and property of the other Party; or

- c) a holder of an encumbrance takes possession of the undertaking and property of the other party, or the other party enters or proposes to enter into any scheme of arrangement or any composition for the benefit of its creditors; or
- d) the other party is or is likely to be unable to pay its debts as and when they fall due or is deemed to be unable to pay its debts pursuant to section 585 or any other section of the *Corporations Act 2001* (Cth); or
- e) as a result of the operation of section 459F or any other section of the *Corporations Act 2001* (Cth), the other party is taken to have failed to comply with a statutory demand; or
- f) a force majeure event substantially and adversely affecting the ability of a party to perform its obligations to the other party, continues for a period of three Months; or
- g) the other party breaches any of the terms of any of its loans, security or like agreements or any lease or agreement relating to significant equipment used in conjunction with the business of that other party related to the supply of the Service under this FAD; or
- h) the other party seeks or is granted protection from its creditors under any applicable legislation; or
- i) anything analogous or having a substantially similar effect to any of the events specified above occurs in relation to the other party.

7.9 The cessation of the operation of this FAD:

- a) does not operate as a waiver of any breach by a party of any of the provisions of this FAD; and
- b) is without prejudice to any rights, liabilities or obligations of any party which have accrued up to the date of cessation.

7.10 Without prejudice to the parties' rights upon termination of the supply of the Service under this FAD, or expiry or revocation of this FAD, the Access Provider must refund to the Access Seeker a fair and equitable proportion of those sums paid under this FAD by the Access Seeker which are periodic in nature and have been paid for the Service:

- a) for a period extending beyond the date on which the supply of the Service under this FAD terminates, or this FAD ceases to have effect, and/or,
- b) as applicable, in respect of a Service which has been suspended for a period of 10 or more consecutive Business Days under Schedule 7 of this FAD, for the period extending beyond that 10 Business Day suspension period to the extent the Service remains suspended under Schedule 7 of this FAD,

subject to any invoices or other amounts outstanding from the Access Seeker to the Access Provider. In the event of a dispute in relation to the calculation or quantum of a fair and

equitable proportion, either party may refer the matter for dispute resolution in accordance with the dispute resolution procedures set out in Schedule 5 of this FAD.

Schedule 8 - Liability and Indemnity

8.1 Subject to clause 8.2, each Party's liability in respect of:

- a) the 12 Month period commencing on the date of the first supply of the Service under this FAD is limited to the aggregate amount paid or payable by the Access Seeker to the Access Provider for the Service provided by the Access Provider in that initial 12 Month period;
- b) any subsequent 12 Month period commencing on any anniversary of the date of the first supply of the Service under this FAD is limited to the aggregate amount paid or payable by the Access Seeker to the Access Provider for the Service provided by the Access Provider in the 12 Month period immediately prior to that anniversary.

For the purposes of this clause 8.1, Liability arises when the act or omission giving rise to the Liability occurs, not when any claim is made by a party under this FAD in connection with that Liability.

8.2 The liability limitation in clause 8.1 does not apply to the Access Seeker's liability to pay the Charges for the Service provided under this FAD, or the Parties' indemnification obligations under clauses 8.3 and 8.4.

8.3 Each Party indemnifies the other Party against all Loss arising from the death of, or personal injury to, a Representative of the other Party, where the death or personal injury arises from:

- a) an act or omission that is intended to cause death or personal injury; or
- b) a negligent act or omission;

by the first Party or by a Representative of the first Party.

8.4 Each Party indemnifies the other Party against all Loss arising from any loss of, or damage to, the property of the other party (or the property of a representative of the other Party), where the loss or damage arises from:

- a) an act or omission that is intended to cause death or personal injury; or
- b) a negligent act or omission;

by the first Party or by a Representative of the first Party.

8.5 Each Party indemnifies the other Party against all Loss arising from a claim by a third person against the Innocent Party to the extent that the claim relates to a negligent act or omission by the first Party or by a Representative of the first Party.

