

**IN THE MATTER OF UNDERTAKING  
DATED 22 MARCH 2006 LODGED BY  
TELSTRA CORPORATION LIMITED  
WITH THE AUSTRALIAN COMPETITION  
AND CONSUMER COMMISSION IN  
RESPECT OF PSTN ORIGINATING AND  
TERMINATING ACCESS AND LOCAL  
CARRIAGE SERVICE  
("the Access Undertaking")**

**STATEMENT OF [C-I-C]**

On 5 September 2006, I, [c-i-c] of [c-i-c], state as follows:

1 The information in this statement is confidential to Telstra Corporation Limited ("Telstra"). I have prepared this statement on the basis that the information in it and documents attached to it will remain confidential and that the information and documents will only be disclosed to a person:

- (a) who has executed a confidentiality undertaking in terms that are satisfactory to Telstra; and
- (b) who may only use the documents and the information for the following purposes:
  - (i) making submissions to the Australian Competition and Consumer Commission ("ACCC") in respect of the Access Undertaking; or
  - (ii) any application made to the Australian Competition Tribunal under s 152E of the Trade Practices Act for review of a decision made by the ACCC in respect of any of the Access Undertaking; or
  - (iii) any other purpose approved by Telstra in writing.

2 [c-i-c].

3 [c-i-c].

4 This statement covers four separate calculations:

- (a) the calculation of PSTN originating and terminating access in historic and current cost terms (paragraphs 8 to 48 below);

- (b) the extrapolation of the ACCC's only available Total Service Long Run Incremental Cost ("TSLRIC") estimates of PSTN originating terminating access costs, based on the ACCC's n/e/r/a model (paragraphs 49 to 67 below);
- (c) the estimate of the average local call retail costs used to calculate the price of the Local Carriage Service ("LCS") (paragraphs 68 to 72 below); and
- (d) the average number of local calls per access line (paragraphs 74 to 80 below).

5 [c-i-c]

6 [c-i-c].

7 I am aware that the Access Undertakings have been provided to the ACCC by Telstra and contain certain wholesale prices for PSTN OTA and LCS. These prices were developed on the basis of recovery by Telstra of the efficient costs of the local switching and transmission elements of the PSTN (known as the Interexchange network or the "IEN"). In the context of the Access Undertaking, Telstra also relies on the relevant historic and current costs of the IEN, and PSTN OTA costs based on the n/e/r/a model. I was the person responsible within Telstra for the calculation of these historic, current and n/e/r/a costs for OTA. I explain and set out in this statement my calculation of these costs.

#### **A Historic and current costs of PSTN OTA**

8 As discussed in further detail below, Telstra's historic and current cost accounts are prepared in accordance with record keeping rules determined by the ACCC and are audited on an annual basis. The historical costs reflect the costs that Telstra has actually incurred in the provision of OTA. The current costs convert the historic costs into current cost terms.

9 Telstra prepares historic and current cost accounts in accordance with the record keeping rules determined by the ACCC.

10 Under s. 151BU of the *Trade Practices Act*, the ACCC has the power to make a record keeping rule ("RKR") by written instrument and require that carriers and carriage service providers comply with it.

- 11 On 14 May 2001, the ACCC notified Telstra and three other carriers as being required to report under the Telecommunications Industry Regulatory Accounting Framework (“**RAF**”). As a notified carrier, the RAF requires Telstra to generate and report to the ACCC on the retail and wholesale components of its business via a set of core reports and several usage reports.
- 12 These reports are prepared on the basis of historic cost accounts. The core reports are the:
- (a) Capital Adjusted Profit and Loss Statements;
  - (b) Capital Employed Statements;
  - (c) Fixed Asset Statements; and
  - (d) Weighted Average Cost of Capital Report.
- 13 The usage reports are the:
- (a) Service Usage Reports; and
  - (b) Key Network Asset Usage Report.
- 14 On 19 June 2003, the Government released the Australian Competition and Consumer Commission (Accounting Separation – Telstra Corporation Limited) Direction (No.1) 2003. Under this Direction, Telstra is required to prepare current cost accounts, as well as publish current cost and historical cost key financial statements in respect of “core” interconnect services. Core interconnect services include PSTN OTA and LCS.
- 15 The historic and current accounts Telstra prepares in accordance with those recording and reporting requirements set out at paragraphs 9 to 14 above are submitted to the ACCC every six months and are audited annually. They are commonly referred to within Telstra as the “RAF”, or the “regulatory accounts”.
- 16 I have extensive knowledge of and experience with Telstra’s regulatory accounts. I was closely involved in the development of the RAF when the transition was made from Chart of Accounts/Cost Allocation Manual (“**COA/CAM**”) to the regulatory accounts that are in place today. Therefore, I have a good understanding of the cost allocation rules that are used to convert the costs in Telstra’s General Ledger to the product costing and retail, internal and external costs that are reported in the RAF. I use the RAF regularly in both my cost modeling and imputation testing work. I often use the RAF to assess the reasonableness of cost estimates built-up from

bottom-up models, as the costs in the RAF reflect the costs that Telstra has actually incurred and hence provide a useful basis for checking the range of assumptions and methodology choices that are used in bottom-up models. I draw largely from the RAF for determining transformation costs in my imputation test models. This requires me to have a good understanding of the cost categories in the RAF and how these inter-relate with the access products provided by Telstra.

