

In other words, Optus is stepping down a rung in the ladder of investment, and limiting the scope of its competition with Telstra. I am aware of no other local network competitor which dual sources in this way. I examine the reasons why Optus may have adopted this policy, one of which one of which [sic] is likely to be the price set by the ACCC for Unconditioned Local Loop Service (ULLS) in Australia or ULLS.

98. Third, Telstra's Undertaking price provides the expectation of financial capital maintenance for Telstra's and other facilities based competitors' new investments in CAN infrastructure. This expectation is important, because Telstra's network is in constant need of expansion, reinforcement and refurbishment. As new customers come on to the CAN and existing customers move from one location to another, for example, Telstra must change the capacity in the network. To increase capacity, Telstra must dig trenches in built-up areas, lay additional conduit and cable and reinstate the trenches according to local council requirements. These costs would be similar, if not the same, as those faced by a new entrant digging and reinstating the same trenches, and laying the same cable. Over the course of a year, these investments in the CAN are substantial. Telstra alone invested \$629m dollars of capital in the CAN in the 2006/07 financial year.⁵³ Without the expectation of financial capital maintenance, there would be little incentive to make these investments. The reality is that, while ULLS represented a small proportion of total lines, Telstra faced only a small disincentive to invest in the CAN by low ULLS prices (\$12.30-\$16 per month). However, now that a substantial number of Telstra's lines are used to provide ULLS, the disincentive has increased significantly. Hence, ULLS pricing that is below TSLRIC+ will, particularly in the near future, put pressure on Telstra to reduce its CAN investment below efficient levels.
99. Fourth, with the correct incentives for facilities-based entry, a price properly based on the TSLRIC+ of an efficient new entrant will provide other benefits of competition – improvements in quality standards driven by facilities-based competition and the development of new and innovative services by new entrants. These outcomes cannot be achieved through regulation and regulated pricing alone. It is through actual entry or the credible threat of entry, not regulation, that firms strive to improve service quality and develop new and innovative services.
100. In contrast, pricing below the TSLRIC+ of an efficient new entrant will result, in the long-run, in a continued reliance on declaration and regulation. While the regulator might achieve prices below competitive market levels, by doing so it will never provide the incentive for service providers to improve quality standards or develop new and innovative products. Two examples of this are at the forefront of debate in the telecommunications industry. The first is Telstra's compact to deploy ADSL2+ infrastructure in areas outside a competitive footprint only after Telstra had assurances from government that services provided over that infrastructure would not be declared and subjected to pricing that undermined Telstra's financial capital maintenance.⁵⁴ The second is the necessity for the Government to request proposals to substantially rewrite legislation in a way that would prevent Telstra's (and other proponents') expectations of financial capital maintenance being

⁵³ Telstra's 2007 Annual Report, at page 44.

⁵⁴ Telstra (2008), *Media Release: More high-speed broadband after Government removes roadblock*, 6 February 2008, <http://www.asx.com.au/asx/statistics/announcementSearch.do?method=searchByCode&issuerCode=tl&timeFrameSearchType=Y&year=2008>

undermined after investing in the replacement of Telstra's copper main network with fibre (the National Broadband Network). While the Government's request for proposals also offered subsidies for extending the investments into rural areas, the investments in Band 2 areas would likely require no Government subsidy, just assurance that regulation could not be used to undermine the proper return of and on the investment being made.

101. Furthermore, while accepting Telstra's Undertaking means increasing ULLS prices, access seekers will continue to make substantial returns on the investments they have made in DSLAMs (Attachment 1 shows that Optus will earn 46.75% or \$157m per annum EBIT and iiNet will earn 40.62% or \$74m per annum EBIT). They will, more generally, continue to face incentives to invest further in DSLAM infrastructure, where demand supports such investment.
102. Ultimately, on the ACCC's own repeated findings, as endorsed by the Tribunal, a decision to accept Telstra's Undertaking and to set ULLS prices on the basis of the TSLRIC+ of an efficient new entrant is a decision to promote new entry into the market, to facilitate enduring and effective facilities-based competition, and to eventually eliminate the need for declaration of ULLS. A decision to reject Telstra's Undertaking is a decision to undermine continuing investment in Telstra's network, to outright reject the goal of facilities based competition and hence ensure the industry remains reliant on the regulation of resale competition for as long as telecommunications services are required by consumers.
103. The ACCC has, in its Draft Decision, chosen the latter, on the basis of:
 - An incomplete review of the specific reasonableness criteria to which the ACCC must have regard; and,
 - The ACCC's incorrect view that Telstra's inputs into the TEA model result in an overestimate of TSLRIC+.
104. The ACCC's review of the specific reasonableness criteria is discussed below. The inputs into the TEA model are discussed in the section that follows.

D.1 Promoting competition

105. In determining whether something promotes competition, s152AB(4) requires that the ACCC have regard to:

...the extent to which the thing will remove obstacles to end-users of listed services gaining access to listed services.
106. The price of ULLS can be a factor that determines whether some end users face obstacles to gaining access to listed services. It is not a valid interpretation of s152AB(4) to suggest that prices must be below TSLRIC+ or more generally, that the section permits or encourages the setting of prices below cost. Rather, as discussed below, the intention of s152AB(4) is to ensure that end-users will not face obstacles that are greater than would otherwise be present in a competitive market.⁵⁵

⁵⁵ Telstra's Undertaking price is below the TSLRIC+ estimated using Telstra's inputs. This reflects that Telstra has been seeking a \$30 commercial price and is consistent with Telstra's previous positions on ULLS pricing in Band 2 areas.

107. First, the Explanatory Memorandum to the *Trade Practices Amendment (Telecommunications) Bill 1996* (“**Explanatory Memorandum**”) states, in the context of declaration, that the access regime is not intended to apply where competitive market conditions exist:⁵⁶

First, promoting competition in markets for carriage services or services provided by means of carriage services (paragraph (2)(c)). It is not intended that the access regime embodied in this Part impose regulated access where existing market conditions already provide for the competitive supply of services. In considering whether a thing will promote competition, consideration will need to be given to the existing levels of competition in the markets to which the thing relates.

108. This implies that the prices that would prevail for a service provided in a competitive market should be regarded as presumptively reasonable, as that service would, according to the Explanatory Memorandum, not warrant regulation. Put in those terms, there can be no justification for relying on the promotion of competition criterion to force prices (or obstacles to end-users more generally) below the level that market conditions would otherwise provide for were the supply of services competitive.
109. Second, pricing below the level of a new entrant’s cost will, in the long run, unequivocally prevent any entry in the supply of ULLS because, as discussed above, a strict prerequisite for entry is the expectation of financial capital maintenance. Pricing below an efficient entrant’s cost will also reduce the level of entry and competition by substitutable networks, which have proven to be the primary source of competition for the incumbent’s fixed line CAN based services in other parts of the world (e.g. cable networks in the United States). For example, potential new entrants wishing to supply broadband and voice services over wireless CANs would be forced to compete against ULLS priced below the cost of new ULLS network entry. Even if wireless based entrants could remain competitive in the face of below cost competition through differentiating their products, the corresponding level of new wireless network entry would be below the level that would eventuate were ULLS prices set at economic cost – a level that will also serve to promote efficient ULLS network entry. The same impact will apply for other networks that are substitutable with ULLS in Band 2 areas – Optus’ HFC network, TransACT’s fibre network, mobile networks (owned by Hutchison, Vodafone, Optus and Telstra) and others (see Attachment 4).
110. Preventing entry in the supply of ULLS and investment in substitutable networks creates obstacles to end users gaining access to a range of choices that they would otherwise have, resulting from the availability of alternative networks and services delivered on those entrant networks. This would be contrary to the particular intention of s152AB(4), which is set out in the Explanatory Memorandum:⁵⁷