8.6 Subject to clauses 8.3 and 8.4, a Party has no Liability to the other Party for or in respect of any consequential, special or indirect Loss or any loss of profits or data.

- 8.7 A Party has no Liability to the other Party for or in relation to any act or omission of, or any matter arising from or consequential upon any act or omission of, any end-user of a Party or any other third person who is not a Representative of a Party.
- 8.8 The Indemnifying Party is not obliged to indemnify the Innocent Party under this Schedule 8 to the extent that the liability the subject of the indemnity claim is caused or contributed to by:
- a) a breach of this FAD;
 - b) an act intended to cause death, personal injury, or loss or damage to property; or
 - c) a negligent act or omission;
- by the Innocent Party.
- 8.9 The Indemnifying Party is not obliged to indemnify the Innocent Party under this Schedule 8 or for in respect of a claim brought against the Innocent Party by an end-user of the Innocent Party, or a third person with whom the Innocent Party has a contractual relationship, to the extent that the Loss under such claim could have been excluded or reduced (regardless of whether such a Liability actually was excluded or reduced) by the Innocent Party in its contract with the end-user or third person.
- 8.10 The Innocent Party must take all reasonable steps to minimise the Loss it has suffered or is likely to suffer as a result of an event giving rise to an indemnity under this Schedule 8. If the Innocent Party does not take reasonable steps to minimise such Loss then the damages payable by the Indemnifying Party must be reduced as is appropriate in each case.
- 8.11 A Party's liability to the other Party for Loss of any kind arising out of the supply of the Service under this FAD or in connection with the relationship established by it is reduced to the extent (if any) that the other Party causes or contributes to the Loss. This reduction applies whether the first Party's liability is in contract, tort (including negligence), under statute or otherwise.
- 8.12 The Indemnifying Party must be given full conduct of the defence of any claim by a third party that is the subject of an indemnity under clause 8.3 or 8.4, including, subject to the Indemnifying Party first obtaining the written consent (which must not be unreasonably withheld) of the Innocent Party to the terms thereof, the settlement of such a claim.
- 8.13 Nothing in this Schedule 8 excludes or limits a Party's entitlement to damages under Part 5 of the Telecommunications (Consumer Protection and Service Standards) Act 1999.

Schedule 9 - Communication with end users

- 9.1 The Access Provider may communicate and deal with an Access Seeker's end-users as expressly provided in clauses 9.2 to 9.4 and as otherwise permitted by law.
- 9.2 Subject to clause 9.3, the Access Provider may communicate and deal with the Access Seeker's end-users:
- a) in relation to goods and services which the Access Provider currently supplies or previously supplied to the end-user provided that the Access Provider only communicates and deals through its Retail Business Unit;
 - b) as members of the general public or a part of the general public or members of a particular class of recipients of carriage or other services;
 - c) where the Access Provider performs wholesale operations which require communications or dealings with such end-users, to the extent necessary to carry out such operations;
 - d) in a manner or in circumstances agreed by the Parties; or
 - e) in or in connection with an Emergency, to the extent it reasonably believes necessary to protect the safety of persons or property.
- 9.3 If:
- a) an end-user of the Access Seeker initiates a communication with the Access Provider in relation to goods and/or services supplied to that end-user by the Access Seeker, the Access Provider must advise the end-user that they should discuss any matter concerning the Access Seeker's goods and/or services with the Access Seeker and must not engage in any form of marketing or discussion of the Access Provider's goods and/or services;
 - b) an end-user of the Access Seeker initiates a communication with the Access Provider in relation to goods and/or services supplied to that end-user by the Access Provider, the Access Provider may engage in any form of marketing or discussion of the Access Provider's goods and/or services; and
 - c) an end-user of the Access Seeker initiates a communication with the Access Provider in relation to goods and/or services supplied to that end-user by the Access Provider and the Access Seeker, the Access Provider must advise the end-user that they should discuss any matter concerning the Access Seeker's goods and/or services, with the Access Seeker, but may otherwise engage in any form of marketing or discussion of the Access Provider's goods and/or services.
- 9.4 Where a Party communicates with the end-user of the other Party, that first mentioned Party must, where practicable, make and maintain records of that communication with the other Party's end-user in circumstances where that communication discusses anything concerning the other Party's goods or services with the end-user. For the avoidance of

doubt, the obligation in this paragraph does not include a requirement to provide such records to the other Party (however such a requirement may arise pursuant to any dispute resolution procedure).

