Australian
Competition &
Consumer
Commission

**IMPUTATION TESTING AND NON-PRICE TERMS AND CONDITIONS REPORT RELATING TO THE**

**ACCOUNTING SEPARATION OF TELSTRA**

**FOR THE DECEMBER QUARTER 2010**

**March 2011**

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## Glossary and acronyms

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

# Summary

This is the 28th set of reports produced in accordance with a direction issued by the Minister for Communications, Information Technology and the Arts on 19 June 2003.

The reports are intended to provide greater transparency of Telstra's operations to ensure that it does not unfairly discriminate between access seekers using its network and its own retail operations.

*Imputation testing*

Imputation testing is designed to reveal whether sufficient margins exist between Telstra's retail prices and the prices Telstra charges access seekers to use its network (plus related costs) to enable equally efficient access seekers to compete in retail telecommunications markets.

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

Imputation testing has been undertaken for the following retail services: local calls and line rental, domestic and international long-distance calls, fixed-to-mobile calls and ADSL services (both stand-alone and bundled).

For the December 2010 quarter, Telstra passed the imputation tests for:

- domestic and international long-distance calls for both business and residential customers
- fixed-to-mobile calls for both business and residential customers
- the bundle of fixed-line voice telephony services for residential customers
- bundled ADSL and fixed voice services for business customers.

However, Telstra failed the imputation tests for:

- local call services (line rental and local calls combined) for both residential and business customers
- the bundle of fixed-line voice telephony services for business customers and the total bundle of fixed-line voice telephony services
- stand-alone ADSL services for business and residential customers, and
- bundled ADSL and fixed telephony services for residential customers.

Particular trends of note in the December 2010 quarter imputation report are:

- The margins for local call services (line rental and local calls combined) for both business and residential customers remained highly negative. There was a slight improvement in the margin for residential customers.
- The margin for international long-distance calls for residential customers continued to decline since the March 2010 quarter. This decline has been caused by a decline in retail price coupled with an increase in unit cost.

- The margin for the bundle of fixed voice services (total) remains negative. This is only the second time since the ACCC commenced imputation testing that this margin has been negative.
- The margin for ADSL services for residential customers remains negative and continues to worsen in the December 2010 quarter. This has been caused by a decrease in retail price compounded by rising unit cost and access price.

*Non-price terms and conditions key performance indicators*

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

The December quarter results indicate a mixed performance from Telstra in achieving the same level of service for its wholesale business customers as its retail business customers. For six out of eleven performance metrics, Telstra has exceeded its target for its wholesale customers when compared with its retail customers. For residential customers, the results indicate a mainly positive performance for Telstra achieving similar levels of performance for its wholesale and retail customers.

Of particular concern is Metric 3 (business and residential), Metric 5 (business and residential), and Metric 9 (residential), which report worse service levels for wholesale customers against retail customers with a variance of greater than the two per cent tolerance threshold.

For Metric 3 (new basic access service which requires additional cable of network capacity), Telstra advise that the variances for business customers are due to the lower number of wholesale orders than retail orders. For Metric 5 (basic access faults that are rectified in the quarter, on or by the performance standard), Telstra advise that the result is due to process changes which are inadvertently causing delays in response times and processing faults. Telstra state that this issue is under further investigation to determine an appropriate cause of action. While for Metric 9 (ADSL service activation – held orders), Telstra advise that the variance is due to the small number of orders held and that this is a statistically insignificant result.

The ACCC will continue to monitor Telstra's performance against the relevant threshold tests in ensuing quarters to ensure that results return to appropriate levels.

# 1 Introduction

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

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

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

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

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

The comments are to include any qualifications that the ACCC considers necessary.

For the imputation report, the ACCC must also summarise the results of the imputation analysis.

## 1.1 Purpose of the reports

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

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

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

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

## 1.2 Limitations of the Reports

It should be noted that there are limitations associated with the information published in this report. In particular, the information captured under these arrangements is highly aggregated and can hide specific instances of anti-competitive behaviour. Further, accounting separation only requires a notional allocation of costs across wholesale and retail operations, and therefore does not contribute greatly to detecting and remedying specific occurrences of anti-competitive conduct. As a result, it does not completely remove incentives for Telstra to favour the company's retail operations. It does not compel Telstra to ensure that it consistently applies equivalent treatment of its wholesale and retail customers in the normal course of business.

# 2 Imputation report

## 2.1 Introduction to the imputation RKR

This section presents the imputation analysis of core telecommunications services supplied to access seekers. 'Core services' refer to wholesale services—the local carriage service (LCS), domestic PSTN originating access service (PSTN-O), domestic PSTN terminating access service (PSTN-T), and unconditioned local loop service (ULLS). These are the underlying services in the provision of certain retail services.

The imputation tests are conducted in accordance with an ACCC record keeping rule that was issued in September 2004.[3]

The primary objective of the reports provided under the imputation RKR is to indicate whether Telstra is engaging in systemic price squeeze behaviour in relation to core telecommunications services.[4] However, a 'fail' result for an imputation test does not exclusively determine that Telstra has contravened the competition provisions of the Act.

## 2.2 Background

### 2.2.1 Vertical price squeezing

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

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

If the difference between the retail price and the wholesale access price is not sufficient to cover Telstra's network transformation and retail costs of supply, competitors who are equally efficient as Telstra in the supply of the retail services may not be able to remain in the market, as their profit margins would be negative. Imputation testing can therefore be used as a first step in detecting possible price squeezes in a retail market. Given the aggregated nature of the data in this report, imputation testing results alone should not be solely relied upon to determine that a price squeeze is occurring.

### 2.2.2 What are the elements of an imputation test?

An imputation test compares:

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

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

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

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

## 2.3 The imputation tests in this RKR

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

- local calls and line rental, which use the LCS
- domestic long-distance calls, which use the PSTN-O/T services
- outgoing international calls, which use the PSTN-O services
- fixed-to-mobile calls, which use the PSTN-O services
- ADSL services, which use the ULLS.

There are three main variables in an imputation test:

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

The imputation RKR details how each variable is calculated. The results are presented in tables 2.1 to 2.4 of this report.

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

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

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

The imputation RKR requires Telstra to provide data calculated on both a historical cost accounting basis and a current cost accounting basis.[5]

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

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

- The 'imputed margin' is calculated by subtracting the 'access price' and 'unit cost' from the 'retail price' for each retail service. This 'imputed margin' (in dollar terms) represents the profit margin that could be available to Telstra's competitors in the

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

retail markets, who are equally efficient as Telstra, if they supply the retail service to their customers using Telstra's core service.[6]

- The 'imputed margin' is further expressed as a percentage of the retail price.

## 2.4 Results submitted by Telstra

### 2.4.1 Current quarter results

In accordance with the ACCC's imputation testing RKRs, Telstra has submitted imputation reports in relation to the December 2010 quarter for both fixed-line voice telephony services and ADSL services. These reports are shown in the following Tables 2.1 to 2.4.

Separate reports are presented based on historical accounting costs and current accounting costs.