Further, in considering this objective, proposed s. 152AB(4) requires that regard must be had (but not be limited to) the extent to which the thing will remove obstacles to end-users of carriage services or services provided by means of carriage services gaining access to those services. In this regard, it is intended that particular regard be had to the

⁵⁶ Explanatory Memorandum to the *Trade Practices Amendment (Telecommunications) Bill 1996*, Division 1, Proposed Section 152AB

⁵⁷ Explanatory Memorandum to the *Trade Practices Amendment (Telecommunications) Bill 1996*, Division 1, Proposed Section 152AB

extent to which the particular thing would enable end-users to gain access to an increased range or choice of services. [Emphasis added]

111. Therefore, if ULLS prices are currently below the TSLRIC+ of an efficient new entrant, which is currently the case, then increasing prices closer to cost will promote competition. This price increase is necessitated by a proper interpretation of s152AB(4).
112. Furthermore, any attempt by the ACCC to deliberately price ULLS below the TSLRIC+ of a new entrant in an attempt to increase the number of downstream competitors (ULLS access seekers providing ADSL and voice service over Telstra's CAN) is futile and would have a long term debilitating effect on competition. Such pricing would only serve to distort the evolution of an effectively competitive, facilities-based market for broadband and voice services by propping up inefficient suppliers, thereby undermining otherwise economic investment and innovation. In any case, as discussed in Attachment 1, access seekers currently in the market will continue to earn substantial margins at a Band 2 ULLS price of \$30 and will not, therefore, exit the market. Indeed, financial analysis of Optus and iiNet's data shows that at a \$30 ULLS price in band 2, they will earn EBIT margins of 40.62% and 46.75%, respectively, from services supplied using ULLS. Indeed, further entry will be profitable.
113. Importantly, however, it is not the number of competitors that the ACCC should give consideration to when assessing Telstra's Undertaking against this legislative objective, but the efficient outcomes that would prevail in an effectively functioning competitive market. Indeed, it is the express objective of the Act to promote competition, not protect specific competitors.⁵⁸ If prices are set closer to the TSLRIC+ of a new entrant, the resultant outcomes in downstream markets can be expected to be the same as that which would have resulted had the process of competition in the supply of ULLS worked effectively and if declaration had not been necessary.
114. The TEA model, as constructed and populated with Telstra's inputs, produces costs equivalent to those an efficient new entrant would face. Prices set on this basis would, on the reasoning repeatedly set out by the ACCC and the Tribunal, promote (the process of) competition.
115. In its discussion of this criterion in the Draft Decision, the ACCC relies on four arguments to, in Telstra's view incorrectly, conclude that Telstra's Undertaking does not promote competition.

116. First, the ACCC states:⁵⁹

The ACCC considers that prices that reflect efficient forward-looking costs of supply will best promote effective competition in the supply of fixed-line voice services and broadband/DSL services in the present environment. . . As noted previously, the ACCC considers that Telstra's application of the TEA model results in an estimated access price that does not reflect efficient forward-looking costs. Further, the ACCC's preliminary view is that the TEA model network cost assumptions would result in an over-estimation of the cost of providing the ULLS. As a

⁵⁸ Section 2 of the Act.

⁵⁹ ACCC Draft Decision, at page 48

consequence the ACCC does not consider that the TEA Model is able to support a conclusion that the Proposed Monthly Charge reflects the efficient forward-looking costs of providing the ULLS.

117. Telstra submits that the ACCC has erred in its assessment of the TEA model and Telstra's inputs into the TEA model (see section E). The TEA model does calculate the efficient forward-looking costs of supplying ULLS. Therefore, the ACCC is incorrect in concluding that Telstra's Undertaking does not promote competition.

118. Second, the ACCC argues:⁶⁰

The ACCC also considers that the 2008 Undertaking does not provide certainty to access seekers, potentially affecting their ability to compete in telecommunications markets. In particular, the ACCC notes that the 2008 Undertaking does not include all the relevant costs in the monthly charge such that access seekers will need to negotiate with Telstra on other aspects of the monthly charge. The contemporaneous nature of the undertaking assessment also adds uncertainty to the regulatory environment as it is unclear when, and if, all aspects of the monthly charge would come into operation.

119. Telstra's Undertaking encompasses all elements of the ULLS monthly charge.⁶¹ The costs associated with the monthly charge in Telstra's Undertaking are ULLS network costs and ULLS specific costs. Most attention to Telstra's Undertaking has been given to Telstra's estimate of ULLS network costs, since this, on its own, supports a \$30 ULLS price. Given this, and for the purpose of limiting the scope of debate around Telstra's Undertaking, Telstra is willing to accept the ACCC's \$2.45 cost estimate for ULLS specific costs set out in its 2008 ULLS pricing principles. It is not clear to Telstra what other costs the ACCC might consider should be included and recovered from the monthly charge for ULLS. As such, after acceptance of Telstra's Undertaking, access seekers will not have to negotiate with Telstra on other aspects of the monthly charge and there are no other "aspects of the monthly charge" that would come into operation subsequently. In any event, as noted below, even were it the case that Telstra's Undertaking did not encompass all aspects of the relevant charges, that would not in itself affect whether those elements it did cover were in fact reasonable.

120. Third, the ACCC argues:⁶²

Further, the ACCC notes the lack of industry operators with access to the full version of the TEA model - insufficient external review of the full version of the TEA model does not generate confidence in the reasonableness of the undertaking.

121. The ACCC's assertion is incorrect. As set out in section E.1, 18 individuals had approval for, and 13 individuals had, full access to the TEA model and 29 individuals had access to the same version of the TEA model but with simulated vendor prices and simulated network data. Additionally, ACCC staff and ACCC consultants had access to the full version of the model.

⁶⁰ ACCC Draft Decision, at page 48

⁶¹ Excluding taxes.

⁶² ACCC Draft decision, at page 49

122. Further, all ACCC staff and their consultants have had unfettered access to the full version of the TEA model, with which to conduct their own enquiry and analysis.

123. Fourth, the ACCC states:⁶³

As noted previously, the ACCC also considers the incomplete nature of the undertaking (absence of key terms and conditions in the undertaking) may create a degree of uncertainty amongst market participants although this, of itself, is not likely to be determinative of reasonableness in most circumstances.

124. Telstra agrees with the ACCC that this is not determinative of the reasonableness of Telstra's Undertaking, for the reasons set out in section B.1 of Telstra's response to the ACCC's discussion paper.

D.2 Encouraging efficient investment in infrastructure

125. When assessing whether Telstra's Undertaking encourages efficient investment in infrastructure, s152AB(6)(c) requires the ACCC to have regard to:

The incentives for investment in:

(i) the infrastructure by which services are supplied; and

(ii) any other infrastructure by which services are, or are likely to become capable of being supplied.

126. This criterion should be interpreted with a forward-looking focus. That is, that incentives should be maintained for infrastructure suppliers to undertake efficient investments in:

- The augmentation to and replacement of existing infrastructure;
- The addition of infrastructure to serve new customers; and
- New networks that are or likely to become capable of supplying substitutable services.

127. Additionally, as stressed in section B above, consideration must be given to the signal being sent to investors in other regulated or potentially regulated services as to the consistency and predictability of the regulatory scheme.

128. Generally, efficient new investment is encouraged when investors expect they will receive prices for output that recover the cost of their investment (that is, they expect their financial capital to be maintained intact). Telstra is no different from other competitors in this regard. It is discouraged from investing in facilities when its expectation is that it will not be allowed to set prices at compensatory levels.

