



Australian
Competition &
Consumer
Commission

Interim access determination for the wholesale ADSL service

Statement of Reasons

February 2012



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List of abbreviations and acronyms

ACCC	Australian Competition and Consumer Commission
ADSL	Asymmetric DSL
AD	access determination
AGVC	Aggregating Virtual Circuit
ATM	Asynchronous Transfer Mode
CBD	Central Business District
CCA	<i>Competition and Consumer Act 2010</i>
DSL	Digital Subscriber Line
ESA	Exchange Service Area
FAD	final access determination
GST	Goods and services tax
IAD	interim access determination
LSS	Line sharing service
LTIE	Long term interests of end users
Model Terms	<i>Model Non-Price Terms & Conditions Determination 2008</i>
NBN	National Broadband Network
RAF	Regulatory Accounting Framework
RMRC	Retail price minus retail cost
SAOs	standard access obligations
Service	the declared wholesale ADSL service

SIO	service in operation
SSU	Structural Separation Undertaking
Tribunal	Australian Competition Tribunal
TWE	Telstra Wholesale Ethernet
ULLS	Unconditioned local loop service
VLAN	Virtual LAN
VOIP	Voice over internet protocol

1 Executive Summary

On 14 February 2012, the Australian Competition and Consumer Commission (ACCC) declared the wholesale ADSL service (the Service) under section 152AL of the CCA and commenced a public inquiry under Part 25 of the *Telecommunications Act 1997* (Cth) about a proposal to make a final access determination (FAD) in respect of the Service.

While the legislation does not require the ACCC to do so, the ACCC is providing this Statement of Reasons as a guide to its decision to issue this IAD for the Service.

For a newly declared service such as the declared wholesale ADSL service, in certain circumstances the ACCC must make an interim access determination (IAD), and can otherwise choose to make an IAD, to operate until a FAD is made.

The ACCC has made this IAD as it considers that it is unlikely that a FAD will be made within the next six months given the range of access terms that would likely be raised for possible inclusion in the FAD, and the range of possible approaches to developing such access terms. The IAD will also provide additional certainty as to the terms and conditions of access to the Service until a FAD can be made.

The IAD contains key price-related terms and non-price terms which will provide a default position to apply where an access seeker and access provider cannot agree those terms. The IAD also restricts the application of the Standard Access Obligations to Telstra as the dominant supplier of the Service.

The IAD applies from 15 February 2012 to 14 February 2013 unless sooner revoked. The IAD will be automatically revoked when the ACCC issues the FAD.

2 Legislative framework

Part XIC of the CCA provides for a telecommunications access regime under which the ACCC can set default terms of access to declared services by way of an Access Determination ('AD').

An AD can also incorporate provisions which provide that the standard access obligations (SAOs) are not applicable to a carrier or carriage service provider (either unconditionally or subject to specified conditions or limitations). Similarly, it may include provisions that restrict or limit the application to a carrier or carriage service provider of any or all of the SAOs.¹

A term of access that is specified in an AD applies where there is no commercial agreement between the access seeker and access provider that addresses that term. Hence, an AD creates a benchmark which the parties can fall back on while still allowing them to negotiate different terms.

Where ADs specify terms and conditions of access, they must include terms and conditions relating to price (or a method of ascertaining a price) and may also contain non-price terms.²

An AD can be of an interim (IAD) or final (FAD) nature. Compliance with IADs and FADs is a carrier licence condition³ and a service provider rule.⁴ However, IADs and

¹ Paragraphs 152BC(3)(h) and (i) of the CCA.

² See section 152BC of the CCA.

³ Section 152BCO of the CCA.

FADs do not apply to the extent they are inconsistent with access agreements reached between parties.⁵

Interim access determinations

The ACCC can make IADs in various circumstances, including where a service is declared and no FAD has previously been made in relation to that service.⁶

For services that are newly declared (that is, the service is declared after the commencement of section 152BCG of the CCA and does not replace an earlier declaration), such as the declared wholesale ADSL service, the ACCC must make an IAD in certain circumstances.

These circumstances are that a FAD inquiry has been commenced but the ACCC considers either:

- it is unlikely that a FAD will be made within six months of the FAD inquiry commencing, or
- there is an urgent need for an access determination to apply before the FAD inquiry concludes.⁷

The CCA does not require the ACCC to undertake a public inquiry before making an IAD⁸ or observe any requirement of procedural fairness when making an IAD.⁹ The CCA does not specify any matters that the ACCC must take into account when making an IAD.¹⁰ The ACCC can amend an IAD at any time before a FAD is made.¹¹

An IAD for a declared service is automatically revoked when a FAD is made for that declared service.¹²

3 Background to ADSL services

Digital subscriber line (DSL) technology, in broad terms, enables the supply of high bandwidth services (such as broadband internet access).

ADSL (asymmetric) services have a downstream data rate that is higher than the upstream data rate, and is the major technology for fixed line internet connections in Australia.¹³ ADSL services are typically used by residential or small business customers.

⁴ Section 152BCP of the CCA.

⁵ Section 152BCC of the CCA. An access determination also does not apply to the extent it is inconsistent with a final migration plan: section 152BCCA of the CCA.

⁶ Subsection 152BCG(2) of the CCA.

⁷ Subsection 152BCG(1) of the CCA.

⁸ Subsection 152BCH(2) of the CCA.

⁹ Subsection 152BCG(4).

¹⁰ Subsection 152BCA(4) of the CCA.

¹¹ Subsection 152BCN(1) of the CCA.

¹² Subsection 152BCF(9A) of the CCA.

¹³ By June 2011, DSL technology accounted for 83 per cent of total internet connections in Australia: Australian Bureau of Statistics (ABS), Internet Activity, Australia, June 2011.

There are approximately 2800 “ADSL-enabled” exchange service areas (ESAs).¹⁴ In the large majority (approximately 80 per cent) of Telstra’s ADSL-enabled ESAs, Telstra is the only provider of wholesale ADSL services.¹⁵

In the remaining ESAs, there has been investment in competing DSL networks operated over the ULLS or LSS. However, the largest of these networks reaches only [c-i-c] per cent of the ADSL-enabled ESAs, and has a much smaller market share in the ESAs in which competing networks are present (of around [c-i-c] per cent of services in those areas as compared to the around [c-i-c] per cent market share of Telstra’s DSL network in those areas).¹⁶

Wholesale ADSL services allow service providers to enter ESAs and supply end-user ADSL services without the need to deploy their own DSL network infrastructure. Access seekers must still invest in other input services such as international and domestic inter-capital transmission, internet connectivity and other downstream applications and content support, and customer support and retailing facilities.

