



Optus Submission

in response to the ACCC's Draft Report

Public Inquiry to make a Final Access Determination for the  
Wholesale ADSL service

April 2013

**Public Version**

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## Section 1. Overview

- 1.1 Optus welcomes the proposed adoption of cost-based Wholesale ADSL (WADSL) rates, and the use of the Fixed-Line Services Model (FLSM). It is accepted that the long term interest of end-users (LTIE) is promoted by setting access prices at a level reflecting the efficient cost of supply. The recovery of efficient costs also promotes the legitimate commercial interests of access providers. However, the adoption of an appropriate modelling methodology is only the first step to ensure that regulated access prices promote the LTIE — an efficient methodology does not by itself guarantee efficient rates. The LTIE will only be promoted through the use of an appropriate methodology and use of appropriate cost inputs and modelling assumptions.
- 1.2 Optus has some significant concerns with the way the ACCC has implemented its cost based methodology for WADSL in the FLSM. In particular, Optus considers that the Draft Report has placed too much emphasis on price stability over other components of the LTIE in setting prices. This appears to have manifested itself in an over reliance on the modelling of the assumptions and forecasts put forward by Telstra.
- 1.3 As a result of this approach, WADSL prices have largely remained stable notwithstanding a material change in the underlying cost methodology. Further, the proposed prices are materially above comparable services supplied by alternative competitive suppliers and the NBN fibre services.
- 1.4 Optus raised similar concerns in 2010 when the ACCC introduced the FLSM to set prices for other fixed-line access services, such as ULLS. Notwithstanding a material reduction in Telstra's Regulatory Asset base at that time, the output prices for those access services remained stable.
- 1.5 Optus has the following detailed concerns in the setting of WADSL access prices in the FAD Draft Report:
  - (a) The proposed WADSL rates are inconsistent with the competitive price of supply. Further, it is set at a level that precludes competitive carriers from using WADSL to replicate current Telstra retail ADSL offers. Either the costs used in the model are above efficient costs incurred, or Telstra is engaging in margin squeeze behaviour by pricing under the efficient cost of supply.
  - (b) The proposed WADSL port and AGVC charges imply corresponding asset costs that are far in excess of the data equipment and transmission costs faced by Optus. Further, the AGVC cost is over 50% higher than NBN Co's CVC pricing — even though the NBN backhaul service leases access to Telstra ducts and fibre links. It is not clear how one provider can charge significantly less using some of the same assets.
  - (c) Failure to adjust required revenue attributed to other regulated services means that Telstra will receive a windfall of \$[CIC] million in 2013-14 above the required revenue for all fixed-line services.
  - (d) The amendments to the FLSM required to include the WADSL service contain several errors that do not promote the LTIE, including:
    - (i) Failure to remove building and land costs from allocation factors transposed into the FLSM from the Analysis Mason Model.

- (ii) Failure to adjust capex allocation to take into account capex that is driven by Telstra's agreement with NBN Co.
- (iii) Use of an arbitrary ratio to allocate costs between WADSL port and AGVC charges rather than using cost-based allocations.
- (iv) Acceptance of Telstra's assertion that it does not have any expenditure forecasts, notwithstanding that such a claim is at odds with proper governance of publicly listed companies.
- (v) Transforming per SIO AGVC revenue to a peak per Mbps rate using average usage per SIO. The ACCC also fails to use information provided by Telstra during the current consultation process showing it experiences **[CiC]** per annum growth in peak traffic.

- 1.6 Optus considers that with the application of more reasonable, the FLSM would result in WADSL port charge in zone 1 of **\$16.05**; WADSL port charge in zone 2/3 of **\$19.48** and an AGVC charge of **\$13.96** per Mbps. These estimates should be treated as upper bounds as no adjustments have been made to take into account the prudence of Telstra's expenditure or differences between forecast assumptions and Telstra's public statements to the stock exchange. Optus also queries how a port charge of \$16 could be considered efficient given pricing in other jurisdictions. Optus notes the current New Zealand proposal to set WADSL port charge at \$7.14 per month.<sup>1</sup> It is unclear how the cost to supply and operate the same piece of telecommunications equipment can cost more than twice as much for Telstra than in New Zealand.
- 1.7 Further, the ACCC has refused to allow the unbundling of WADSL, on the basis that Telstra will incur some costs to enable unbundled services to be supplied. Optus' analysis shows that consumers would be better off by more than \$6 per connection per month if the ACCC required Telstra to provide naked WADSL. Given this clear net benefit to end-users it is unclear why the ACCC does not allow unbundling.
- 1.8 In summary, it is unclear how the WADSL pricing proposed in the FAD Draft Report will stimulate further competition in the transition to the NBN. In finalising the FAD, Optus submits that the primary focus of the ACCC should be to stimulate increased competition in the transition to the NBN. Further, given current uncertainties around the NBN roll-out, the ACCC should be mindful that it is likely that WADSL may have a greater role to play in the mix of competitive access technologies.

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<sup>1</sup> NZCC, 2012, Draft Determination to amend the price payable for the regulated service Chorus' unbundled bitstream access made under s 30R of the Telecommunications Act 2001, table 1. 1NZD = 0.80AUD.

## Section 2. Proposed rates are inconsistent with the LTIE

- 2.1 The WADSL declaration decision stated that “*Telstra has strong incentives to engage in entry-detering conduct to maintain and grow its market share*”.<sup>2</sup> It was highlighted that WADSL charges were high, and “*even without considering network and overhead costs, any of the wholesale ADSL charges would make it difficult to replicate Telstra’s entry level bundled phone and ADSL \$59.95 offer*”.<sup>3</sup> It was concluded that in “*the future with declaration, the availability of wholesale ADSL on regulated terms is likely to promote competition by encouraging entry and expansion by efficient operators*”.<sup>4</sup> The decision also identified that declaration may allow access seekers to build scale prior to transition to NBN “*in order to promote product innovation and differentiation, and to engage in effective competition with Telstra*”.<sup>5</sup> For these reasons the ACCC concluded that declaration of the WADSL service would promote the LTIE.
- 2.2 However, the proposed pricing in the FAD Draft Report appears inconsistent with the statements made during the declaration process. The ACCC seems to no longer place the same weight on these factors. The ACCC takes the view that the LTIE is promoted by ensuring adequate compensation for, and recovery of all costs, by Telstra.<sup>6</sup> The FAD Draft Report states:

*the ACCC considers that adopting a cost-based approach will promote the LTIE for the following reasons:*

- (i) *The cost-based approach ensures the access provider is adequately compensated for the cost of providing the declared service over time. The estimated revenue requirement allows the access provider to recoup its efficiently incurred costs, including a commercial risk-adjusted return on its investments.*
- (ii) *Determining pricing through a transparent and cost-based pricing model will provide regulatory certainty for both the access provider and access seekers about the way in which the ACCC will set prices for wholesale ADSL over time. Such certainty promotes efficient investment and competition in the markets for carriage services.*
- (iii) *Using a cost-based approach will ensure that prices for wholesale ADSL services are based on the efficient costs of providing access. This will allow access seekers to obtain access to the wholesale ADSL service on reasonable price terms for the purpose of providing downstream broadband services and thereby promote competition in downstream markets.*<sup>7</sup>

- 2.3 Optus agrees with the view expressed in the draft decision that “*when effectively implemented, a cost-based approach provides a direct estimate of the efficient costs*” of supply.<sup>8</sup> Optus has long advocated for use of a depreciated actual cost method in relation to fixed line services.<sup>9</sup> However, the efficiency of FLSM outputs is dependent on the efficient

<sup>2</sup> ACCC, Declaration of WADSL, final decision paper, p.32.

<sup>3</sup> Ibid., p.34.

<sup>4</sup> Ibid., p.38.

<sup>5</sup> Ibid., p.45.

<sup>6</sup> ACCC, FAD Draft Report, pp.5, 7 & 27.

<sup>7</sup> Ibid., p.27.

<sup>8</sup> Ibid., p.23.

<sup>9</sup> See Optus, 2010, *Submission to Australian Competition and Consumer Commission in response to discussion paper Telecommunications Access Pricing Principles for Fixed Line Services*.

implementation of the model. Optus has previously commented that access prices must be clearly linked to expenditure which is likely to be prudently incurred.<sup>10</sup> The ACCC has already artificially uplifted the RAB by \$911 million to maintain ULLS pricing stability. Optus is concerned that the ACCC is again proposing a RAB adjustment that results in stable access prices, rather than examining whether the RAB adjustment reflects efficient and prudent actual costs.