129. Demand for Telstra's ongoing investment in the CAN is substantial. For example, Telstra's capital expenditure in the CAN was \$629m in the 2006/07 financial year.⁶⁴ Figure 4 below illustrates Telstra's capital expenditure in CAN

⁶³ ACCC Draft decision, at page 49

⁶⁴ Telstra's 2007 Annual Report, at page 44

ducts and pipes and CAN copper cables from 2000/2001 to 2006/07.⁶⁵ While Telstra has continued to invest in CAN infrastructure, the adverse effect of prices being below TSLRIC+ is evident from declining investment over time.



130. Much of the investment that does take place requires Telstra to incur costs that are, by their very nature similar to those a new entrant would incur. That is, Telstra must dig trenches, place conduit and haul cable through the conduit ducts, and reinstate the affected area to a similar state as originally encountered. Thus, regardless of Telstra's historic or embedded costs (which also required significant trenching and reinstatement), the cost to Telstra and other existing facilities-based competitors of adding to and upgrading existing networks is very similar to the costs that would be faced by a new entrant undertaking the same work.

131. Thus, the ongoing incentives for investment in infrastructure will not be maintained by prices that are less than the forward-looking costs that would be faced by a new entrant building a network as measured by a properly constructed TSLRIC+ model. Figure 4 shows the real consequence of pricing below this level – reduced investment in infrastructure.

132. ULLS access seekers will also undertake efficient investments if they expect their prices to recover the costs of their investments (that is, they expect their financial capital to be maintained). As shown in Attachment 1, ULLS prices based upon TSLRIC+ will afford access seekers the ability to continue to earn substantial margins on their investments. Additionally, such prices will

⁶⁵ Other CAN investment was in, for example, radio equipment, fibre cables, and CAN multiplexing plant.

encourage ULLS access seekers to efficiently become new entrants (as ULLS prices will be based on the cost of new entry) in the supply of ULLS rather than being forever an access seeker (that is, to build rather than buy). This will promote facilities-based competition, leading to a more sustainable and effective form of competition than arbitrage based resale competition. Such competition should be encouraged.⁶⁶

133. If prices are set below the TSLRIC+ of an efficient new entrant, efficient facilities-based investment will be stifled. This is the current outcome that the Australian industry is experiencing, given the current level of ULLS prices, which are extremely low and below cost.⁶⁷

134. In its discussion of this criterion in the Draft Decision, the ACCC argues:⁶⁸

The ACCC considers that an access price that reflects efficient, forward-looking costs best meet the objective of encouraging the economically efficient use of and investment in infrastructure.

And

The ACCC's view is that where access prices are based on costs that are not the costs of a fully optimised and efficient network, the resulting access prices may not reflect the efficient costs of providing the service and will not encourage appropriate build/buy decisions. On this basis the ACCC considers that the objective of promoting efficient investment is not achieved when costs of providing the ULLS are based on a network which has not been fully optimised and does not use forward looking and efficient cost values.

As discussed above, the ACCC does not consider that the TEA Model is able to support a conclusion that the Proposed Monthly Charge reflects efficient forward-looking costs of providing the ULLS.

135. Telstra submits that the ACCC has erred in its assessment of the TEA model and Telstra inputs into the TEA model (see section E). The TEA model does calculate the efficient forward-looking costs of supplying ULLS. Therefore, the ACCC is incorrect in concluding that Telstra's Undertaking does not encourage efficient use of and investment in infrastructure.

136. Further, by reference to the term "fully optimised", it appears that the ACCC is creating a standard of optimisation in a cost model that the ACCC cannot or will not define.⁶⁹ As Telstra understands it, the ACCC proposes that full optimisation would involve trenching inputs being based on Telstra's actual incurred costs while other inputs should be based on forward-looking efficient costs.⁷⁰ This is hardly "optimisation" in any conventional sense and in any event is unobtainable. No provider can benefit from the cost savings associated with undertaking trenching work over many past decades while

⁶⁶ See for example Jan Bouckaert, Theon van Dijk, Frank Verboven "How does access regulation affect broadband penetration?" 19 December 2008 available at <http://www.voxeu.org/index.php?q=node/2715>

⁶⁷ See, for example, Cave, Martin (2007), *Applying the Ladder of Investment in Australia*, 17 December 2007; Eisenach, J. A. (2008), Evidence Relating to the ACCC's Draft Decision Denying Telstra's Exemption Application for the Optus HFC Footprint, 13 October 2008; Ergas, H. (2008), *Wrong Number*, Allen & Unwin, Sydney.

⁶⁸ ACCC Draft Decision, at page 50-51

⁶⁹ For instance, in a letter dated 2 December 2008, Telstra requested that the ACCC "provide clarification/explanation regarding which optimisations and efficiencies it would like included in the TEA model design". The ACCC responded in a letter dated 18 December 2008 by saying "...the ACCC does not consider that any further explanation/clarification of these issues would significantly assist Telstra in responding to the Draft Decision".

⁷⁰ See, for example, section E.4.

also benefiting from the cost savings associated with deploying the entire network today using the latest technologies. As noted by the Tribunal and the ACCC, in assessing the reasonableness of an undertaking, the ACCC must have regard to the actual process by which operators compete and whether outcomes are realisable in practice.⁷¹ In this case, the ACCC has not had due regard to these factors.

137. The ACCC also argues:⁷²

The ACCC considers that access prices should be set so as to allow more efficient sources of supply to displace less efficient sources of supply in dependent markets. At an inflated access price, access seekers will look to build and not buy, when it may be more efficient to buy.

138. This is inconsistent with the ACCC's view that trenching costs should be based on Telstra's historic or embedded costs.⁷³ In effect, on the ACCC's own arguments, as set out above, efficient build/buy decisions are made when investors face the forward looking costs of "buying" relative to the forward looking costs of "building". To that extent, if prices are based on the historic or embedded costs of trenching (and assuming these are below current costs), then access seekers will never build their own infrastructure even when it is more efficient for them to do so.

139. Put slightly differently, if prices are set below the costs that even a fully efficient new builder would incur, then it is plain that any firm contemplating entry, no matter how efficient it is, will not enter, as it will not expect to recover its investment.

140. The ACCC also argues:⁷⁴

The ACCC considers that a significant, unanticipated rate increase may also reduce the incentive for access seekers and potential new entrants to make infrastructure-based investment such as in DSLAMs.

141. It is notable that, if the ACCC applies its current approach to pricing (particularly its approach to depreciation), the network cost component of ULLS prices will increase from their current levels to almost \$70 (as shown in section D from paragraph 90). Moreover, if the rate increase is correcting a previous error, and is based on a credible model that can inform future price expectations, then efficiency and predictability is more likely to be enhanced than undermined. Finally, as shown in Attachment 1, access seekers will continue to earn substantial margins on their DSLAM infrastructure at a ULLS price of \$30.

D.3 Encouraging efficient use of investment in infrastructure

142. In a competitive market, it would be economically efficient for an access seeker to use its own CAN infrastructure if the resource cost of doing so was less than the competitive market price of buying access to another firm's CAN infrastructure. Thus, if ULLS prices reflect the prices which would result in a competitive market, those being approximated by the TSLRIC+ of an efficient new entrant, this will encourage access seekers to use their own investments

⁷¹ See the quotes in paragraph 60 in section C.1, and paragraph 69 in section C.2

⁷² ACCC Draft Decision, at page 51

⁷³ ACCC Draft Decision, at page 79-80

⁷⁴ ACCC Draft Decision, at page 51

in infrastructure, where they can do so more efficiently. Conversely, setting ULLS prices below TSLRIC+ stifles all new infrastructure investment, including investment by providers who could build alternatives to ULLS more efficiently than the incumbent, because the expectation of financial capital maintenance is a necessary prerequisite for investment to take place.

