Australian
Competition &
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Commission

IMPUTATION TESTING AND NON-PRICE TERMS AND CONDITIONS REPORT RELATING TO THE ACCOUNTING SEPARATION OF TELSTRA FOR THE MARCH QUARTER 2010

June 2010

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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 indicators
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 27th 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.

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 March quarter 2010, Telstra passed the imputation tests for:

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

The imputed margins for all services except for international long-distance (both residential and business) services deteriorated during the March 2010 quarter.

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.

For business and residential customers, all of the reported measures fall within the two percent tolerance threshold except one. For the one measure that does fall outside these levels, Telstra reports it was likely due to one-off factors or reflect only small differences in absolute terms – that is, there are relatively few events within the relevant reporting class.

Telstra reported that wholesale customers received materially lower service levels for basic access service connections (which require additional cable or network capacity). They reported that this was due to missed timeframes in locations where mass service disruptions were declared.

The ACCC will continue to monitor Telstra's performance in ensuing quarters to ensure 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* (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 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.

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

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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.

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.

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. The ACCC considers that the enhanced accounting separation regime should be kept under review to ensure that the intended benefits of enhanced accounting separation are being realised.

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

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. In addition to March 2010 quarter results, imputation test results from previous quarters have been included in this report to enable comparison.

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 as equally efficient as Telstra in the supply of 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.

might not be able to remain in the market, as they would be achieving negative profit margins. Imputation testing can therefore be used to detect possible price squeezes in a retail market.

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
- 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.

Where the retail price is less than the sum of the wholesale access price and additional costs, a price squeeze is said to occur.

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 price of the retail service, the access price for the core service, and the additional costs of transforming the core service into the retail service. These variables are defined as follows:

- the ‘retail price’ is the average retail price of each retail service. This is calculated by using the total revenue and volume data provided by Telstra
- the ‘access price’ is the volume-weighted average of the prices Telstra charges its access seekers for the core service
- the ‘unit cost’ is 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 provide the 'retail costs' for the imputation tests. However, there are further costs incurred in transforming a core service to a retail service, such as the cost of transmission. These are listed as '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 retail 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 retail markets, who are equally efficient as Telstra, if they supply the retail service to their customers using Telstra's core service.[6]

- The imputation 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 March quarter 2010 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.

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[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.

[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 March 10 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	209,019,735	496,200,729	34,738,310	111,496,469	4,087,385	31,663,475	81,550,762	186,531,328	329,396,192	825,892,002	1,155,288,194
other	0	0	0	0	0	0	0	0	0	0	0
total	209,019,735	496,200,729	34,738,310	111,496,469	4,087,385	31,663,475	81,550,762	186,531,328	329,396,192	825,892,002	1,155,288,194
Retail Costs											
organisation	23,713,986	58,332,615	1,909,240	8,575,247	247,195	2,451,968	4,375,506	7,807,335	30,245,927	77,167,164	107,413,091
product and consumer	30,645,790	75,150,284	3,094,383	13,898,253	1,056,321	10,477,814	30,649,824	54,689,322	65,446,319	154,215,673	219,661,992
total	54,359,776	133,482,899	5,003,622	22,473,500	1,303,517	12,929,782	35,025,330	62,496,656	95,692,245	231,382,837	327,075,083
Other Costs											
organisation	0	0	44,335	199,128	18,672	185,208	242,948	433,498	305,954	817,834	1,123,788
product and consumer	0	0	3,691	16,578	2,857	28,340	48,020	85,683	54,568	130,601	185,169
network expenses	0	0	139,696	627,436	32,164	319,042	741,849	1,323,701	913,709	2,270,179	3,183,888
total	0	0	187,722	843,142	53,693	532,590	1,032,816	1,842,882	1,274,231	3,218,614	4,492,846
Ancilliary*	N/A	N/A	330,457	1,484,231	7,394	73,342	169,335	302,149	507,186	1,859,722	2,366,908
Cost of Capital	13,282,518	32,801,465	1,294,404	5,813,744	183,021	1,815,418	3,888,121	6,937,681	18,648,065	47,368,308	66,016,373
Retail Volume*	2,140,302	5,377,288	256,618,799	1,152,589,502	11,483,625	113,907,846	262,996,554	469,271,958			
Retail price	$97.66	$92.28	$0.14	$0.10	$0.36	$0.2780	$0.31	$0.40	$153.90	$153.59	$153.68
Access price	$100.38	$87.15	$0.02	$0.02	$0.00	$0.0086	$0.01	$0.01	$104.88	$92.14	$95.76
Unit cost	$31.60	$30.92	$0.03	$0.03	$0.13	$0.1348	$0.15	$0.15	$54.25	$52.78	$53.20
Imputed margin	-$34.33	-$25.79	$0.09	$0.05	$0.21	$0.1346	$0.14	$0.23	-$5.24	$8.67	$4.71
Imputed margin %	-35.2%	-28.0%	63.4%	54.4%	59.4%	48.4%	46.4%	58.6%	-3.4%	5.7%	3.1%