Wholesale ADSL services comprise both a local access component from the network termination point at the customer premise to the local exchange, and a backhaul transmission component between the local exchange and the point of interconnection with the access seeker’s network, which is typically located in the CBD of the relevant state.

This backhaul transmission is supplied in an aggregate form, whereby data from the service provider’s end-users, including from end-user services physically connected to different DSLAMs, is aggregated into a “stream” for delivery to the access seeker.

The backhaul interface can be either an AGVC or VLAN (using either ATM or Gigabit Ethernet as the communication protocol respectively). The access seeker acquires backhaul transmission capacity over that interface to a specified throughput that it chooses.

Notwithstanding this aggregation in the backhaul component, the declared wholesale ADSL service is from the perspective of the access seeker a layer 2 service, which is used by service providers to access end-users of ADSL services.

Access seekers are able to differentiate their end-user services in a variety of ways, including through the level of contention that they use in provisioning backhaul transmission services, the usage quotas they offer, and the customer support, applications or content that they provide.

¹⁴ Telstra ADSL-enabled exchange list: <http://www.telstrawholesale.com.au/products/data-broadband/adsl/adsl-reports-plans/index.htm>

¹⁵ ACCC, data obtained under CAN RKR, December 2011.

¹⁶ ACCC, data obtained under CAN RKR, December 2011

4 Background on wholesale ADSL pricing

Telstra levies a range of charges when supplying wholesale ADSL services.¹⁷

The main access charges (in order of materiality) are:

- **A monthly charge for each end user access.**

In general, a zone structure applies to these charges, under which the charge paid by access seekers is potentially dependent upon the zone in which the end-user is located. The zone structure applies to most, but not all, access seekers.

The first of these zones (Zone 1) comprises ESAs that are predominantly located in metropolitan areas, but also include some regional areas.

Telstra also maintains Zone 2+3, which comprises all other ESAs that are not included in Zone 1.

The common understanding of access seekers is that ESAs are categorised in this way largely on the basis of the presence or otherwise of competing DSL networks. In this regard, ESAs contained in Zone 1 do appear to overlap significantly with those ESAs in which competing DSL networks have been built while few such ESAs are contained in Zone 2+3.¹⁸

- **Backhaul transmission (AGVC or VLAN) charges.**

The monthly charge depends upon the ‘size’ of the AGVC or VLAN that is acquired, i.e., the data throughput capacity that the access seeker acquires.

These charges are levied per AGVC or per VLAN, with at least one AGVC or VLAN required per state in which wholesale ADSL is acquired.

These charges are in addition to separate charges for ATM or TWE access.

- **A connection charge**

This is a one off charge for the connection of an ADSL service and can be referred to as an installation charge or a transfer charge.

Different charges can apply depending upon whether or not the service is being transferred and if so the type of transfer involved: where the end-user service is being migrated from another wholesale ADSL service (Type A) or from a line sharing service (Type B).

- **An early termination charge**

This is a one off charge that is imposed on cancellation of a service.

¹⁷ See Telstra, Fact Sheet Data Solutions DSL Internet Grade, available at: <http://www.telstrawholesale.com>; Telstra, “A Guide to Telstra’s price-related interim equivalence and transparency obligations”, published on 5 September, at p.3, and available at: <http://www.accc.gov.au/content/index.phtml/itemId/1003999>, p4; and information that Telstra supplied to the ACCC on 12 January 2012 in response to a s.155 notice.

¹⁸ Exchanges specified by Telstra on the ADSL Enabled Exchange list as Zone 1 exchanges correlate strongly with the presence of competitor infrastructure (as shown in data obtained under the Telstra CAN RKR). There are also public sources for ESAs in which competitor DSL infrastructure has been deployed.

It is only applied where the service is terminated within a prescribed period, and is waived in some circumstances, e.g., where the service is migrated to a Telstra wholesale fibre access broadband product supplied to the customer.¹⁹

5 IAD for wholesale ADSL

The ACCC has decided to make an IAD for the declared wholesale ADSL to commence from 15 February 2012. This IAD contains key price and non-price terms of access that will be applicable where the access seeker and access provider cannot agree on the terms to apply.

The ACCC made this IAD as it considers that a FAD for the Service will not be made within six months, and that an IAD is required to provide certainty as to the default terms and conditions of access until the FAD is made.

6 Overall approach to making the IAD

The CCA mandates a list of criteria to be considered when the ACCC makes an access determination. However the listed criteria are not mandatory in the case of an interim access determination.²⁰

In making this IAD, the ACCC has been guided by the object of Part XIC of the CCA, namely to promote the long term interests of end-users of carriage services or of services provided by means of carriage services (the LTIE).²¹

This object has three limbs: the promotion of competition, the achievement of any-to-any connectivity and the encouragement of economically efficient use of and investment in infrastructure. The ACCC's views on how this object should be interpreted and applied when making an access determination are provided in Attachment A.

In deciding to address particular access terms in this IAD, the ACCC has considered their likely importance to achieving these objectives, and whether it has sufficient information available to it to reasonably specify terms to apply, in the interim period until the FAD is made. Other access terms can be addressed through the FAD inquiry process.

Competition in markets

In deciding whether making the IAD would promote the LTIE, the ACCC considered whether doing so would be likely to promote competition in markets for carriage services and services supplied by means of carriage services.

The ACCC first broadly identified the scope of the relevant markets likely to be affected by the IAD. In this regard, the ACCC's view is that the IAD will affect retail and wholesale markets for the supply of fixed-line broadband services, either as standalone services or bundled with voice services (excluding Voice over Internet Protocol (VoIP) and mobile originated calls).

¹⁹ See Telstra submission, 19 January 2012, p.16.