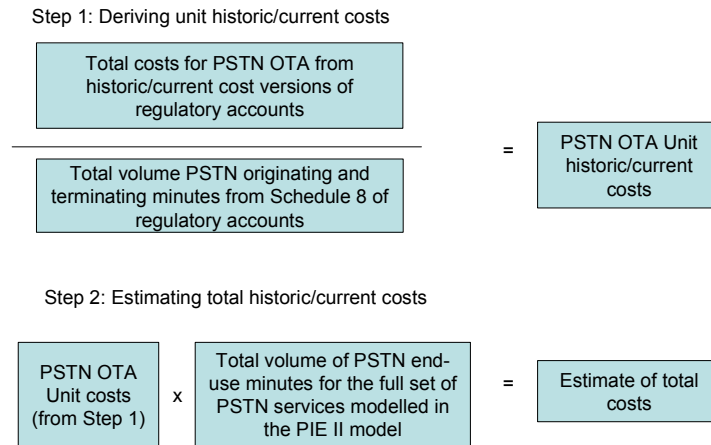
- 17 In order to calculate Telstra's historic and current IEN costs, I used the most recent audited RAF regulatory accounts available, namely those for the 12 month period to 30 June 2005. Those accounts are very voluminous in size. Accordingly, where I have made reference in this statement to certain information contained in those accounts, I have annexed the relevant extracts from the accounts to this statement.

***Historic and Current Cost Calculation - Overview***

- 18 In order for the IEN costs from the RAF to be comparable to those costs as determined by the PIE II model and incorporated in the Access Undertaking, I carried out the following two-step calculation:
- (a) Step 1: I divided the total costs from the RAF for the product PSTN OTA supplied to external parties, excluding the end-user access adjustment, by the volume of total PSTN OTA. The purpose of this step is to derive a per unit (historic or current) cost for PSTN OTA.
  - (b) Step 2: I then multiplied the resulting unit costs for PSTN OTA by the total volume of PSTN end-use minutes for the full set of PSTN services modelled in the PIE II model: namely local calls, long distance calls, international calls, fixed-to-mobile calls, PSTN OTA and LCS.
- 19 The second step summarised above converts the unit costs for the PSTN OTA product to a level of equivalent costs for the total volume of traffic that is supplied over the PSTN. This step is required to make the PSTN OTA cost pool from the RAF comparable with the PIE II, IEN cost pool, which is calculated for the full set of services supplied over the PSTN, rather than services supplied to external parties (eg PSTN OTA) only.
- 20 ISDN traffic has been excluded from the traffic volumes for the purposes of this calculation of end-use minutes and hence the results understate the cost pool as compared with the results of the PIE II model, which includes ISDN traffic.

21 Figure 1 summarises the calculations I carried out:

**Figure 1: Overview of cost calculations**



22 Most of the cost inputs used in my calculations are taken from the *Capital Adjusted Profit Statement - External Wholesale Business* of the RAF. A copy of relevant extracts from this report is annexed and marked with the letter “A”. That report contains various “line items”. Reference to “line items” below are references to line items in Annexure “A”.

23 In undertaking the relevant calculations, I made the following adjustments:

- (a) I excluded Line item 4-2-01, which comprises installation costs allocated to the PSTN OTA product, from both my historic and current costs account calculations. I excluded this line item from the total costs as installation costs are not part of the PIE II IEN cost pool.
- (b) In my current cost calculation, I excluded line item 4-4-01-1, which is the holding gains/losses on the asset adjustment. This line item reflects the difference between the opening and closing current cost value, adjusted for additions and retirements, for the reporting period. Therefore, it represents the “notional profit or loss” that Telstra would make if it were to realise the value of these assets at the closing current cost value. These gains/losses are “notional” and are inconsistent with the TSLRIC concept.
- (c) In my current cost calculation, I also excluded line item 4-4-01-4, which is the inflation adjustment. The inflation adjustment represents the “notional”

cost of maintaining the purchasing power of the financial capital of the business and does not impact on the value of the underlying assets.

24 I have presented the results of the analysis described above are presented in summary form in Table 1 below.

**Table 1: Summary of historical and current cost estimates**

	Historic costs	Current costs
Organisation Costs	[c-i-c]	[c-i-c]
Product and Customer Costs	[c-i-c]	[c-i-c]
Network Costs	[c-i-c]	[c-i-c]
Cost of Capital	[c-i-c]	[c-i-c]
CCA adjustment	[c-i-c]	[c-i-c]
Total annual costs	[c-i-c]	[c-i-c]

25 I expand on these calculations in the following paragraphs of my Statement:

- Paragraphs 26 to 37 below describe the derivation of the total cost pool using historic costs; and
- Paragraphs 38 to 48 below describe the derivation of the total cost pool using current costs.

***Historic costs calculation***

26 As summarised above, Step 1 of my calculation involves calculating historic unit costs of PSTN OTA, by taking total historic costs for PSTN OTA supplied to external parties, excluding the end-user access adjustment, and dividing these total costs by the volume of total PSTN OTA minutes. The adjustment for end-user access is excluded as these costs reflect the deficit between revenues and costs for the end-user access product. Telstra is no longer claiming this deficit in the price for either PSTN OTA or LCS and hence it is excluded from the PIE II cost pool. I have therefore excluded it from the calculation of actual historic costs to enable appropriate comparability with the PIE II model costs.

- 27 Table 2 summarises the components that comprise total historic costs, which I took from Telstra’s historic cost accounts and used in my calculations. As noted, above, these costs pertain only to the external PSTN OTA product.