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

**Table 2.1: Fixed Telephony Report for December 2010 Quarter on Historic Cost basis**

| | Local carriage service | | Domestic PSTN originating and terminating access services | | Domestic PSTN originating access service | | | | Total Bundle of Fixed Voice Products | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Local calls and Line rental | | Domestic long distance | | International long distance | | Fixed to mobile | | Bundle | | |
| | Business | Residential | Business | Residential | Business | Residential | Business | Residential | Business | Residential | Total |
| Revenues | | | | | | | | | | | |
| retail | 203,314,788 | 474,645,874 | 30,103,987 | 102,223,207 | 3,861,708 | 28,569,326 | 75,657,539 | 172,982,885 | 312,938,022 | 778,421,292 | 1,091,359,314 |
| other | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| total | 203,314,788 | 474,645,874 | 30,103,987 | 102,223,207 | 3,861,708 | 28,569,326 | 75,657,539 | 172,982,885 | 312,938,022 | 778,421,292 | 1,091,359,314 |
| | | | | | | | | | | | |
| Retail Costs | | | | | | | | | | | |
| organisation | 21,647,323 | 54,683,062 | 1,620,556 | 7,728,571 | 216,356 | 2,303,042 | 3,724,519 | 7,441,257 | 27,208,755 | 72,155,932 | 99,364,687 |
| product and consumer | 31,470,372 | 79,204,365 | 3,019,164 | 14,398,652 | 1,154,053 | 12,284,511 | 28,702,269 | 57,344,572 | 64,345,858 | 163,232,100 | 227,577,958 |
| total | 53,117,695 | 133,887,427 | 4,639,720 | 22,127,222 | 1,370,409 | 14,587,553 | 32,426,788 | 64,785,829 | 91,554,613 | 235,388,032 | 326,942,645 |
| | | | | | | | | | | | |
| Other Costs | | | | | | | | | | | |
| organisation | 0 | 0 | 41,179 | 196,387 | 22,487 | 239,367 | 337,657 | 674,609 | 401,323 | 1,110,362 | 1,511,686 |
| product and consumer | 0 | 0 | 5,365 | 25,588 | 3,761 | 40,034 | 58,167 | 116,212 | 67,293 | 181,834 | 249,127 |
| network expenses | 0 | 0 | 109,981 | 524,511 | 36,348 | 386,909 | 893,902 | 1,785,937 | 1,040,231 | 2,697,357 | 3,737,588 |
| total | 0 | 0 | 156,526 | 746,486 | 62,596 | 666,310 | 1,289,726 | 2,576,757 | 1,508,848 | 3,989,553 | 5,498,401 |
| | | | | | | | | | | | |
| Ancilliary* | N/A | N/A | 311,000 | 1,483,186 | 7,341 | 78,147 | 165,502 | 330,658 | 483,843 | 1,891,991 | 2,375,835 |
| Cost of Capital | 12,160,934 | 30,880,800 | 1,155,134 | 5,508,934 | 195,650 | 2,082,630 | 3,854,477 | 7,700,900 | 17,366,195 | 46,173,265 | 63,539,460 |
| | | | | | | | | | | | |
| Retail Volume* | 2,057,843 | 5,310,565 | 226,429,814 | 1,079,863,239 | 10,690,135 | 113,792,952 | 240,994,084 | 481,484,670 | | | |
| | | | | | | | | | | | |
| Retail price | $98.80 | $89.38 | $0.13 | $0.09 | $0.36 | $0.25 | $0.31 | $0.36 | $152.07 | $146.58 | $148.11 |
| Access price | $100.09 | $86.85 | $0.02 | $0.02 | $0.01 | $0.01 | $0.01 | $0.01 | $104.40 | $91.79 | $95.31 |
| Unit cost | $31.72 | $31.03 | $0.03 | $0.03 | $0.15 | $0.15 | $0.16 | $0.16 | $53.90 | $54.13 | $54.06 |
| Imputed margin | -$33.01 | -$28.50 | $0.08 | $0.05 | $0.20 | $0.09 | $0.14 | $0.19 | -$6.23 | $0.66 | -$1.26 |
| Imputed margin | -33.41% | -31.89% | 61.55% | 51.91% | 54.89% | 35.54% | 45.55% | 53.00% | -4.10% | 0.45% | -0.85% |

**Table 2.2: Fixed Telephony Report for December 2010 Quarter on Current Cost basis**

| | Local carriage service | | Domestic PSTN originating and terminating access services | | Domestic PSTN originating access service | | | | Total Bundle of Fixed Voice Products | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Local calls and Line rental | | Domestic long distance | | International long distance | | Fixed to mobile | | Bundle | | |
| | Business | Residential | Business | Residential | Business | Residential | Business | Residential | Business | Residential | Total |
| Revenues | | | | | | | | | | | |
| retail | 203,314,788 | 474,645,874 | 30,103,987 | 102,223,207 | 3,861,708 | 28,569,326 | 75,657,539 | 172,982,885 | 312,938,022 | 778,421,292 | 1,091,359,314 |
| other | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| total | 203,314,788 | 474,645,874 | 30,103,987 | 102,223,207 | 3,861,708 | 28,569,326 | 75,657,539 | 172,982,885 | 312,938,022 | 778,421,292 | 1,091,359,314 |
| | | | | | | | | | | | |
| Retail Costs | | | | | | | | | | | |
| organisation | 21,007,772 | 53,068,416 | 1,565,801 | 7,467,440 | 209,116 | 2,225,966 | 3,598,301 | 7,189,085 | 26,380,990 | 69,950,906 | 96,331,896 |
| product and consumer | 31,423,050 | 79,084,891 | 3,015,113 | 14,379,334 | 1,153,517 | 12,278,809 | 28,692,931 | 57,325,914 | 64,284,611 | 163,068,948 | 227,353,559 |
| total | 52,430,822 | 132,153,306 | 4,580,914 | 21,846,774 | 1,362,633 | 14,504,775 | 32,291,232 | 64,514,999 | 90,665,601 | 233,019,854 | 323,685,454 |
| | | | | | | | | | | | |
| Other Costs | | | | | | | | | | | |
| organisation | 0 | 0 | 41,926 | 199,950 | 22,387 | 238,305 | 334,722 | 668,744 | 399,035 | 1,107,000 | 1,506,035 |
| product and consumer | 0 | 0 | 5,421 | 25,852 | 3,754 | 39,956 | 57,949 | 115,778 | 67,124 | 181,585 | 248,709 |
| network expenses | 0 | 0 | 109,981 | 524,511 | 36,348 | 386,909 | 893,902 | 1,785,937 | 1,040,231 | 2,697,357 | 3,737,588 |
| total | 0 | 0 | 157,329 | 750,313 | 62,489 | 665,170 | 1,286,573 | 2,570,459 | 1,506,390 | 3,985,942 | 5,492,332 |
| | | | | | | | | | | | |
| Ancillary* | N/A | N/A | 311,000 | 1,483,186 | 7,341 | 78,147 | 165,502 | 330,658 | 483,843 | 1,891,991 | 2,375,835 |
| | | | | | | | | | | | |
| Cost of Capital | 11,894,617 | 30,208,444 | 1,155,111 | 5,508,824 | 193,799 | 2,062,925 | 3,784,006 | 7,560,106 | 17,027,533 | 45,340,299 | 62,367,833 |
| | | | | | | | | | | | |
| Retail Volume* | 2,057,843 | 5,310,565 | 226,429,814 | 1,079,863,239 | 10,690,135 | 113,792,952 | 240,994,084 | 481,484,670 | | | |
| | | | | | | | | | | | |
| Retail price | $98.80 | $89.38 | $0.13 | $0.09 | $0.36 | $0.25 | $0.31 | $0.36 | $152.07 | $146.58 | $148.11 |
| Access price | $100.09 | $86.85 | $0.02 | $0.02 | $0.01 | $0.01 | $0.01 | $0.01 | $104.40 | $91.79 | $95.31 |
| Unit cost | $31.26 | $30.57 | $0.03 | $0.03 | $0.15 | $0.15 | $0.16 | $0.16 | $53.30 | $53.52 | $53.46 |
| Imputed margin | -$32.54 | -$28.05 | $0.08 | $0.05 | $0.20 | $0.09 | $0.14 | $0.19 | -$5.63 | $1.27 | -$0.66 |
| Imputed margin | -32.94% | -31.38% | 61.74% | 52.18% | 55.14% | 35.90% | 45.82% | 53.24% | -3.70% | 0.86% | -0.45% |

Notes to Tables 2.1 and 2.2: All retail volumes are reported in minutes with the exception of the local carriage service where volumes are in SIOs.