²⁰ subsection 152BCA(4) of the CCA

²¹ Section 152AB of the CCA

These markets have been the subject of ongoing competition concerns, which stem from the terms on which Telstra supplies the wholesale ADSL service.²² These competition concerns relate to:

- The level and structure of prices for wholesale ADSL services, including that access charges are high when compared to prevailing retail charges
- Price discrimination between access-seekers that has the potential to diminish competition and is not based on efficiencies between access seekers – in particular price discrimination that is directed against access seekers who choose to use their own infrastructure or obtain wholesale services from alternative providers
- Telstra’s ability and incentive to leverage its dominant position in the supply of wholesale ADSL services to discourage competitive conduct and the use of competitive infrastructure where it is efficient to do so.

The ACCC considers that making the IAD to apply until a final access determination can be made will promote competition by providing interim safeguards against these competition concerns.

In this regard, the IAD provides for a ‘protected retail margin’ between Telstra’s retail service prices and the wholesale charges that are paid by access seekers for the Service. This margin has been calculated with a view to allowing a service provider that is as efficient as Telstra to acquire the Service and compete in the supply of downstream services, including expanding operations in geographic areas in which it is not currently competing.

The IAD specifies prices that are generally below the wholesale prices that most of the significant access seekers (in terms of number of SIOs acquired) are currently paying for the Service. Hence, the IAD price terms will generally increase the retail margin that is available to access seekers when supplying ADSL services based upon wholesale ADSL inputs, and promote competition with Telstra’s retail ADSL services.

In addition, the prices at which Telstra supplies the Service are currently spread over a broad range. This is apparent from the information that Telstra published in support of the approach to wholesale ADSL pricing that was proposed in its SSU.²³ This was confirmed by the information that Telstra provided to the ACCC on 12 January 2012 pursuant to a notice to produce information.

As the IAD price terms are positioned at the lower end of this range, or in some cases slightly below it, the IAD will generally place access seekers on an equivalent footing with each other in terms of prices paid for the Service. Hence the IAD is likely to promote competition between access seekers.

Further, each service provider will have access to the charges specified in the IAD irrespective of its business model or whether it acquires other Telstra services. This ensures that access to the level of charges contained in the IAD will not be subject to limitations or restraints that have the potential to impede competitive activity.

²² See ACCC, *Final Decision - Declaration of the wholesale ADSL service under Part XIC of the Competition and Consumer Act 2010*, Section 3.2.

²³ See Telstra, *A guide to Telstra’s price-related interim equivalence and transparency obligations*, 5 September 2011.

The IAD also prevents the imposition of certain terms of access that have the potential to impede the development of wholesale markets. Examples of such access terms are prohibitions on resale, or notification and/or consent requirements for resale, or the imposition of a surcharge on resale services.²⁴ This reflects the view that these restrictions or limitations on supply can impede wholesale markets from developing, including for those service providers that would prefer to acquire wholesale ADSL services from a single wholesale supplier.

Economically efficient use of and investment in infrastructure

The ACCC also considered whether making the IAD would be likely to encourage the economically efficient use of, and economically efficient investment in, the infrastructure by which listed carriage services are supplied, and any other infrastructure by which listed services are, or are likely to become, capable of being supplied.²⁵

In doing so, the ACCC firstly formed the view that it is technically feasible for the services to be supplied and charged for as per the IAD. In this regard, the IAD is consistent with Telstra's existing charging construct for the Service, including the structure of charges.

This includes retaining the zone structure – as it exists on the date that the IAD is made – which Telstra applies for wholesale ADSL monthly end user access charges.

That said, categorising ESAs into zones based upon the presence or otherwise of competing infrastructure, and not upon significant differences in the economic characteristics of the ESA that affect the cost of service provision, would on its face raise issues that the ACCC would intend to consider in detail during the FAD inquiry.

The ACCC also considered the legitimate commercial interests of Telstra as the dominant supplier of the Service and of other suppliers, including the ability to exploit economies of scale and scope.

In this regard, the ACCC formed the view that, by strengthening competition, the IAD would tend to increase cumulative demand for the Service and downstream ADSL services to some extent, which in turn would tend to assist in exploiting these economies. This reflects that Telstra uses common network infrastructure to provide both retail and wholesale ADSL services, and hence it is overall demand for retail and wholesale services that drives the bulk of these economies.

On the other hand, by reducing some of the relevant charges below levels currently prevailing in the market, the IAD will likely reduce the revenues earned from supplying wholesale ADSL services to some extent.

The possible effect on these wholesale revenues will depend mainly upon the extent to which the IAD prices are below the average wholesale price that would otherwise be paid by each individual access seeker. It will also depend upon the extent to which the IAD prices are taken up by individual access seekers.

Information that Telstra has supplied concerning the commercial agreements of all significant access seekers of the Service provides transparency over the range of

²⁴ In this regard, the charges specified in schedule 2 of the IAD would also apply to wholesale ADSL services acquired for the purpose of resale.

²⁵ Subsection 152AB(2) of the CCA.

wholesale prices that those access seekers currently face, and in turn allows an estimate to be made of the overall effect on Telstra's wholesale ADSL revenues if access seekers were to instead have access to the charges specified in the IAD.²⁶

Based upon this information, the ACCC estimates this revenue effect as being up to around [c-i-c] per month. This estimate has been prepared on the following basis:

- access seekers have access to the IAD prices (whereas some access seekers might not be able to access these prices for some time, e.g., where they are currently 'on contract')
- special discounts or rebates that wholesale customers might have obtained in any event under their contracts are not considered, e.g., any discounted 'winback' pricing that Telstra offers is not taken into account
- where a customer's contract sets out multiple rate tables to apply, e.g., to grandfathered services and new services respectively, it is assumed all current supply is as per the higher of these rate tables
- average prices for ADSL1 plans are calculated by applying (i) the ADSL1 customer profile across all wholesale customers (ii) to each wholesale customer's rate table for ADSL1 services (which includes prices for each speed tier)
- potential reductions that might have been made to ADSL prices in the absence of the IAD are not considered
- the observed revenue effect for those wholesale customers included in the analysis (which represents around 90 percent of wholesale SIOs) is scaled up to provide an estimate for all wholesale services

A number of the positions taken during this analysis tend towards overstating the revenue effect of the IAD, hence the estimate represents an upper bound. For instance, if the analysis was instead undertaken on the basis that all supply was currently made to wholesale customers with multiple rate tables at the lesser rather than the higher of those rate tables, then the estimate of this revenue effect would reduce to around [c-i-c] per month.