9.5 For the purposes of clauses 9.2 to 9.4, a “**communication**” shall include any form of communication, including without limitation telephone discussions and correspondence.

9.6 Neither Party may represent that:

- a) it has any special relationship with or special arrangements with the other Party, including through the use of the other party’s trade marks, service marks, logos or branding unless otherwise agreed;
- b) there are no consequences for an end-user when an end-user signs an authority to transfer their accounts or services;
- c) a Service has any characteristics or functionality other than as specified in a relevant standard form of agreement or the service description for the Service or in any specifications, collateral or brochures published in relation to the Service; or
- d) the other Party participates in the provision of the first mentioned Party’s services, provided that a Party may, upon enquiry by an end-user, inform the end-user of the nature of its relationship with the other Party.

9.7 Where a Party communicates with an end-user of either Party, the first mentioned Party shall ensure that it does not attribute to the other Party:

- a) blame for a Fault or other circumstance; or
- b) the need for maintenance of a Network; or
- c) the suspension of a Service,

provided that this requirement does not require a Party to engage in unethical, misleading or deceptive conduct.

9.8 This Schedule 9 shall be subject to any applicable industry standard made by the ACMA pursuant to Part 6 of the *Telecommunications Act 1997* (Cth) and any applicable industry code registered pursuant to Part 6 of the *Telecommunications Act 1997* (Cth) in relation to communications or dealings with end-users.

Schedule 10 - Network modernisation and upgrade notice periods

Notice to be provided where Access Provider undertakes a Major Network Modernisation and Upgrade

10.1 Except where the parties agree otherwise, the Access Provider may make a Major Network Modernisation and Upgrade by:

- a) providing the Access Seeker with notices in writing in accordance with clauses 10.2 and 10.4 (**General Notification**) and clauses 10.3 and 10.5 (**Individual Notification**); and
- b) consulting with the Access Seeker, and negotiating in good faith, to address any reasonable concerns of the Access Seeker, in relation to the Major Network Modernisation and Upgrade.

This clause 10.1 does not apply to an Emergency Network Modernisation and Upgrade.

10.2 The period of notices given under a General Notification provided by the Access Provider to the Access Seeker:

- a) must be an Equivalent Period of Notice; and
- b) in any event, must not be less than 30 weeks before the Major Network Modernisation and Upgrade is scheduled to take effect.

10.3 An Individual Notification must be provided by the Access Provider to the Access Seeker as soon as practicable after the General Notification, taking account of all the circumstances of the Major Network Modernisation and Upgrade.

Information to be provided in the notices

10.4 A General Notification must include information on:

- a) the ESA affected by the proposed Major Network Modernisation and Upgrade;
- b) the distribution area affected by the proposed Major Network Modernisation and Upgrade; and
- c) a general description of the proposed Major Network Modernisation and Upgrade, including the indicative timing for the implementation of the Major Network Modernisation and Upgrade.

10.5 An Individual Notification must include the following information in addition to the information provided in the relevant General Notification:

- a) the anticipated commencement date for implementing the Major Network Modernisation and Upgrade

- b) the anticipated amount of time it will take to implement the Major Network Modernisation and Upgrade;
- c) details of the Access Seeker's activated Services, or Services in the process of being activated at the date of the notice, that are likely to be affected by the Major Network Modernisation and Upgrade;
- d) the likely action required by the Access Seeker as a result of the Major Network Modernisation and Upgrade (including the possible impact of the Major Network Modernisation and Upgrade upon the Access Seeker's Service); and
- e) details of who the Access Seeker may contact to obtain further information about the Major Network Modernisation and Upgrade.