**Table 2: Components of total historic costs sourced from Telstra historic cost accounts**

<b>Cost component</b>	<b>Historic costs</b>
Organisation Costs	[c-i-c]
Product and Customer Costs	[c-i-c]
Network Costs	[c-i-c]
Cost of Capital	[c-i-c]
Total annual historic costs	[c-i-c]

- 28 I sourced the historic cost data for Organisation Costs, Product and Customer Costs and Network Costs shown in Table 2 from the statement in the RAF accounts entitled *Capital Adjusted Profit Statement - External Wholesale Business*, Annexure “A”.
- 29 I have summarised the line items included in the Organisation, Product and Customer, and Network Cost components that comprise total historic costs shown table 2 above in Table 3, Table 4 and Table 5 below respectively. In the historic cost accounts (Annexure “A”), Total Product and Customer Costs include line item 4-2-01, which represents Installation costs. As noted above, I excluded this line item from the calculation for the purpose of this exercise.

**Table 3: Summary of Organisation Historic Costs**

<b>Line Item</b>	<b>Cost</b>
4-1-01 General Administration	[c-i-c]
4-1-10 Information Technology	[c-i-c]
4-1-20 Accommodation & Property	[c-i-c]
4-1-30 Other Non Communications Asset Costs	[c-i-c]
4-1-40 Other Organisational Costs	[c-i-c]
Total Organisation Costs	[c-i-c]

**Table 4: Summary of Product and Customer Historic Costs**

<b>Line Item</b>	<b>Cost</b>
4-2-10 Marketing	[c-i-c]
4-2-15 Sales	[c-i-c]
4-2-20 Operator Services	[c-i-c]
4-2-25 Customer Support	[c-i-c]
4-2-30 Billing	[c-i-c]
4-2-31 Bad Debt Expenses	[c-i-c]
4-2-40 Interconnection Costs	[c-i-c]
4-2-50 International Settlement Costs	[c-i-c]
4-2-60 USO Payments	[c-i-c]
4-2-70 Other Product Expenses	[c-i-c]
<b>Total Product and Customer Costs</b>	<b>[c-i-c]</b>

**Table 5: Summary of Network Historic Costs**

<b>Line Item</b>	<b>Cost</b>
4-3-01 CAN Ducts & Pipes	[c-i-c]
4-3-05 CAN Copper Cables	[c-i-c]
4-3-10 CAN Other Cables	[c-i-c]
4-3-15 CAN Pair Gain Systems	[c-i-c]
4-3-20 CAN Radio Bearer Equipment	[c-i-c]
4-3-25 Other CAN	[c-i-c]
4-3-30 Switching Equipment - Local	[c-i-c]
4-3-35 Switching Equipment - Trunk	[c-i-c]
4-3-40 Switching Equipment - Other	[c-i-c]
4-3-45 Inter-exchange Cables	[c-i-c]
4-3-50 Transmission Equipment	[c-i-c]
4-3-55 Radio Bearer Equipment	[c-i-c]
4-3-60 Data Equipment	[c-i-c]
4-3-65 Mobile Network and Terminal Equipment	[c-i-c]
4-3-70 Customer Equipment	[c-i-c]
4-3-75 Satellite Equipment	[c-i-c]
4-3-80 International Network Cables	[c-i-c]
4-3-85 International Network - Other Systems	[c-i-c]
4-3-90 Other Communications Plant & Equipment	[c-i-c]
<b>Total Network Costs</b>	<b>[c-i-c]</b>

- 30 I sourced the Cost of Capital line item shown in Table 2 above from the RAF statement entitled *Capital Employed Statement - External Wholesale Business*, which is attached at Annexure “B” to this Statement.



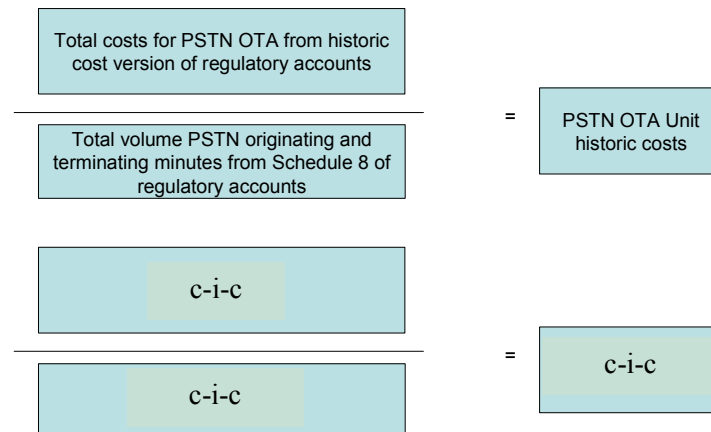
- 31 I derived the unit costs by dividing total historic costs by the volume of total PSTN OTA. I sourced the volume of these minutes from *Schedule 8(b): Service Usage Report - External Wholesale*. Annexure “C” contains relevant data from *Schedule 8 (a) and (b): Service Usage Reports* that is used in my calculations.
- 32 I have entered below extracts the relevant line items from Schedule 8(b) in Table 6 below, and added an additional line that sums those relevant line items. These volumes are also for the 12 month period to 30 June 2005.

**Table 6: Derivation of total PSTN originating and terminating minutes**

Call type	Volume (minutes)
Domestic PSTN Originating call minutes	[c-i-c]
Domestic PSTN Terminating call minutes	[c-i-c]
<b>Total PSTN OTA minutes</b>	[c-i-c]

- 33 Unit costs are then calculated as total historic costs divided by total volumes, as shown in Figure 2.