143. Further, setting input prices below economic cost encourages the production of goods and services in downstream markets that are valued by consumers at less than the cost of their production. This creates an economic inefficiency and imposes dead-weight losses on society.

D.4 Telstra's legitimate business interests

144. The ACCC is required, under s152AH(1)(b) and s152AB(6)(b) to have regard to the legitimate business and commercial interests of Telstra when assessing whether Telstra's Undertaking is reasonable.
145. The ACCC considers that the term 'legitimate commercial interests' should be interpreted as it is in other parts of the Act, that "*it is unlikely the access provider's legitimate business interest would extend to achieving a higher than normal commercial return through the use of market power*", and "*carriers should also not be precluded from earning higher than normal commercial returns where these returns are generated from, for example, innovative investments or unique cost-cutting measures rather than through the exercise of market power or barriers to entry*".⁷⁵
146. This interpretation is broadly consistent with the Explanatory Memorandum, which states:⁷⁶

Consistent with Part IIIA of the TPA, the references here to the 'legitimate' business interests of the carrier or carriage service provider and to the 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.

147. The ACCC interprets this quote (at page 54) as meaning:

This requires that an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.

148. Prices based on TSLRIC+ meet this criterion interpreted as above. Prices that reflect the costs of a new entrant and competitive market outcomes would not deliver to Telstra or any firm a higher than normal commercial return, as might be secured through the use of market power or barriers to entry. In the exercise of modelling an efficient new entrant's costs with the TEA model, barriers to entry are assumed not to exist. For example, it is assumed:

- The entrant has immediate access to capital to fund the build of a new network;

⁷⁵ Draft Decision, at page 52

⁷⁶ Explanatory Memorandum to the *Trade Practices Amendment (Telecommunications) Bill 1996*, Division 1, Proposed Section 152AH

- There are no barriers to the new entrant to immediately achieving sufficient scale by building a network to supply approximately 7 million customers throughout Australia, in a very short time;
 - There are no barriers to customer acquisition, such as switching costs or brand recognition as the new entrant ‘replaces’ Telstra’s customer base; and,
 - The new entrant has access to the latest technology to provide ULLS and best engineering practices.
149. The ACCC considers that two of Telstra’s inputs into the TEA model would allow Telstra to recover more than its legitimate business interests – the WACC and the trenching and reinstatement costs.
150. A discussion of the ACCC’s comments on Telstra’s WACC is included in section E.7, below.
151. In relation to trenching and reinstatement costs, the ACCC appears to consider Telstra’s historic or embedded costs (albeit incorrectly in Telstra’s view – see section E.4) when assessing whether Telstra’s Undertaking is consistent with Telstra’s legitimate commercial interests. The ACCC comments (at page 53):
- In a substantial majority of cases, local copper pairs were installed in turf and only subsequently paved over. Telstra has proposed that forward-looking costs should include the retrenching and re-paving of trenches where local copper pairs were initially laid. The result would be that Telstra would be compensated for costs that it (in most cases) never incurred and is not likely to incur within the economic life of the existing copper pairs. [Emphasis added]*
152. Telstra considers that historic or embedded costs are irrelevant to the consideration of legitimate commercial interests. As discussed above, it is legitimate for Telstra to earn a return that would otherwise occur in a competitive market for the supply of ULLS. Such a return would not be determined by Telstra’s historic or embedded costs but rather the costs of an efficient new entrant. Further, in consideration of Telstra’s legitimate business interests, the ACCC is singularly focused upon the prevention of recovery of higher than a normal commercial return, while ignoring its responsibility to enable Telstra to earn a normal commercial return. This approach is exemplified through the ACCC’s exclusive focus on the prospect that forward looking providers may incur costs that Telstra has not historically incurred, while ignoring all costs which Telstra has efficiently incurred in the past, which can be avoided by new entrants going forward. It is noteworthy that the ACCC takes the opposite tact when considering the interest of persons who have a right to use ULLS. In that instance the ACCC is singularly focused on assuring that those rights are protected through the lowest possible price, while ignoring the danger that the rights can be abused through access to services at prices that do not fully reflect the costs the provision of those services requires.
153. More generally, as noted in section B above, the ACCC’s approach involves a “heads you lose, tails I win” form of regulation, in which the estimate of costs is reduced to historical costs when current costs are considered higher than those historically incurred, while current costs are used when these are lower than historical costs. Telstra submits that this is plainly inconsistent with its

legitimate interests and is suggestive of an element of bias, or systematic lack of neutrality, in the approach adopted.

154. Telstra submits that it is also in its legitimate interests that it be able to rely on consistent application by the regulator of a cost methodology. As noted in section B above, the ACCC's approach in this draft decision, which involves changing its approach to costing, arguably for purely opportunistic reasons, creates regulatory risk that is unnecessary and prejudicial to Telstra's legitimate interests.

D.5 Interests of persons who have rights to use ULLS

155. Telstra submits that this criterion is served when end users and persons who have a right to use ULLS benefit from the same outcomes (ULLS price) that they would obtain were the market in which ULLS was supplied was competitive and ULLS was not declared. This is the competitive market outcome.

156. Consistent with the precedent discussed above (section C), the TSLRIC+ of an efficient new entrant approximates the outcome that would occur in a competitive market and, therefore, promotes the interest of persons who have rights to use the ULLS. End users would be no worse off, in terms of the amount they pay for services downstream from ULLS, than they would otherwise pay were the market competitive and ULLS not declared. Furthermore, prices so set allow efficient new entrants to recover the costs of their investments. If entry occurs in the supply of ULLS or substitutes, then the other benefits of competition will result – greater quality and new services supplied to end users. These outcomes will not be achieved if prices are set below the TSLRIC+ of a new entrant, as even efficient new entrants will not expect to recover the cost of entering the market and, therefore, entry will not occur.

157. The ACCC considers that this criterion is served when prices enables access seekers to compete on their merits. The ACCC states:⁷⁷

The interests of persons who have a right to use the ULLS, access seekers, are served by an access price that enables them to compete on their merits (that is, on the basis of their own efficiency) in downstream markets.

158. Prices based on the TSLRIC+ of a new entrant achieve this criterion as well. Access seekers that can be more efficient in the supply of the CAN have the incentive to invest in the CAN and profit from their efficiencies. If access seekers can be more efficient in the supply of downstream products, they pay a competitive market price for use of the CAN which enables them to compete in those markets on equal terms and conditions. As noted above, to be even handed in the consideration of the legislative criteria, an impartial arbiter would necessarily conclude that the interest of those who have a right to use ULLS do not extend to receiving access at prices below those which they could expect in a competitive market – a level the ACCC and the Tribunal have repeatedly identified as being defined by TSLRIC+.

159. The ACCC also comments:⁷⁸

⁷⁷ ACCC Draft Decision, at page 53

⁷⁸ ACCC Draft Decision, at page 53

The ACCC considers that the TEA model network cost assumptions result in cost estimates that would overcompensate Telstra. The ACCC also notes that a Proposed Monthly Charge that is significantly above the current prevailing ULLS price is not in the interests of access seekers. These findings favour Telstra over others which would distort the competitive process and consequently harm access seekers' interests.