- 2.4 The ACCC seems to take the view that adoption of a modelling methodology automatically results in recover of efficient costs and setting of efficient prices. There is no evidence in the FAD Draft Report that Telstra's RAF cost inputs have been investigated to identify and exclude inefficient costs. Notwithstanding comments that the FLSM allows recovery of efficient costs, there does not appear to be any investigation into whether the costs added to the FLSM represent efficient and prudent expenditure.
- 2.5 Optus recognises that an analysis of the efficiency of the costs put forward by Telstra may not be practical in the current FAD process. However, the ACCC should undertake an assessment whether the outputs of the FLSM produce reasonable and efficient outcomes. Where the output of the FLSM is inconsistent with efficient comparators, it can be inferred that the costs incurred are above the prudent level.
- 2.6 To this end, the remainder of this section:
  - (a) assesses whether the proposed WADSL charges are consistent with the cost of supply using alternative suppliers, including NBN Co;
  - (b) compares the implied equipment costs from the FLSM to actual equipment costs;
  - (c) assesses whether the AGVC charge is consistent with competitive supply and other regulatory benchmarks; and
  - (d) assesses whether the proposed pricing enables competition using regulated services.

### **Proposed WADSL rates are inconsistent with competitive price of supply**

- 2.7 The proposed cost to supply a retail ADSL service using the WADSL service is as follows:
  - (a) \$24.56 for WADSL port;
  - (b) \$22.84 for WLR;
  - (c) **[CiC]** per connection for AGVC (using the ACCC's assumptions as to usage per SIO).<sup>11</sup>
- 2.8 The total cost for the wholesale cost to supply ADSL is around **[CiC]** (not including connection and other ancillary charges). This cost is the same whether the access provider wishes to provide ADSL alone or bundled with voice services.
- 2.9 This can be directly compared to the pricing for supply fibre broadband. The wholesale charge for the NBN 25/5 Mbps AVC service is \$27 per month and the CVC is \$20 per Mbps. The CVC

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<sup>10</sup> Optus, 2010, *Submission to Australian Competition and Consumer Commission in response to the Draft Report Telecommunications Access Pricing Principles for Fixed Line Services*.

<sup>11</sup> See FLSM, sheet 'J. WADSL price structure'.

charge equates to a monthly usage fee of \$4.13, assuming the same usage as in the FAD Draft Report. This results in a monthly wholesale charge of \$31.13.

- 2.10 This can also be compared to the price to supply retail and wholesale ADSL through the use of the ULLS and DSLAM investments. [CiC]
- 2.11 Optus submits that a regulated monthly WADSL charge of \$[CiC] per line is not reasonable when Optus can supply a similar wholesale product using the inflated regulated ULLS charge<sup>12</sup> for [CiC]. Given the scale and scope advantages of Telstra, such a result should cast doubt onto the efficiency of the costs used in the FLSM.
- 2.12 Further, it is not immediately clear how the adoption of a WADSL access prices of \$[CiC] a month is consistent with the stated objective of the declaration: to assist the growth of competition during the transition to the NBN. Moreover, the proposed pricing does not promote price stability or certainty during the transition phase to NBN. It is unclear how the proposed pricing in the FAD Draft Report promotes the LTIE. [CiC]
- 2.13 To suggest that Telstra is unable to supply wholesale ADSL services over its network at a level comparable, or better, than competitors that rely upon regulated access, with scale far below Telstra's, does not appear reasonable. The proposed WADSL price is also inconsistent with NBN access prices — which rely upon leased access to Telstra ducts and pipes and backhaul equipment. The significant cost difference between NBN and Telstra's access network is the use of fibre optic rather than copper in the last mile. To suggest that a new deployment of fibre optic cable is substantially less than the cost to access sunk and depreciated copper lines does not seem reasonable.
- 2.14 In addition to Australian market comparators, the rates in the FAD Draft Report differ from similar costs-based rates issued by the New Zealand Commerce Commission for the equivalent bitstream access service. The latest draft decision states that the cost of bitstream access comprises:
- (a) Unbundled line rental: \$18.81;
  - (b) Bitstream access: \$7.14;<sup>13</sup> and
  - (c) Bitstream backhaul: \$5 - \$15 per Mbps.<sup>14</sup>
- 2.15 Using the same usage per SIO as in the FLSM, the latest New Zealand rates result in a total monthly cost of \$26.98 to \$29.04. These rate are around half of the proposed rates in the FAD Draft Report.

#### Costs should be allocated using cost causation principles

- 2.16 Total monthly WADSL costs are allocated between port and AGVC charges using the same ratio as the IAD. The ACCC claim that ideally costs should be allocated on a cost causation basis, but Telstra has failed to provide sufficient cost information to allow such allocations.<sup>15</sup> The ACCC has failed to request that Telstra provide adequate information to allow proper allocations.

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<sup>12</sup> Optus notes that the ULLS charge is artificially inflated by the arbitrary inclusion of \$911 million into the CAN.

<sup>13</sup> NZCC, 2012, Draft Determination to amend the price payable for the regulated service Chorus' unbundled bitstream access made under s 30R of the Telecommunications Act 2001, table 1. 1NZD = 0.80AUD.

<sup>14</sup> See STD for Chorus' Unbundled Bitstream Access Backhaul Service, Schedule 2, table 2. Rates reflect a 200Mbps link. 1NZD = 0.80AUD.

<sup>15</sup> ACCC, FAD Draft Report, p.60.

- 2.17 Notwithstanding this, Optus disagrees that the cost categories contained in the FLSM and the 2008-09 Analysys Mason model (AM Model) are not sufficiently clear to undertake a cost causation allocation. There are two relevant types of costs: costs associated with the equipment in the local exchange (DSLAM); and costs associated with backhauling traffic from local exchange to the relevant POIs. The details of these allocations are outlined in paragraph 4.22.
- 2.18 This cost based allocation results in the following charges:
- (a) WADSL port charge: \$19.17; and
  - (b) AGVC charge: \$65.32 per Mbps.
- 2.19 The reasonableness of the AGVC charge is discussed below. But it can be seen that the FLSM, using appropriate cost causation principles, estimates a WADSL port charge that approaching reasonable levels. However, a port charge of \$19 does not appear reasonable given Telstra's scale. It does not seem reasonable when Optus, with an ADSL subscriber base around 16% of Telstra's broadband base<sup>16</sup>, is able to offer WADSL service at [CiC] below Telstra's alleged cost-based price. Such disparity indicates further adjustments are required.

### **The implied unit cost from port charges is far in excess of the cost of new DSLAMs**

- 2.20 The proposed WADSL port charge can be used to estimate the implied cost for DSLAM and other data equipment. This cost can be checked against the actual cost of deploying DSLAMs and other data equipment.
- 2.21 The estimated cost of a WADSL port is \$24.56 per month per SIO. This implies the cost of a DSLAM with capacity of 576 end-users<sup>17</sup> is in excess of \$1.1 million.<sup>18</sup> This figure includes both capital costs, return on capital, and operating costs. The proportion of capital costs (depreciation) from total yearly costs (depreciation, return on capital, opex) is applied to identify the capital related costs. Using the 2013/14 revenue requirement data in the FLSM, it is calculated that [CiC] of total costs relate to capital costs.<sup>19</sup> This implies that the capital costs associated with each DSLAM is around \$450,000.<sup>20</sup>
- 2.22 The FLSM combined the cost of all DSL equipment, including BRAS and IGRs. As such the \$450,000 cost includes a share of BRAS/IGR. Optus uses Telstra's actual data to estimate the costs associated with BRAS/IGR that can be attributed to each DSLAM. [CiC]
- 2.23 The grossed-up value is far below the implied cost per DSLAM/BRAS/IGR of \$450,000. The observed cost disparity between actual equipment and implied equipment cost from the FLSM implies that the increase in the RAB value for data equipment may be above the efficient level. Given the vast disparity in the input cost values, it is not surprising that the output of the FLSM appears excessive. While the use of a building-block model and the FLSM is an appropriate methodology, the automatic inclusion of all of Telstra's costs result in excessive access prices to the detriment of the LTIE.

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<sup>16</sup> Optus has around 500,000 ULL customers compared to Telstra's 3 million broadband customers.