Table 2.2: Fixed Telephony Report for March 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	209,019,735	496,200,729	34,738,310	111,496,469	4,087,385	31,663,475	81,550,762	186,531,328	329,396,192	825,892,002	1,155,288,194
other	0	0	0	0	0	0	0	0	0	0	0
total	209,019,735	496,200,729	34,738,310	111,496,469	4,087,385	31,663,475	81,550,762	186,531,328	329,396,192	825,892,002	1,155,288,194
Retail Costs											
organisation	23,299,021	57,312,526	1,870,801	8,402,601	242,276	2,403,173	4,287,048	7,649,497	29,699,145	75,767,797	105,466,943
product and consumer	30,613,766	75,071,559	3,091,416	13,884,929	1,055,942	10,474,048	30,642,998	54,677,140	65,404,121	154,107,677	219,511,798
total	53,912,786	132,384,085	4,962,217	22,287,531	1,298,218	12,877,221	34,930,046	62,326,638	95,103,267	229,875,474	324,978,740
Other Costs											
organisation	0	0	43,050	193,357	18,328	181,801	233,407	416,475	294,786	791,633	1,086,418
product and consumer	0	0	3,592	16,133	2,831	28,077	47,283	84,369	53,706	128,579	182,285
network expenses	0	0	139,696	627,436	32,164	319,042	741,849	1,323,701	913,709	2,270,179	3,183,888
total	0	0	186,338	836,925	53,323	528,920	1,022,540	1,824,546	1,262,200	3,190,391	4,452,591
Ancilliary*	N/A	N/A	330,457	1,484,231	7,394	73,342	169,335	302,149	507,186	1,859,722	2,366,908
Cost of Capital	13,027,217	32,173,869	1,297,291	5,826,713	181,404	1,799,375	3,804,718	6,788,863	18,310,630	46,588,819	64,899,449
Retail Volume*	2,140,302	5,377,288	256,618,799	1,152,589,502	11,483,625	113,907,846	262,996,554	469,271,958			
Retail price	$97.66	$92.28	$0.14	$0.10	$0.36	$0.28	$0.31	$0.40	$153.90	$153.59	$153.68
Access price	$100.38	$87.15	$0.02	$0.02	$0.01	$0.01	$0.01	$0.01	$104.88	$92.14	$95.76
Unit cost	$31.28	$30.60	$0.02	$0.03	$0.13	$0.13	$0.15	$0.15	$53.82	$52.35	$52.77
Imputed margin	-$34.00	-$25.47	$0.09	$0.05	$0.21	$0.14	$0.14	$0.23	-$4.79	$9.10	$5.14
Imputed margin %	-34.8%	-27.6%	63.5%	54.6%	59.6%	48.6%	46.6%	58.8%	-3.1%	5.9%	3.4%

— 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 March 2010 Quarter on Historic Cost basis

	Unconditioned Local Loop Service ADSL Service		Unconditioned Local Loop 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	63,433,043	229,947,790	232,842,738	461,939,852
other	0	0	0	0
total	63,433,043	229,947,790	232,842,738	461,939,852
Retail Costs				
organisation	4,638,729	25,461,115	20,194,322	47,137,278
product and consumer	8,412,382	46,173,990	42,071,669	89,492,985
total	13,051,111	71,635,105	62,265,992	136,630,263
Other Costs				
organisation	6,513,083	35,749,091	7,183,674	38,398,049
product and consumer	668,571	3,669,663	5,039,345	9,365,566
network expenses	18,769,200	103,020,620	46,878,282	143,852,082
total	25,950,854	142,439,373	59,101,301	191,615,697
Ancillary Charges (TEBA)	1,780,791	9,774,426	1,846,002	10,296,819
Cost of Capital	9,917,250	54,433,926	46,758,054	107,295,092
Retail Volume	275,191	1,510,474	275,191	1,510,474
Retail price	$230.51	$152.24	$846.11	$305.82
Access price	$51.65	$51.65	$76.18	$60.50
Unit cost	$184.25	$184.24	$617.65	$295.16
Imputed margin	-$5.38	-$83.65	$152.28	-$49.84
Imputed margin %	-2.3%	-55.0%	18.0%	-16.3%

Table: 2.4 - ULLS Report for March 2009 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	sidential	Business - 1 x ADSL Service + 4 x Voice Lines	Residential - 1 x ADSL Service + 1 x Voice Lines
Revenues				
retail	63,433,043	229,947,790	232,842,738	461,939,852
other	0	0	0	0
total	63,433,043	229,947,790	232,842,738	461,939,852
Retail Costs				
organisation	4,552,940	24,990,233	19,827,321	46,273,315
product and consumer	8,405,789	46,137,799	42,043,373	89,426,458
total	12,958,728	71,128,031	61,870,694	135,699,773
Other Costs				
organisation	6,730,344	36,941,595	8,618,628	41,136,028
product and consumer	685,338	3,761,690	5,150,093	9,576,872
network expenses	18,769,199	103,020,618	46,878,284	143,852,083
total	26,184,880	143,723,902	60,647,005	194,564,983
Ancillary Charges (TEBA)	1,780,791	9,774,426	1,846,002	10,296,819
Cost of Capital	5,755,662	31,591,751	64,250,722	114,612,286
Retail Volume	275,191	1,510,474	275,191	1,510,474
Retail price	$230.51	$152.24	$846.11	$305.82
Access price	$51.65	$51.65	$76.18	$60.50
Unit cost	$169.63	$169.63	$685.39	$301.35
Imputed margin	$9.23	-$69.04	$84.54	-$56.02
Imputed margin %	4.0%	-45.4%	10.0%	-18.3%

— Notes to Tables 2.3 and 2.4

— * As per instructions from the ACCC, ancillary charges are calculated as TEBA revenues per ULL service that are reasonably expected in a mature market. This is calculated as the TEBA revenue for the September 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 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 that are reported based on historical cost and those based on 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 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 the integrated access provider.