10.6 An Individual Notification only needs to be given where a Service has been activated or the Access Provider is in the process of activating a service as at the date of the Individual Notification, and:

- a) the Major Network Modernisation and Upgrade will require the Access Seeker to take particular action in order to continue to use the Service; or
- b) the Major Network Modernisation and Upgrade will result in the Service no longer being supplied or the Service being suspended for a period of no less than 20 Business Days.

10.7 Where the Access Provider has provided the Access Seeker with an Individual Notification, the Access Provider must provide the Access Seeker with:

- a) updates about the Major Network Modernisation and Upgrade covered by the notice, including:
 - i. any update or change to the information provided in the Individual Notification;
 - ii. any new information available at the time of the update about:
 - 1. Services provided by the Access Provider in the relevant ESA that may be available to the Access Seeker;
 - 2. how the Access Seeker may be impacted by the Major Network Modernisation and Upgrade; and
 - 3. what steps the Access Seeker will be required to take to facilitate the Major Network Modernisation and Upgrade; and
- b) weekly reports about the anticipated cutover dates for the Access Seeker's affected Services, beginning no less than five weeks prior to the anticipated commencement date for the Major Network Modernisation and Upgrade.

10.8 The updates referred to in subclause 10.7(a) must be provided regularly (which is not

required to be any more frequently than Monthly) after the Individual Notification.

Emergency Network Modernisation and Upgrade

10.9 In the event of an Emergency, the Access Provider may conduct an Emergency Network Modernisation and Upgrade, and

- a) must use its best endeavours to provide the Access Seeker with an Individual Notification prior to the Emergency Network Modernisation and Upgrade being implemented; or
- b) where it is not practicable for prior notice to be given, the Access Provider must provide the Access Seeker with an Individual Notification as soon as reasonably practicable after the Emergency Network Modernisation and Upgrade is implemented.

Coordinated Capital Works Program

10.10 The Access Provider must provide the Access Seeker with a written three year Coordinated Capital Works Program forecast in accordance with clause 10.11 of this schedule 14 Calendar Days from the date this Schedule takes effect (**Coordinated Capital Works Program Forecast**).

10.11 The Coordinated Capital Works Program Forecast will:

- a) be for the three year period commencing on the date the forecast is provided;
- b) describe generally the Access Provider's indicative investment plans (as at the date of the forecast) for its Coordinated Capital Works Program over the next three years;
- c) include an evaluation of the impact that the Access Provider's indicative investment plans may have on individual ESAs and Distribution Areas; and
- d) specify anticipated timeframes for implementation.

10.12 The Access Provider must update the Coordinated Capital Works Program Forecast (and provide the update forecasts in writing to the Access Seeker) regularly, at not less than six Month intervals.

10.13 At the same time as the Access Provider provides a Coordinated Capital Works Program Forecast under clause 10.10 of this Schedule, the Access Provider must provide a copy of the Coordinated Capital Works Program Forecast to the ACCC.

10.14 The Access Provider must provide a written Coordinated Capital Works Program schedule to the Access Seeker by giving notice not less than 12 Months before the anticipated commencement date of the Coordinated Capital Works Program in accordance with clause 10.15 of this Schedule (**Coordinated Capital Works Program Schedule**).

10.15 The Access Provider must provide the Coordinated Capital Works Program Schedule and make its best endeavours to identify:

- a) the ESAs and Distribution Areas affected;
- b) the Access Provider's plan for the Coordinated Capital Works Program for each ESA;
- c) the Access Seeker's Services in that Exchange that will be affected and the expected impact of the Coordinated Capital Works Program on the Access Seeker's Services; and
- d) the anticipated timeframe for implementation of the Coordinated Capital Works Program.

10.16 At the same time as the Access Provider provides a Coordinated Capital Works Program Schedule under clause 10.15 of this Schedule, the Access Provider must provide a copy of the Coordinated Capital Works Program Schedule to the ACCC.

10.17 For the avoidance of doubt, the Access Provider must also comply with clauses 10.1 to 10.8 of this Schedule when complying with clauses 10.10 to 10.16 of this Schedule.