<sup>17</sup> 512 ADSL and 64 SDSL end-users.

<sup>18</sup> Assuming straight line depreciation and a 6 year lifetime, as per the FLSM.

<sup>19</sup> See sheet '6. Revenue Requirement'. In 2013/14 return of capital (depreciation) represented [CiC] of total yearly revenue required (excluding tax).

<sup>20</sup> Using a WADSL port charge of \$19.17 results in DSLAM cost of \$314,000.



## AGVC charge is inconsistent with real world comparators

- 2.24 The FAD Draft Report proposed to increase the AGVC charge to \$36.08 per Mbps. The ACCC claim that the 7% increase is a result of a fall in actual traffic compared to the IAD forecast. As discussed above, cost based allocations results in the AGVC increasing to \$65.32 per Mbps.
- 2.25 It is far from clear, how the proposed \$36 per Mbps price relates to the efficient cost of supply. Optus notes that the \$20 per Mbps CVC price proposed by NBN Co has been subject to much criticism by industry. Yet the ACCC is proposing to set a cost-based price for essentially the same service, using essentially the same cost elements<sup>21</sup>, which is over 50% higher.
- 2.26 In addition, the cost for Optus to backhaul its traffic from its ULLS/DSLAM service is less than [CiC] per Mbps. The proposed WADSL charge is significantly above the rate that Optus charges its wholesale ADSL customers. [CiC]. It is not reasonable to argue that Telstra cannot provide ADSL backhaul at a price equal or below that offered by competitive carriers.
- 2.27 The proposed AGVC is significantly in excess of what competitive carriers can offer the service. This is more troubling given that the ACCC is proposing to maintain the forced bundling of WADSL access and backhaul. Optus reiterates that Australia is one of the only markets where such bundling is mandated under access regulations.
- 2.28 The FAD draft decision claims that the LTIE is promoted by “*maintaining the AGVC pricing structure*”.<sup>22</sup> The justification put forward in the draft decision appears to argue that maintaining a structure comprising a fixed port charge and a usage charge promotes the LTIE. The draft decision states that a price structure that varies access seekers’ costs on the level of capacity consumed will “*encourage greater efficiency in the use of network capacity and promote efficient investments in expanding network capacity*”.<sup>23</sup>
- 2.29 Optus agrees with the principle that cost based pricing, reflecting cost causality, promotes the LTIE. Where any party consumes capacity, such consumption should be charged at the efficient cost of using the capacity. However, these statements do not justify why the ACCC is proposing to set the AGVC at the same ratio as the non-cost based current pricing. Optus notes there is no attempt in the draft decision to explain how maintaining the current high price is in the LTIE. Optus further notes that the decision to set the AGVC at the proposed rate is not based on the efficient costs to supply backhaul transmission.
- 2.30 Moreover, the proposal to maintain the ratio between port and AGVC masks the actual extreme price implied by the FLSM (and using Telstra’s RAF costs) — see paragraph 4.22.
- 2.31 If the total WADSL cost was allocated to the AGVC and port charge using cost causation principles, as derived from the FSLM and AM Model, it is shown that the AGVC charge would be upwards of \$65 per Mbps. There are two possible interpretations:
- (a) Should the AGVC reflect actual Telstra costs, it demonstrates that Telstra is much more inefficient than competitive carriers. As such, the WADSL access and backhaul should be separated to allow competition in the backhaul segment.
  - (b) The transformation of the monthly per SIO AGVC price to a per Mbps price is not correct. It is discussed below that the manner in which the ACCC converts a per SIO monthly charge to a per Mbps charge may not be correct.

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<sup>21</sup> While active equipment may differ, the passive costs (cabling, ducting, etc) are the same. This is especially the case since NBN Co is leasing transit links from Telstra, using Telstra ducts and using Telstra fibre.

<sup>22</sup> ACCC, FAD Draft Report, p.72.

<sup>23</sup> Ibid.

- 2.32 It is also instructive to benchmark the proposed AGVC rate against other regulated DSL backhaul rates. For example, in New Zealand wholesale bitstream access has long been a feature of the regulatory regime. Bitstream access is provided separately from ULLS, and is also separated between bitstream access<sup>24</sup> and bitstream backhaul.<sup>25</sup> To replicate the declared WADSL service, an access seeker in New Zealand would require a ULLS connection and bitstream access and bitstream backhaul.
- 2.33 Optus submits that the regulated backhaul rates in New Zealand provide a direct comparison of the reasonableness of the proposed AGVC rates in the FAD Draft Report. Table 1 below shows that the regulated price for backhaul is substantially less than the rate proposed in the FAD Draft Report (\$36.08). Moreover, as demand increases the price per Mbps decreases.
- 2.34 The disparity is even starker if one uses the cost causation based AGVC cost of \$65 per Mbps as estimated by the FLSM. Even with the ACCC arbitrarily deflating the real FLSM output, it is clear that the cost output is inconsistent with the rates offered by Chorus in New Zealand.

TABLE 1 REGULATED BITSTREAM BACKHAUL RATES IN NEW ZEALAND

Distance Group	Length of Link	50 Mbps link (\$/Mbps)	200 Mbps link (\$/Mbps)	1 Gbps link (\$/Mbps)
1	< 5km	\$11.80	\$5.04	\$1.87
2	5 – 10 km	\$20.60	\$8.79	\$3.27
3	10 – 15 km	\$26.70	\$11.39	\$4.24
4	15 – 20 km	\$31.66	\$13.51	\$5.02
5	20 – 25 km	\$35.94	\$15.35	\$5.71

Source: STD for Chorus' Unbundled Bitstream Access Backhaul Service, Schedule 2, table 2. 1NZD = 0.80AUD.

- 2.35 Optus is puzzled as to how the incumbent fixed-line operator in New Zealand is able to not only unbundle backhaul for access, but also do so at a rate that is a fraction of the cost claimed by Telstra. Further, the pricing put forward in New Zealand undermines the claim that the AGVC pricing in the FAD Draft Report reflects efficient costs.

### The ACCC errs in its use of average usage for AGVC

- 2.36 A potential reason for the unrealistic per Mbps rate estimated by the ACCC is that it is not using appropriate forecasts of usage per SIO. It must be remembered that the FLSM does not estimate a cost per Mbps, rather it estimates a total cost per SIO. [CiC]
- 2.37 The FAD Draft Report converts this monthly total charge to a per Mbps charge. This is done using an 'average usage per SIO' basis. It is not clear in the FAD Draft Report over what time period the average is calculated, but one interpretation is that usage is averaged over a 12 month period.<sup>26</sup> The usage figure in table 4.7 of the FAD Draft Report is described as the "yearly average figure".<sup>27</sup>
- 2.38 However, the ACCC errs in its focus on *average* usage per SIO. The AGVC is a peak charge. Access seekers need to buy sufficient AGVC capacity to deal with peak capacity. So that if peak

<sup>24</sup> See UBA STD, <http://www.comcom.govt.nz/unbundled-bitstream-access-service/>

<sup>25</sup> See UBA Backhaul STD, <http://www.comcom.govt.nz/current-version-of-uba-backhaul-std/>

<sup>26</sup> FAD Draft Report states the 2013-/4 usage value is calculated as the mid-point of the June 2013 and June 2014 forecasts. See p.46.

<sup>27</sup> ACCC, 2013, FAD Draft Report, p.46.

usage is 0.75 Mbps during busy hours, but average yearly usage is only 0.2 Mbps, access seekers require an AGVC of 0.75 Mbps. It is clear from this simple example that the ACCC's approach is flawed and results in substantial over-recovery from Telstra. So that total AGVC per SIO per month will be much higher than the [CiC] in total because of the need to buy peak AGVC capacity.

