

# Price Equivalence Framework Strategy

Dated 30th June 2006

Telstra Corporation Limited (ABN 33 051 775 556) ("**Telstra**")

## **Disclaimer**

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# Price Equivalence Framework Strategy

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## **1 Background**

- 1.1 Telstra is required under the OSP to establish by 30 June 2006 a price equivalence framework relating to Designated Services.
- 1.2 This Price Equivalence Framework Strategy describes how the price equivalence framework (“**PEF**”) will apply to material price changes proposed by Telstra for Designated Services and relevant retail services and generally describes the elements of the PEF.
- 1.3 The PEF is aimed at achieving the following outcomes:
  - (a) public assurance that Telstra is acting legitimately in the pricing of relevant Eligible Services supplied to customers of a Retail Business Unit, when compared with the prices at which Telstra provides Designated Services to wholesale customers;
  - (b) increased certainty for Telstra that its pricing decisions do not contravene Part XIB of the Trade Practices Act; and
  - (c) improved information for the ACCC in the performance of its functions under Part XIB of the Trade Practices Act.
- 1.4 The PEF is comprised of:
  - (a) this Price Equivalence Framework Strategy;
  - (b) Telstra’s Retail Pricing Tool, which is also referred to as the “**PEF Imputation Tests**” and includes notional wholesale prices for Designated Services; and
  - (c) the ACCC’s Retail Pricing Protocol (where such a protocol has been developed by the ACCC).
- 1.5 The PEF sets out the arrangements and approach under which Telstra will conduct PEF Imputation Tests and will consider results from those tests in assessing Telstra’s proposals for material price changes under the PEF.
- 1.6 The Strategy and Retail Pricing Tool may be updated from time-to-time.
- 1.7 Definitions used in this Price Equivalence Framework Strategy are as set out in clause 11. Capitalised words and phrases that are not defined in clause 11 have the meaning given in the OSP.

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## **2 Aim of the Price Equivalence Framework Strategy**

- 2.1 This Price Equivalence Framework Strategy describes the following elements of the PEF:
  - (a) the general principles for testing price equivalence within the context of the PEF;

- (b) the application of the PEF Imputation Test approach, including a description of the customer classes to which the PEF will apply;
- (c) a description of inputs to the PEF Imputation Test approach;
- (d) a description of the process associated with the PEF;
- (e) a description of the reporting arrangements to the ACCC and to the public in relation to the PEF;
- (f) a description of the way the Annual Compliance Report will report on Telstra's compliance with the PEF; and
- (g) a workplan and timeline for implementation describing the implementation dates for each of the elements of the PEF.

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### **3 Relationship to the *Trade Practices Act 1974***

- 3.1 Nothing in the PEF replaces, limits, extends or affects the Trade Practices Act.
- 3.2 The outcomes described in clause 1.3 resulting from the application of the PEF will not be determinative of whether Telstra has or has not acted inconsistently with the Trade Practices Act. The ACCC will not be inhibited in its exercise of its functions under Parts XIB and Part XIC of the Trade Practices Act by any material resulting from, or by the application of, the PEF.
- 3.3 Imputation testing is an analytical tool to assist in understanding the competitive implications of Telstra's conduct. In certain circumstances, it may not be particularly informative in, or relevant to, explaining the market circumstances that Telstra may face and may need to respond to.

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### **4 General principles for testing price equivalence**

- 4.1 The aim of PEF Imputation Tests is to assess if there is sufficient margin for an efficient competitor to compete with Telstra in the relevant retail market(s) given the wholesale costs or costs of self supply that are, or would be, faced by an efficient competitor and the costs of transforming wholesale products or inputs that are self supplied into retail products. That is, the aim of a PEF Imputation Test is to determine if an efficient competitor can replicate Telstra's retail offers.
- 4.2 The following general principles should guide the construction of the PEF Imputation Tests:
  - (a) where the price of the proposal being tested is conditional on customers taking a bundle of services or where this is a common method of supply in the market, the assessment should occur across the relevant bundle of services;
  - (b) where it is not possible to fully replicate a bundle, the costs and revenues from those services in the bundle that cannot be replicated should be excluded from the bundle;