The ACCC has also considered incentives for investment in the infrastructure by which services are supplied; and any other infrastructure (for example, the NBN) by which services are, or are likely to become, capable of being supplied, and the risks involved in making the investment.²⁷

The ACCC's view is that the IAD will provide appropriate incentives for Telstra to continue to invest in infrastructure used to supply ADSL services.

In this regard, the prices specified in the IAD are in line with the allowances that Telstra implicitly makes for the recovery of these investments, including an appropriate return on capital employed, when supplying retail ADSL services. This is because the IAD prices have been set at a level that Telstra implicitly provides to recover its average network costs from retail ADSL revenues after accounting for its retail costs.

²⁶ This information was supplied on 12 January 2012 pursuant to a s.155 notice.

²⁷ Subsections 152AB(6) and (7A) of the CCA.

Hence, it is unlikely that the IAD would prevent Telstra from recovering the costs of its DSL network and other relevant investments, including earning an appropriate return commensurate with risk on capital employed.

The ACCC also formed the view that the IAD will not materially affect incentives for service providers to invest in their own DSL networks and other facilities.

In this regard, the ACCC considers that making the IAD will not deter service providers from maintaining existing DSL and backhaul networks, and augmenting capacity on those networks. This conclusion arises from the largely fixed and sunk nature of these networks, and hence a service provider would face lesser costs by using its existing network facilities rather than migrating services to the Telstra DSL network and pay the charges specified in the IAD.

Further, the IAD charges are unlikely to deter investment by other service providers in existing facilities to provide wholesale services. This view reflects the difference between regulated access rates for the ULLS and those specified in the IAD, either alone or in combination with the regulated rates for the WLR. These differences indicate that it is likely that an efficient service provider could acquire the ULLS and supply downstream wholesale services at the rates specified in the IAD. As noted previously, these networks have limited geographic reach, and this wholesale competition has not fully developed to date.

Similarly, the ACCC considered whether making the IAD could deter service providers from investing in further DSL network and backhaul facilities so as to expand into additional ESAs. The ACCC formed the view that the risk of the IAD having this effect was low given the limited prospects for significant network expansion in any event.

This reflects, firstly, the low trend data for DSL network expansion that Telstra reports under the Telstra Customer Access Network Record Keeping Rule²⁸, and secondly the absence of a clear catalyst to invigorate a significant expansion in the footprint of competing networks. Consequently, the prospect for significant network expansion appears modest in any event.

Further, whether the IAD would preclude service providers from making additional network investments that were otherwise economically feasible would depend upon the costs and benefits of providing on-net services as compared to using the Telstra network at the IAD rates. In this regard, the ACCC's view is that the access charges provided in the IAD would not 'tip the balance' in a way that meant an access seeker would always choose to buy access to the Telstra DSL network instead of investing in their own facilities.

The ACCC also considered the possible consequences of making the IAD for NBN investment incentives. In this regard, the ACCC formed the view that the IAD will not deter NBN Co from investing in its fibre access networks. This is because the access prices in the IAD are materially above the level at which NBN Co has announced an intention to supply similar access services, and hence there is little potential for the IAD to deter service providers from migrating services onto the NBN as it becomes available.

²⁸ Summary reports for each quarter since September 2007 are available at www.accc.gov.au

Any-to-any connectivity

The ACCC considered that the making of the IAD would not have an effect on the achievement of any-to-any connectivity. This is because the IAD deals with commercial terms of access only and does not address issues relating to the interconnection of networks.

7 Particular issues relevant to making the IAD

7.1 Price related terms and conditions

A number of issues of methodology and quantification arose when developing the price terms that are specified in the IAD.

Choice of methodology

The IAD is based upon a Retail Minus Retail Cost (RMRC) methodology, which calculates a wholesale rate table from Telstra's retail price terms and the costs it incurs in transforming network access into retail ADSL services.

This method takes as its starting point Telstra's average retail price for ADSL services (net of discounts), and then deducts Telstra's average cost of converting wholesale access into retail services to provide a measure of monthly wholesale yield.

That is, the RMRC method will identify the residual of retail ADSL revenues after Telstra has accounted for the costs it incurs to transform the wholesale input into a retail service. This residual is the implicit wholesale revenue that Telstra would have available to recover its wholesale input costs when it supplies ADSL services.

The RMRC method then breaks this wholesale yield measure down into a wholesale rate table that includes the material individual charge items that wholesale customers face: connection, early termination, monthly end user access and AGVC/VLAN charges. An allowance is also provided for the other wholesale charges that are imposed from time to time for access to the Service.

This step essentially seeks to identify the charge terms that Telstra would implicitly face if the same charging structure was applied to both the retail business and to wholesale customers.

Further details concerning the implementation of this methodology are provided later in these reasons.

The choice of the RMRC methodology reflects the ACCC's view that if properly applied this methodology can address the immediate competition concerns relating to the Service. Further, the RMRC methodology can be applied relatively quickly, as typically less information is required and necessary data are more readily available as compared to other pricing methodologies.

An alternative would have been to adopt a cost based method, similar to that which the ACCC used in developing the 2011 FAD for fixed line access services.²⁹ However, developing cost based charges would take more time and hence was not considered as suitable for making a timely IAD in this case.

²⁹ See ACCC, Inquiry to make final access determinations for the declared fixed line services, Final report, July 2011

While the ACCC has not chosen a cost based methodology for the purposes of this IAD, this is an issue that the ACCC will consider further during the FAD inquiry. It should not be presumed from making this IAD that the ACCC has a current presumption as to which methodology would be preferable for the purpose of a FAD.

Application of the RMRC methodology

The detailed RMRC method that was used to calculate the IAD price terms is based on a method proposed by Telstra in support of its SSU, and reflected in a confidential price model that Telstra provided to the ACCC on 18 November 2011 (the Telstra price model).

This price model contains a range of data that are confidential to Telstra such as the amount of costs it incurs in retailing ADSL services, and the distribution of its retail customers across individual ADSL plans and bundled products that include ADSL.

The ACCC made some changes to the detailed method that was reflected in the Telstra price model. These changes are outlined below. The updated methodology is applied in the price model at Attachment B (the ACCC price model). The ACCC price model uses a range of data that are confidential to Telstra and which were sourced from the Telstra price model.