10.18 The Access Provider is taken to have complied with clause 10.10 if it has complied with subparagraph 11.1(a) in Schedule 4 of the Structural Separation Undertaking.

Negotiations in good faith

10.19 Except where the parties agree otherwise, the Access Provider must not commence implementation of a Major Network Modernisation and Upgrade unless:

- a) it complies with clauses 10.1 to 10.8; and
- b) it has consulted with the Access Seeker and has negotiated in good faith, and addressed the reasonable concerns of the Access Seeker in relation to the Major Network Modernisation and Upgrade.

10.20 Except where the parties agree otherwise, the Access Provider must not commence the implementation of a Coordinated Capital Works Program unless:

- a) it complies with clauses 10.14 to 10.16 of this Schedule; and
- b) it has consulted with the Access Seeker and has negotiated in good faith, and addressed the reasonable concerns of the Access Seeker in relation to the Coordinated Capital Works Program.

10.21 Notwithstanding any continuing negotiations between the Access Provider and the Access Seeker pursuant to clauses 10.1, 10.19 and 10.20, if the Access Provider has complied with this Schedule 10, a Major Network Modernisation and Upgrade may proceed within a reasonable time period, taking account of all the circumstances, after an Individual Notification has been issued, unless both parties agree otherwise.

10.22 In attempting to reach a mutually acceptable resolution in relation to a variation under clauses 10.1, 10.19 and 10.20, the parties must recognise any need that the Access Provider may have to ensure that the specifications for the Services which the Access Providers

supplies to more than one of its customers need to be consistent (including, without limitation having regard to the incorporation by the Access Provider of any relevant international standards).

Dispute Resolution

10.23 If a dispute arises in relation to a Major Network Modernisation and Upgrade, then the matter may be resolved in accordance with the dispute resolution procedures set out in Schedule 5 of this FAD.

Miscellaneous

10.24 A requirement for the Access Provider to provide information in written form includes provision of that information in electronic form.

10.25 Any information provided by the Access Provider in electronic form must be in a text-searchable and readable format.

Schedule 11 - Changes to operating manuals

11.1 Operational documents concerning the Service that have been provided to the Access Seeker by the Access Provider, or should be provided because they affect the supply of the Service including the technical and operational quality of the Service, or affect the rights and/or obligations of an Access Seeker, may be amended:

- (a) by the Access Provider from time to time to implement or reflect a change to its standard processes, subject to:
 - i. giving 20 Business Days prior written notice to the Access Seeker including a documented list of all amendments, and a marked-up copy of the proposed new operational document that clearly identifies all amendments; and
 - ii. allowing the Access Seeker to provide comments during the notice period on the proposed amendments, and where provided, the Access Provider having reasonably considered those comments and implemented any such comments where the Access Provider considers it reasonable to do so; and
- (b) otherwise, by agreement of the parties.

11.1A Operational documents referred to in this clause include ordering and provisioning manuals, fault management procedures and operational manuals.

11.1B For the purposes of 11.1(a)(ii), an Access Provider in considering whether it is reasonable for it to implement any comments may consider whether the changes reflect all Access Seeker and the Access Provider's interests.

11.2 Upon completion of the process set out in clause 11.1, the Access Provider must notify the Access Seeker and make available to the Access Seeker a copy of the new operational document

11.3 Where operational documents concerning the Service are amended in accordance with clause 11.1 and the Access Seeker believes that the amendments:

- a) are unreasonable; or
- b) deprive the Access Seeker of a fundamental part of the bargain it obtained under this FAD;

the Access Seeker may seek to have the matter resolved in accordance with the dispute resolution procedures set out in Schedule 5 of this FAD.

Schedule 12 – Resale services (Wholesale ADSL only)

12.1 The Access Seeker can acquire a Service for the purpose of supplying to a Reseller.

12.2 The Access Seeker is not required to:

- a) notify the Access Provider when the Access Seeker acquires, or seeks to acquire, a Service for the purpose of supplying a Reseller; and/or
- b) obtain the Access Provider’s consent to that supply.