160. The network cost assumptions in the TEA model result in cost estimates that reflect the prices that would occur in a competitive market for the supply of ULLS. This criterion does not and cannot be used to promote access seekers' interests beyond access at these prices. Nor can it be used to justify continuing current prices that have, for whatever reason, been set below the forward looking cost of supply through regulatory intervention in the market. Below cost access serves to distort the market away from the outcomes which would prevail were that market effectively competitive. Such price-setting unjustly and unwisely discriminates against access providers and, in the long term, access seekers first because of reduced incentives for access providers to offer better and new wholesale services to access seekers and second, because it raises barriers to the efficient entry of alternative sources of ULLS supply (or of services that substitute for ULLS).
161. In any case, the ACCC's current pricing methodology sets low prices today but on the basis of significant increases in prices in the future. This is the result of the tilted annuity formula the ACCC applies. If the ACCC were to continue its pricing methodology, ULLS prices would increase 50% in 9 years, over 100% in 15 years and 200% in 23 years (see section D, from paragraph 92).
162. Furthermore, continuing below-TSLRIC+ prices is beyond the interests of access seekers who, as the analysis at Attachment 1 shows, will remain very profitable if Telstra's Undertaking is accepted.

D.6 Direct costs

163. The ACCC uses the Explanatory Memorandum to interpret this criterion (at page 54) as follows:

This requires that an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.

164. Prices based on the TSLRIC+ of a new entrant include no inflation to recover the profits the access provider (or any party) may lose in a dependent market as a result of the provision of access. Prices so set would allow parties to recover only the return that would be available from the supply of ULLS if the market was competitive. Consequently Telstra's price proposed in the Undertaking is consistent with this interpretation of the statutory criterion.

165. The ACCC also states (at page 54):

This criterion also implies that, at a minimum, an access price should cover the direct incremental costs incurred in providing access. It also implies that the access price should not exceed the stand-alone costs of providing access.

166. This implies that, in the ACCC's view, the direct costs fall between the direct incremental and standalone costs of providing ULLS. The price proposed in Telstra's Undertaking is below the standalone cost of providing ULLS, since only a proportion of (not all) indirect costs are allocated to ULLS, and therefore is consistent with the direct cost criterion.

167. However, the ACCC's analysis in the Draft Decision is inconsistent with its own two interpretations of the direct costs criterion. The ACCC relies on two sets of material to incorrectly assert that the price proposed in Telstra's Undertaking exceeds the level necessary to ensure that Telstra would be able to recover the direct costs of providing ULLS.

168. First, the ACCC asserts that international benchmarking can be used to assess the direct costs criterion. The ACCC states (at page 54):

The ACCC has examined evidence from international benchmarks which suggests that overseas operators are able to provide similar unconditioned local loop services at much lower prices, suggesting that they were able to provide these services at much lower direct costs.

169. The international benchmarking analysis relied upon by the ACCC has serious flaws and, as explained above, is inconsistent with the ACCC's previously expressed views in relation to international benchmarking. These flaws are discussed in more detail in Attachment 3.

170. Notwithstanding those flaws, the ACCC cannot conclude that the international benchmarking suggests that overseas operators "were able to provide these services at much lower direct costs". International benchmarking does not compare the direct costs incurred by overseas operators: rather, it compares the prices that they are, in most if not all cases, required to charge by their respective regulators. The regulatory regimes in those countries seek to achieve objectives that are different to the objectives of Part XIC and the criteria for regulated pricing in those countries are different to s152AH of the Act. It is incorrect to assume that overseas regulators have had regard to direct costs in the same way as regard is required to be had by the ACCC in Australia. Even if they had, there is no evidence that overseas regulators correctly determined the direct cost of provision of services in their own country let alone Australia.

171. Furthermore, there is nothing that suggests the international benchmarking undertaken by the ACCC is of costs that are consistent with the ACCC's own interpretation of the direct costs criterion – that is, costs that are not "inflated to recover any profits the access provider (or any other party) may lose in a dependent market" and fall between the "direct incremental costs" and "standalone costs" of providing ULLS.

172. For these reasons and others, the ACCC's international benchmarking material is flawed, and its use of that material is inconsistent with the ACCC's own interpretation of the direct costs criterion.

173. Second, the ACCC also draws on Telstra's RAF data to assess direct costs. Although the ACCC lists two qualifications to using RAF data, they are by no means comprehensive. For example, the ACCC should also be concerned that the RAF data:

- Does not account for assets that have reached the end of their accounting lives but not their economic lives and, therefore, substantially understates the economic value of CAN assets;
- Values assets at their written down value, rather than their economic value; and
- Values a different mix of types of assets and network designs than would be used by an efficient new entrant.

174. The RAF is a measure of Telstra's written down historic/embedded cost of supplying the CAN. The RAF provides no evidence as to the direct incremental or standalone costs of supplying ULLS. It is noteworthy that Telstra relied on its historic costs, measured by the RAF, in an earlier undertaking. In considering that undertaking, the Tribunal commented:⁷⁹

Telstra submitted that its historic ULLS costs provided a useful basis for assessing the reasonableness of its network costs. Telstra estimated that the historic cost of a ULLS line is \$27.05 per month by reference to Telstra's regulatory accounting framework (RAF) accounts prepared for the Commission using the Commission's record keeping rules (RKR) accounts.

and

We do not accept that the historic ULLS costs put forward by Telstra provide a useful basis for assessing the reasonableness of the ULLS costs estimated for the periods covered by the undertakings, or are consistent with a TSLRIC analysis because they are based on the actual costs incurred by Telstra in providing the service and these need not necessarily represent the forward looking efficient costs of providing the ULLS. The Tribunal has previously stated that TSLRIC is a forward looking cost concept which is designed to determine how an access provider would build a network today using the most efficient technology available. Historic costs need not bear any resemblance to what Telstra's costs would be if it were to build the network today. [Emphasis added]

175. The ACCC's reliance on historic/embedded costs derived from the RAF is also inconsistent with its 2002 ULLS pricing principles. In that context, the ACCC clearly concludes that TSLRIC is consistent with the direct cost criterion. The ACCC then stated:⁸⁰

In the past the Commission has adopted the TSLRIC approach to access pricing. This is consistent with the requirements of Part XIC of the Trade Practices Act that pricing should reflect the direct costs of supply... The Commission therefore considers that TSLRIC should be applied in the costing of provision of the ULLS.

176. The ACCC's use of Telstra's embedded historic costs is inconsistent with its own interpretation of the direct cost criterion.

D.7 The economically efficient operation of a carriage service, telecommunications network or a facility

177. The ACCC states in the Draft Decision (at page 56):

The ACCC considers that, in the context of access prices, prices that reflect the efficient forward-looking costs of the service best meet this criterion.

178. Prices based on the TSLRIC+ of an efficient new entrant reflect the efficient forward-looking costs of the service and, therefore, meet this criterion.

⁷⁹ Telstra Corporation Ltd (No 3) [2007] ACompT 3, at 378 and 380

⁸⁰ ACCC (2002), *Pricing of Unconditioned Local Loop Services (ULLS): Final Report*, March 2002, at page 17-128

E The ACCC's assessment of inputs into the TEA model

E.1 Ability to properly assess the TEA model (ACCC section B.1)

179. The ACCC states:⁸¹

...it is in the public interest...and it is Telstra's responsibility to enable the ACCC, and other parties, to sufficiently scrutinise its model and to enable sensitivity testing of Telstra's preferred assumptions and input values such that the ACCC can be satisfied that the model is capable of generating efficient forward-looking cost estimate.

180. As stated in Telstra's response to the ACCC's Discussion Paper, and as acknowledged by the ACCC in its Draft Decision, Telstra considers that the documentation provided with the TEA model is comprehensive, very detailed and more than adequate to evaluate the TEA model.