- (c) evaluation of the costs and revenues of the relevant service should be determined by the revenues foregone less the efficient wholesale input prices, the cost of efficient self supply and the incremental transformation costs avoided if the relevant volume was not produced or sold;
  - (d) the mix of wholesale input prices and self supply should reflect the most efficient mix of network technologies available for delivering the relevant volume of product. In this way the test will reflect an efficient competitor's network delivery;
  - (e) up-front costs and revenues should be amortised over the average customer tenure for the relevant retail and/or wholesale service. Estimates of customer tenure may be based on historical information projected forward, but may require modification to reflect changed future expectations about customer take-up on a case-by-case basis; and
  - (f) where forecasting of demand, revenue or costs is required, forecasts should be based on Telstra's reasonable expectations of the future prices and costs of supplying retail customers.
- 4.3 The application of the above general principles to this type of modelling involves making decisions based on judgement and interpretation of data. Deviations from the application of these general principles may occur where such deviations have a conservative (narrowing) effect on the imputation test.
- 4.4 In addition to updating inputs to the PEF Imputation Tests on a regular basis, specific methodological issues in the PEF Imputation Tests may require change from time to time to achieve these general principles or otherwise to ensure the PEF Imputation Tests more accurately reflect the actual competitive dynamics in the relevant markets.

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## **5 Application of PEF Imputation Test approach**

- 5.1 The scope of the PEF Imputation Tests is to test the efficient supply by Telstra of BigPond ADSL and PSTN voice telephony services to the class of customers described in clause 5.4.

### Matching of Designated Services and retail services

- 5.2 The list of Designated Services, as at 30 June 2006, which are applicable to the PEF are as described in the Designated Services Determination. Each of the Designated Services as at 30 June 2006 has been matched to those retail services that will be subject to the PEF, as listed in the table below. The list of relevant retail services may change from time to time.
- 5.3 Where retail services could be provided by alternative Designated Services, the aim of the PEF Imputation Test approach would be to identify the most efficient mix of Designated Services to include in the test consistent with the objective of promoting efficient competition, including efficient self supply.

<b>Designated Services</b>	<b>Relevant retail service(s)</b>
1. Domestic PSTN Originating Access Service	National long distance calls, International long distance calls, Fixed-to-Mobile calls
2. Domestic PSTN Terminating Access Service	National long distance calls
3. Local Carriage Service (LCS)	Basic access and Local calls
4. Wholesale ADSL Layer 2 Service	BigPond ADSL
5. Line Sharing Service (LSS) aka Spectrum Sharing Service (SSS)	BigPond ADSL
6. Unconditioned Local Loop Service (ULLS)	Basic access, Local calls, National long distance calls, International long distance calls, Fixed-to-Mobile calls and BigPond ADSL
7. Domestic Transmission Capacity Service	BigPond ADSL

#### Customer Class

- 5.4 The PEF relates only to mass market residential and business offerings and does not extend to arrangements that are customised or tailored specifically for individual customers.

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## **6 Inputs to PEF Imputation Test**

### Internal Wholesale Price

- 6.1 The internal wholesale price for Designated Services used in the PEF Imputation Tests will initially be based on the average wholesale yield calculated across all wholesale customers taking the relevant Designated Service. Telstra may also additionally run the PEF Imputation Tests using the internal wholesale price set at the wholesale yield associated with the lowest available or actual wholesale price.

### Avoidable Cost

- 6.2 The PEF Imputation Tests will incorporate the avoidable cost of transforming the Designated Service to a retail service to the extent practicable. If sufficient estimates of avoidable costs are not available, Telstra may use the average costs of transforming the Designated Service to a retail service.

## Revenues

- 6.3 In general, the PEF Imputation Tests will incorporate all revenues derived from the relevant retail services associated with the full relevant customer base, regardless of whether customers were on superseded plans. In addition, the tests may include all incremental revenue or other commercial benefit expected to be received through the supply of relevant retail services, as well as revenue or benefit that would be lost if Telstra did not supply the service.
- 6.4 In specific instances it may be appropriate to consider revenue from particular sub-sets of services or customers, but when this is done the assessment should be based on costs related specifically to those sub-sets.

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## 7 Processes for PEF

### Materiality Threshold

- 7.1 Only material retail price decreases and material wholesale price increases will be subject to the PEF.
- 7.2 The threshold for materiality of a proposed price change will be a change in the incremental revenue for the relevant retail voice, retail ADSL service, wholesale voice and/or wholesale ADSL of more than 3%. The threshold will be determined by comparing the incremental revenue from a service (calculated by averaging the annual forecast incremental revenue) to the annual revenue from that service (calculated using the PEF Imputation Test).