Schedule 13 (a) – Ordering and provisioning (Managed Network Migrations to the ULLS and the LSS)

Minimum number of services

- 13.1 Except where the parties agree otherwise, it is at the discretion of the Access Seeker whether a particular Service is to be connected as part of any managed network migration (MNM), or outside of an MNM.
- 13.2 The Access Seeker will notify the Access Provider at the time the order is made whether a particular Service is to be connected as part of an MNM or outside of an MNM.
- 13.3 Except where the parties agree otherwise, there is no minimum number of services required as a pre-requisite for requesting an MNM.

Migration plan terms (forecasting timeframes)

- 13.4 Unless the parties agree otherwise, the period of notice that an Access Seeker must give for an MNM is 56 Calendar Days.
- 13.5 Subject to clause 13.6, the Access Provider must not cancel an MNM where the number of Services to be cutover as specified in the 20 Business Day forecast differs to the number of Services specified in the 56 Calendar Day forecast.
- 13.6 If the cutover of Services cannot occur within the 56 Calendar Day forecast period because of a significant variation between the 56 Calendar Day forecast and the 20 Business Day forecast, the Access Provider must take all reasonable steps to ensure that cutover occurs as soon as practicable following the conclusion of that period.
- 13.7 For the purpose of this determination a reference to a significant variation refers to a variation of more than 10 per cent of the MNM forecast.

Note: for instance the cutover may not occur because of a significant variation between the 56 Calendar Day forecast and the 20 Business Day forecasts.

Connections outside Business Hours

- 13.8 Except where the parties agree otherwise, it is at the discretion of the Access Seeker whether a particular Service is to be connected within Business Hours or outside of Business Hours.

Note: additional charges may be payable for work done outside of Business Hours.

Limits on the number of exchanges per state per day at which MNM cutovers can be scheduled

- 13.9 Except where the parties otherwise agree, and subject to clause 13.10, the Access Provider must not refuse to schedule a cutover for an MNM at an Exchange because the Access Seeker has requested an MNM cutover at another Exchange or other Exchanges in that

state on the same day.

13.10 The Access Provider may refuse a requested MNM cutover date where it would be inconsistent with a capacity limitation notice (**Limitation Notice**), provided that the Access Provider has published the Limitation Notice on its website, and has, on the Access Seeker's request, provided a copy of the notice to the Access Seeker as soon as is practicable.

- a) For the avoidance of doubt, a request by an Access Seeker for a copy of a Limitation Notice may be made generally for all future Limitation Notices or for one or more specific Limitation Notices.

13.11 The Limitation Notice must specify:

- a) the limit that is to apply
- b) the period and the ESAs to which it applies; and
- c) the reasons for the limit being necessary by reference to forecast demand and available capacity.

13.12 The Limitation Notice lapses 60 Calendar Days after it is published, unless withdrawn earlier.

Note: Another Limitation Notice may be issued to replace a lapsed notice.

13.13 The Access Provider must not unreasonably refuse to vary or withdraw the Limitation Notice on the request for an Access Seeker.

13.14 Where an Access Seeker disagrees with a decision made by the Access Provider not to vary or withdraw the Limitation Notice, the Access Seeker may seek dispute resolution in accordance with the dispute resolution procedures set out in Schedule 5 of this FAD.

Capacity Limits on ULLS provisioning

13.15 Except where the parties agree, and subject to clause 13.16, the Access Provider must not unreasonably limit the number of Services that can be provisioned per day at a particular Exchange and must use its best endeavours to supply all requested cutovers for a particular day.

13.16 The Access Provider may refuse a requested cutover for a Service at a particular Exchange where it is not reasonably able to perform the cutover on that day having regard to the volume of work orders, for that Exchange or for all Exchanges, and the labour that is available on that day, subject to the Access Provider performing the cutover the following Business Day.

Advice regarding Complex Services affecting ULLS orders

13.17 Except where the parties agree otherwise, where:

- a) an Access Seeker has submitted a ULLS request; and
- b) the Service Qualification query fails due to the presence of Complex Services on the line,
the Access Provider will provide to the Access Seeker a list of the Complex Services present on the line at the time it advises the Access Seeker of the results of the Service Qualification query.