181. In addition, the ACCC's Draft Decision acknowledges that, since reports by Ovum and other interested parties became available, Telstra has proactively sought to address all errors identified by submitting a revised version of the TEA model, together with additional documentation.⁸²

182. The ACCC concludes:⁸³

The ACCC considers that most of the TEA model calculations are well documented but could be improved with access to documentation for certain aspects of the model (such as the Access database).

183. This conclusion is consistent with Telstra's view and its submission regarding the adequacy of documentation provided.

184. Following the ACCC's Draft Decision, Telstra has continued to proactively file further documentation including documents entitled:

- *TEA Model Route Optimisation Process documentation* which provides a detailed, step-by-step explanation of the methodology used to extract necessary data from Telstra's source databases, rationalise and optimise the network data to adhere to strict efficiency guidelines and format the data for loading into the TEA model's excel spreadsheets; and
- *An Assessment of Telstra's TEA Cost Model for Use in the Costing and Pricing of Unconditioned Local Loop Services (ULLS)*", an expert report of Dr. Robert G Harris and Dr. William Fitzsimmons.

⁸¹ ACCC Draft Decision, at page 60

⁸² Including Telstra's documents entitled *TEA Model Issues Schedule* available at <http://www.accc.gov.au/content/item.php?itemId=842768&nodeId=3bc5af58c181b5235589754840e5259a&fn=TEA%20model%20issues%20schedule.pdf>, *Measure of TEA Model Efficiency* available at <http://www.accc.gov.au/content/item.php?itemId=842770&nodeId=a00d0b6613a3a278bd5366f739b25175&fn=Measure%20of%20TEA%20model%20optimisation.pdf> and *Modifications in v1.2 of the TEA Model* available at <http://www.accc.gov.au/content/item.php?itemId=842773&nodeId=eb58e0eb2c734a19acdef53fc0d0bb96&fn=TEA%20model%20version%201.2%20%20modifications.pdf>

⁸³ ACCC Draft Decision, at page 63

185. This additional documentation bolsters Telstra's, already substantial, body of material provided to the ACCC in support of Telstra's ULLS Undertaking.

186. Telstra acknowledges the conclusion that:⁸⁴

Overall, the ACCC considers that it is satisfied with the useability of the TEA model.

and the ACCC's recognition of:⁸⁵

...the difficulties and complexities inherent in any cost modelling exercise.

187. In addition, Telstra welcomes the ACCC's understanding that:

...any cost model will need to be refined and adjusted to ensure that the model is robust.

188. Telstra considers that it has made considerable and consistent efforts to ensure any concerns or suggestions regarding the TEA model that are brought to Telstra's attention are addressed in a timely manner and, if appropriate, acted upon. The release of version 1.1 and 1.2 of the TEA model clearly evidence Telstra's efforts in this regard.

E.1.1 Confidentiality arrangements

Telstra's arrangements comply with the ACCC's expectations

189. Telstra remains perplexed by the ACCC's statement (at page 64) to the effect that it continues to hold concerns that Telstra's confidentiality arrangements have made it difficult for interested parties to gain reasonable access to the TEA model.

190. Telstra's confidentiality arrangements are fully and clearly documented in Telstra's submission entitled *Accessing Telstra's Confidential Information* dated 23 May 2008⁸⁶ (**Confidentiality Submission**). This Confidentiality Submission was provided by Telstra in direct response to correspondence from the ACCC⁸⁷ (**14 May Letter**) stating:

The ACCC expects that Telstra will prepare two forms of confidentiality undertaking, one for access seeker employees (commercial) and one for external advisers (non-commercial), which will allow those who execute the undertaking to view all subsequent [to the TEA model which had been release from late February 2008] confidential supporting material that Telstra submits in relation to the ULLS Undertaking. The ACCC anticipates that the confidentiality undertaking prepared for external advisers (non-commercial) will encompass the confidential versions of the O&M Factor Study, Factor Calculation excel documents and the redacted version of the Access Network Costing information. The ACCC expects that interested parties will not be required to sign any further forms of confidentiality undertakings in relation to the ULLS Undertaking.

⁸⁴ ACCC Draft Decision, at page 63

⁸⁵ ACCC Draft Decision, at page 64

⁸⁶ Available at

<http://www.accc.gov.au/content/item.php?itemId=830207&nodeId=25ed9c9fd87ef3f6cd85badb946e4f9&fn=Telstra%20submission%20-%20confidentiality%20regime.pdf>

⁸⁷ Letter from Mr Ed Seymour, Acting General Manager, Compliance and Regulatory Operations, Communications Group to Ms Rebecca Mitchell, Legal Counsel dated 14 May 2008.

191. As explained in Telstra's letter responding to the ACCC's 14 May Letter⁸⁸ and in Telstra's Confidentiality Submission, Telstra's confidentiality arrangements comply with the ACCC's expectations as described in the 14 May Letter. Telstra's arrangements have not changed and, as such, continue to comply with those expectations on an ongoing basis.
192. In considering Telstra's confidentiality arrangements, it is important to recognise that Telstra made the TEA model available for access by interested parties from 28 February 2008. The confidentiality undertakings applicable to the TEA model were made available at that time to ensure that access seekers and their external advisers/consultants would gain access to the TEA model promptly. Telstra had not lodged any other confidential supporting material with the ACCC in support of Telstra's Undertaking at that time. As such, the TEA Model Confidentiality Undertakings dealt only with access to the TEA model⁸⁹.
193. By the date of the ACCC's 14 May Letter, Telstra had already received 16 executed TEA Model Confidentiality Undertakings from approved access seeker employees and external advisers/consultants. These access seeker employees and external advisers/consultants represented 7 different interested parties. Pursuant to those executed TEA Model Confidentiality Undertakings, Telstra had also already provided access to appropriate versions of the TEA model. In addition, other access seekers had requested amendments to one or other of the provisions of the existing TEA Model Confidentiality Undertakings.
194. In light of the established and widely socialised TEA Model Confidentiality Undertakings, Telstra did not consider that approved access seekers or external advisers/consultants who had already agreed, executed or negotiated amendments to the TEA Model Confidentiality Undertakings should be asked to forego the benefit of those undertakings and re-execute or re-negotiate a new undertaking which would relate to both the TEA model and any further confidential supporting material that Telstra had, or intended, to file. For this reason, Telstra prepared a separate Confidential Materials Confidentiality Undertaking which covered access to Telstra's other confidential information (as distinct from the TEA model). The Confidential Materials Confidentiality Undertaking was, and remains, in very similar terms to the TEA Model Confidentiality Undertaking.
195. In its Confidentiality Submission, Telstra notes the consistency between the TEA Model Confidentiality Undertakings and the Confidential Material Confidentiality Undertakings, and the fact that TEA Model Confidentiality Undertakings had already been executed by numerous individuals by the date of the ACCC's 14 May Letter. In those circumstances, Telstra considered the preparation of the Confidential Material Confidentiality Undertakings was the best way to proceed and represented a straight-forward approach and process which would not place an unreasonable burden on interested parties, either from an administrative or legal perspective. In its Confidentiality Submission, Telstra also expressly stated (at page 3):

⁸⁸ Letter from Tony Warren, Executive Director Regulatory to Mr Robert Wright, General Manager, Compliance and Regulatory Operations, Communications Group dated 23 May 2008.

⁸⁹ The TEA Model Confidentiality Undertakings also had the advantage of permitting use of the TEA model for the purposes of Telstra's ULLS Undertaking and, in addition, in relation to any arbitrations under Part XIX of the Trade Practices Act 1974 involving the relevant access seeker. Telstra deliberately provided broad terms of use as a means of facilitating the immediate desire for interested parties to gain access to the TEA model and as a means to assist access seekers in the arbitral context.