**Figure 2: Derivation of unit historic costs**



- 34 As noted above, Step 2 involves taking the resulting unit costs for PSTN OTA, and multiplying these by total volume of PSTN end-use minutes for the full set of PSTN services modelled in the PIE II model, to derive estimates of total costs.

35 Table 7 below summarises the components that comprise total end-use minutes, which I sourced as follows:

- (a) Local, domestic long distance, international and fixed-to-mobile minutes are sourced from *Schedule 8(a): Service Usage Report – Retail* (Annexure “C”). In this schedule, minutes are reported in terms of conversation minutes, not end-use minutes. Given that the per unit cost for PSTN OTA is calculated in terms of end-use minutes, it was necessary for me to convert the conversation minutes in *Schedule 8(a): Service Usage Report – Retail*, to end-use minutes. I did this by multiplying the conversation minutes for local calls and domestic long distance calls by two, as these call types both originate and terminate on the PSTN and so for each conversation minute, there are two end-use minutes. International and fixed-to-mobile traffic only use the PSTN at the originating end, so in these cases, conversation minutes are equal to end-use minutes, so I did not consider it necessary to make any adjustment in this regard.
- (b) I sourced the PSTN OTA minutes from *Schedule 8(b): Service Usage Report - External Wholesale* (Annexure “C”).
- (c) Estimates for LCS minutes are not listed in Schedule 8 (Annexure “C”). Hence, I sourced LCS minutes from the PSTN Flash Report prepared by Telstra Wholesale. A copy of the Flash Report for the period 2004/05 is annexed and marked with the letter “D”. For the purpose of deriving LCS end-use minutes, I multiplied the LCS conversation minutes contained in the PSTN Flash Report by two, for the same reasons as set out above in relation to the local calls conversation minutes.

**Table 7: Components of PSTN end-use minutes**

Call type	Volume	Adjustment factor	Volume (end-use minutes)
	(1)	(2)	(3) = (1) x (2)
Local	[c-i-c]	[c-i-c]	[c-i-c]
Domestic long distance	[c-i-c]	[c-i-c]	[c-i-c]
International	[c-i-c]	[c-i-c]	[c-i-c]

Fixed-to-mobile	[c-i-c]	[c-i-c]	[c-i-c]
PSTN OTA	[c-i-c]	[c-i-c]	[c-i-c]
LCS	[c-i-c]	[c-i-c]	[c-i-c]
Total			[c-i-c]

- 36 I calculated the total IEN cost pool by multiplying the unit cost ([c-i-c]), by total volume of PSTN end-use minutes for ([c-i-c] from table 7 above), yielding an overall estimate of total annual historic costs of [c-i-c].
- 37 I undertook similar calculations to those just described for the purpose of deriving historic cost based estimates of the sub-components (Organisation costs, etc.) of the total cost pool. Table 8 summarises my calculations in this regard. The figures in the final column are those figures presented in Table 1 of my Statement.

**Table 8: Summary of derivation of total cost pool using historic costs**

	Historic costs	PSTN OTA minutes	Per unit historic costs	Total volume of PSTN end-use minutes	Total Cost Pool
	(1)	(2)	(3) = (1) / (2)	(4)	(5) = (3) x (4)
Organisation Costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Product and Customer Costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Network Costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Cost of Capital	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Total annual costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]

***Current costs calculation***

- 38 The method by which I derived estimates of the total cost pool using current costs is largely the same as the method I used to estimate the total historic cost pool.

- 39 Step 1 involved calculating unit current costs of PSTN OTA, by taking total current costs for PSTN OTA supplied to external parties, excluding the end-user access adjustment, and dividing these total costs by the volume of total PSTN OTA minutes from Schedule 8(b) of the RAF.
- 40 Table 9 summarises the components that comprise total current costs, which I took from Telstra’s current cost accounts (“CCA”), and used in the calculations.

**Table 9: Components of total current costs sourced from CCA**

<b>Cost component</b>	<b>Current costs</b>
Organisation Costs	[c-i-c]
Product and Customer Costs	[c-i-c]
Network Costs	[c-i-c]
Cost of Capital	[c-i-c]
CCA adjustment	[c-i-c]
<b>Total annual current costs</b>	<b>[c-i-c]</b>

- 41 I sourced the above cost data from the statement in the CCA entitled *Capital Adjusted Profit Statement - External Wholesale Business*, which is annexed and marked with the letter “E”. The relevant column is that labelled *Domestic PSTN Origin/Term (Declared)*.
- 42 The line items which I included in the Organisation, Product and Customer, Network Cost and CCA Adjustment are summarised in the tables below. All items in these tables are taken from *Capital Adjusted Profit Statement - External Wholesale Business* (Annexure “E”). Again, I have excluded from the calculation line item 4-2-01, which represents Installation costs. For the purpose of deriving the CCA Adjustment to network costs, I excluded line items 4-4-01-1 and 4-4-01-4, for the reasons noted at paragraphs 23 (b) and (c) above.