**Table: 2.3 - ULLS Report for December 2010 Quarter on Historic Cost basis**

| | Unconditioned Local Loop Service | | Unconditioned Local Loop Service | |
|---|---|---|---|---|
| | ADSL Service | | ADSL, local calls, line rental, domestic long distance, international and fixed to mobile | |
| | Business | Residential | Business 1 x ADSL Service + 4 x Voice Lines | Residential 1 x ADSL Service + 1 x Voice Lines |
| **Revenues** | | | | |
| **retail** | 78,879,619 | 216,643,630 | 303,862,458 | 438,095,207 |
| **other** | 0 | 0 | 0 | 0 |
| **total** | 78,879,619 | 216,643,630 | 303,862,458 | 438,095,207 |
| | | | | |
| **Retail Costs** | | | | |
| **organisation** | 5,422,953 | 22,151,205 | 24,984,343 | 42,678,707 |
| **product and consumer** | 9,990,799 | 40,809,547 | 56,251,442 | 87,247,134 |
| **total** | 15,413,752 | 62,960,752 | 81,235,785 | 129,925,841 |
| | | | | |
| **Other Costs** | | | | |
| **organisation** | 8,118,876 | 33,163,279 | 8,411,289 | 35,065,480 |
| **product and consumer** | 815,293 | 3,330,238 | 6,643,710 | 8,969,553 |
| **network expenses** | 23,988,304 | 97,985,334 | 60,911,838 | 137,174,795 |
| **total** | 32,922,473 | 134,478,851 | 75,966,837 | 181,209,828 |
| | | | | |
| **Ancillary Charges (TEBA)** | 2,654,103 | 10,841,247 | 2,741,066 | 11,379,496 |
| **Cost of Capital** | 12,914,800 | 52,753,248 | 61,018,016 | 103,589,394 |
| | | | | |
| **Retail Volume** | 369,865 | 1,510,792 | 369,865 | 1,510,792 |
| **Retail price** | $213.27 | $143. 40 | $821.55 | $289.98 |
| **Access price** | $51.87 | $51.87 | $75.76 | $59.49 |
| **Unit cost** | $172.78 | $172.78 | $597.41 | $282.04 |
| **Imputed margin** | -$11.38 | -$81.25 | $148.38 | -$51.56 |
| **Imputed margin** | -5.34% | -56.66% | 18.06% | -17.78% |

**Table: 2.4 - ULLS Report for December 2010 Quarter on Current Cost basis**

| | Unconditioned Local Loop Service | | Unconditioned Local Loop Service | |
|---|---|---|---|---|
| | ADSL Service | | ADSL, local calls, line rental, domestic long distance, international and fixed to mobile | |
| | Business | Residential | Business 1 x ADSL Service + 4 x Voice Lines | Residential 1 x ADSL Service + 1 x Voice Lines |
| **Revenues** | | | | |
| **retail** | 78,879,619 | 216,643,630 | 303,862,458 | 438,095,207 |
| **other** | 0 | 0 | 0 | 0 |
| **total** | 78,879,619 | 216,643,630 | 303,862,458 | 438,095,207 |
| | | | | |
| **Retail Costs** | | | | |
| **organisation** | 5,232,243 | 21,372,209 | 24,198,522 | 41,272,408 |
| **product and consumer** | 9,976,716 | 40,752,022 | 56,193,325 | 87,143,194 |
| **total** | 15,208,959 | 62,124,231 | 80,391,848 | 128,415,601 |
| | | | | |
| **Other Costs** | | | | |
| **organisation** | 8,516,518 | 34,787,530 | 10,759,793 | 38,578,471 |
| **product and consumer** | 844,715 | 3,450,417 | 6,817,477 | 9,229,481 |
| **network expenses** | 23,988,303 | 97,985,332 | 60,911,841 | 137,174,796 |
| **total** | 33,349,536 | 136,223,279 | 78,489,111 | 184,982,749 |
| | | | | |
| **Ancillary Charges (TEBA)** | 2,654,103 | 10,841,247 | 2,741,066 | 11,379,496 |
| **Cost of Capital** | 6,764,939 | 27,632,835 | 83,141,842 | 107,674,550 |
| | | | | |
| **Retail Volume** | 369,865 | 1,510,792 | 369,865 | 1,510,792 |
| **Retail price** | $213.27 | $143.40 | $821.55 | $289.98 |
| **Access price** | $51.87 | $51.87 | $75.76 | $59.49 |
| **Unit cost** | $156.75 | $156.75 | $661.77 | $286.24 |
| **Imputed margin** | $4.64 | -$65.23 | $84.03 | -$55.76 |
| **Imputed margin** | 2.18% | -45.49% | 10.23% | -19.23% |

Notes to Tables 2.3 and 2.4

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

** Retail volumes are reported in terms of service in operations (SIOs).

## 2.5 Summary of results

### 2.5.1 Overview

***Background***

While imputation results based upon both historical and current cost have been presented, the following analysis focuses on the historical cost results.

There is generally little difference between the imputation results based on historical cost and current cost measures. While the use of current costs will generally be expected to increase the cost base and reduce imputed margins, this purported effect is limited by the use, in imputation tests, of access prices instead of Telstra's actual cost (based on current or historical cost accounts) of supplying the core service using its fixed assets.

The imputation RKR uses average total cost in calculating the cost of transforming Telstra's core service into a retail service. The ACCC believes that this measure provides an important indicator of the long-run impacts of particular pricing.[7]

The imputation tests are conducted on a fully allocated cost basis, that is, all direct and common costs incurred in providing the retail service are taken into consideration in estimating the imputed profit margin for each retail service.

Further, the imputation tests are conducted on the premise that an access seeker is at least as efficient as Telstra. This implies that, where the imputed margin for a service is positive, a competitor's inability to compete or to remain in the retail market is likely to be due to factors (such as its inefficiency) other than any alleged price squeeze behaviour by Telstra.

The aggregated nature of the imputation tests (that is, the use of high-level, averaged data) means that the imputation tests do not necessarily provide accurate reflections of commercial situations faced by each access seeker. Some access seekers may be competing for higher value customers or operating in lower cost areas, whereas the tests are conducted on a fully averaged basis. However, the results do allow certain conclusions to be made that are relevant for access seekers. For instance, the results indicate that in the absence of market developments, the use of the ULLS to supply competitive services will likely be limited to areas in which costs of supply are lower, and/or services are able to be directed to customers who yield higher revenues per service supplied, as compared with the average revenue and cost estimates used in these tests.