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 will 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—these are described in section 2.7 of this report—Telstra and the ACCC have worked together to ensure that these issues are treated appropriately.

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

Results for the Quarter

Table 2.5 provides a summary of the imputation test results for Telstra for the March 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 March quarter 2010, the imputation test results indicate that Telstra passes the imputation tests for:

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

Compared to the last quarter, imputation margins of all services have deteriorated except in the international long-distance service area.

However, as per the previous period Telstra fails the imputation test for local call services (line rental and local calls combined) for both residential and business customers. For the first time, Telstra fails the test for bundle of fixed voice services for business customers. Telstra also fails both stand-alone ADSL services and bundled ADSL and fixed line telephony services for residential customers. These results appear primarily due to an increase in Telstra’s stated costs and declining volume.

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

Retail service	Core service(s)		Mar 2009	Jun 2009	Sep 2009	Dec 2009	Mar 2010	
Local calls and line rental	LCS	Business	–28%	–33%	–27%	–25%	-35%	*Fail*
		Residential	–22%	–26%	–19%	–18%	-28%	*Fail*
Domestic long-distance	PSTN–O/T	Business	67%	67%	67%	67%	63%	*Pass*
		Residential	58%	59%	59%	60%	54%	*Pass*
International long-distance	PSTN–O	Business	62%	68%	51%	44%	59%	*Pass*
		Residential	59%	60%	37%	33%	48%	*Pass*
Fixed-to-mobile	PSTN–O	Business	50%	50%	51%	52%	46%	*Pass*
		Residential	60%	60%	61%	62%	59%	*Pass*
Bundle of fixed voice services #	LCS and PSTN–O/T	Business	4%	0%	4%	5%	-3%	*Fail*
		Residential	11%	9%	11%	13%	6%	*Pass*
		Total	9%	6%	9%	11%	3%	*Pass*
ADSL	ULLS	Business	20%	19%	5%	8%	-2%	*Fail*
		Residential	–18%	–21%	–43%	–38%	-55%	*Fail*
Bundle of ADSL and fixed voice services *	ULLS and PSTN–T	Business	21%	21%	22%	23%	18%	*Pass*
		Residential	–0%	–1%	–9%	–6%	-16%	*Fail*

Source: Telstra imputation testing quarter reports for the March quarter 2009, June quarter 2009 and September quarter 2009, December quarter 2009 and March 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.

2.5.2 Comparison of current quarter results with the previous period

For the ULLS services, in the March quarter 2010, the margin for stand-alone ADSL services for business customers failed the imputation test for the first time since the June 2008 quarter. The stand-alone ADSL services for residential service also failed the imputation test, as in the last quarter, with a decline of a further seventeen percentage points since the December 2009 quarter. These results appear to result due to increase in Telstra's stated cost of capital and decrease in revenue.

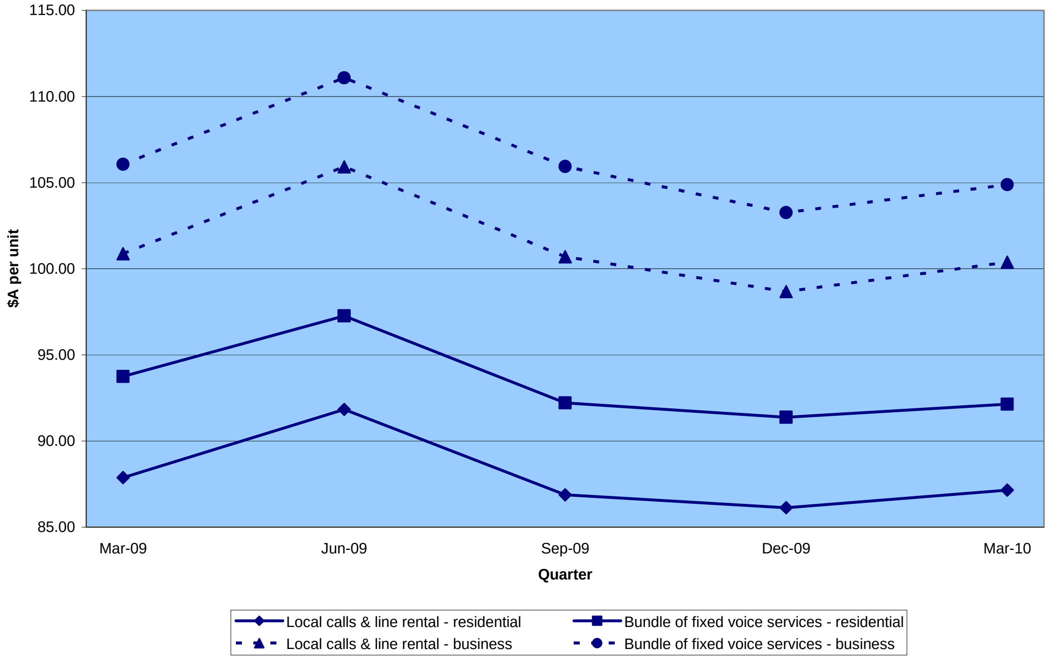
In the bundle of ADSL and fixed voice services, the business sector passed the imputed margin test, although, the margin decreased by five percentage points since the December 2009 quarter. The residential bundle of ADSL and fixed voice services failed the imputation test and the margin further decreased by ten percentage points since the December 2009 quarter.