**Table 10: Summary of Organisation Current Costs**

<b>Line Item</b>	<b>Cost</b>
4-1-01 General Administration	[c-i-c]
4-1-10 Information Technology	[c-i-c]
4-1-20 Accommodation & Property	[c-i-c]
4-1-30 Other Non Communications Asset Costs	[c-i-c]
4-1-40 Other Organisational Costs	[c-i-c]
<b>Total Organisation Costs</b>	<b>[c-i-c]</b>

**Table 11: Summary of Product and Customer Current Costs**

<b>Line Item</b>	<b>Cost</b>
4-2-10 Marketing	[c-i-c]
4-2-15 Sales	[c-i-c]
4-2-20 Operator Services	[c-i-c]
4-2-25 Customer Support	[c-i-c]
4-2-30 Billing	[c-i-c]
4-2-31 Bad Debt Expenses	[c-i-c]
4-2-40 Interconnection Costs	[c-i-c]
4-2-50 International Settlement Costs	[c-i-c]
4-2-60 USO Payments	[c-i-c]
4-2-70 Other Product Expenses	[c-i-c]
<b>Total Product And Customer Costs</b>	<b>[c-i-c]</b>

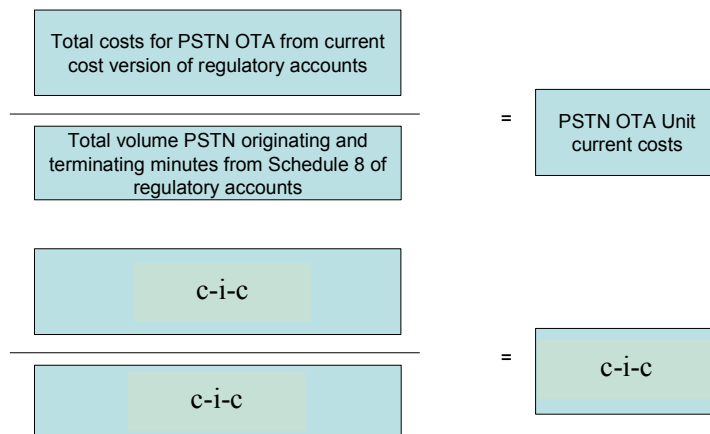
**Table 12: Summary of Network Current Costs**

<b>Line Item</b>	<b>Cost</b>
4-3-01 CAN Ducts & Pipes	[c-i-c]
4-3-05 CAN Copper Cables	[c-i-c]
4-3-10 CAN Other Cables	[c-i-c]
4-3-15 CAN Pair Gain Systems	[c-i-c]
4-3-20 CAN Radio Bearer Equipment	[c-i-c]
4-3-25 Other CAN	[c-i-c]
4-3-30 Switching Equipment - Local	[c-i-c]
4-3-35 Switching Equipment - Trunk	[c-i-c]
4-3-40 Switching Equipment - Other	[c-i-c]
4-3-45 Inter-Exchange Cables	[c-i-c]
4-3-50 Transmission Equipment	[c-i-c]
4-3-55 Radio Bearer Equipment	[c-i-c]
4-3-60 Data Equipment	[c-i-c]
4-3-65 Mobile Network And Terminal Equipment	[c-i-c]
4-3-70 Customer Equipment	[c-i-c]
4-3-75 Satellite Equipment	[c-i-c]
4-3-80 International Network Cables	[c-i-c]
4-3-85 International Network - Other Systems	[c-i-c]
4-3-90 Other Communications Plant & Equipment	[c-i-c]
<b>Total Network Costs</b>	<b>[c-i-c]</b>

**Table 13: Summary of CCA Adjustments**

Line Item	Cost
4-4-01-2 Supplementary Depreciation Adjustments	[c-i-c]
4-4-01-3 Backlog Depreciation Adjustment	[c-i-c]
Total CCA Adjustments	[c-i-c]

- 43 I sourced the Cost of Capital line item from the statement in the CCA accounts entitled *Capital Employed Statement - External Wholesale Business*, which is attached to this statement at Annexure “F”. The relevant column is that labelled *Domestic PSTN Origin/Term (Declared)*.
- 44 I derived the unit costs by dividing total current costs by the volume of total PSTN OTA minutes from Schedule 8(b) of the regulatory accounts (as summarised previously in Table 6).
- 45 I calculated the unit costs as total current costs divided by total volumes, as shown in Figure 3.

**Figure 3: Derivation of unit current costs**

- 46 Step 2 involves taking the resulting unit current costs for PSTN OTA, and multiplying these by total volume of PSTN end-use minutes for the full set of PSTN services modelled in the PIE II model (as summarised previously in Table 7), to derive estimates of total costs.

- 47 I calculated the total cost pool as the unit cost ([c-i-c]), multiplied by total volume of PSTN end-use minutes ([c-i-c]), yielding an estimate of total annual current costs of [c-i-c].
- 48 I undertook similar calculations to those just described for the purpose of deriving current cost based estimates of the sub-components of the total cost pool. Table 14 summarises my calculations in this regard. The figures in the final column are those figures presented in Table 1 above.

**Table 14: Summary of derivation of total cost pool using current costs**

	Current costs	PSTN OTA minutes	Per unit current costs	Total volume of PSTN end-use minutes for PIE II model services	Total Cost Pool
	(1)	(2)	(3) = (1) / (2)	(4)	(5) = (3) x (4)
Organisation Costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Product and Customer Costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Network Costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Cost of Capital	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
CCA adjustment	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Total annual costs	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]

**B. ACCC's Cost Estimates of PSTN Originating and Terminating Access**

- 49 I have also been asked to forecast what the ACCC's TSLRIC cost estimates for the IEN would have been for 2006/07 and 2007/08 based on the ACCC's most recently published cost estimates.
- 50 The last available cost estimates of the IEN that the ACCC published using its own TSLRIC model, the "n/e/r/a model", are contained in its assessment of Telstra's

PSTN undertakings for 1999/00 and 2000/01 (“**2000 Decision**”), a copy of which is annexed hereto and marked with the letter “**G**”. (As the 2000 Decision is voluminous, I have annexed the relevant extracts from it as referred to in this statement.) In the 2000 Decision, the ACCC estimated the TSLRIC for both the Customer Access Network (“**CAN**”) and the IEN.