- 2.39 It is not clear why the ACCC has not used peak throughput per SIO. Telstra has provided this information to the ACCC in its response to the second discussion paper in August 2012<sup>28</sup>. While the data is redacted, the ACCC has access to the information. Moreover, Telstra advised the ACCC that peak traffic has increased by more than [CiC] since 2010<sup>29</sup> and is increasing by [CiC] per annum since 2010.<sup>30</sup> It is unclear, therefore, why the ACCC has assumed 30% growth in its forecasts in the FLSM. Optus recommends the ACCC adopt actual stated Telstra growth rates.
- 2.40 Applying Telstra's actual growth rate to the starting assumption throughput of [CiC] in 2010/11, results in a midpoint average throughput of [CiC] in 2013/14. Applying the corrected 2013/14 usage figures into the FLSM results in an AGVC charge of \$15.52 per Mbps using the proposed arbitrary allocation, or results in an AGVC charge of \$28.40 per Mbps using cost-based allocations.
- 2.41 The evidence put forward by Telstra shows that most daily traffic occurs during a few busy hours.<sup>31</sup> As such, it is possible to convert the yearly average Mbps to an estimated peak Mbps. To this end, the average Mbps usage per SIO is converted to Mb per day<sup>32</sup>. The 2010 actual of [CiC] Mbps equates to [CiC] Mb per day. Assuming that the busy period lasts for 7 hours per day, and that 50% of daily traffic occurs during these hours, this equates to an estimated peak throughput of [CiC] Mbps.
- 2.42 Applying Telstra's growth of [CiC] per annum since 2010 to this throughput per SIO, results in yearly estimates of:
- (a) 2011/12 — [CiC];
  - (b) 2012/13 — [CiC]; and
  - (c) 2013/14 — [CiC].
- 2.43 Combining Telstra's growth assumptions with the busy hour approach results in an AGVC charge of \$9.07 per Mbps using the arbitrary allocation proposed by the ACCC; and an AGVC charge of \$16.58 per Mbps using cost-based allocation.
- 2.44 As demonstrated above, assumptions with regard to peak Mbps throughput per SIO has significant impacts on the calculation of the AGVC per Mbps charge. This is because the FLSM does not calculate a cost-based per Mbps rate. Rather it calculates a total cost per SIO. Should the ACCC take the view that there is insufficient information to correct the approach proposed in the FAD Draft Report, Optus recommends that it would be preferable to set the AGVC as a

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<sup>28</sup> Telstra, 2012, Response to the Commission's Issues Paper (a second discussion paper) into the public inquiry to make a final access determination for the wholesale ADSL service: Pricing to Improve Customer Experience Public version, 24 August 2012, p.7.

<sup>29</sup> Statement by David John Peltz, p.18.

<sup>30</sup> Telstra, 2012, Response to the Commission's Issues Paper (a second discussion paper) into the public inquiry to make a final access determination for the wholesale ADSL service: Pricing to Improve Customer Experience Public version, 24 August 2012, p.7.

<sup>31</sup> See Telstra, 2012, Response to the Commission's Issues Paper (a second discussion paper) into the public inquiry to make a final access determination for the wholesale ADSL service: Pricing to Improve Customer Experience Public version, 24 August 2012, p.9.

<sup>32</sup> Mb per day = Mbps\*60\*60\*24.

total charge per SIO. While this is second-best to estimating to correct per Mbps charge, it is superior to setting an incorrect Mbps charge. An incorrect Mbps charge, based on significant under-estimation of the peak throughput required, will result in a significant over-recovery by Telstra. Such a result is not in the LTIE.

### **Proposed pricing does not enable competition using regulated services**

- 2.45 It has been a consistent theme from access seekers that the regulated access prices do not allow effective competition against Telstra. Telstra has consistently failed the equivalence test for ULLS in the ACCC imputation tests. The December 2012 imputation tests show that Telstra would have a negative margin of 21% if it had to use ULLS to supply consumer broadband services and negative 11% if bundled with PSTN.<sup>33</sup>
- 2.46 The ACCC observe that in the absence of market developments, the ability of access seekers to use ULLS to supply competitive services are “likely limited to areas” where the costs to supply are lower, and the revenue opportunities are above, the average figures used in the imputation test.<sup>34</sup> The ACCC also note that one of the possible market developments is a reduction in other access prices, including WADSL. The ACCC state:
- 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.<sup>35</sup>*
- 2.47 However, as shown above, the cost of WADSL is significantly greater than the costs of competitive providers to supply an equivalent service using ULLS.
- 2.48 In the context of geographically-limited competition through ULLS, and the need to develop national competition to ensure that the current competitive failures in the fixed line market are not transposed to the NBN, it is troubling that the proposed access price for WADSL is substantially above the cost to supply broadband through ULLS. The ACCC acknowledged that uncertainty around the deployment of NBN may have led to a decline in the roll-out of DSLAMs by access seekers.<sup>36</sup> Such market realities make it even more important that access seekers are able to access wholesale ADSL services at an efficient level, and at a level that enables access seekers to compete against Telstra propositions.
- 2.49 To this end, Optus has analysed current Telstra ADSL plans and tested whether access seekers can use the WADSL service to replicate the service. The details of the analysis are shown in Appendix A. The analysis is conservative with Telstra plan costs included all costs including retail and common costs, as well as international connectivity costs. Whereas, the WADSL comparative costs include only WADSL costs.
- 2.50 The results for Telstra’s bundled offers are shown below in table 2.<sup>37</sup> Notwithstanding the exclusion of retail and other costs from the WADSL FAD costs, it can be seen that it is not possible to offer an equivalent service using the WADSL service.

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<sup>33</sup> ACCC, 2013, *Accounting separation of Telstra: imputation testing and non-price terms and conditions report for the December quarter 2012*, March.

<sup>34</sup> *Ibid.*, p.19.

<sup>35</sup> *Ibid.*, pp.18-9.

<sup>36</sup> ACCC, 2013, FAD Draft Report, pp.46, 97 & 109.

<sup>37</sup> More details are contained in Appendix A.

TABLE 2 REPLICATING TELSTRA RETAIL BUNDLED OFFERS USING WADSL SERVICE

	<b>Starter 5GB</b>	<b>T-Bundle Connector Freestyler 200GB</b>	<b>T-Bundle Connect Everyday® 200GB</b>	<b>T-Bundle Connect Edge® 500GB</b>
<i>Detail of the plan</i>	24 month bundled plan	24 month bundled plan	24 month bundled plan	24 month bundled plan
<i>Included Internet usage (GB)</i>	5	200	200	500
<i>Min Telstra Retail cost over 24 months</i>	<b>\$ 1,269.60</b>	<b>\$1,920.00</b>	<b>\$ 2,760.00</b>	<b>\$3,120.00</b>
<i>WADSL FAD Costs 24 months</i>	<b>\$1,287.57</b>	<b>\$4,211.46</b>	<b>\$4,211.46</b>	<b>\$8,709.74</b>
<i>WADSL FAD compare to Telstra Retail (Margins)</i>	<b>-\$17.97</b>	<b>-\$2,291.46</b>	<b>-\$1,451.46</b>	<b>-\$5,589.74</b>

- 2.51 The results above assume that end-users use 100% of their monthly data allowance. However, a negative margin is still maintained when assuming end-users use 75% of data allowance. Assuming that end-users use only 50% of data allowance, only the 'Starter 5GB' plan results in a positive result on \$19.51 over 24 months. However, once retail and other costs are included, it would not be possible to replicate this offer.
- 2.52 Another possible way in which access seekers could compete against Telstra is to adopt a high contention ratio, or in other words offer a lower quality of service. The analysis in table 2 assumes a contention ratio of 50:1. This ratio would be typical in the industry, although many operators offer a higher quality service through a lower ratio. However, even if the contention ratio is increased to 100:1 (meaning the ADSL bandwidth is shared with 100 users) only the 'Starter 5GB' plan results in a positive margin — although again, when retail and other costs are added, it is unlikely this could be replicated.
- 2.53 The inability of access seekers to use the WADSL service to replicate Telstra offerings, even if access seekers adopted a lower quality of service, undermines the claim made by the ACCC that access seekers could use WADSL to expand their competitive footprint. It also undermines claims that in "*the future with declaration, the availability of wholesale ADSL on regulated terms is likely to promote competition by encouraging entry and expansion by efficient operators*",<sup>38</sup> and that the WADSL service may allow access seekers to build scale prior to transition to NBN "*in order to promote product innovation and differentiation, and to engage in effective competition with Telstra*".<sup>39</sup>
- 2.54 It is unclear how the WADSL prices proposed in the FAD Draft Report promotes the LTIE — while the prices may enable Telstra to recover all its costs, it does not promote competition or ensure that Telstra recovers only its *legitimate* costs. Moreover, the proposed prices risks imposing the current market structure into the NBN world. Failure to allow access seekers to compete against Telstra allows Telstra to gain significant first-mover advantage by maintaining its current subscriber base on the NBN.

<sup>38</sup> ACCC, 2013, FAD Draft Report, p.38.