– Average retail price

The method used to calculate the average retail price (which provides the starting point for the RMRC calculation) was modified to:

- include in the calculation all retail ADSL plans that Telstra was offering at the time it provided its model, and not just retail ADSL2+ plans – this in effect results in an average retail price that is ‘blended’ across both ADSL2+ and other ADSL services. This reduces the retail yield somewhat to the extent that other ADSL services are sold at a discount to ADSL2+ plans.
- reduce the measure of Telstra’s connection revenue to better reflect Telstra’s current retail ADSL connection charges of \$90 (GST excl) on a twelve month contract or \$0 on a twenty four month contract.³⁰ The monthly connection revenue was calculated by amortising an average charge of \$45 (GST excl) over an eighteen month period. This reflects an equal distribution of retail connections on twelve month and twenty four month plans. This reduces the monthly yield somewhat from the value used in the Telstra model, which calculated this measure by amortising a charge of [c-i-c] (GST excl) over [c-i-c] months.
- make an allowance for short term offers, and billing level discounts and rebates, that Telstra offers from time to time, as short term offers and not all discounts and rebates would be reflected in the Telstra price model.

These changes reduce the average retail price used in the ACCC price model to [c-i-c] per month, which is around [c-i-c] per month less than the Telstra price model provides.

³⁰ Source: <http://go.bigpond.com/broadband/29-plan/>

The ACCC made these changes to ensure that access seekers are not disadvantaged when matching Telstra's retail plans (including for more basic ADSL services), to the extent that they have a similar customer mix as Telstra.

Making these reductions better aligns the average retail price used in the ACCC price model with the retail yields for fixed broadband services (excl hardware³¹) that Telstra reports in its public 2011 full year results and operations review.³² Telstra's most recent public results indicate that this retail yield measure has not materially changed from the June 2011 value.³³

These publicly reported retail yield data reflect both retail DSL and cable services, however, they provide an indication that the yield Telstra actually achieves on retail ADSL products is likely to be close to, and is unlikely to be below, the average retail price that is used in the ACCC price model.

In this regard, most recent data that Telstra has supplied to the ACCC under the Division 12 RKR broadly indicates that Telstra's average retail ADSL yields would be at or slightly below the yield it earns on retail fixed broadband services more generally. Further, the average retail price used in the ACCC price model remains above (by less than five percent) the publicly reported yield for retail fixed line broadband services (excl hardware) that Telstra reports.

The IAD does not specify separate wholesale prices for where the Service is acquired on a stand alone basis or as part of a broader product bundle, but rather specifies a 'blended' wholesale price that applies to each circumstance.

This issue arises because Telstra offers a 'bundling discount' where the retail ADSL service is taken as part of a broader retail product bundle. Hence, an average 'bundled' retail price will be lower than an average 'stand alone' retail price. The method that the ACCC has applied results in an overall average retail price which falls between the two bounds.

The ACCC's current view is that a blended approach will allow service providers to compete through the offering of bundling discounts to the same extent that Telstra does.

Consequently, for the purpose of the IAD, a single retail starting price has been calculated, rather than calculating separate starting prices for stand alone and bundled ADSL services.

A related issue is the treatment of retail ADSL services that are sold as part of a bundled product without an explicit price for the ADSL component. For those bundled plans, the ACCC has adopted the same method as was used in the Telstra price model, which is to derive the bundling discount by deducting the bundled product price from the sum of the prices at which it sells the component products on a stand alone basis. This bundling discount is then split equally between the component products.

³¹ The exclusion of fixed broadband hardware revenue is consistent with the approach taken in the ACCC price model and Telstra price model, which each exclude revenues and costs associated with the supply of ADSL hardware

³² Telstra 2011 Annual Report, p.14, reports a monthly yield of \$56.04 for retail fixed broadband services (excl hardware) for 2010-11, trending down from the prior year.

³³ Telstra, Report for Half Year ended 31 December 2011, p.14, reports a monthly yield of \$55.39 for retail fixed broadband services (excl hardware) for the six month period ending 31 December 2011.

The ACCC did not adopt an approach for the IAD that took the lowest retail price in the market as the starting point. This reflected the view that such an approach would not provide a reasonable basis to set wholesale ADSL prices that were broadly applicable to the Service.

– *Retail cost measures*

The overall retail cost measure was calculated using the same method as was used in the Telstra price model and was based upon the same underlying cost data.

However, the ACCC applied the WACC value that was used in the July 2011 fixed line final access determination (8.54 per cent)³⁴ rather than a higher WACC value that was used in the Telstra price model. This was done so that regulatory pricing decisions for fixed line services reflect a consistent view of an appropriate return commensurate with risk on capital employed in providing these services.

This lowered the allowance for the cost of capital that Telstra has employed in the retailing of ADSL services. This had the effect of slightly *reducing* the measure of Telstra's retail costs (by 2 per cent) and *increasing* the derived wholesale yield.

The ACCC also reclassified certain of the retail cost categories from being of a fully fixed nature so that a proportion of those costs are treated as being variable in the short run. The relevant cost categories were sales, installation/activation, customer support and billing. This reflects the view that, although Telstra would face these costs should it cease to supply retail ADSL services across all ESAs in which it currently operates, the amount of costs Telstra would face would reduce to an extent.

The ACCC modified these classifications after reviewing Appendix A to the ADSL2+ reference price documentation and a listing of cost pool allocation driver trees that Telstra provided to the ACCC in 2011, which provided additional explanation of the nature of the costs included within the relevant cost categories.

A geographic increment was chosen for this analysis as the classification of costs informs the balance of monthly end user access charges in Zone 1 and Zone 2+3 respectively – that is, the RMRC model calculates monthly end user access charges in each Zone so that they allow an access seeker to recover all short run marginal retail costs, and a proportion of fixed costs, from revenues that would be earned in that Zone.

This adjustment rebalances Zone 1 and Zone 2+3 charges to an extent, so that Zone 1 prices increase and Zone 2+3 prices decrease.

The ACCC did not move to implement a nationally consistent wholesale charge for the purpose of the IAD. Such a fundamental change in the structure of access charges would be better suited to consideration during the FAD inquiry.

– *Connection and other charges*

The Telstra price model was prepared on the basis that all new services would require the payment of a standard connection charge, and that this charge should be recovered over twenty four months.