The ACCC considers that the principles on which the imputation tests are based are sound. Although some assumptions have been made to overcome data limitations (described in section 2.7). Telstra and the ACCC have worked together to ensure that these issues are treated appropriately.

As noted earlier, the results of imputation testing are a possible indicator of potentially anti-competitive behaviour but should not be solely relied upon.

***Results for the Quarter***

Table 2.5 provides a summary of the imputation test results for Telstra for the December 2010 quarter. A discussion of results in relation to the specific retail services is provided in sections 2.5.2 to 2.5.8.

For the December 2010 quarter, Telstra passes the imputation tests for:

- domestic and international long-distance calls for both business and residential customers

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[7] The ACCC has discussed this issue in its report, ACCC, *Bundling in telecommunications markets–an information paper,* August 2003.

- fixed-to-mobile calls for both business and residential customers
- the bundle of fixed-line voice telephony services for residential customers
- bundled ADSL and fixed telephony services for business customers.

Compared to the previous quarter, imputed margins for most services have fallen. The imputed margins for international long distance calls for residential customers and fixed-to-mobile calls for residential customers fell yet still remained highly positive. This means that there is still the opportunity for those access seekers, who are equally as efficient as Telstra, to compete for customers in these markets.

However, Telstra has failed the imputation tests for:

- local call services (line rental and local calls combined) for both residential and business customers
- the bundle of fixed-line voice telephony services for business and total customers
- stand-alone ADSL services for business and residential customers, and
- bundled ADSL and fixed telephony services for residential customers.

With respect to local call services, the imputed margins for both business and residential customers remain strongly negative. Although for residential customers, the margin improved during the quarter. While the imputed margins for local calls and line rental for business customers remain steady, the imputed margin for residential ADSL customers declined from negative 52 per cent to negative 57 per cent in the December 2010 quarter.

**Table 2.5: Telstra imputation testing results (on a historical cost basis)**

| | | | Dec | Mar | Jun | Sep | Dec | |
|---|---|---|---|---|---|---|---|---|
| | | | 2009 | 2009 | 2010 | 2010 | 2010 | |
| **Retail service** | **Core service(s)** | | | | | | | |
| **Local calls and line rental** | **LCS** | Business | –25% | -35% | -35% | -33% | -33% | Fail |
| | | Residential | –18% | -28% | -28% | -35% | -32% | Fail |
| **Domestic long-distance** | **PSTN–O/T** | Business | 67% | 63% | 64% | 63% | 62% | Pass |
| | | Residential | 60% | 54% | 53% | 53% | 52% | Pass |
| **International long-distance** | **PSTN–O** | Business | 44% | 59% | 62% | 55% | 55% | Pass |
| | | Residential | 33% | 48% | 48% | 42% | 36% | Pass |
| **Fixed-to-mobile** | **PSTN–O** | Business | 52% | 46% | 48% | 45% | 46% | Pass |
| | | Residential | 62% | 59% | 59% | 56% | 53% | Pass |
| **Bundle of fixed voice services #** | **LCS and PSTN–O/T** | Business | 5% | -3% | -2% | -3% | -4% | Fail |
| | | Residential | 13% | 6% | 5% | 0% | 0% | Pass |
| | | Total | 11% | 3% | 3% | -1% | -1% | Fail |
| **ADSL** | **ULLS** | Business | 8% | -2% | 1% | -3% | -5% | Fail |
| | | Residential | –38% | -55% | -53% | -52% | -57% | Fail |
| **Bundle of ADSL and fixed voice services *** | **ULLS and PSTN–T** | Business | 23% | 18% | 19% | 19% | 18% | Pass |
| | | Residential | –6% | -16% | -16% | -16% | -18% | Fail |

Source: Telstra imputation testing quarter reports for, December quarter 2009, March quarter 2010, June quarter 2010, September quarter 2010 and December quarter 2010, on a historical cost basis.

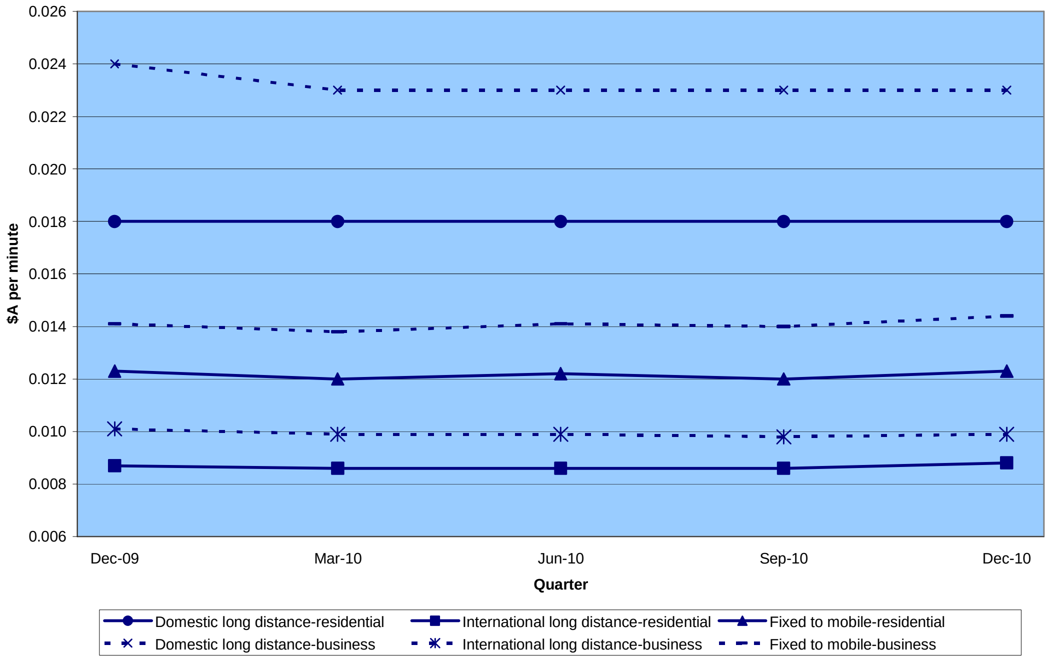
# The bundle of fixed voice services comprises local calls and line rental, domestic and international long-distance and fixed-to-mobile calls.