<sup>39</sup> Ibid., p.45.

### Section 3. Approach to forecasting values

- 3.1 The draft decision proposes to adopt the same forecasting method as adopted in the 2011 fixed-line FAD process.<sup>40</sup> However, such an approach was criticised at the time of the fixed-line FAD process, and these criticisms apply today. In short, given the significant changes in Telstra's fixed-line business over the coming years, it does not appear reasonable that the ACCC should project historic averages going forward.
- 3.2 Further, the ACCC commented that Telstra had failed to provide forecast values. Telstra claimed that it does not have forecast values. Optus notes that Telstra refused to supply forecasts for the development of the original FLSM during the 2011 fixed-line FAD process.<sup>41</sup>
- 3.3 Optus reiterates that Telstra is a publicly listed company which regularly provides updates to its shareholders regarding revenue and profit expectations, including planned expenditure. We note that Telstra has recently reassured investors that it plans to maintain its dividend policy. Capex is expected to be driven by mobile investments,<sup>42</sup> and yet over time (excluding spectrum expenditure), total yearly capex is predicted to fall. Margins for PSTN and fixed broadband products are forecasted to grow by analysts.<sup>43</sup> Notwithstanding analysts' views, opex and capex forecasts are required for the internal budgeting and planning purposes of telecommunications companies. Consequently, Telstra's claimed inability to provide suitable information to the ACCC is unconvincing. Optus submits that the ACCC is entitled to draw the inference that Telstra's withholding of forecast data is a strategic practice, which it is repeating due to the ACCC's preferential assumptions in the FLSM.
- 3.4 The ACCC has stated that it intends to make a record keeping rule (RKR) to obtain forecast capex and opex data from Telstra. Optus supports this proposal but notes that, considering the new RKR would have to be subject to further consultation, the forecast data would not be available for the purposes of this review. The ACCC also stated this intention in 2010, and as yet has failed to implement such changes.
- 3.5 Optus notes that the ACCC also has the power to issue a s.155 notice to Telstra. Section 155 provides the ACCC with statutory power to require Telstra to provide the requested information within the time and manner specified in the notice. Optus considers a s.155 notice is appropriate given that the repeated failure of Telstra to provide the ACCC with information that it uses to make public statements to the stock exchange.
- 3.6 In the absence of Telstra's own data, the ACCC has generated its own forecasts, relying on limited information. Unfortunately, it appears that the expenditure forecasts the ACCC has been forced to make are unrealistically high, as is discussed below. Given Telstra's failure to provide its own data in response to the ACCC's request, the proposed adoption of generous forecasts is unjustifiable. This cannot encourage Telstra to submit the requested information, now or in future. Optus submits that the ACCC should take a firm approach with Telstra and adopt 'low end' forecasts for capex and opex.

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<sup>40</sup> ACCC, 2013, FAD draft decision, pp.40, 42-45.

<sup>41</sup> ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft Report, September 2010, p64

<sup>42</sup> Telstra, 2013, Investor Day Transcripts, p.10.

<sup>43</sup> CBA, 2013, Telstra Corporation Limited, 7 February 2013.

### Capital costs forecast

- 3.7 The FAD Draft Report proposes to adopt a **[CiC]**. This follows Telstra's suggestion that the ACCC should adopt such a rate. It does not appear reasonable, given the deployment of NBN that historic levels of data equipment capital costs are maintained. The ACCC has accepted that other operators are less likely to deploy new DSLAMs due to deployment of NBN. It would appear reasonable that Telstra would face same pressures.
- 3.8 Telstra announced in its 2013 half year results, that it had just completed an upgrade to around 2,000 sites to be able to provide ADSL2+.<sup>44</sup> It is therefore reasonable to assume that fixed-line capex will likely fall from the current level due to the end of the upgrade programme.
- 3.9 David Thodey has recently stated there is an internal objective to reduce capex to 12-13% of sales. Telstra is forecasting a reduction in nominal capex from the current level of 15% of sales, which is driven by the requirement for NBN-specific investments.<sup>45</sup> Notwithstanding such public commitments, Telstra claims there are no forecasts available. Optus recommends that the ACCC accept the Telstra CEO's forecasted decrease in nominal capex. This is a conservative forecast with respect to fixed-line WADSL capex, given that the majority of capex going forward is likely to be driven by mobile-related costs, or compliance with its NBN agreement.
- 3.10 Optus recommends that the ACCC should utilise public information to verify its capex forecasts. In the absence of suitable public information, the ACCC should use its statutory powers to require Telstra to supply the relevant information. Optus submits that it is not adequate that the ACCC fails to accurately forecast capex, or to critically analyse Telstra's failure to assist.

### Usage forecasts

- 3.11 Optus submits that it is unreasonable for the ACCC to accept Telstra's claims that it does not have accurate forecasts of data usage for the next few years. Such a claim is counter to basic corporate governance, and if true, would indicate that Telstra is failing to adhere to proper corporate governance requirements. However, as would be expected by one of Australia's largest listed companies, such an indication is clearly not true.
- 3.12 In addition, such a claim is counter to actual data already provided to the ACCC in the course of this consultation. Telstra advised the ACCC that peak traffic has increased by more than **[CiC]** since 2010<sup>46</sup> and is increasing by **[CiC]** per annum since 2010.<sup>47</sup> It is unclear, therefore, why the ACCC has assumed 30% growth in its forecasts in the FLSM. Optus recommends the ACCC adopt actual stated Telstra growth rates.

### Removing NBN-driven capital and operating costs from the RAB

- 3.13 In addition to the above corrections, it is not clear whether the use of the AM Model allocation factors accurately portrays the cost drivers of capex and opex — especially during the transition to NBN Co and Telstra's investment commitments under its NBN Co agreements.

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<sup>44</sup> Telstra, 2013, Transcript from Analyst Briefing - Half Year Financial Results for the year ended 31 December 2012, p.2.

<sup>45</sup> Telstra, 2013, Investor Day Transcripts, p.35.

<sup>46</sup> Statement by David John Peltz, p.18.

<sup>47</sup> Telstra, 2012, Response to the Commission's Issues Paper (a second discussion paper) into the public inquiry to make a final access determination for the wholesale ADSL service: Pricing to Improve Customer Experience Public version, 24 August 2012, p.7.

- 3.14 Optus notes that Telstra has acknowledged that its capex over the next few years will be driven by mobile 4G investment and the need to invest as per its NBN Co agreement. David Thodey commented that in addition to the spectrum costs and 4G network roll-out:

*... we're dragging quite a lot of CAPEX at the moment just on the NBN rollout, so beyond 2014 – 2015 that would be our sort of aspirational sort of target to aim to bring down the CAPEX to sales ratio by another percent or so.*<sup>48</sup>

- 3.15 Optus is concerned that expenditure that is caused for the purpose of providing NBN infrastructure will be allocated to WADSL under the AM Model allocation factors. Optus recommends that the ACCC investigate in greater detail how costs are allocated to NBN-related projects and WADSL-related projects. For example, Telstra announced last year that it planned to increase capex by \$500 million over two years to bring forward NBN-related revenue.<sup>49</sup> Telstra has also announced that capex has increased to around 15% of sales over 2013 and 2014 due to mobile network and the delivery of infrastructure to NBN Co to bring forward benefits from the NBN agreement.<sup>50</sup> Capex is then expected to fall back to 12% of sales.
- 3.16 Should Telstra fail to supply such information, the ACCC should use its statutory powers to force Telstra to produce the information. There appears little doubt that information exists at this granular level given public announcements by Telstra. The failure to provide it to the ACCC indicates possible gaming of the WADSL process.

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<sup>48</sup> Telstra, 2013, Investor Day Transcript, p.35.

<sup>49</sup> [http://www.afr.com/p/business/companies/telstra\\_dash\\_for\\_bn\\_nbn\\_bonus\\_bSphQkmm03PM64npLBBvJL](http://www.afr.com/p/business/companies/telstra_dash_for_bn_nbn_bonus_bSphQkmm03PM64npLBBvJL)

<sup>50</sup> Telstra, 2012, TELSTRA SHAREHOLDER UPDATE 2012.