³⁴ ACCC, Inquiry to make final access determinations for the declared fixed line services, Final report, July 2011, at p.49

The ACCC varied each of these assumptions. An average wholesale connection charge was calculated, rather than a Standard access charge, reflecting that Telstra offers a different connection charge when work is required at the exchange and when the connection does not require this work. This reduced the wholesale connection charge amount.

The amortisation period was reduced from twenty four months to eighteen months. This change is consistent with the view, taken when calculating available retail connection revenues, that retail customers would choose between twelve month and twenty four month plans in roughly equal numbers. This tends to increase the monthly allowance to recover the wholesale connection charge.

The net effect was to reduce the allowance made for the recovery of wholesale connection charges. As discussed later, this tends to *increase* the monthly end user access charge.

The Telstra price model made an allowance for wholesale early termination charges, but did not include an allowance for other miscellaneous charges that an access seeker would need to pay from retail ADSL revenues. These include charges for reversals, fault reporting, port reconfiguration, service qualifications and ATM/TWE access.³⁵

For the purposes of the IAD, the ACCC provided an allowance of \$1.30 per SIO/mth from which to pay these miscellaneous charges. This includes the amount that Telstra proposed for wholesale early termination charges, as well as an additional allowance from which to pay the other miscellaneous charges.

The allowance was made having regard to the level of Telstra's standard charges³⁶ and the ACCC's view that many of the miscellaneous charges, although of a material value, would be incurred relatively infrequently.

This change tends to reduce the monthly end user access charge given that the Telstra price model only made an allowance for early termination charges and not the full range of such charges that access seekers face under Telstra's wholesale ADSL contracts.

The ACCC did not make an allowance for wholesale 'fast fix' charges. This is because Telstra charges for this service at the retail level, and hence a wholesale customer that acquired the wholesale fast fix service could similarly pass the wholesale charges through to the retail customer as an additional fee.

– *AGVC/VLAN charges*

In broad terms, under a RMRC methodology, wholesale ADSL charges should reduce as customers use their ADSL connections to send and receive more data, i.e., as AGVC/VLAN network utilisation increases. Telstra explained this when supporting the use of RMRC for calculating wholesale ADSL prices for the purpose of its SSU:

³⁵ As noted previously, ATM/TWE access is a prerequisite to the supply of wholesale ADSL services – see Telstra, Fact Sheet Data Solutions DSL Internet Grade, available at: <http://www.telstrawholesale.com>

³⁶ These standard charges for many of the miscellaneous charges are provided in the information Telstra provided on 12 January 2012; details of the ATM/TWE charges were provided in confidential submissions to the wholesale ADSL declaration inquiry.

Increases in retail customer usage mean that more data needs to be transported from its sources to end users and, to replicate the offers made by Telstra's retail business units, wholesale customers would need to purchase more AGVC transmission. Therefore, the AGVC price component will need to fall as Telstra's retail customer usage increases.³⁷

The ACCC has implemented this objective in the IAD pricing by first calculating the monthly AGVC/VLAN yield that was implied from the Telstra price model **(c-i-c)** per SIO per month = **(c-i-c)** Mbps x \$55 per Mbps).

The ACCC then unitised this yield based upon the forecast busy hour network utilisation rate for Telstra's retail ADSL services in the period to which the IAD will apply.

This method applies the resulting price changes to the AGVC/VLAN price element, rather than monthly end user access charges. This approach was considered appropriate given it more directly allows wholesale customers to match the Telstra retail offers that are causing the increase in network utilisation.

A separate estimate was made for average network utilisation (averaged over Telstra retail ADSL SIOs) for the half year to 30 June 2012 and the half year to 31 December 2012. The ACCC made these estimates based upon data points that are contained in the Telstra price model for June 2011 and June 2012 using a simple arithmetic progression.

These estimates were then applied to derive separate monthly AGVC/VLAN charge rates per Mbps to apply up until 30 June 2012 and from 1 July 2012 respectively.

The ACCC calculated separate AGVC/VLAN charge rates for each six month period, rather than specified a more averaged annual rate. This reflects that the busy hour network utilisation rate for fixed broadband services is growing strongly, and is likely to continue to do so for the period to which the IAD relates.

This is apparent in the average network utilisation data that are contained in the Telstra price model. Similarly, the ABS reports show strong growth in volume of data downloaded over fixed broadband services, which is consistent with a substantial increase in the average busy hour network utilisation.³⁸

Looking ahead, a key driver of network utilisation is demand for high bandwidth applications supplied over ADSL services, such as IPTV and other audio visual applications or content. In this regard, Telstra is actively promoting IPTV services supplied over ADSL services, and has indicated that it wishes to continue to grow this business further in future.³⁹

The resulting AGVC/VLAN charge rates specified in the IAD are less than the \$55 per Mbps rate that is used in the Telstra price model. This results from applying (higher) demand forecasts specific to the period to which the IAD will apply.

³⁷ See Telstra, "A Guide to Telstra's price-related interim equivalence and transparency obligations", published on 5 September, at p.3, and available at: <http://www.accc.gov.au/content/index.phtml/itemId/1003999>

³⁸ ABS, Internet Activity Australia, June 2011 published 28 September 2011. The correlation between increases in volume of data downloaded and busy hour network utilisation rate will depend upon the distribution of the additional downloads around the busy hour.

³⁹ McDulligan, Telstra expands its vision for T-Box, Australian Financial Review, 30 January 2012.

On the other hand, the AGVC/VLAN rate that was contained in the Telstra price model was for the 12 month period ending 30 June 2012, and included in its calculations data for the six month period preceding the making of the IAD, in which demand was relatively low.

– *Wholesale early termination charges*

Telstra charges an early termination fee when a Service is cancelled within a specified period from connection, but does not charge a fee for a Service that is connected for more than the specified period. Telstra's standard term is that a fee of \$50 is payable for a termination within six months of connection. For the purposes of the IAD, the ACCC preserved this position.

The ACCC notes that Telstra waives this fee for services that migrate to a Telstra wholesale fibre access broadband service only, but not when services are migrated to competing networks. Hence this price term has the potential to distort commercial decisions of access seekers should they migrate services to wholesale fibre products.

At this stage it is not clear that there will be significant migration of services from wholesale ADSL to fibre networks during the period in which the IAD will be in effect. Consequently, the IAD does not address this price term. This is a matter that the ACCC could consider further during the FAD inquiry process, given the greater potential for a significant migration of services in the medium term.