...if any Access Seeker or External Adviser believes that this process is cumbersome, or that it imposes an unreasonable burden upon them, Telstra would be pleased to hear those concerns and seek to address them.

196. Telstra's covering letter responding to the ACCC and enclosing its Confidentiality Submission also stated:

I trust that the arrangements outlined above are satisfactory. We would be pleased to discuss these arrangements in more detail with the Commission, if the Commission has any remaining concerns.

197. The ACCC did not indicate it had any remaining concerns and, in fact, published Telstra's letter, Telstra's Confidentiality Submission and all the forms of confidentiality undertakings on the ACCC's website.

Telstra has attempted to address any concerns

198. Following Telstra's response to the ACCC's 14 May Letter and Telstra's Confidentiality Submission, the ACCC released its Discussion Paper. The Discussion Paper contained statements which purported to continue to take issue with Telstra's confidentiality arrangements. In response, Telstra's letter dated 4 July 2008, once again, explained Telstra's confidentiality arrangements and specifically stated:

...Telstra has not received any complaints from access seekers or their representatives to the effect that Telstra's confidentiality arrangements are confusing, onerous or complex and is not aware of any such complaint to the ACCC. Indeed, as the ACCC is aware, Telstra has received signed confidentiality undertakings from 25 individuals. In the circumstances, Telstra cannot understand the basis for the position taken by the ACCC in relation to Telstra's confidentiality arrangements as described in the Discussion Paper. The ACCC has never made clear in what respect the proposed confidentiality arrangements are either "onerous" or "confusing". Further, Telstra notes that the form of confidentiality undertaking proposed by the ACCC in its draft Procedural Rules is virtually identical to the form of undertaking Telstra has employed in the Undertaking context.

...Telstra wishes to address any issues which arise regarding its confidentiality arrangements promptly and with a satisfactory outcome for all parties. As such, please provide details of any complaints or concerns that Telstra's confidentiality arrangements are confusing, onerous or complex (or to that effect), so Telstra may have an opportunity to address and resolve any issues directly and promptly."

199. No response to Telstra's letter has ever been received from the ACCC.⁹⁰ Where Telstra ultimately became otherwise aware of access seeker concerns in this regard, it has proactively sought to deal with the same on a balanced and ongoing basis.⁹¹

⁹⁰ This is despite the fact that, unbeknownst to Telstra at the time of its 4 July 2008 letter to the ACCC, the ACCC had already received a letter from Optus dated 28 March 2008 on the matter - now available at <http://www.accc.gov.au/content/item.do?itemId=839900&nodeId=b710d429892b58cc3e3382c5f941f6c3&fn=Optus%20letter%20responding%20to%20discussion%20paper.pdf>

⁹¹ See Telstra letters to Optus dated 2 September 2008 and 16 December 2008 both copied to the ACCC and Telstra's *Response to Access Seeker Submissions* dated 18 November 2008, section E.

E.1.2 Telstra's confidential information

200. There are two classes of information contained within the TEA Model which Telstra considers to be confidential to such a degree that they cannot be disclosed or can only be disclosed in carefully controlled circumstances. Those classes of information are:

- Telstra's confidential network base data; and
- Telstra's confidential vendor pricing information.

201. Telstra has also claimed confidentiality in relation to some of the content of 3 documents (Category 2 confidential material) (as discussed below).

Why Telstra's network base data is highly confidential

202. Telstra considers the network base data to be confidential for a number of reasons. Telstra's concerns around its network information extend beyond commercial confidentiality to national security and criminal damage.

203. The network base data details the characteristics of Telstra's physical network assets. Those assets, and the information about them, are proprietary and go to the core of Telstra's business. They affect the value and pricing of Telstra's services – both retail and wholesale – and Telstra's position in the market. The unqualified disclosure of the information would cause detriment to Telstra's interests and confer advantages on its competitors. Aside from the obvious national security concerns, the commercial sensitivity of Telstra's network base data has caused it to be kept securely with limited access within Telstra.

204. By way of specific examples:

- Cable lengths in particular exchange service areas covered by competing networks goes to the extent and quality of broadband services provided in those areas. Competing network owners, on receipt of Telstra's confidential network base data, could deploy or reconfigure their own network facilities to target specific customers on Telstra's network who might, for example, experience relatively low speeds due to the length of the cable between customers' premises and Telstra's exchanges. Access to the confidential network data could similarly be used by a competitor to design a network which sought to exploit regulated wholesale access products. Such an outcome would certainly put Telstra at a substantial competitive and financial disadvantage *vis-a-vis* competitors as Telstra would not have access to the same information in relation to its competitors.
- The confidential network data could be used by competitor's marketing departments to focus their sales efforts on particular geographic areas where Telstra's most valued customers are. This would provide a commercial advantage to competitors, who clearly do not provide the same information to Telstra with respect to their fibre optic, HFC or mobile broadband networks for example.
- Telstra's confidential network data would be a near perfect planning tool for a network builder to roll out a new network

competing against Telstra. The information in Telstra's confidential network data is a culmination of many years of experience in determining the most efficient location and configuration of plant and equipment in the network. It would allow a network builder to develop a near perfect blueprint for a competing network without incurring the costs that other operators are required to bear. As Telstra would not have comparable access to the information about the new by-pass network, its ability to engage a competitive response would be unfairly hampered.

205. For these reasons, Telstra considers its network base data confidential and has restricted access to the same to interested parties' external advisors/consultants.

Why Telstra's vendor pricing information is highly confidential

206. The prices at which Telstra purchases materials and services from third party vendors is highly confidential and not appropriate for disclosure to access seekers.

207. This is because:

- access seekers are Telstra's direct competitors in the retail market and may be Telstra's customers in the wholesale market – as such, Telstra's confidential vendor pricing information, if disclosed, may be used for purposes including:
 - to achieve more favourable terms for the acquisition of goods and/or services, noting that Telstra makes considerable investments in understanding the markets in which it undertakes those purchases and more generally in securing those terms;
 - in the context of future negotiations with Telstra's vendors or other third party vendors; or
 - to achieve an unfair advantage over Telstra in its wholesale or retail operations.
- the pricing is commercially confidential and is subject to contractual terms between Telstra and third party vendors restricting its disclosure.

208. For these reasons, Telstra considers its vendor pricing information confidential and has restricted access to the same to interested parties' external advisors/consultants.

Why Telstra's Category 2 Confidential Material is highly confidential

209. Telstra has nominated the following documents as Category 2 Confidential Information:

- the Operations and Maintenance Factor Study;
- the related Factor Calculation Excel spreadsheet; and

- the redacted version of Access Network Costing Information document.

210. The first two of these documents are highly confidential as they include data prepared for and in accordance with the Regulatory Accounting Framework Record Keeping Rule. This data includes highly sensitive, highly valuable, disaggregated information relating to Telstra's network and its costs which, if disclosed, would cause detriment to Telstra's interests and confer advantages on its competitors. The data would clearly demonstrate, in a detailed manner, Telstra's operational costs and provide an unfair advantage to a competitor with access to it. Given its confidential and highly sensitive nature, Telstra prepared and provided public versions of both these documents.

211. The Access Network Costing Information document contains vendor pricing information and is confidential for the reasons explained above.

Interested parties' access to TEA model and Telstra's other Confidential Materials

212. Telstra has approved more access seeker employees and external advisers/consultants for access to both the TEA Model and Telstra's other Confidential Materials than those who have returned executed confidentiality undertakings. Table 2 sets out a summary of the relevant approvals provided and confidentiality undertakings returned to date.