## Section 4. Other adjustments to the FLSM

- 4.1 This submission has shown that the proposed prices put forward in the FAD Draft Report are unlikely to promote the LTIE. While adoption of the FLSM is a step-forward towards setting WADSL rates that promote the LTIE, the failure to ensure only prudent costs are included undermine these advances.
- 4.2 In addition to these broad failures, Optus has identified the following corrections to the implementation of the WADSL within the FLSM:
- Removing building costs from AM Model allocation factors;
  - Overstate data equipment costs by at least 30%;
  - WADSL RAB should be reduced to take into account the windfall gain accrued to Telstra due to fall in revenue allocated to other regulated services in new FLSM;
  - Use of cost-based allocations between WADSL port and AGVC charges;
  - Convert yearly average Mbps in 2010/11 and 2011/12 to peak Mbps; and
  - Applying Telstra's actual yearly traffic growth of [CiC] per year to years beyond 2010.
- 4.3 The combined impact of the corrections is shown below. Optus notes that these variations may differ from the results shown below as these changes are performed cumulative, and in body changes are performed in isolation.

TABLE 3 COMBINED IMPACT OF CHANGES TO THE FLSM

	Port charge (zone 1)	Port charge (zone 2/3)	AGVC (Mbps)
<b>FAD Draft Report</b>	<b>\$ 23.67</b>	<b>\$ 29.81</b>	<b>\$ 36.08</b>
<i>Remove building costs from AM allocation factors</i>	- \$ 0.89	- \$ 1.08	- \$ 1.31
<i>Reduce data equipment cost</i>	- \$ 0.06	- \$ 0.07	- \$ 0.09
<i>Maintain total service revenue equivalence</i>	- \$ 2.91	- \$ 3.53	- \$ 4.28
<i>Cost-based allocations</i>	- \$ 4.65	- \$ 5.65	\$ 25.22
<i>Peak throughput</i>	\$ 0.00	\$ 0.00	- \$ 23.18
<i>Apply Telstra's peak growth rate</i>	\$ 0.00	\$ 0.00	- \$ 18.49
<b>New rates</b>	<b>\$16.05</b>	<b>\$ 19.48</b>	<b>\$13.96</b>

Source: FLSM version 1.2, Optus Adjustments.

- 4.4 These estimates should be treated as upper bounds as no adjustments have been made to take into account difference between ACCC's forecast of Telstra capex and opex, and Telstra's public statements to the stock exchange
- 4.5 The remainder of this section discusses in more details the following additional adjustments that should be made to the FLSM:

- (a) Adjusting annual required revenue allocated to other services to ensure total required revenue remains stable;
- (b) Removing building costs from AM Model allocation factors;
- (c) Adjusting RAB for data equipment costs; and
- (d) Adopting cost causation principles to allocate costs to port and AGVC charges.

## Adjusting other service annual revenue to ensure total revenue remains stable

4.6 The FAD Draft Report decision claims:

*Aligning the regulatory periods for the wholesale ADSL service and the other declared fixed line services will ensure consistency in the application of the pricing methodology and minimise the risk of over- or under-recovery of costs by Telstra.<sup>51</sup>*

4.7 The ACCC has adjusted the cost-based Fixed Line Services Model (FLSM) to determine the draft prices for wholesale ADSL for 2013-14. This updated model includes allocation changes to the inputs into the FLSM and includes an update to the WACC.

4.8 For the claim that updating the FLSM to include WADSL service ensures consistency and minimises the risk of over and under recovery of costs by Telstra across all regulated services to hold, the total revenue required by Telstra under the amended FLSM should equal the total revenue of the original FLSM plus the allowance for WADSL. This is because the specific costs for WADSL are added to the FLSM in the FAD Draft Report. Should any common or joint costs flow to WADSL from other services, there should be a corresponding adjustment so that total revenue does not change.

4.9 The revenue required per service in the original and updated FLSM is shown in table **Error! Reference source not found.** below. It can be seen that the total revenue required for the non-WADSL services has declined by \$31 million in real terms in 2013/14 compared to the original FLSM. Failure to adjust revenue allocated to, and prices for, the other regulated services results in Telstra over-recovering total costs. That is, Telstra is allowed to recover all existing regulated service based on the previous FLSM, but WADSL is based on the new FLSM. So that the sum of the revenue allocated to all services (including WADSL) is greater under the new FLSM.

**[CiC]**

4.10 Allowing the price for the other regulated services to be set using the previous FLSM (and assuming that \$[CiC] million in revenue should be recovered) results in an over-recovery of revenue — Telstra recovers \$[CiC] million rather than \$[CiC] million.

4.11 Since it is not possible to change the other regulated prices, Optus recommends that a temporary solution is to discount the revenue allocated to WADSL by the amount of the over-recovery (\$[CiC] million). Adjusting the WADSL service revenue by this amount<sup>52</sup> results in the WADSL regulated prices reducing to:

- (a) WADSL port (zone 1) — \$21.59;

<sup>51</sup> ACCC, FAD draft decision, p.7.

<sup>52</sup> Cell L91 in 7. Service Revenue.

- (b) WADSL port (zone 2/3) — \$26.20; and
- (c) AGVC charge — \$31.72.

### Removing building costs from AM Model allocation factors

- 4.12 The ACCC proposes to use allocation factors derived from the AM Model for equipment-related asset classes, and a revenue share allocation for land and building asset classes. However, the allocation factors for “switching equipment – local” and “switching equipment – trunk”, derived from the AM Model, was estimated from costs that included land, building and support costs. As such, it appears there is an element of double counting — with land and building being allocated to switching equipment and being allocated to stand-alone asset classes in the FLSM.
- 4.13 The allocation factors used in the FLSM are sourced from the cost allocation file of the AM Model and represent the proportion of total costs per asset class allocated to each service. The allocation factors for wholesale ADSL are contained in cells W19:W36 of the OUTtI worksheet. These proportions are calculated as the share of total costs in *cost.total.group.service.core* in the comparison worksheet allocated to the wholesale ADSL service (cells Y3666:Y3684). The costs at this stage have been aggregated into their respective core asset groups (which are the core asset classes contained to table 4.9 of the FAD Draft Report).
- 4.14 An analysis of the costs disaggregated into core assets rather than core asset groups (see cells Y3463:Y3662) shows that building assets are allocated to the asset groups of “switching equipment – local” and “switching equipment – trunk”.<sup>53</sup> For example, the cost for the local exchange site acquisition, preparation and maintenance asset are allocated to local switching equipment asset group. The relevant allocations factors for WADSL used in the FLSM **[CiC]** therefore include building costs.
- 4.15 Given the inclusion of building-related costs as a separate asset class in the FLSM, the AM Model allocation factors for switching equipment need to be adjusted to remove the building-related assets.<sup>54</sup> To estimate how this impacts on the allocation factors, Optus has removed building-related assets from the ‘total core cost by asset and service’ matrix in the comparison worksheet in the cost allocation module of the AM Model (cells E3462:AK3662). Building-related assets are; building costs; site acquisition and preparation; signalling transfer point; UPS and generator; and air conditioning.
- 4.16 These adjustments decrease the costs allocated to local and trunk switching equipment asset classes and the total allocated to wholesale ADSL. These changes are shown in **[CiC]**  
**[CiC]**
- 4.17 It can be seen that the allocation factor changes when building costs are removed from the local and trunk switching asset groups. The allocation of local switching to WADSL falls from **[CiC]**; and the allocation of trunk switching to WADSL falls from **[CiC]**.
- 4.18 Updating the allocation factors in the FLSM results in the WADSL port charge decreasing to \$23.68 in zone 1, and \$28.73 in zone 2. The AGVC charge falls to \$34.78. Using these updated allocation factors, together with proper cost-based allocation between port and AGVC charges results in port charge decreasing to \$18.45 in zone 1 and \$22.39 in zone 2.

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<sup>53</sup> Local switching & trunk/IEM switching groups in the AM Model.

<sup>54</sup> These are acquisition and preparation of sites, UPS and generator, and air conditioning costs.

## Adjusting RAB for data equipment costs

- 4.19 It is shown above the implied equipment cost from the proposed WADSL port charge is far in excess of the actual equipment costs incurred by competitive carriers. Absent a proper review, there is *a priori* evidence that the data equipment costs claimed by Telstra are over-inflated. Optus recommends that the data equipment input value be amended to reflect this over-valuation.
- 4.20 It was shown above that the competitive cost to supply ADSL equipment is around 30% of that implied by the WADSL port charge. To that end, it is necessary to reduce the assumed value of data equipment in the RAB to reflect efficient costs. This is done by adjusting cell G48 in '2.RAB' within the FLSM. [CiC]
- 4.21 Reducing the initial RAB value in the FLSM by the amount above results in the regulated price reducing for WADSL port charge in zone 1 to \$24.51, the port charge in zone 2/3 to \$29.74 and the AGVC to \$36 per Mbps.