– *Deriving individual charge items from the average wholesale yield*

The ACCC used the same general method that is used in the Telstra price model to derive the individual charge items (connection, early termination, monthly end user access and AGVC/VLAN charges) from the wholesale yield measure.

This method first deducts, from the wholesale yield, allowance to pay the one off connection charges, early termination and other miscellaneous charges, and the monthly AGVC/VLAN charge per SIO. The remaining wholesale yield is recovered through the monthly end user access charges.

Hence, increases in the amounts allowed for the recovery of the one off connection and early termination charges, other miscellaneous charges, and the monthly average AGVC/VLAN charge, will tend to reduce the monthly end user access charge, and vice versa.

– *Updating the IAD charges*

While the IAD price terms are consistent with current data, there is potential for an RMRC derived charge to fall out of date with market developments. Retail price points, discounts or rebates, or the mix of customers can affect the average retail yield being realised. Similarly, the AGVC/VLAN network utilisation rate could increase at a higher or lower rate than forecast, or retail costs could trend up or down over time. Consequently, there will be potential for the RMRC derived charges in the IAD to require periodic updating.

In this regard, the ACCC intends to monitor market developments and to consider varying the IAD where it is appropriate to do so.

7.2 Non-price terms and conditions

The ACCC decided to include certain non-price terms and conditions in the IAD for the Service to provide greater certainty to service providers of the default commercial terms in the interim period before the FAD is made.

Standard commercial terms

The ACCC considers that the most appropriate standard non-price terms and conditions for the purposes of this IAD are those contained in the 2008 Model Terms. This is consistent with the view taken by the ACCC in making other access determinations.

The non-price terms and conditions in this IAD cover the following matters:

- (a) billing and notification
- (b) creditworthiness and security
- (c) general dispute resolution procedures
- (d) confidentiality
- (e) communication with end-users
- (f) suspension and termination

This ACCC included those particular terms as it considers that they are the fundamental commercial terms that are relevant to the Service, and the inclusion of these terms in the IAD will reduce the potential for disputes between parties in respect of them until a FAD is made.

The IAD does not include the remainder of the 2008 Model Terms. This is because these non-price terms do not appear relevant to the supply of the Service.

Restrictions or limitations on resale services

The ACCC also included additional non-price terms and conditions of access in the IAD in order to respond to concerns (expressed in submissions to the ACCC's inquiry into whether to declare the wholesale ADSL service) that particular access terms could impede competition from developing in wholesale markets.

In particular, submissions have raised a concern that restrictions on the acquisition of the Service for resale have been attached to commercial offers, and that this impedes an access seeker in supplying wholesale ADSL services in certain areas and more generally.⁴⁰

In this regard, the IAD provides that the Service can be acquired for the purpose of resale on the terms specified in the IAD, and that an access seeker is not required to notify Telstra when it acquires the Service for supply to a reseller (such as the identity of its downstream customer) nor seek Telstra's consent to that resale arrangement.

⁴⁰ See [c-i-c] submission, January 2012, [c-i-c]. Information obtained from Telstra on 12 January 2012 under a s.155 notice identifies whether similar terms are being included in access agreements for the Service.

Access terms not addressed in the IAD

In the ACCC's inquiry into whether to declare the Service, access seekers raised concerns about a number of non-price terms. The IAD does not address all of these issues, but they can be considered in the FAD inquiry.

Where the IAD has not addressed these access terms, this reflects the view that there is not a clear requirement for the access terms to be addressed for the interim period, and/or that further information would be required to specify appropriate access terms to apply in respect of those matters.

8 Application of the SAOs to non-dominant carriers

Applying the SAOs to Telstra will ensure that a wholesale ADSL service will be available in all ADSL-enabled ESAs, given that Telstra's DSL network is present in each of those areas. Further, it is only Telstra's access terms that have given rise to competition concerns in regard to the Service.

In these circumstances, it is not clear that applying the SAOs to other access providers – which operate DSL networks that reach only a relatively small proportion of ADSL enabled ESAs – would promote the LTIE. Hence, the IAD provides that the SAOs do not apply to access providers other than Telstra. However, this is a matter that the ACCC can consider further during the FAD inquiry.

9 Commencement and expiry

The IAD will commence on 15 February 2012 being the date immediately following the day that the declaration of the Service came into effect.

The CCA requires an access determination to specify an expiry date. The ACCC considers that the expiry date should provide assurance that an interim access determination will apply up until the date that the FAD is made. As noted below, the ACCC is of the view that the FAD inquiry process will likely take longer than six months. Consequently, the ACCC has specified that the IAD will expire on 14 February 2013, which is twelve months from the date that the FAD inquiry process commenced.

As noted above when a FAD commences, the IAD for that service will automatically be revoked.⁴¹

10 FAD inquiry process

The ACCC has commenced a public inquiry into the FAD for the Service.

The ACCC expects that a wide range of issues will be raised in the course of the FAD inquiry, including issues of fundamental approach to pricing the declared wholesale

⁴¹ Section 152BCF(9A) of the CCA.

ADSL service and the scope and content of non-price terms that should also be included.

It is the ACCC's experience that investigating and reaching a view on such matters takes considerable time. In particular, it is likely that additional information will be required in order to evaluate the alternative approaches to developing the access price terms for the FAD, and to implement the approach that is adopted.

Consequently, the ACCC considers that it is unlikely that a FAD will be made within six months of the FAD inquiry commencement.

Attachment A

The object of Part XIC of the CCA is to promote the long term interests of end-users of carriage services or of services provided by means of carriage services (the LTIE).⁴²

The ACCC considers the LTIE in the course of making access determinations, and a range of other regulatory decisions under Part XIC of the CCA.

The ACCC has published a guideline explaining what it understands by the phrase ‘long-term interests of end-users’ in the context of its declaration responsibilities.⁴³ This approach to the LTIE was also used by the ACCC in making determinations in access disputes. The ACCC considers that the same interpretation is also appropriate when making access determinations.