2.5.3 Access prices over four quarters

Access prices over four quarters

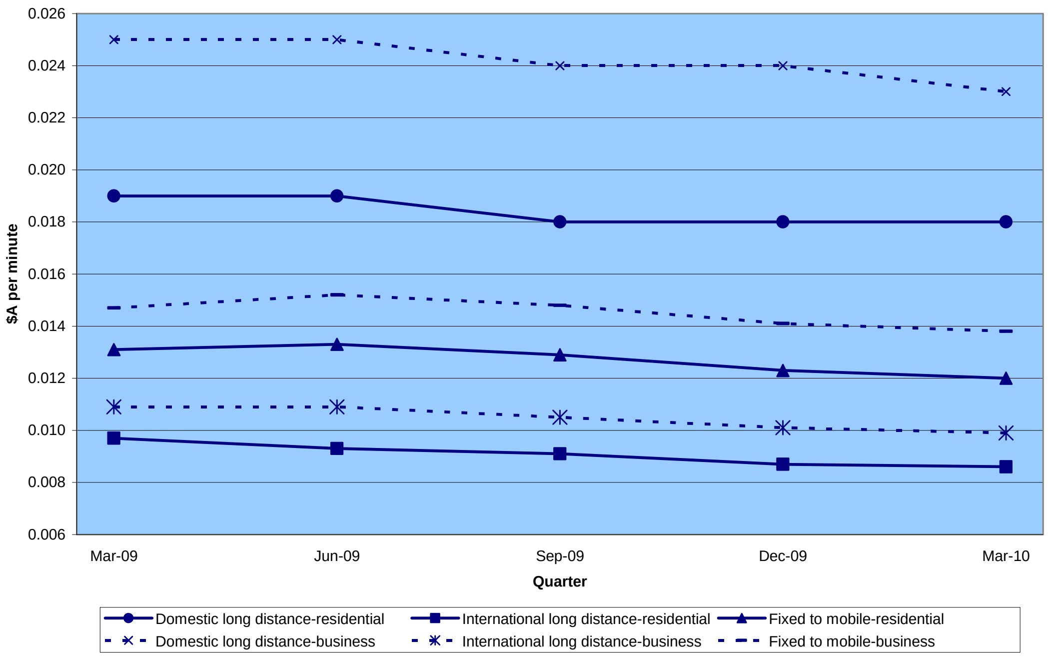
Telstra's estimates of the average access prices for the core services in relation to imputation testing are represented in figures 2.1 and 2.2 below.

Figure 2.1: Average access prices for core services used in supplying local call/ line rental services, and the fixed-line voice services bundle, March quarter 2009 to March quarter 2010



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 domestic long-distance, international long-distance and fixed-to-mobile call services, March quarter 2009 to March quarter 2010



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.

2.5.4 Line rental and local calls

The results for the March quarter 2010 indicate that Telstra would receive a negative margin if it supplied the bundled local call and line rental retail services by purchasing the LCS input at arms' length from itself. Telstra has failed the imputation test for the local call and line rental services in all quarters since reporting commenced.

In the March 2010 quarter, the imputed margin for residential line rental and local calls further deteriorated by ten percentage points from negative 18 per cent to negative 28 per cent. For businesses, the imputed margin for local call and line rental services also decreased by ten percentage points from negative 25 per cent to negative 35 per cent.

For both business and residential sectors, the data indicates the reduced margin results from an increase in the retail costs and the cost of capital. Retail cost (includes organisation and product and consumer costs) and cost of capital for the business sector increased by 16.25 per cent and 13.98 per cent respectively while for the residential sector they increased by 14.18 per cent and 12.26 per cent since the December 2009 quarter.

2.5.5 Domestic and international long-distance and fixed-to-mobile calls

In the retail supply of long-distance and fixed-to-mobile calls, Telstra would make a positive margin if it purchased the essential inputs, the PSTN-O/T, at arm's length from itself.

Telstra's margins vary among the three retail services and between the residential and business customer segments. All three services passed the imputation test in the March 2010 quarter. In this quarter, imputed margins of 54 per cent or higher were again reported for domestic long-distance services. However, the margins decreased by 4 percentage points and 16 percentage points respectively for business and residential customers since last quarter. The imputed margins for international long-distance services for both business and residential customers were the only services that increased imputed margins, they increased by 15 percentage point each for the March 2010 quarter.