### Outputs

- 7.3 PEF Imputation Tests and their results are the confidential information of Telstra and will not be disclosed to the public or to wholesale customers.

### PEF Imputation Test Results

- 7.4 The implementation of the PEF will not directly affect Telstra's pricing conduct or pricing decisions nor is it a price setting mechanism.
- 7.5 Nothing in this Price Equivalence Framework Strategy:
- (a) implies that a negative margin is reflective of anti-competitive behaviour or that Telstra is not behaving legitimately in the pricing of relevant Eligible Services supplied to customers of a Retail Business Unit when compared with the prices at which Telstra provides Designated Services to wholesale customers; or
  - (b) is to be taken as a representation that Telstra will vary or withdraw a proposed material price change as a result of a negative margin resulting from a PEF Imputation Test.

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## **8 Reporting in relation to the application of the PEF**

### Reporting to the Minister and ACCC

- 8.1 Telstra will provide to the ACCC the PEF Imputation Test results for each material price change proposal no later than four business days after customers have been generally advised of the price change by Telstra, or where the price change takes effect within four business days after customers are generally advised of the price change, on the day the price change takes effect.
- 8.2 Telstra will also provide to the Minister and ACCC an Annual Compliance Report, as required by the OSP, which will include a summary of:
- (a) Telstra's performance in meeting all of its obligations under the OSP, including in relation to this Price Equivalence Framework Strategy and the PEF generally;
  - (b) any areas of non-compliance with the OSP and action taken to address the non-compliance including in relation to this Price Equivalence Framework Strategy and the PEF generally;
  - (c) action taken by Telstra to address any systemic problems in relation to its obligations under the OSP; and
  - (d) any matter arising out of implementation or of compliance with the OSP that has impaired Telstra's ability to compete on a fair and efficient basis.

### Reporting to the public

- 8.3 Telstra will produce a quarterly report for public release on Telstra's website containing information about each material price change proposal that has been notified to the ACCC during the previous 3 months.
- 8.4 The report will note if there were no material price change proposals that are relevant to the PEF during the relevant quarter.
- 8.5 The report will be released within 5 business days of the end of the relevant quarters (which are January to March, April to June, July to September and October to December).

### Independent Audit Report

- 8.6 An independent external auditor will audit and report on the extent to which Telstra complied with the OSP during each financial year commencing for the 2006-2007 financial year as specified in Telstra's OSP (which includes compliance with the PEF including this Strategy). This Audit Report will be provided to the Minister and the ACCC within 120 days of the end of each financial year.

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## **9 Publication**

- 9.1 This Price Equivalence Framework Strategy will be made available on Telstra's internet site no later than 30 June 2006.

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## 10 Timeline and Implementation

10.1 The timeline for implementing the PEF is detailed below.

- (a) This Price Equivalence Framework Strategy will be provided to the Department no later than 30 June 2006 as required by the OSP.
- (b) Telstra will begin using Telstra's Retail Pricing Tool as soon as practicable but no later than 1 December 2006.
- (c) Telstra will consider the ACCC's Retail Pricing Protocol (where such a protocol has been developed by the ACCC) in implementing this PEF.
- (d) Telstra will begin providing PEF Imputation Test results to the ACCC for material price change proposals when Telstra starts using the Retail Pricing Tool, and in any event no later than from 1 December 2006.
- (e) Telstra will publish quarterly reports for public release on Telstra's website describing equivalence for material price change proposals that occurred in the previous 3 months. The first public report will be released at the end of the quarter in which Telstra starts using the Retail Pricing Tool.
- (f) The first Annual Compliance Report assessing Telstra's compliance with this Price Equivalence Framework Strategy, and other aspects of the OSP, will be provided to the Minister and the ACCC within 120 days of the end of the 2006/2007 financial year.

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## 11 Definitions

- 11.1 **ACCC's Retail Pricing Protocol** means any retail pricing protocol that is developed from time to time by the ACCC and that is consistent with clause 5.3(d) of the OSP.
- 11.2 **Designated Services Determination** means the *Telecommunications (Operational Separation Designated Services) Determination (No.1) 2005*.
- 11.3 **OSP** means the operational separation plan approved by the Minister under clause 55(1) of Schedule 1 of the *Telecommunications Act 1997* on 23 June 2006.
- 11.4 **PEF** has the meaning given in clause 1.2.
- 11.5 **PEF Imputation Test** has the meaning given in clause 1.4(b).