In the ACCC’s view, particular terms and conditions promote the interests of end-users if they are likely to contribute towards the provision of:

- goods and services at lower prices
- goods and services of a high quality, and/or
- a greater diversity of goods and services.⁴⁴

The ACCC also notes that the Australian Competition Tribunal (Tribunal) has offered guidance in its interpretation of the phrase ‘long-term interests of end-users’ (in the context of access to subscription television services):

Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary to take the following matters into account when applying the touchstone – the long-term interests of end-users:

* End-users: “end-users” include actual and potential [users of the service]...

* Interests: the interests of the end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings. ...[T]his would include access to innovations ... in a quicker timeframe than would otherwise be the case ...

* Long-term: the long-term will be the period over which the full effects of the ... decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the ... industry) to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit – strategies.⁴⁵

More particularly, to consider the likely impact of particular terms and conditions on the LTIE, the CCA requires the ACCC to have regard to whether the terms and conditions are likely to result in:

⁴² section 152AB CCA

⁴³ ACCC, Telecommunications services – declaration provisions: a guide to the declaration provisions of Part XIC of the Trade Practices Act, July 1999, in particular pp. 31–38.

⁴⁴ *ibid.*, p. 33.

⁴⁵ *Seven Network Limited (No 4)* [2004] ACompT 11 at [120].

- promoting competition in markets for carriage services and services supplied by means of carriage services
- achieving any-to-any connectivity, and
- encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied, and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.⁴⁶

Promoting competition

In assessing whether particular terms and conditions will promote competition, the ACCC analyses the relevant markets and considers whether the terms of access remove obstacles to end-users gaining access to services.⁴⁷

Obstacles to accessing these services include the price, quality and availability of the services and operational processes that could impede competing providers from supplying services.

The ACCC is not required to precisely define the scope of the relevant markets. The ACCC considers that it is sufficient to broadly identify the scope of the relevant markets likely to be affected by the ACCC's regulatory decisions. In general terms, the relevant markets could include those for the supply of the declared services, or for the supply of services (retail and/or wholesale) which use the declared services as an input.

Any-to-any connectivity

The CCA gives guidance on how the objective of any-to-any connectivity is achieved. It is achieved only if each end-user who is supplied with a carriage service that involves communication between end-users is able to communicate, by means of that service, with each other end-user who is supplied with the same service or a similar service. This must be the case whether or not the end-users are connected to the same telecommunications network.⁴⁸

The ACCC considers that this criterion militates against the inclusion in an access determination of terms and conditions that create obstacles for the achievement of any-to-any connectivity.

Efficient use of and investment in infrastructure

In determining the extent to which terms and conditions are likely to encourage the economically efficient use of and investment in infrastructure, the ACCC must have regard to:

- whether it is, or is likely to become, technically feasible for the services to be supplied and charged for, having regard to:
 - the technology that is in use, available or likely to become available

⁴⁶ Subsection 152AB(2) of the CCA.

⁴⁷ Subsection 152AB(4) of the CCA. This approach is consistent with the approach adopted by the Tribunal in *Telstra Corporations Limited (No 3)* [2007] A CompT 3 at [92]; *Telstra Corporation Limited* [2006] A CompT at [97], [149].

⁴⁸ Subsection 152AB(8) of the CCA.

- whether the costs involved in supplying and charging for, the services are reasonable or likely to become reasonable, and
 - the effects or likely effects that supplying and charging for the services would have on the operation or performance of telecommunications networks
- the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope
 - incentives for investment in the infrastructure by which services are supplied; and any other infrastructure (for example, the NBN) by which services are, or are likely to become, capable of being supplied, and
 - the risks involved in making the investment.⁴⁹

The objective of encouraging the ‘economically efficient use of, and economically efficient investment in ... infrastructure’ requires an understanding of the concept of economic efficiency. Economic efficiency consists of three components:

- productive efficiency – this is achieved where individual firms produce the goods and services that they offer at least cost
- allocative efficiency – this is achieved where the prices of resources reflect their underlying costs so that resources are then allocated to their highest valued uses (i.e., those that provide the greatest benefit relative to costs), and
- dynamic efficiency – this reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in productive opportunities.

On the issue of efficient investment, the Tribunal has stated that:

An access charge should be one that just allows an access provider to recover the costs of efficient investment in the infrastructure necessary to provide the declared service.⁵⁰

...efficient investment by both access providers and access seekers would be expected to be encouraged in circumstances where access charges were set to ensure recovery of the efficient costs of investment (inclusive of a normal return on investment) by the access provider in the infrastructure necessary to provide the declared service.⁵¹

...access charges can create an incentive for access providers to seek productive and dynamic efficiencies if access charges are set having regard to the efficient costs of providing access to a declared service.⁵²

⁴⁹ Subsections 152AB(6) and (7A) of the CCA.

⁵⁰ Telstra Corporation Ltd (No. 3) [2007] ACompT 3 at [159].

⁵¹ *ibid.* at [164].

⁵² *ibid.*

Attachment B

Confidential ACCC price model

Annexure: Service description for the Wholesale ADSL Service

The wholesale asymmetric digital subscriber line service (Wholesale ADSL Service) is an internet-grade, best efforts point to point service for the carriage of communications in digital form between a **point of interconnection** and an **end-user network boundary** that:

- (a) is supplied by means of **Asymmetric Digital Subscriber Line (ADSL)** technology over a twisted metallic pair that runs from the end-user network boundary to the nearest upstream exchange or RIM or CMUX; and
- (b) uses a static **Layer 2** tunnelling protocol (L2TP) over a transport layer to aggregate communications to the point of interconnection.

Definitions

Where words or phrases used in this declaration are defined in the *Competition and Consumer Act 2010* or the *Telecommunications Act 1997*, they have the meaning given in the relevant Act.

In this Annexure:

Asymmetric Digital Subscriber Line technology or **ADSL** means the protocols, recommendations and standards set out in the ITU-TG.992 Recommendations.

Layer 2 has the same meaning as in the Open System Interconnection (OSI) Reference Model for data exchange.

a **point of interconnection** means an interface that is:

- (a) a physical point of interconnection which allows the interconnection of facilities in accordance with subsection 152AR(5) of the *Competition and Consumer Act 2010*; and
- (b) located in the same state/territory that the access provider associates with the exchange service area in which the **end-user network boundary** is located.

an **end-user network boundary** means the boundary point of the telecommunications network that is:

- (i) associated with the end-user premise; and
- (ii) ascertained in accordance with section 22 of the *Telecommunications Act*.