51 In the following sub-sections of my Statement I:

- (a) first, present relevant material from the 2000 Decision; and
- (b) second, explain how I used this material to forecast what the ACCC’s TSLRIC estimates would be for 2006/07 and 2007/08. In summary, the approach I used was to extrapolate the ACCC’s TSLRIC costs estimates for the IEN from 1999/00 and 2000/01 into the equivalent estimates for 2006/07 and 2007/08. This extrapolation into the later period is based on forecast volume changes I have extracted from the PIE II model, as discussed below and the ACCC’s estimated change in costs due to volume and non-volume related factors.

#### **Relevant material from the ACCC’s 2000 Decision**

52 In the 2000 Decision, the ACCC states that the cost data presented was taken from a model of PSTN TSLRIC costs developed by n/e/r/a.

53 For the IEN, the ACCC presented total annual costs for each of the switching and transmission elements in the n/e/r/a model, together with the volume of call end minutes using each network element and the resulting cost per end minute. (Tables A1.3 and A1.5 of the 2000 Decision, at Annexure “**G**”). This information was presented for both 1999/00 and 2000/01 and is summarised in Table 15 below.

54 I have included an additional network element in Table 15 below referred to as a Remote Access Unit (“**RAU**”). In this RAU element, I have combined the ACCC’s IRIM and RSS/RSU network elements. I have done this because the PIE II model does not distinguish between the IRIM and RSS/RSU and it is therefore necessary that all network elements from the ACCC’s n/e/r/a costing align with the PIE II network elements for the purposes of my extrapolation exercise.



**Table 15 : Summary of ACCC estimates for 1999/00 and 2000/01**

Network element	Annual cost \$m		Call end minutes (million)		Cost per end minute	
	1999/00	2000/01	1999/00	2000/01	1999/00	2000/01
RAU	\$369	\$382	221,074	255,760	\$0.0017	\$0.0015
IRIM	\$82	\$83	73,616	85,165	\$0.0011	\$0.0010
RSS/RSU	\$287	\$299	147,458	170,595	\$0.0019	\$0.0018
LAS	\$354	\$368	224,414	259,624	\$0.0016	\$0.0014
TS	\$60	\$64	65,202	74,939	\$0.0009	\$0.0009
RAU-LAS	\$1,469	\$1,526	286,091	323,550	\$0.0051	\$0.0047
IRIM-LAS	\$1,246	\$1,295	75,408	86,671	\$0.0165	\$0.0149
RSS/RSU-LAS	\$223	\$231	210,683	236,879	\$0.0011	\$0.0010
LAS-LAS	\$164	\$170	80,302	89,776	\$0.0020	\$0.0019
LAS-TS	\$130	\$136	178,280	199,052	\$0.0007	\$0.0007
Total	\$2,546	\$2,646				

55 In addition, the ACCC stated in the 2000 Decision that conveyance costs (i.e. IEN costs) tend to be insensitive with respect to traffic volumes. Specifically, the ACCC states that a 10 per cent increase in the number of call minutes produces only approximately a 0.6 per cent increase in total conveyance costs.<sup>1</sup>

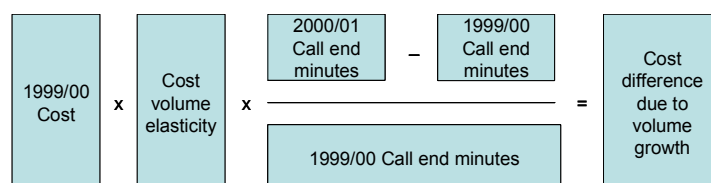
56 Based on this information, it was possible for me to forecast what the Commission's TSLRIC estimates would be for 2006/07 and 2007/08. The remaining sub-sections explain the approach I took to prepare this forecast.

***Attributing cost difference between 1999/00 and 2000/01 to volume and non-volume factors***

57 As Table 15 above shows, the ACCC estimates an increase in the cost pool from 1999/00 to 2000/01. The increase in the ACCC's cost pools from 1999/00 and 2000/01 can be broken down into two sub-components:

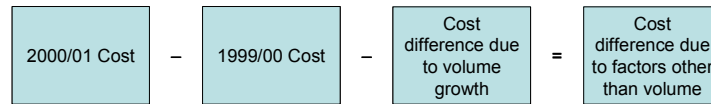
- (a) First, the increase in costs caused by volume increases. Figure 4 shows how I have derived this:

**Figure 4: Derivation of cost increases due to volume change**



- (b) Second, the increase in costs caused by factors other than volume increases. Figure 5 shows how I have derived this:

<sup>1</sup> Section A1.2.1, p. 47 at Annexure "G".