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

### *Access prices over four quarters*

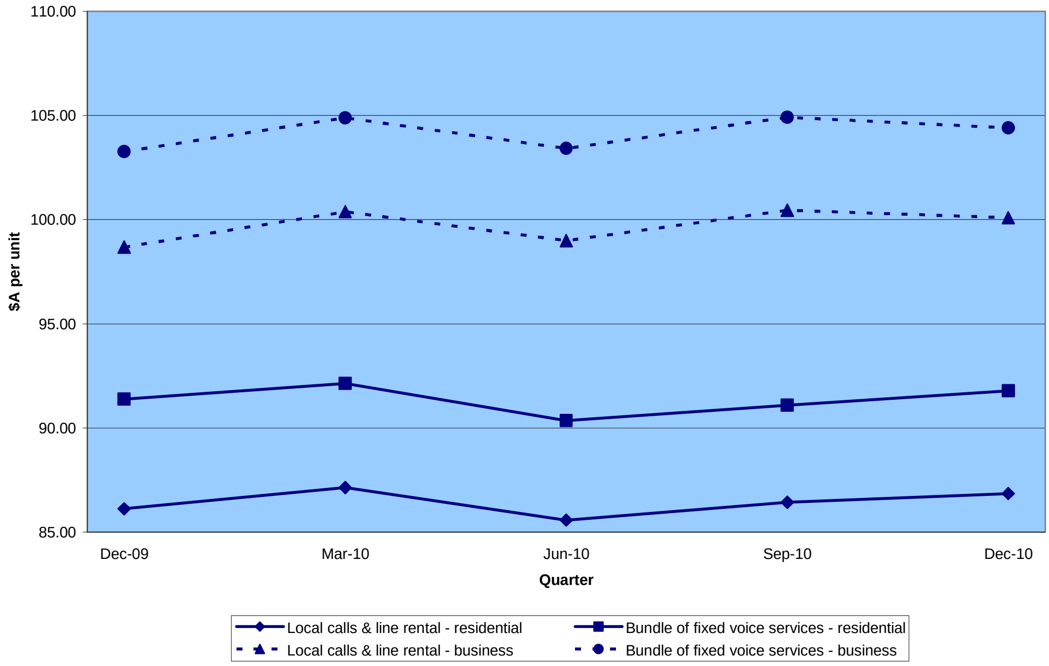
Telstra's estimates of the average access prices for the core services in relation to imputation testing are represented in figures 2.1 and 2.2 below.

**Figure 2.1: Average access prices for core services used in supplying domestic long-distance, international long-distance and fixed-to-mobile call services, December 2009 quarter to December 2010 quarter**



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

**Figure 2.2: Average access prices for core services used in supplying local call/ line rental services, and the fixed voice services bundle, December 2009 quarter to December 2010 quarter**




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

### 2.5.2 Line rental and local calls

Telstra reports a negative imputed margin for the supply of local calls and line rental for the December 2010 quarter. Telstra has failed the imputation test for the local call and line rental services in all quarters since reporting commenced.

In the December 2010 quarter, the imputed margin for residential line rental and local calls rose from negative 35 per cent to negative 32 per cent. This is an improvement from the last four quarters which saw a decline in the imputed margin for this service. For businesses, the imputed margin for local call and line rental services remained steady at negative 35 per cent for this quarter.

For the residential sector, the data indicates that the increased margin since the September 2010 quarter results mainly from an increase in the retail price of around three per cent, from $86.90 in the September 2010 quarter to $89.38 in the December quarter 2010. This increase is driven by an increase in revenues of nearly two percentage points and a decline in the service volume by nearly one per cent.

For the business sector, the imputed margin remained steady at 33 per cent.

### 2.5.3 Domestic and international long-distance and fixed-to-mobile calls

For domestic long-distance calls, international long-distance calls and fixed-to-mobile calls, Telstra has passed the imputation test in the December 2010 quarter. This means that Telstra would make a positive margin if it purchased the essential inputs, the PSTN-O/T, at arm's length from itself.

In this quarter, imputed margins for residential and business customers for domestic long-distance services remained nearly steady. For business customers, the imputed margin for this service declined slightly from 63 to 62 per cent, while for residential customers the imputed margin declined from 53 to 52 per cent.

The imputed margin for international long-distance services for business customers remained steady at 55 per cent in the December 2010 quarter following a 7 percentage points fall in margin in the September 2010 quarter. The imputed margin for residential customers fell by 6 percentage points when compared with the September 2010 quarter. The decline in the imputed margin for residential customers was caused primarily by a decline of the retail price of around 9 per cent. This change in retail price was caused by a rise in the volume of services by 7 per cent and a decline in revenue of nearly 3 per cent.

For fixed-to-mobile services the imputed margin for the business sector increased from 45 per cent to 46 per cent, while for the residential sector, the imputed margin declined from 56 per cent to 53 per cent. The imputed margin for fixed-to-mobile calls in the residential sector has declined from 62 per cent to 53 per cent since the December 2009 quarter. This has been caused by a decline of more than fourteen per cent for revenue which has led to a decline in retail price (from $0.41 to $0.36) as well as an increase in unit cost (from $0.14 to $0.16).

In calculating these margins, it is assumed that Telstra's fixed-to-mobile calls are terminated off-net, that is, on a mobile network other than Telstra's own mobile network. The ACCC estimates that the cost Telstra incurs to terminate a fixed-to-mobile call on its own network is less than that currently charged by other mobile network operators for the mobile terminating access service. Therefore, the imputed margins for fixed-to-mobile calls may be understated in this respect. The margins available to access seekers may also be higher to the extent that an access seeker can supply on-net fixed-to-mobile calls. This qualification is also relevant to the bundles that include fixed-to-mobile calls.

### 2.5.4 Bundle of fixed voice services

Imputation testing has also been undertaken for a bundle of fixed voice services, consisting of line rental and local, domestic and international long-distance and fixed-to-mobile calls. The business sector continues to report a negative margin and fails the imputation test. For the December 2010 quarter, the tests show the imputed margin for residential customers was zero. The imputed margins for business customers declined by around one percentage point compared to the previous quarter.

Since the December 2009 quarter, the imputed margin for a bundle of fixed voice services for business has declined from 5 per cent to negative 4 per cent. This has been driven by a decline in retail price from $159 to $152 and an increase in unit costs from $48 to $54. For residential customers, the decline in the imputed margin over this period was around 12 percent driven by lower retail price (from $161 to $147) and increased unit cost (from $49 to $54).

### 2.5.5 ADSL

Telstra has failed the imputation tests conducted on services that use the ULLS as a core service input in the December 2010 quarter.

The imputation tests indicate that Telstra would continue to make a negative margin if it purchased the essential input, the ULLS, at arms' length from itself, to supply only ADSL services for its customers. The margin for supplying a stand-alone ADSL service to residential customers declined from negative 52 per cent in the September 2010 quarter to negative 57 per cent in the December quarter 2010. For business customers, the imputed margin decreased by two percentage points from negative three per cent to negative five per cent.

The decline in the margin for residential customers since the September 2010 quarter has resulted from a decline in the retail price caused by the rise in revenue of two per cent being outstripped by a rise in volume of more than four per cent as well as an increase in unit cost by around five per cent. .

In assessing the reported cost for the December 2010 quarter, it should be noted that the test excludes costs associated with the installation, removal or connection of customer premise equipment.

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

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

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

- The imputation test uses the average total cost of transforming the ULLS into ADSL, which includes a pre-determined contribution to common costs. When ADSL services were relatively new, Telstra had expressed its view that access seekers would be unlikely to require ADSL services supplied over the ULLS to make a contribution to overheads and common costs. Demand for ADSL services has since experienced strong growth.[9]
- Telstra's product and overhead costs may not give an accurate representation of those costs faced by access seekers; in particular, those who are targeting niche areas and customers, particularly in the business/corporate segment.
- The test focuses on the use of ULLS to supply ADSL, but other retail services can be supplied in conjunction with ULLS (e.g. symmetric high-bitrate DSL) that may yield significantly higher retail revenues.
- On the other hand, the reported imputation tests exclude connection costs and revenues—should access seekers subsidise connections to acquire customers, their actual margins would be less (i.e. more negative) than those reported.