The imputed margins for both business and residential fixed-to-mobile services decreased by 6 and 3 percentage points respectively; from 52 per cent to 46 per cent for business customer groups and from 62 per cent to 59 per cent for residential customer groups.

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. 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.

2.5.6 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. For the first time, the business sector reports a negative margin and fails the imputation test in this quarter although previous quarters indicate that Telstra has consistently been close to failing this particular imputation test. For the March quarter 2010, the tests show the imputed margin of negative 3 per cent for residential customers and 6 percent for business customers. The imputed margins decreased by 8 percentage points for business and 7 percentage points for residential customers.

Again, the increasing cost of capital and falling revenues appear to be the likely source of Telstra failing the imputation test for business bundled fixed voice services.

2.5.7 ADSL

Telstra failed the imputation tests conducted on services that use the ULLS as a core service input for both business and residential sectors in the March 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 residential customers. A margin of negative 55 per cent was reported for supplying a stand-alone ADSL service to residential customers in the March quarter 2010, as compared to negative 38 per cent in the December quarter 2009. For business customers, this imputed margin decreased by 10 percentage points from positive 8 per cent to negative 2 per cent in the March quarter 2010 and failed for the first time in the last four quarters.

In assessing the reported cost for the March quarter 2010, 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 rather than identified directly to each group. 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 the other customer group.

- 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

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[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 December quarter 2009 shows that non-dial up subscribers, which are dominated by digital subscriber line (DSL) access technology, represented 90 per cent of all internet connections at the end of December 2009 with 2.7 per cent increase since June 2009. See http://www.abs.gov.au/ausstats/abs@.nsf/mf/8153.0/.

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, the actual imputed 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 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.

2.5.8 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 16 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, does however, pass the imputation test on the bundle for business customers (comprising one ADSL service and four voice services) with the imputed margin declining by 18 per cent in the March 2010 quarter, compared to 23 per cent in December 2009 quarter.

The factors outlined in section 2.5.7 and the qualifications for fixed-to-mobile calls in section 2.5.5 are 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 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.

[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 31 March 2010 around 4 per cent of ULLS were supplied in band 1, and 94 per cent in band 2. Source: Telstra CAN RKR Data March 2010.

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

	ULLS Test	Business – 1 ADSL + 4 voice lines	Residential – 1 ADSL + 1 voice line
Historic Cost Basis	Unadjusted	18.0%	-16.3%
	Adjusted	18.4%	-16.0%
Current Cost Basis	Unadjusted	10.0%	-18.3%
	Adjusted	10.3%	-18.0%

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 to June and July to 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, the results for this March quarter 2010 imputation report contains unit cost data that was obtained from the RAF data for the period July to December 2009.

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. These allow the previously reported imputed margins to be compared to those that would be obtained using the RAF data that corresponds with the test period.

2.6.1 Summary of reconciliation results

Telstra has provided the ACCC with its latest reconciliation reports which show that overall imputed margins remain broadly consistent when using either the matching RAF data or the lagged RAF data. However, the later RAF data suggests that previously reported total margin was overstated by 3.5 percentage points. This was caused by:

- understated imputed historic cost for:

- access rental and local calls (business and residential)
- International Long Distance services (business and residential), and

- overstated imputed historic cost for:
  - domestic long distance (business and residential)
  - fixed to mobile (business and residential), and
  - bundle of access rental and all call services (business and residential)

in the previous period.

The most significant difference occurred in the International Long Distance service where the business sector was under estimated by 13.3 percentage points and the residential sector was understated by 16.7 percentage points in the previous report.

Table 2.7: Telstra's imputed historic cost half year margins applying the June 2009 RAF

	Access Rental & Local Calls	Domestic Long-Distance	International Long-Distance	Fixed to Mobile	Bundle of Access Rental and all call services
Business	-25.8%	67.1%	47.8%	51.1%	4.6%
Residential	-12.7%	59.3%	34.8%	61.6%	12.2%
Total Margin					10.0%

Table 2.8: Telstra's imputed historic cost half year margins applying the December 2009 RAF

	Access Rental & Local Calls	Domestic Long-Distance	International Long-Distance	Fixed to Mobile	Bundle of Access Rental and all call services
Business	-30.2%	63.5%	61.0%	47.7%	0.7%
Residential	-15.9%	54.3%	51.5%	58.8%	8.8%
Total Margin					6.5%

Table 2.9: Telstra's imputed historic cost half year margins applying the June 2009 RAF

	Standalone ADSL	Bundle of ADSL and voice services*
Business	6.4%	22.5%
Residential	-40.6%	-7.5%

* Residential bundle is 1 ADSL service and 1 PSTN line, the Business bundle is 1 ADSL service and 4 PSTN lines

Table 2.10: Telstra's imputed historic cost half year margins applying the December 2009 RAF

■	■ Standalone ADSL	■ Bundle of ADSL and voice services*
■ Business	-2.4%	19.8%
■ Residential	-53.8%	-14.5%

* Residential bundle is 1 ADSL service and 1 PSTN line, the Business bundle is 1 ADSL service and 4 PSTN lines

Table 2.11: Fixed telephony reconciliation report for July to December 2009 on historic cost basis (applying Dec 2009 RAF)