**Figure 5: Derivation cost increases due to non volume related factors**

58 Table 16 presents the results of these calculations, for each of the relevant network elements.

**Table16: Attributing cost differences between 1999/00 and 2000/01 to volume and non-volume factors**

Network element	Annual cost \$m		Call end minutes (million)		Cost volume elasticity	Cost difference due to volume change	Cost difference due to non-volume related factors (\$)	Cost difference due to non-volume related factors (%)
	1999/00	2000/01	1999/00	2000/01				
	(1)	(2)	(3)	(4)	(5)	(6)	(7) =	(8)
						(1) x (5) x [(4) - (3)]/(3)	(2) - (1) - (6)	
RAU	\$369	\$382	221,074	255,760	0.06	\$3.47	\$9.53	2.58%
IRIM	\$82	\$83	73,616	85,165	0.06	\$0.77	\$0.23	0.28%
RSS/R	\$287	\$299	147,458	170,595	0.06	\$2.70	\$9.30	3.24%
SU	\$354	\$368	224,414	259,624	0.06	\$3.33	\$10.67	3.01%
LAS	\$60	\$64	65,202	74,939	0.06	\$0.54	\$3.46	5.77%
TS	\$1,469	\$1,526	286,091	323,550	0.06	\$11.54	\$45.46	3.09%
RAU-LAS	\$1,246	\$1,295	75,408	86,671	0.06	\$11.17	\$37.83	3.04%
IRIM-LAS	\$223	\$231	210,683	236,879	0.06	\$1.66	\$6.34	2.84%
RSS/R-LAS	\$164	\$170	80,302	89,776	0.06	\$1.16	\$4.84	2.95%
SU-LAS	\$130	\$136	178,280	199,052	0.06	\$0.91	\$5.09	3.92%
Total	\$2,546	\$2,646				\$20.95	\$79.05	3.10%

59 The overall difference in costs between 1999/00 and 2000/01 is \$100m (i.e. \$2,646 minus \$2,546). As Table 16 shows:

- the difference caused by volume increases is \$21 million across all IEN network elements; and
- the difference caused by non-volume related factors is \$79 million across all IEN network elements. Expressed as a percentage of 1999/00 costs, this change is 3% across all IEN network elements.

### Forecast change in costs due to volume and non-volume related factors

60 Using the analysis described above, I was able to uplift the ACCC's 2000/01 cost pool, for both 2006/07 and 2007/08, due to both volume and non-volume related factors.

### Forecast change in costs due to volume related factors

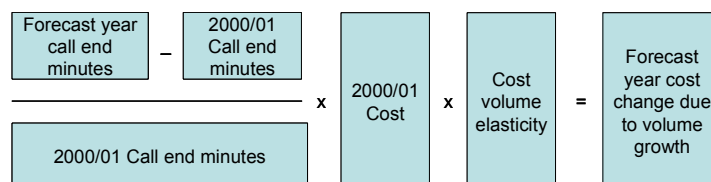
61 The calculation I have used to forecast cost changes due to volume change from the 1999/00 and 2000/01 period to the 2006/07 and 2007/08 periods relies upon forecast volume data I have extracted from the PIE II model, being Quarter 4, 2004/05 Physical Target Package ("PTP"). The relevant extracts of this PTP are annexed to this Statement and marked with the letter "H". Table 17 summarises the data relied upon.

**Table 17: Forecast total call minutes (m) extracted from PIE II model**

Forecast total call minutes (m)		
Network element	2006/07	2007/08
RAU	[c-i-c]	[c-i-c]
LAS	[c-i-c]	[c-i-c]
TS	[c-i-c]	[c-i-c]
RAU-LAS	[c-i-c]	[c-i-c]
LAS-LAS	[c-i-c]	[c-i-c]
LAS-TS	[c-i-c]	[c-i-c]

62 Using the forecast volume data from the PIE II model, I estimated forecast cost changes due to volume change for 2006/07 and 2007/08, respectively. Figure 6 shows my calculation.

**Figure 6: Derivation of forecast cost changes due to volume change**



63 Table 18 presents my forecast cost changes due to volume increases, for 2006/07 and 2007/08, derived using the calculation shown in Figure 6. As the table shows,

across all network elements, this change is  $-[c-i-c]$  for 2006/07 and  $-[c-i-c]$  for 2007/08.

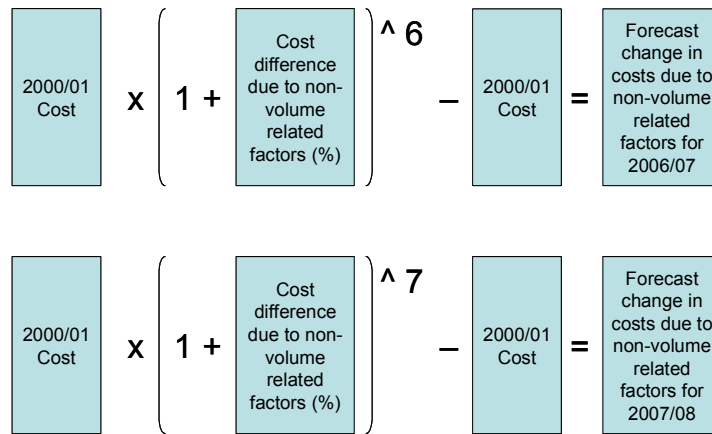
**Table 18: Forecast cost changes due to volume increases, for 2006/07 and 2007/08**

Network element	Forecast volumes 2006/07 (1)	Forecast volumes 2007/08 (2)	2000/01 Annual cost \$m (3)	Cost volume elasticity (4)	2000/01 Call end minutes (million) (5)	Forecast cost change 2006/07 (6) = $[(1) - (5)] / (5) \times (3) \times (4)$	Forecast cost change 2007/08 (7) = $[(2) - (5)] / (5) \times (3) \times (4)$
RAU	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
TS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
RAU-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS-TS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
						[c-i-c]	[c-i-c]

**Forecast change in costs due to non-volume related factors**

64 The forecast cost changes due to non-volume related factors, for both 2006/07 and 2007/08, was calculated by me based on the figures contained in Table 16, as Figure 7 illustrates.