Notwithstanding the qualifications above (which could mean that actual margins differ from those reported under the current imputation test), the results suggest that any business model involving the use of ULLS to supply only ADSL to customers is unlikely to be sustainable. The

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

[9]For instance, the ABS internet data activity report for June quarter 2010 shows that non-dial up subscribers, which are dominated by digital subscriber line (DSL) access technology, represented 92 per cent of all internet connections at the end of December 2009 with 4.5 per cent increase since June 2009. See http://www.abs.gov.au/ausstats/abs@.nsf/mf/8153.0/.

tests that combine ADSL and voice services may therefore more accurately reflect current market conditions.

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

### 2.5.6 Bundle of ADSL and fixed voice services

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

Telstra reports a negative 18 per cent margin for the bundle of ADSL and fixed voice services for residential customers (comprising one ADSL service and one voice service). This indicates that a service provider as efficient as Telstra would incur a loss in supplying these services.

Telstra passes the imputation test on the bundle for business customers (comprising one ADSL service and four voice services) with the imputed margin of 18 per cent in the December 2010 quarter.

Given the bundle of ADSL and fixed voice services is made up of the ADSL service and voice services, the reasons outlined by Telstra for failing the stand-alone ADSL imputation test (as discussed in 2.5.5) are also relevant for Telstra failing the bundle of ADSL and fixed voice service for residential customers. Likewise the qualification for termination of fixed-to-mobile calls in section 2.5.3 is also relevant for these tests.

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

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

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

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

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

Finally, the ACCC notes that Telstra has been critical of the ability of the imputation tests using the ULLS to accurately depict market conditions faced by ULLS access seekers. For example, Telstra has argued that the ACCC should model access seekers' costs rather than basing the test on Telstra's costs. However, imputation testing is based on Telstra's costs in order to present the margins available on the ULLS for an access seeker at least as efficient as Telstra. The ACCC regards this as being the fundamental concept behind the imputation testing procedure and will retain the use of Telstra's costs in the test.

Telstra has provided additional imputation results for the ULLS/ADSL and voice services bundle that are prepared on the basis that certain geographically averaged transformation costs are replaced by costs specific to the geographic areas where ULLS is currently being supplied.[10]

The transformation costs that have been substituted concern the costs of termination of local calls that originate on an access seeker's ULLS. The geographically-specific termination costs are estimated from overall PSTN–O/T yields and the rate table specified in Telstra's 2004–05 PSTN-O/T access undertakings. Table 2.6 sets out the unadjusted and adjusted results.

**Table 2.6: Summary of imputed margins when local call termination charges are estimated on a geographic-specific basis, December quarter 2010**

| | ULLS Test | Business – 1 ADSL + 4 voice lines | Residential – 1 ADSL + 1 voice line |
|---|---|---|---|
| **Historic Cost Basis** | Unadjusted | 18.06% | -17.78% |
| | Adjusted | 18.38% | -17.53% |
| **Current Cost Basis** | Unadjusted | 10.23% | -19.23% |
| | Adjusted | 10.55% | -18.98% |

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

## 2.6 Reconciling imputation RKR data with the RAF

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

Ideally, the imputation test results would be based on retail price, access price and unit cost figures appropriate to the quarter. Telstra is able to obtain retail price and access price data from its management systems on a quarterly basis. However, the RAF report is published twice a year only (i.e. for the January–June and July–December reporting periods) and is not available until after the imputation testing results must be submitted to the ACCC. Imputation testing is therefore conducted using cost data from the last available half-year RAF report. For example, for this December 2010 quarter imputation report, the unit cost data was obtained from the RAF data for the period January to June 2010.

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

[10]The ULLS is predominantly supplied in urban areas (bands 1 and 2) with few services supplied outside those areas (bands 3 and 4). Telstra advised that as at 30 June 2010 around 4 per cent of ULLS were supplied in band 1, and 94 per cent in band 2. Source: Telstra CAN RKR Data June 2010.

In relation to this December quarter 2010 report, RAF data for the period July to December 2010 will be available when the next imputation report (for March quarter 2011) is prepared. A reconciliation report will be provided at that time.

## 2.7 Extent to which the reports comply with the RAF and other RKRs

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

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

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

### 2.7.1 Relationship between the RAF and the imputation RKR

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

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

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

The RAF records volume information for retail and core services. The imputation RKR requires Telstra to use volume data for retail services from the RAF for the previous six months to unitise cost information. It also requires that volume data for the relevant quarter be used, which can later be compared to the volume data that appears in the RAF.[11]

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

### 2.7.2 Revenue differences between the imputation RKR and the RAF

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

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

- The domestic long-distance service in the imputation RKR excludes revenues from operator-assisted calls, which are included in the corresponding RAF category.

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[11]The ACCC has released some volume information pursuant to section 151BUA of the Act. See, for example, ACCC, Telecommunications market indicators report 2004-05 (published in July 2006).

Therefore, the domestic long-distance revenues in the RKR will be lower than the RAF revenue for the national long-distance retail service.

- The RAF fixed-to-mobile service includes ISDN-originated calls.

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

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

### 2.7.3 Cost differences between the imputation RKR and the RAF

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

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

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

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

***Mobile termination methodology for fixed-to-mobile services***

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

***Double-counting ULLS and PSTN originating and terminating costs***

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

To overcome this issue, Telstra deducts the common elements located in the External Wholesale accounts (which are used to calculate the access price) from the costs located in the Internal Wholesale accounts in the RAF. This adjustment is done at a relatively high level, and Telstra and ACCC are considering whether more precise adjustments could be made in future imputation tests.

***Non-ULLS call costs***

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

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

***Ancillary charges***

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

#### 2.7.4 Conclusion on the extent to which the reports comply with the RAF

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

### 2.8 Accuracy of the imputation RKR reports

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

#### 2.8.1 Audit process

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

#### 2.8.2 Accuracy of report

Given that the underlying Telstra data used in the December 2010 quarter results have not yet been audited, the ACCC cannot conclusively state whether the reports provided by Telstra for the period comply in all respects with the imputation RKR.

The ACCC also notes that it has identified throughout this report particular factors which should be considered in assessing whether imputation test results prepared under the imputation RKR give an accurate indication of the margins actually available to access seekers competing with Telstra in the retail markets.

# 3 Non-price terms and conditions report

## 3.1 Overview

### 3.1.1 What does this report do?

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

The KPIs are on the ordering and provisioning (i.e. the connection of new services) and handling of faults for the basic access service and the ADSL service. The KPIs measure Telstra's basic access service levels against the standard specified in the customer service guarantee (CSG)[12] and Telstra's ADSL service levels against similar standards. Separate KPIs are presented for residential and business services.

The reporting of KPIs is intended to provide an initial indicator to the public, industry and the government of whether or not Telstra's systems or processes are impeding Telstra in providing equivalent service levels, on average, to Telstra wholesale and Telstra retail customers, for example, by causing wholesale customers to receive a lesser or better quality of service than it provides to its retail customers.

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

### 3.1.2 Overview of reported KPIs

***Business services***

The current report indicates a mixed performance from Telstra in achieving the same level of service for its wholesale business customers as its retail business customers. For six performance metrics, Telstra has exceeded its target for its wholesale customers when compared with its retail customers. However, for five performance metrics, Telstra has exceeded its target for its retail customers when compared with its wholesale customers.