	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	434,383,409	1,043,978,109	75,056,346	235,541,438	9,041,358	71,362,389	174,678,977	394,299,996	693,160,090	1,745,181,932	2,438,342,022
other	0	0	0	0	0	0	0	0	0	0	0
total	434,383,409	1,043,978,109	75,056,346	235,541,438	9,041,358	71,362,389	174,678,977	394,299,996	693,160,090	1,745,181,932	2,438,342,022
Retail Costs											
organisation	48,149,219	119,674,026	4,021,219	17,872,336	522,771	5,184,047	9,094,733	16,341,418	61,787,943	159,071,827	220,859,770
product and consumer	62,325,285	154,386,266	6,517,355	28,966,426	2,233,919	22,152,604	63,735,365	114,518,837	134,811,923	320,024,133	454,836,056
total	110,474,504	197,276,494	10,538,574	46,838,762	2,756,690	27,336,651	72,830,098	130,860,255	196,599,866	479,095,960	675,695,826
Other Costs											
organisation	0	0	93,378	415,019	39,487	391,574	504,980	907,348	637,845	1,713,941	2,351,786
product and consumer	0	0	7,774	34,552	6,042	59,918	99,812	179,341	113,628	273,811	387,439
network expenses	0	0	294,226	1,307,687	68,021	674,531	1,541,975	2,770,620	1,904,221	4,752,838	6,657,060
total	0	0	395,378	1,757,258	113,551	1,126,023	2,146,766	3,857,310	2,655,694	6,740,590	9,396,285
Ancilliary*	N/A	N/A	783,227	3,535,486	17,613	178,631	398,229	724,932	1,199,069	4,439,049	5,638,118
Cost of Capital	26,913,038	67,179,465	2,726,259	12,116,875	387,056	3,838,228	8,081,677	14,521,158	38,108,030	97,655,727	135,763,757
Retail Volume*	2,148,366	5,465,510	540,487,675	2,402,201,044	24,285,685	240,828,421	546,653,055	982,226,251			
Retail price	$202.19	$191.01	$0.14	$0.10	$0.37	$0.30	$0.32	$0.40	$322.65	$319.31	$320.25
Access price	$199.38	$173.00	$0.02	$0.02	$0.01	$0.09	$0.02	$0.01	$209.21	$183.60	$190.83
Unit cost	$63.95	$48.39	$0.03	$0.03	$0.14	$0.14	$0.15	$0.15	$111.04	$107.57	$108.55
Imputed margin	-$61.13	-$30.37	$0.09	$0.05	$0.23	$0.15	$0.15	$0.24	$2.40	$28.14	$20.87
Imputed margin %	-30.2%	-15.9%	63.5%	54.3%	61.0%	51.5%	47.7%	58.8%	0.7%	8.8%	6.5%

Table 2.12: Fixed telephony reconciliation report for July to December 2009 on current cost basis (applying Dec 2009 RAF)

	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	434,383,409	1,043,978,109	75,056,346	235,541,438	9,041,358	71,362,389	174,678,977	394,299,996	693,160,090	1,745,181,932	2,438,342,022
other	0	0	0	0	0	0	0	0	0	0	0
total	434,383,409	1,043,978,109	75,056,346	235,541,438	9,041,358	71,362,389	174,678,977	394,299,996	693,160,090	1,745,181,932	2,438,342,022
Retail Costs											
organisation	47,306,380	117,580,640	3,940,260	17,512,512	512,368	5,080,882	8,910,869	16,011,051	60,669,877	156,185,085	216,854,962
product and consumer	62,260,239	154,224,709	6,511,107	28,938,656	2,233,116	22,144,642	63,721,175	114,493,341	134,725,636	319,801,349	454,526,985
total	109,566,618	195,101,896	10,451,367	46,451,169	2,745,484	27,225,523	72,632,044	130,504,392	195,395,513	475,986,433	671,381,946
Other Costs											
organisation	0	0	90,671	402,989	38,761	384,370	485,150	871,718	614,582	1,659,078	2,273,660
product and consumer	0	0	7,565	33,624	5,986	59,362	98,281	176,591	111,832	269,577	381,409
network expenses	0	0	294,226	1,307,687	68,021	674,531	1,541,974	2,770,620	1,904,221	4,752,838	6,657,059
total	0	0	392,462	1,744,301	112,768	1,118,263	2,125,406	3,818,929	2,630,636	6,681,493	9,312,129
Ancilliary*	N/A	N/A	783,227	3,535,486	17,613	178,631	398,229	724,932	1,199,069	4,439,049	5,638,118
Cost of Capital	26,394,493	65,891,538	2,732,340	12,143,903	383,635	3,804,309	7,908,320	14,209,669	37,418,787	96,049,419	133,468,206
Retail Volume*	2,148,366	5,465,510	540,487,675	2,402,201,044	24,285,685	240,828,421	546,653,055	982,226,251			
Retail price	$202.19	$191.01	$0.14	$0.10	$0.37	$0.30	$0.32	$0.40	$322.65	$319.31	$320.24
Access price	$199.38	$173.00	$0.02	$0.02	$0.01	$0.01	$0.02	$0.01	$209.21	$183.60	$190.82
Unit cost	$63.28	$47.75	$0.03	$0.03	$0.13	$0.13	$0.15	$0.15	$110.15	$106.70	$107.67
Imputed margin	-$60.47	-$29.74	$0.09	$0.05	$0.23	$0.15	$0.15	$0.24	$3.29	$29.01	$21.75
Imputed margin %	-29.9%	-15.6%	63.6%	54.4%	61.2%	51.7%	47.9%	59.0%	1.0%	9.1%	6.8%

— Notes to Tables:2.11, 2.12

— * All retail volumes are reported in minutes with the exception of the local carriage service where volumes are in SIOs.