**Figure 7: Derivation of forecast change in costs due to non-volume related factors**



65 Table 19 presents the results of my calculations for each network element, as well as overall. As the table shows, across all network elements, the forecast cost change is  $[c-i-c]$  between 2000/01 and 2006/07 and  $[c-i-c]$  between 2000/01 and 2007/08.

**Table 19: Forecast cost changes due to non-volume related factors, for 2006/07 and 2007/08**

Network element	Annual cost \$m for 2000/01	Remaining cost difference due to non-volume related factors (%)	Forecast change in costs due to non-volume related factors	
			2006/07	2007/08
RAU	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
IRIM	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
RSS/RSU	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
TS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
RAU-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
IRIM-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
RSS/RSU-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS-TS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Total	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]

***Estimate of the IEN cost pool for 2006/07 and 2007/08***

66 I then added the two changes in the cost pools estimated in paragraphs 60-65 above, to the ACCC's IEN cost pool estimate for 2000/01 to arrive at an estimate of the IEN cost pool for 2006/07 and 2007/08. Table 20 summarises actual and forecast volume and non-volume related cost pool changes.

**Table 20: Summary of actual and forecast volume and non-volume related cost pool changes**

	Difference in ACCC cost pools for 1999/00 and 2000/01		Forecast difference between ACCC cost pools for 2000/01 and 2006/07		Forecast difference between ACCC cost pools for 2000/01 and 2006/07	
	Volume related	Non-volume related	Volume related	Non-volume related	Volume related	Non-volume related
RAU	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
TS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
RAU-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS-TS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Total	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]

67 As can be seen from Table 20, there is a relatively large change in the cost pool due to non-volume related factors. Because of this large change, I present the results in Table 21, which summarises my estimates of the total cost pools from the ACCC's TSLRIC model for 2006/07 and 2007/08, with and without the non-volume related cost increases. As the table shows, the total IEN cost pool is estimated to be between [c-i-c] and [c-i-c] for 2006/07 and between [c-i-c] and [c-i-c] for 2007/08.

**Table 21: Forecast total costs, both with and without non volume related cost changes**

Network element	ACCC Annual cost \$m	Forecast cost changes due to non volume related factors		Forecast cost changes due to volume increases		Estimate of total cost pool including both volume and non-volume changes		Estimate of total cost pool including volume changes only	
		2000/01	2006/07	2007/08	2006/07	2007/08	2006/07	2007/08	2006/07
RAU	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
TS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
RAU-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS-LAS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
LAS-TS	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]
Total	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]	[c-i-c]

### C. Calculation of Local Call Avoidable Costs

68 I have also been asked to estimate the average retail costs for local calls and end-user access to calculate the Retail Minus Retail Cost ("RMRC") based price for LCS. At the time of undertaking the calculation of average retail costs, I used the most recent audited RAF accounts available, namely those for the 12 month period to 30 June 2005.

69 All of the cost inputs used in my calculations were taken from the RAF *Capital Adjusted Profit Statement – Retail Business*, attached at Annexure "I", and the RAF, *Schedule 8: Service Usage Reports* at Annexure "C".

70 I calculated the average retail costs by taking the total of the Retail Specific Costs for both the local call and end-user access products (see Annexure "I") and divided these costs by the total volume of retail local calls from Annexure "C". The only adjustment I made to the costs was to exclude installation costs (line item 4-2-01 of Annexure "I") as these costs are not relevant to the ongoing supply of local calls.

71 The retail costs for both local calls and end-user access are presented in Table 22 below.

**Table 22: Historic Costs of Local Calls and End-User Access**

	<b>End-User Access</b>	<b>Local Calls</b>	<b>Total</b>
Organisation Costs	[c-i-c]	[c-i-c]	[c-i-c]
Product and Customer Costs	[c-i-c]	[c-i-c]	[c-i-c]
Retail Cost of Capital	[c-i-c]	[c-i-c]	[c-i-c]
<b>Total annual costs</b>	[c-i-c]	[c-i-c]	[c-i-c]

72 As shown in Annexure “C”, the total number of retail local calls in 2004/05 was [c-i-c]. Therefore, the average retail costs for end-user access and local calls is [c-i-c] cents per local call.

**D. Average number of retail local calls per access line**

I have also been asked to provide information as to the average number of local calls made by Telstra’s retail customers per Basic Access line..

*Average number of local calls per retail Basic Access line*

73 The total volume of local calls made by Telstra’s retail customers are set out in Schedule 8 of the RAF accounts. The relevant extract from the 2004/05 RAF accounts containing this information is at Annexure “C”. As that material demonstrates and as noted at paragraph 72 above, a total of [c-i-c] retail local calls were made during the 12 month period to 30 June 2005.

74 The average number of local calls made per retail Basic Access line can be derived by dividing this total number of local calls by the average number of retail Basic Access lines in operation. The total number of retail Basic Access lines in operation in 2004/2005 is sourced from Annexure “C”, namely [c-i-c]. Dividing the total volume of retail local calls by the average number of retail Basic Access lines provides an average of [c-i-c] local calls per Basic Access line made annually by Telstra’s retail customers.

**DATED:** 5 September 2006

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**[C-I-C]**