The current report raises two areas of concern. The first is in Metric 3, which represents the percentage of Basic Access customer installation orders provisioned in the quarter, on or by the performance standard for a new service which requires additional cable or network capacity. For the December 2010 quarter, Telstra has exceeded its target for this metric for its retail orders relative to its wholesale orders by almost ten per cent.

Telstra claims that this result is due to the low number of wholesale orders relative to retail orders.

The second area of concern is Metric 5, which represents the percentage of basic access faults that are rectified in the quarter on or by the performance standard. For this metric, the wholesale business customers received inferior levels of service than retail business customers during the quarter. Telstra claims this is due to process changes that are inadvertently causing delays in response times in processing faults. Telstra state that the issue is under further investigation to determine an appropriate course of action.

The performance of Telstra with regard to Metrics Three and Five is discussed further in section 3.4.

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

***Residential services***

The performance metrics in the December quarter and over the last four quarters, indicate a mainly positive performance for Telstra in achieving a similar level of service supplied to wholesale and retail residential customers. For seven performance metrics out of eleven, Telstra has exceeded its target for its wholesale customers when compared with its retail customers.

The current report raises two areas of concern. The first is in Metric 3, which represents the percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard for new service which requires additional cable or network capacity. For the December 2010 quarter, Telstra has exceeded its target for this metric for its retail orders relative to its wholesale orders by more than two per cent.

Telstra claims that this result is due to the low number of wholesale orders relative to retail orders.

Also of particular concern is the performance of Telstra with regard to the percentage of basic access faults that are rectified in the quarter, on or by the performance standard (Metric 5). Metric 5 had a variance of negative 3.16 per cent for residential customers in the December quarter and negative 1.94 per cent on average over the last four quarters. Telstra claims this is due to process changes that are inadvertently causing delays in response times in processing faults. Telstra state that the issue is under further investigation to determine an appropriate course of action.

For Metrics 9 and 10 Telstra met its performance target for its retail residential customers in a higher percentage of cases than it met its performance target for its wholesale customers. These differences, however, were within the two percentage point tolerance threshold.

## 3.2 KPIs for the quarter ending 31 December 2010

Table 3.1 presents Telstra's KPI report for the quarter.

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

Conversely, for any performance metric, if the difference between the percentage of wholesale customers and retail customers for which Telstra has met the performance standard is negative, then Telstra has performed worse in meeting the performance standard for its wholesale customers than its retail customers. A negative performance metric may indicate that Telstra is systematically discriminating in its own interests and against the interests of competitors in that area.

### Table 3.1: Telstra’s KPI report for non-price terms and conditions

**Ordering and Provisioning – Basic Access**

| Metric | Measure | The difference between percentage of Wholesale Business customers and Retail Business customers in meeting the target (that is, that have met the performance standard) | The difference between percentage of Wholesale Residential customers and Retail Residential customers in meeting the target (that is, that have met the performance standard) |
|---|---|---|---|
| 1 | The percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard – previous service available for automatic connection | 1.06% | 5.48% |
| 2 | The percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard – new service with available cabling and capacity | 3.81% | 3.14% |
| 3 | The percentage of Basic Access orders provisioned in the quarter, on or by the performance standard - new service which requires additional cable or network capacity | -9.83% | -2.42% |
| 4 | The percentage of basic access order appointments that are met in the quarter | 0.94% | 2.60% |

**Faults and Maintenance – Basic Access**

| Metric | Measure | The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard) | The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard) |
|---|---|---|---|
| 5 | The percentage of basic access faults that are rectified in the quarter, on or by the performance standard (Includes dial-up faults) | -3.15% | -3.16% |
| 6 | The percentage of basic access fault appointments that are met in the quarter (includes dial-up faults) | -0.03% | 0.21% |
| 7 | The percentage difference in recurring fault ratio | 0.03% | 0.55% |

**Service Activation – ADSL**

| Metric | Measure | The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard) | The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard) |
|---|---|---|---|
| 8 | The percentage of services provisioned within performance standards the performance standard – where the customer or end-user has an existing and functioning basic access service capable of supporting ADSL services | 0.63% | 0.37% |
| 9 | The percentage of services provisioned within performance standard – held orders | -7.69% | -0.61% |

**Faults and Maintenance – ADSL**

| Metric | Measure | The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard) | The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard) |
|---|---|---|---|
| 10 | The percentage of faults rectified within performance standards | -1.07% | -1.68% |
| 11 | The percentage of appointments kept | 2.79% | 0.51% |

**Notes:**

- The performance standard used for all metrics is the same as that used for the Customer Service Guarantee, unless otherwise stated.
- A positive difference means that Telstra Wholesale met the performance standard in a greater percentage of cases than Telstra Retail, that is, Telstra's performance in relation to Telstra Wholesale customers was better than for Telstra Retail customers.
- For metric 1-3 the performance standard = target provisioning time.
- For metric 5 the performance standard = target date/time.

## 3.3 KPIs for the four quarters ending 31 December 2010

The KPIs that are reported for a particular quarter may be influenced by transient or seasonal factors. Care therefore needs to be taken when making inter-quarter comparisons, or drawing conclusions based on the results that are reported for a single quarter.

To minimise the effect of these factors, and to examine Telstra's KPI performance over a longer timeframe, the ACCC has calculated an average quarterly difference for all KPI metrics over the last four quarters. The results are shown in Table 3.2 below.

### Table 3.2: Average variances in KPI metrics - 12 months ending 30 December 2010

| Metric | The difference between percentage of Wholesale Business customers and Retail Business customers in target (i.e. that have met the performance standard) | | | | | The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (i.e. that have met the performance standard) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **2010** | | | | **Av.** | **2010** | | | | **Av.** |
| | **Mar** | **Jun** | **Sep** | **Dec** | | **Mar** | **Jun** | **Sep** | **Dec** | |
| 1 | 1.82 | 1.90 | 1.77 | 1.06 | **1.64** | 6.71 | 8.31 | 9.62 | 5.48 | **7.53** |
| 2 | 2.95 | 2.32 | 0.48 | 3.81 | **2.39** | 2.29 | 3.02 | 3.23 | 3.14 | **2.92** |
| 3 | -2.76 | -4.09 | -7.11 | -9.83 | **-5.95** | -2.07 | -2.59 | -0.74 | -2.42 | **-1.96** |

| Metric | The difference between percentage of Wholesale Business customers and Retail Business customers in target (i.e. that have met the performance standard) | | | | | The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (i.e. that have met the performance standard) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 4 | -1.04 | 0.41 | 0.43 | 0.94 | **0.19** | 2.23 | 3.02 | 3.21 | 2.60 | **2.77** |
| 5 | 0.57 | -0.73 | -2.42 | -3.15 | **-1.43** | -0.82 | -0.90 | -2.87 | -3.16 | **-1.94** |
| 6 | 0.60 | 0.43 | 0.32 | -0.03 | **0.33** | -0.02 | 0.15 | 0.08 | 0.21 | **0.11** |
| 7 | -0.06 | 0.02 | 0.78 | 0.03 | **0.19** | -0.02 | -0.65 | 0.68 | 0.55 | **0.14** |
| 8 | 0.34 | 1.18 | 0.58 | 0.63 | **0.68** | 0.63 | 2.17 | 0.45 | 0.37 | **0.91** |
| 9 | 8.89 | 0.00 | 0.00 | -7.69 | **0.30** | 3.91 | -2.77 | -9.52 | -0.61 | **-2.25** |
| 10 | -0.22 | 1.62 | 0.30 | -1.07 | **0.16** | -1.92 | -1.60 | -1.83 | -1.68 | **-1.76** |
| 11 | -0.98 | 1.93 | 0.81 | 2.79 | **1.14** | 0.24 | -0.08 | -0.18 | 0.51 | **0.12** |

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

## 3.4 Discussion of reported KPIs

### 3.4.1 Introduction

In this section, the ACCC notes any qualifications that are necessary in interpreting the reported data, and discusses likely causes of any KPIs that disclose material differences in service levels. A difference in the percentages of Telstra wholesale and retail meeting the performance standards is considered material if its absolute value is greater than two percentage points (i.e. greater than two percentage points or less than negative two percentage points).