## Allocating costs to port charges and AGVC using cost causation

- 4.22 Costs are allocated between WADSL port and AGVC charges using the same ratio as the IAD. The ACCC claim that ideally costs should be allocated on a cost causation basis between WADSL port and AGVC charges, but Telstra has failed to provide sufficient cost information to allow such allocations.<sup>55</sup> Optus further notes that the ACCC has failed to request that Telstra provide adequate information to allow proper allocations.
- 4.23 Notwithstanding this, Optus disagrees that the cost categories contained in the FLSM and the AM Model are not sufficiently clear to undertake a cost causation allocation. There are two relevant types of costs: costs associated with the equipment in the local exchange (DSLAM); and costs associated with backhauling traffic from local exchange to the relevant POIs.
- 4.24 Reviewing the AM Model and documentation,<sup>56</sup> shows that costs associated with the inter-exchange network represent the path through which backhaul WADSL traffic would follow. Comparing the AM Model asset list and asset group list shows that:
- (a) DSLAM and associated equipment (BRAS/IGR) are allocated solely to 'data equipment' asset group;
  - (b) Transmission equipment used to backhaul traffic from local exchange to TNS are allocated to 'transmission' and 'IEN cables' asset groups;
  - (c) Building and other equipment used to support local exchange, PoCs, LAS' and TNS' are allocated to the 'switching equipment' asset groups.
- 4.25 Optus therefore believes that it is clear that the data equipment asset group be allocated to WADSL port, as this is the only category where actual DSLAM equipment costs are allocated. The 'switching equipment: local exchange' asset group, with building costs removed, are also allocated to WADSL port charge. And all other AM Model asset groups are allocated to AGVC.
- 4.26 The additional network land and building costs introduced into the FLSM also need to be allocated to WADSL port and AGVC services. As an approximation, Optus has allocated the cost of local exchanges to WADSL, and the cost of other aggregation nodes to AGVC. The proportion of total WADSL building costs allocated to WADSL ports is determined by the

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<sup>55</sup> ACCC, FAD Draft Report, p.60.

<sup>56</sup> See, for example, slide 44 of *Analysys cost model: Workshop for industry stakeholders*, 26 June 2009.

percentage of total building costs<sup>57</sup> that are within local exchange asset group out of total building costs in the AM Model.<sup>58</sup> The AM Model shows that 81% of total building costs allocated to the WADSL service come from local exchanges. The calculation is shown below.

**[CiC]**

4.27 Using these asset group allocations to allocate the FLSM WADSL costs in 2013/14 shows that 61% of costs are related to WADSL port, and 39% relate to AGVC services. This cost based allocation results in the following charges:

- (a) WADSL port charge: \$19.17; and
- (b) AGVC charge: \$65.32 per Mbps.

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<sup>57</sup> Site acquisition, UPS and air conditioning costs assets from the AM Model are defined as building costs.

<sup>58</sup> In addition to these adjustments, Optus highlights that building costs are double-counted as they are included in the 'switching equipment' asset group and also added as a new cost category in the FLSM.

## Section 5. Unbundling WADSL

- 5.1 The WADSL service requires an active PSTN line to be purchased. Optus has previously submitted that the WADSL access service should be unbundled from both a PSTN line and the backhaul service. The unbundling of WADSL service is a common feature of wholesale bitstream access in other markets. For example, in New Zealand bitstream access is available unbundled from a PSTN line, and allows for access seekers to self-supply backhaul.
- 5.2 Notwithstanding international precedents showing that it is technically possible to unbundle, and that it is in fact the standard regulatory practice, the ACCC relies solely on claims by Telstra that the costs of unbundling would be prohibitive. The ACCC also comments that access seekers have not provided detailed cost information. However, it is unreasonable to expect access seekers to provide cost information on how unbundling would impact on Telstra's network.
- 5.3 Moreover, it is unreasonable to accept without challenge the costs put forward by the monopoly provider of a service for the purpose of defending existing monopoly rents. Optus is not aware of any historic regulatory access decision that Telstra has agreed to. Telstra claimed adoption of the BBM would deprive the industry of hundreds of millions of dollars of revenue, would introduce a period of uncertainty and instability, and would result in Telstra not recovering its costs.<sup>59</sup> History shows it did not. Telstra's latest annual report shows that fixed broadband revenue (including wholesale) grew by 2.3% and that fixed broadband EBITDA margin was a healthy 37%, while PSTN EBITDA was 60%.<sup>60</sup> These results do not show that regulated access has destroyed the value of Telstra — indeed fixed broadband EBITDA has increased by 6 percentage points since end of 2011.<sup>61</sup>
- 5.4 Optus maintains its position that Telstra's refusal to offer its retail or wholesale residential customers unbundled DSL services is made for purely commercial reasons. The mandatory enforced bundling of a Telstra PSTN Line with a Telstra DSL service is a restrictive practice that limits choice and increases costs for consumers. The use of traditional fixed-line PSTN services has been in steady decline for several years with mobile substitution and the uptake of over the top IP voice services. Without unbundling consumers are forced to connect a Telstra phone service along with their broadband service even if they have no requirement for this. There are many exchanges in Australia where Telstra is the only provider offering DSL services and a decision by the ACCC to maintain the status quo with enforced bundling here will be detrimental to consumers and will restrict competition between carriers and the uptake of competitive services in the future. As unbundled broadband services will be freely available on the NBN any decision to not support a similar offering over the copper network in the interim period prior to migration is inconsistent and restrictive.
- 5.5 Optus has previously advised the ACCC that **[CiC]** of Optus' retail ULLS customers are naked broadband customers.<sup>62</sup> These metrics measure the number of *end-users* that have chosen to adopt broadband-only retail or wholesale packages (service unbundling). From a network technology viewpoint, all Optus services supplied over ULLS or HFC are unbundled from an active PSTN line (network unbundling).

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<sup>59</sup> Ibid., p.4.

<sup>60</sup> Telstra, Full year results and operations review - June 2012, p.6.

<sup>61</sup> Telstra, Full year results and operations review - June 2012, p.8.

<sup>62</sup> Optus, Submission in response to the ACCC's Issues Paper Public Inquiry to make a Final Access Determination for the Wholesale ADSL Service, August 2012, section 5.

- 5.6 Optus is requesting network unbundling of the WADSL and the WLR services. That is, enabling access seekers to not to have an active PSTN line when using the WADSL service. This still enables access seekers to supply telephony bundles to end-users using IP-technologies. For example, [CIC]. It is likely that telephony services provided by competitive carriers through the WADSL service will be provided through IP-technology irrespective of the requirement for an active PSTN line.
- 5.7 From an end-user perspective, there is little or no benefit to mandating bundling of WADSL and WLR. But there is a cost. Removing the requirement for WLR will enable access seekers to provide the same voice service currently provided through ULLS and HFC but without the need to pay for a service that it not used. The combined cost of WLR plus WADSL (\$46) is greater than ULLS plus WADSL (\$40) – even with the ULLS access fee being artificially inflated above its actual cost to provide. The same end-user service can therefore be provided at less cost. Moreover, there is no reason why the voice component of a bundled consumer product could not be delivered through mobile networks. Unbundling WADSL from WLR will allow operators like Optus to offer more innovative bundling products where consumers wanted a voice/broadband bundle.
- 5.8 Optus notes that Telstra Retail currently offers unbundled broadband over its cable network. Although this is not a DSL Service, this still demonstrates that Telstra is quite capable of provisioning and supporting a broadband only service without an associated telephone service.<sup>63</sup>
- 5.9 Telstra already offers and provides service assurance on the ULLS to wholesale customers that have no associated voice line and has built many systems and processes to support this service. ULL services are not identified by a local telephone number and Telstra provides an alternate service number on these services for all assurance, billing and provisioning processes. Optus also notes that Telstra Retail offers a range of business products that utilise DSL services (for example BDSL) that have no associated Telstra phone service.
- 5.10 The ACCC has indicated that the reliable operation of an unbundled DSL service will likely be diminished though Telstra’s inability to deploy certain fault testing methods through the PSTN to diagnose and locate line faults. However the ACCC appears not to have considered that Telstra’s testing equipment may be out-dated and could easily be updated to support testing methods on an unbundled DSL service. Telstra already supplies a remote diagnostic DSL line testing tool that could be modified to support a naked DSL service or a hybrid version of this. Optus successfully uses testing processes on ULL that provide line results on naked DSL services or services including a voice line, with or without CPE connected. Telstra’s inability to perform remote line testing on an unbundled service may because they have made a commercial decision not to deploy the relevant diagnostic hardware/software which is readily available or to modify the existing tools to support testing on a DSL service that is not identified by a local number.
- 5.11 Telstra has claimed that an unbundled service will have higher assurance costs and in its response to the ACCC it has referred to the percentage of ULL interference investigations it has to conduct. Optus submits that these claims do not appear to be accurate, as Telstra fully recovers (and potentially over recovers) any additional service assurance expenses it incurs on ULL for interference investigations by charging these back to wholesale customers at a fee for service charge for each 15 minutes of labour in addition to the access charge. If Telstra applied this same process to an unbundled DSL service as it currently does on ULL services it would recover any additional assurance costs.