Schedule 13 (b) - New ULLS ordering and provisioning processes (LSS to ULLS Transfer processes)

Scope

13.18 Except where the parties subsequently agree otherwise, clauses 13.18 to 13.23 apply where an Access Seeker requests the Transfer of a LSS to a ULLS from the Access Provider.

Terms

13.19 The Access Seeker must provide instructions about whether or not the Transfer should occur as part of a MNM in accordance with the MNM forecasting timeframes and notice periods specified in clauses 13.4 to 13.7 of this FAD, or as otherwise agreed between the parties.

13.20 The Access Provider must take all reasonable efforts to comply with the Access Seekers instructions provided pursuant to clause 13.19.

13.21 Both the Access Provider and the Access Seeker must allow for the Transfer of the LSS to ULLS in accordance with the following minimum characteristics:

- a) the period in which a LSS to ULLS Transfer is performed (that is, the period in which a LSS is disconnected and a ULLS is connected) will be no longer than four hours;
- b) a Transfer must not require end-user involvement with the Access Provider (including, without limitation, the making of a telephone call or sending of correspondence by the end-user to the Access Provider). A request for a LSS to ULLS Transfer will be deemed a cancellation of any existing PSTN line rental and LSS provided the Access Seeker has obtained the necessary customer authority for the cancellation of end-user PSTN services;
- c) a Transfer is commenced and executed by a single provisioning order from the Access Seeker to the Access Provider; and
- d) the Access Provider will charge the Access Seeker a single charge for undertaking a LSS to ULLS Transfer whether the Transfer occurs as a single connection or as part of an MNM.

13.22 The Access Provider must ensure that the development and implementation of the LSS to ULLS Transfer process will result in no changes to how the Access Seeker currently interfaces to the ULLS Carrier Interface System (ULLCIS).

Connect Outstanding process for ULLS order

13.23 Except where the parties agree otherwise, the Access Provider will maintain a Connect Outstanding process for the ULLS from the Commencement Date.

13.24 The Connect Outstanding process for the ULLS must:

- a) support the cancellation of an existing service on a line upon the Access Provider receiving from the Access Seeker advice that the Access Seeker has obtained Proof of Occupancy; and,

- b) facilitate the connection of a ULLS in response to a ULLS request submitted by an Access Seeker in respect of that line.

Schedule 14 – Recourse to regulated terms

14.1 Unless otherwise agreed by the parties, if

- (a) an Access Agreement between an Access Provider and an Access Seeker is in force and the Access Agreement relates to access to the same Service which one of the FADs relates to;
- (b) the ACCC makes or varies a Regulatory Determination in relation to the Service and the new Regulatory Determination or the variation deals with a matter other than price; and
- (c) a party to the Access Agreement proposes, by written notice, to the other party to vary the Access Agreement to reflect the terms and conditions in the new or varied Regulatory Determination about that matter,

each party must:

- (i) consider the proposed changes in good faith; and
- (ii) negotiate the proposed changes in good faith for a reasonable period not exceeding 20 Business days unless a longer period of time is agreed in writing, including, if requested by the other party, to meet with the other party to discuss the other party's proposal.

14.1A If the process under clause 14.1 does not result in a variation to the Access Agreement, this is not a Non-Billing Dispute or Billing Dispute for the purposes of this FAD.

14.2 Unless otherwise agreed by the parties, if

- (a) an Access Agreement between an Access Provider and an Access Seeker is in force and the Access Agreement relates to access to the same Service which one of the FADs relates to; and
- (b) the ACCC makes or varies a Regulatory Determination in relation to the Service and the new Regulatory Determination or the variation deals with a matter other than price;

either party may terminate the Access Agreement in respect of that Service (but only in respect of that Service) by providing the other party with a written notice, and termination will take effect on the expiry of the period specified in the notice, which must be no less than 120 Business Days after the day that notice is provided.