Table 2.13: ULLS Reconciliation Report for July to December 2009 on historic cost basis (applying Dec 2009 RAF)

	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	127,297,741	470,097,841	484,358,075	960,139,954
other	0	0	0	0
total	127,297,741	470,097,841	484,358,075	960,139,954
Retail Costs				
organisation	9,327,269	51,739,848	41,155,411	96,407,207
product and consumer	16,915,096	93,830,739	86,358,837	183,692,613
total	26,242,365	145,570,588	127,514,248	280,099,820
Other Costs				
organisation	13,096,103	72,646,172	14,580,539	78,421,925
product and consumer	1,344,322	7,457,167	10,147,162	19,067,464
network expenses	37,739,943	209,349,483	94,677,582	293,524,720
total	52,180,367	289,452,823	119,405,282	391,014,108
Ancillary Charges (TEBA)	3,589,422	19,911,635	3,743,864	21,157,394
Cost of Capital	19,940,991	110,615,859	94,725,837	219,480,441
Retail Volume	276,669	1,534,726	276,669	1,534,726
Retail price	460.12	306.31	1750.68	625.61
Access price	102.69	102.69	156.16	122.43
Unit cost	368.50	368.50	1248.39	594.08
Imputed margin	-11.08	-164.88	346.14	-90.90
Imputed margin %	-2.4%	-53.8%	19.8%	-14.5%

Table 2.14: ULLS Reconciliation Report for July to December 2009 on current cost basis (applying Dec 2009 RAF)

	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 - ADSL Service + 1 x 4 x Voice Lines**	**Residential - 1 x ADSL Service + 1 x Voice Lines**
Revenues				
retail	127,315,913	470,079,669	484,226,349	959,763,152
other	0	0	0	0
total	127,315,913	470,079,669	484,226,349	959,763,152
Retail Costs				
organisation	9,150,974	50,745,489	40,390,038	94,570,001
product and consumer	16,894,833	93,688,010	86,264,678	183,421,605
total	26,045,808	144,433,499	126,654,716	277,991,606
Other Costs				
organisation	13,527,349	75,014,080	17,454,142	83,911,273
product and consumer	1,377,463	7,638,535	10,365,202	19,481,506
network expenses	37,724,300	209,194,997	94,638,233	293,307,960
total	52,629,112	291,847,612	122,457,577	396,700,739
Ancillary Charges (TEBA)	3,587,927	19,896,875	3,742,320	21,141,974
Cost of Capital	11,568,332	64,150,617	129,832,426	234,152,282
Retail Volume	276,554	1,533,594	276,554	1,533,594
Retail price	460.37	306.52	1750.93	625.83
Access price	102.69	102.69	156.16	122.43
Unit cost	339.29	339.29	1383.77	606.41
Imputed margin	18.39	-135.46	211.00	-103.01
Imputed margin %	4.0%	-44.2%	12.1%	-16.5%

— Notes to Tables: 2.13 and 2.14

— * As per instructions from the ACCC, ancillary charges are calculated as TEBA revenues per ULL service that are reasonably expected in a mature market. This is calculated as the TEBA revenue for the September 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 SIOs.

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)
- 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]

[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).

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. 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 are 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 terminates 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 deducted 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 March quarter 2010 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.

Information in this report may need to be updated once the audit report is due.

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 service levels 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 that is 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 reveal to the public, industry and the government 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 discrimination may have occurred. The ACCC will, therefore, continue to monitor any trends in performance and respond to complaints of discrimination on their merits.

3.1.2 Overview of reported KPIs

Business services

The current report indicates that for almost all of the metrics the service level supplied to wholesale business customers during the quarter, and over the last four quarters, was practically as good as or better than the service level supplied to retail business customers.

The only area of concern was in Metric 3, which represents the percentage of Basic Access orders provisioned in the quarter, on or by the performance standard for new service which requires additional cable or network capacity. For this metric, the wholesale business customers received inferior levels of service than retail business customers during the quarter. Telstra advised that this was due to missed timeframes in locations where mass service disruptions were declared.

Residential services

The current report indicates that wholesale residential customers received inferior levels of service than retail residential customers for Ordering and Provisioning of Basic Access for new service which requires additional cable or network capacity

[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.

(Metric 3). However there was a significant improvement in this metric from -9.08% in the December Quarter to -2.07% in the March Quarter.

For other metrics, however, the service level supplied to wholesale residential customers during the quarter, and over the last four quarters, was practically as good as or better than the service level supplied to retail residential customers.

3.2 KPIs for the quarter ending 31 March 2010

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

A positive difference for all metrics means that Telstra performed better in meeting the performance standard for its wholesale customers than for its retail customers. A negative difference for these metrics means that Telstra performed worse in meeting the performance standard for its wholesale customers than for its retail customers.