While the closer that differences in service levels are to zero the better, it is recognised that the causes of relatively small differences in service levels are difficult to determine and that investigating and explaining small differences would be of only limited benefit, if any.

***Discussion of materially different service levels—that is, those for which the reported difference in service levels for the quarter exceeds two percentage points***

*Basic access connections with previous service available for connection (Metric 1)*

Wholesale business and residential customers received better service levels for connections with a previous service available for connection.

Telstra reports a difference of positive 5.48 percentage points for residential connections with a previous service available for connection. A result of positive 7.53 percentage points is obtained when averaging over the past four quarters.

Although wholesale business customers also received better service for this metric than retail business customers, the difference between the two is far less than for residential customers. The difference between the two measures for the December 2010 quarter is positive 1.06

percentage points in favour of wholesale business customers with a result of 1.64 percentage points in favour of wholesale business customers when averaging over the last four quarters.

Telstra advises that the positive result for wholesale customers was due to the differences in the order entry processes between the retail and wholesale business units and order entry delays for retail caused by legacy system download issues, system outages and process-related issues. Telstra states that the program of work relating to some of these processes has been addressed and this is starting to deliver improvements in retail performance.

*New basic access connections with available cable and capacity (Metric 2)*

Wholesale business customers received service levels for connections with available cable or network capacity during the quarter materially better than service levels achieved for Telstra's business retail customers.

Telstra reports a difference of positive 3.81 percentage points for business wholesale connections with available cable or network capacity. A result of positive 2.39 percentage points is obtained when averaging over the past four quarters.

For this performance metric, wholesale residential customers received better service than retail residential customers. Telstra reports a difference of positive 3.14 percentage points for wholesale connections with available cable or network capacity. A result of positive 2.92 percentage points is obtained when averaging over the past four quarters.

Telstra advised that the variances for Residential and Business customers are due to ongoing order entry delays for retail customers caused by legacy system download issues and some outages.

*New basic access connections requiring additional cable or network capacity (Metric 3)*

Wholesale business customers received significantly worse service levels than wholesale business customers for connections requiring additional cable or network capacity during the quarter.

Telstra reports a variation of negative 9.83 percentage points for wholesale business connections requiring additional cable or network capacity. A result of negative 5.95 percentage points is obtained when averaging over the past four quarters. The result for this metric has remained outside the tolerance threshold for six consecutive quarters.

Wholesale residential customers also received worse service than retail customers. Telstra reports for wholesale customers a variation of negative 2.42 percentage points for connections requiring additional cable or network capacity. A result of negative 1.96 percentage points is obtained when averaging over the past four quarters. The result for this metric has been outside the tolerance threshold for four of the past five quarters.

Telstra advised that the variance for business and residential customers is due to the significantly lower number of wholesale orders than retail orders. Telstra advises that the reason for missing the two per cent materiality threshold is the result of missing the target on thirty-three tickets of work for wholesale business customers and two tickets of work for wholesale residential customers.

Telstra has advised the ACCC that some business wholesale orders are recorded as missed due to delays of third parties, such as building developers. Telstra notes this means the connection must be rescheduled, however, the rescheduled date has not been recorded suggesting that orders have been missed. Telstra has initiated training to correct this problem.

Telstra advises that it will closely monitor the results of this metric for the next few quarters.

*Basic access order appointments met in the quarter (Metric 4)*

Wholesale business customers received service levels for appointments met in the quarter similar to service levels achieved for Telstra's business retail customers.

Wholesale residential customers received better service levels than retail residential customers. Telstra reports a difference of positive 2.60 percentage points in favour of the wholesale residential customers in Metric 4. A result of positive 2.77 percentage points is obtained when averaging over the past four quarters.

Telstra advised the reason for the variance for residential customers is due to differences in the order entry processes between the retail and wholesale business units and ongoing order entry delays for retail.

*Basic access - percentage of faults rectified in the quarter, on or by the performance standard (Includes dial-up faults) (Metric 5)*

Metric 5 measures the percentage of basic access faults that are rectified in the quarter, on or by the performance standard (includes dial-up faults). Telstra's wholesale business customers received worse service levels than its retail customers in the December quarter. Telstra reported a variance of negative 3.15 percentage points for wholesale business customers for this metric. Over the past three quarters, Telstra's wholesale business customers have faced declining service levels relative to retail business customers for this metric.

For residential customers, Telstra reported a variance negative 3.16 percentage points for this metric. This indicates that the retail business unit received better service than the wholesale business unit for this metric.

Telstra explains that the variance for business and residential customers is due to process changes which are inadvertently causing delays in response times in processing faults. Telstra reports that the issue is under further investigation to determine an appropriate course of action.

The ACCC will continue to monitor this metric...

*ADSL services provisioned within the performance standard for held orders (Metric 9)*

Metric 9 measures the variance in KPI for ADSL service activation, where the customer's order was held from a previous period.

Telstra reports a large difference in meeting its performance target for its business wholesale and retail business customers for this metric in the December 2010 quarter. Telstra reports negative variance of 7.69 per cent for business wholesale customers. The average variance over the past four quarters is only 0.30 per cent. However, this metric has been volatile with a result of positive 8.89 per cent in favour of wholesale customers reported by Telstra in the March 2010 quarter.

Telstra advised that the variances for business customers are due to the small number of held orders and that the results are statistically insignificant.

*Faults and Maintenance - ADSL - The percentage of appointments kept (Metric 11)*

For business wholesale customers, Telstra reports a variation of positive 2.79 percentage points for percentage of appointments kept for the December quarter 2010. This indicates that wholesale customers of Telstra have received better service than customers of Telstra's retail arm for this service. The average over four quarters is 1.14 percentage points in favour of wholesale customers.

Telstra advises that the variance for business customers is due to the small number of wholesale orders. Telstra states this is a statistically insignificant result.

## 3.5 Extent to which Telstra's reports conform with the RKR requirements

The ACCC is satisfied that the December quarter 2010 report conforms to the requirements of the RKR.

## 3.6 Accuracy

Telstra has certified that to the best of its knowledge the December quarter 2010 results are true and correct. The ACCC understands that Telstra staff has checked these results, and that Telstra's auditors have been engaged to progressively investigate the accuracy of the results that Telstra submits throughout a year. As such, the ACCC would expect that the reported KPIs are robust and reliable measures.