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<sup>63</sup> [http://www.telstra.com.au/latest-offers/broadband-offer/?tc=G|E|D|BP|bphbb|NakedBBBrand&mqp=s92W3gfZx\\_24452012466\\_telstra%20naked%20broadband\\_e](http://www.telstra.com.au/latest-offers/broadband-offer/?tc=G|E|D|BP|bphbb|NakedBBBrand&mqp=s92W3gfZx_24452012466_telstra%20naked%20broadband_e)

## Consumer welfare will increase with unbundling of PSTN lines

- 5.12 Optus submits that the ACCC should not accept the cost imposts claimed by Telstra. Further, even if its claim of costs is correct, the consumer benefits of unbundling far outweigh the alleged costs. As noted above, the same end-user service will be provided with or without unbundling. Only the cost to provide the service end-users want will change.
- 5.13 Telstra claims that it would cost around **[CiC]** to upgrade its systems to allow the provision of WADSL without the supply of an active PSTN line. Depreciating this upfront capital cost over a 10 year lifetime, implies a yearly capital cost of **[CiC]**. Even if this is distributed among Telstra's alleged potential base of **[CiC]** customers, this equates to a monthly cost of **[CiC]**. This is a minor amount.
- 5.14 This monthly per subscriber cost should be assessed against the likely benefits accruing to consumers from avoiding the need to pay the \$22.84 a month cost for WLR. In the absence of WLR, access seekers would need to purchase ULLS, currently at a regulated rate of \$16. This implies access cost would decline by \$6.84 per month per SIO if ULLS could be substituted for WLR. Assuming that this benefit accrues only to the alleged potential customer base of **[CiC]**, this result in additional consumer welfare of **\$(CiC)** per month.<sup>64</sup> Moreover, one would reasonably expect the number of customers taking up naked DSL through the WADSL service would increase following the increase of competitive suppliers offering the service.
- 5.15 This simple analysis demonstrates that the net benefit to consumers of unbundling WADSL from an active PSTN line is in the order of \$6 per month. Should the number of end-users willing to take up naked services increases due to the wider availability of WADSL compared to naked ULLS<sup>65</sup>, this net consumer benefit would increase.
- 5.16 Irrespective of the potential size of the net consumer benefits of allowing unbundled WADSL, consistent with the regulatory approach in other markets, would enable the market to determine the extent to which naked WADSL is taken up. Under the current approach, the ACCC is making an assessment that the market does not need such a service. Optus submits that the ACCC should leave it to the market to decide the success or failure of naked DSL.

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<sup>64</sup> Assuming there is no increase in the level of demand as a result of the price decrease.

<sup>65</sup> Taking into account the capacity constraints in zones 1 and 2 that restrict the ability of competitive carriers to use ULLS to meet demand.



## Appendix A. Replicating Telstra retail plans using WADSL service

Table A.1: Telstra Retail Charges (as of 2 April 2013)								
Plan Name	Starter 5Gb	T-Bundle Connector Freestyler 200GB	T-Bundle Connect Everyday® 200Gb	T-Bundle Connect Edge® 500Gb	BigPond Elite 5GB Liberty	BigPond Elite 50GB plan	BigPond Elite 200GB plan	BigPond Elite 500GB plan
<b>Detail of the plan</b>	24 month bundled plan	24 month bundled plan	24 month bundled plan	24 month bundled plan	24 month plan with Telstra BigPond Member Benefit	24 month plan with Telstra BigPond Member Benefit	24 month plan with Telstra BigPond Member Benefit	24 month plan with Telstra BigPond Member Benefit
<b>Included Internet usage (GB)</b>	5	200	200	500	5	50	200	500
<b>Term</b>	24	24	24	24	24	24	24	24
<b>Monthly Bundled Charge</b>	\$52.90	\$80	\$100	\$130				
<b>Monthly Internet Charge</b>					\$29.95	\$49.95	\$69.95	\$79.95
<b>Fixed Line Plan</b>					HomeLine®Plus	HomeLine®Plus	HomeLine®Plus	HomeLine®Plus
<b>Monthly Fixed Line Charge</b>					\$33.95	\$33.95	\$33.95	\$33.95
<b>Included value</b>	Line Rental only (basic \$29.95 5GB plan + \$22.95 line rental)	Line Rental only	Line Rental; Unlimited calls discounted IDD calls	Line Rental; Unlimited calls discounted IDD calls	Line Rental	Line Rental	Line Rental	Line Rental
<b>Min Telstra Retail cost over 24 months</b>	\$1,269.60	\$1,920.00	\$2,400.00	\$3,120.00	\$1,533.60	\$2,013.60	\$2,493.60	\$2,733.60

<b>Table A.2: Telstra Retail Plans vs. Telstra's Wholesale DSL offer</b>								
	<b>Starter 5Gb</b>	<b>T-Bundle Connector Freestyler 200GB</b>	<b>T-Bundle Connect Everyday® 200Gb</b>	<b>T-Bundle Connect Edge® 500Gb</b>	<b>BigPond Elite 5GB Liberty</b>	<b>BigPond Elite 50GB plan</b>	<b>BigPond Elite 200GB plan</b>	<b>BigPond Elite 500GB plan</b>
<b>Monthly Wholesale Line Rental</b>	\$22.84	\$22.84	\$22.84	\$22.84	\$22.84	\$22.84	\$22.84	\$22.84
<b>Monthly Wholesale ADSL Port Charge</b>	\$24.56	\$24.56	\$24.56	\$24.56	\$24.56	\$24.56	\$24.56	\$24.56
<b>Monthly AGVC/VLAN Charge (Mbps)</b>	\$36.08	\$36.08	\$36.08	\$36.08	\$36.08	\$36.08	\$36.08	\$36.08
<b>Included Monthly Usage (GB)</b>	5	200	200	500	5	50	200	500
<b>Peak usage throughput (Mbps)</b>	0.09	3.46	3.46	8.66	0.09	0.87	3.46	8.66
<b>Monthly Usage Cost</b>	\$3.12	\$124.95	\$124.95	\$312.38	\$3.12	\$31.24	\$124.95	\$312.38
<b>Total Monthly Charge</b>	\$50.52	\$172.35	\$172.35	\$359.78	\$50.52	\$78.64	\$172.35	\$359.78
<b>Connection Charge</b>	\$75.00	\$75.00	\$75.00	\$75.00	\$75.00	\$75.00	\$75.00	\$75.00
<b>Telstra Wholesale Costs 24 months</b>	<b>\$1,287.57</b>	<b>\$4,211.46</b>	<b>\$4,211.46</b>	<b>\$8,709.74</b>	<b>\$1,287.57</b>	<b>\$1,962.31</b>	<b>\$4,211.46</b>	<b>\$8,709.74</b>
<b>Telstra Wholesale compare to Telstra Retail (Margins)</b>	<b>-\$17.97</b>	<b>-\$2,291.46</b>	<b>-\$1,811.46</b>	<b>-\$5,589.74</b>	\$246.03	\$51.29	<b>-\$1,717.86</b>	<b>-\$5,976.14</b>

**Assumptions:** Monthly data usage is transformed to peak Mbps throughput using following assumptions. Assume there are 22 busy days in a month, that daily traffic occurs during a 7 hour period each day, and a contention ratio of 50:1.