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 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)
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	1.82	6.71
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	2.95	2.29
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	-2.76	-2.07
4	The percentage of basic access order appointments that are met in the quarter	-1.04	2.23

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)	0.57	-0.82
6	The percentage of basic access fault appointments that are met in the quarter (includes dial-up faults)	0.60	-0.02
7	The percentage difference in recurring fault ratio	-0.06	-0.02

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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 basis access service capable of supporting ADSL services	0.34	0.63
9	The percentage of services provisioned within performance standard – held orders	8.89	3.91

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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	-0.22	-1.92
11	The percentage of appointments kept	-0.98	0.24

— **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 March 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 31 March 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)				
	2009			2010	Av.	2009			2010	Av.
	Jun	Sep	Dec	Mar		Jun	Sep	Dec	Mar	
1	1.87	2.68	3.53	1.82	2.48	5.12	5.78	6.55	6.71	6.04
2	2.99	4.35	2.69	2.95	3.25	0.48	1.01	1.98	2.29	1.44
3	-0.20	-3.86	-5.11	-2.76	-2.98	-0.36	-0.96	-9.08	-2.07	-3.12
4	1.39	1.61	0.77	-1.04	0.68	3.11	2.06	2.22	2.23	2.41
5	0.08	-0.26	-0.82	0.57	-0.11	-1.57	-1.16	-1.59	-0.82	-1.29
6	0.31	-0.97	0.40	0.60	0.09	0.20	-0.15	0.18	-0.02	0.05
7	1.24	0.44	-0.35	-0.06	0.32	0.71	0.07	0.53	-0.02	0.32
8	-0.13	0.22	0.49	0.34	0.23	0.54	0.54	0.66	0.63	0.59
9	0.00	0.00	0.00	8.89	2.22	-1.78	-3.17	-3.70	3.91	-1.19
10	3.52	-2.31	-0.14	-0.22	0.21	4.76	-2.63	-2.46	-1.92	-0.56
11	3.30	0.09	2.40	-0.98	1.20	0.05	1.68	-0.72	0.24	0.31

— **Notes:**

- A positive difference means that Telstra Wholesale 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 service level is considered material if it is greater than 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

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

Telstra reports a difference of positive 6.71 percentage points for residential connections with a previous service available for connection. A result of positive 6.04 percentage points is obtained when averaging over the past four quarters.

Telstra advised that the positive result for wholesale 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 which continue to impact performance. Telstra notes that there is currently a focus on improving order entry processes. Further, the migration of the remaining Retail consumer customers to the new platform is expected to result in some improvement.

New basic access connections with available cable and capacity

Wholesale business customers received better service levels for connections with available cable or network capacity during the quarter.

Telstra reports a difference of positive 2.95 percentage points for wholesale connections with available cable or network capacity. A result of positive 3.25 percentage points is obtained when averaging over the past four quarters.

Similarly wholesale residential customers also received better service. Telstra reports a difference of positive 2.29 percentage points for wholesale connections with available cable or network capacity. A result of positive 1.44 percentage points is obtained when averaging over the past four quarters.

Telstra advised that the variances for Residential and Business customers are due to missed timeframes in locations where mass service disruptions were declared.

New basic access connections requiring additional cable or network capacity

Retail business customers received better service levels for connections requiring additional cable or network capacity during the quarter.

Telstra reports a variation of negative 2.76 percentage points for business connections requiring additional cable or network capacity. A result of negative 2.98 percentage points is obtained when averaging over the past four quarters.

Similarly retail residential customers also received better service. Telstra reports a variation of negative 2.07 percentage points for business connections requiring additional cable or network capacity. A result of negative 3.12 percentage points is obtained when averaging over the past four quarters.

Telstra advised that the variance for Residential and Business customers are due to missed timeframes in locations where mass service disruptions were declared. They also stated that in March 2010 four extra wholesale met orders would have brought the metric within tolerance.

Basic access order appointments met in the quarter

Wholesale residential customers received better service levels for appointments met in the quarter.

Telstra reports a difference of positive 2.23 percentage points for wholesale residential basic access orders met during the quarter. A result of positive 2.41 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 order entry delays for retail caused by legacy system download issues. Telstra notes there is currently a focus on improving order entry processes. Further, the migration of the remaining retail consumer customers to the new platform is expected to result in some improvement.

ADSL services provisioned within the performance standard for held orders

Wholesale business customers received better service levels for ADSL services provisioned within the performance standard for held orders.

Telstra reports a significant difference of positive 8.89 percentage points for wholesale ADSL held orders during the quarter. A result of positive 2.22 percentage points is obtained when averaging over the past four quarters.

Similarly wholesale residential customers received better service levels for ADSL services provisioned within the performance standard for held orders.

Telstra reports a difference of positive 3.91 percentage points for retail residential ADSL held orders during the quarter. A result of negative 1.19 percentage points is obtained when averaging over the past four quarters.

Telstra advised that the variances for Residential and Business customers are due to the small number of held orders.

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

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

3.6 Accuracy

Telstra has certified that to the best of its knowledge the March 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.