Table 2: Approvals provided and executed confidentiality undertakings returned as at 23 December 2008

Access Seeker	ACCESS TO TEA MODEL				ACCESS TO CONFIDENTIAL MATERIALS			
	Access seeker employees		External advisor/consultant		Access seeker employees		External advisor/consultant	
	Approved	Executed CU returned	Approved	Executed CU returned	Approved	Executed CU returned	Approved	Executed CU returned
AAPT/ Powertel	7	0	No request	-	No request	-	No request	-
Adam Internet	4	4	5*	5*	No request	-	No request	-
Agile	3	3	No request	-	No request	-	No request	-
Commander	1	0	No request	-	No request	-	No request	-
iiNet	2	2	5*	5*	No request	-	1	1
CCC	1	1	3#	3#	No request	-	No request	-
Last Mile	1	0	No request	-	No request	-	No request	-
Macquarie	4	1	No request	-	No request	-	No request	-
NEC	3	0	No request	-	No request	-	No request	-
Optus	17	15	10	5	6	6	9	4
Primus	5	2	No request	-	No request	-	No request	-
Soul	2	0	No request	-	No request	-	No request	-
TransAct	1	1	No	-	No	-	No	-

TPG	2	0	request 1#	1#	request No request	-	request No request	-
Total	53	29	24 (18*#)	19 (13*#)	6	6	10	5
<i>* Note: Adam Internet and iiNet retain five common external advisers with access to the TEA model. # Note: CCC and TPG retain one common external adviser with access to the TEA model. These common external advisers/consultants are accounted for once only in counts marked with (*#)</i>								
Total incl ACCC experts				25 (19*#)				11

213. As can be seen from Table 2, Telstra has approved the following people, not all of whom have returned executed confidentiality undertakings:

- For access to the TEA model - 53 access seeker employees and 18 external advisers/consultants; and
- For access to Telstra's Confidential Materials - 6 access seeker employees and 10 external advisers/consultants.

214. Telstra is not, however, responsible for approved access seeker employees and/or their external advisers/consultants failing to facilitate their own access to the TEA model and Telstra's other Confidential Material by electing not to return appropriate executed confidentiality undertaking documents.

215. In addition:

- Telstra has approved all external advisers/consultants for whom access to the full version (v1.0/1.1/1.2) of the TEA model has been requested.
- Telstra has provided access to the full version (v1.0/1.1/1.2) of the TEA model to **13** external advisers/consultants retained by interested parties (when common external advisers/consultants are accounted for once only).
- to Telstra's knowledge, 7 of the 13 external advisers/consultants are employed by/represent 3 different economic consultancy firms and, as such, Telstra assumes they are external economic advisers/consultants (as opposed to legal advisers).
- the various Ovum reports considering the TEA model name 6 other individuals from Ovum, the ACCC's own economic experts.
- the total number of external economic advisers/consultants with access to the full version (v1.0/1.1/1.2) of the TEA model, including the ACCC's own experts, is therefore **13**.

216. In light of the above, Telstra cannot accept the ACCC's statements (at page 64) that:

Telstra's confidentiality arrangements have affected interested parties' ability to provide full, timely analysis and comment on the 2008 Undertaking and the TEA model.

217. Telstra considers that its confidentiality arrangements are clear and appropriate. This is evidenced by the strictly limited nature of Telstra's confidentiality claims and the number of approvals provided and confidentiality undertakings returned. Telstra has proactively sought to understand any purported difficulties with its confidentiality arrangements which may be experienced by interested parties. In this regard, Telstra has granted approvals in a timely manner and continues to do so upon request on an ongoing basis. Telstra has also proactively sought to address any concerns raised in relation to its confidentiality arrangements once it becomes aware of the same.

218. Similarly, Telstra corrects the ACCC's statement (at page 64) that:

...only six individuals gained access to the full version of the TEA model.

219. In fact, including Ovum, 19 individuals plus ACCC staff gained access to the full version of the TEA model and, of these, on the information available to Telstra, 13 are economic advisors/consultants retained by access seekers or the ACCC. Telstra has approved each and every external advisor/consultant for whom access to the full version (v1.0/1.1/1.2) of the TEA model has been requested.

220. Finally, Telstra cannot accept the ACCC's statement (on page 64) that:

These restrictive arrangements contribute to the ACCC's ongoing concerns that the model has not been subject to comprehensive external review...

221. Telstra has clearly explained on multiple occasions to the ACCC and access seekers alike the need for, and appropriateness of, its confidentiality arrangements. The ACCC itself acknowledges (at page 76) that:

...it is usually the case that vendor prices are confidential.

222. Further, other than making broad allegations without substantiation, no access seeker has stated how the confidentiality arrangements have in any way prevented or hindered them or their external advisors from reviewing the TEA model.

223. In summary, therefore, Telstra remains of the view that its confidentiality arrangements:

- are limited to only the most confidential materials/information;
- appropriately and carefully balance Telstra's legitimate commercial interests with interested parties' ability to make (or have made on their behalf) fully informed submissions on Telstra's Undertaking;
- are clear and easily comprehended by interested parties as evidenced by the number of approvals sought and confidentiality undertakings executed and returned to Telstra without any apparent difficulty;

- comply with the ACCC's expectations as expressed by the ACCC to Telstra; and
- have not inappropriately restricted access to the TEA model or Telstra's other Confidential Material as evidence by the lengthy submissions made by multiple interested parties and their external advisers/consultants in relation to Telstra's Undertaking.

E.2 Network design and engineering rules (ACCC section B.2)

224. The ACCC concludes that the TEA model has not been implemented using the most efficient network build and does not incorporate all efficiencies and optimisations that would theoretically be possible using efficient forward-looking technology. This conclusion is flawed. The ACCC states:⁹²

The ACCC agrees with commissioned reports, including from Ovum and MJA that as the TEA model reflects Telstra's actual network, this suggests that the model has not been implemented using the most efficient network build.

And:⁹³

The ACCC considers that given the starting point of scorched node and the need to model a copper network, the TEA model is broadly based on a best practice engineering rules and practices. However design and implementation issues mean the extent of the efficiencies in the model is not as extensive as claimed by Telstra. The ACCC also notes that Telstra's application of its TEA model does not incorporate all efficiencies and optimisations that would be theoretically possible using efficient forward-looking technology.

225. The ACCC has no basis for its conclusion. As has been demonstrated through the documentation, statements, studies and reports submitted by Telstra, the TEA Model produces an efficient, optimised network design. In stark contrast to this abundance of evidence, the ACCC does not cite a single example of "efficiencies and optimisations that would be theoretically possible using efficient forward-looking technology," which have not been incorporated into the TEA model. The only rationale the ACCC provides for this conclusion is their allegation that the TEA Model reflects Telstra's actual network.⁹⁴

The ACCC does not consider that the costs of the existing network reflect forward-looking costs as they reflect past investment decisions that are not assessed for relevance or adjusted for efficiency.

Further, the ACCC's view is that where access prices are based on actual network costs, rather than the costs of an efficient network, the resulting access prices will not reflect the efficient costs of providing the service and will not encourage appropriate build/buy decisions. Therefore, the object of promoting efficient investment is not achieved when costs of Telstra's existing network, without taking account of efficiency savings, are used to determine costs of providing the ULLS.

⁹² ACCC Draft Decision, at page 71

⁹³ ACCC Draft Decision, at page 72

⁹⁴ ACCC Draft Decision, at page 71

226. Unfortunately, the ACCC's opinion that the TEA Model reflects Telstra's actual network and produces actual network cost is unsubstantiated, ill-considered and incorrect. The only support for this opinion cited by the ACCC is purported agreement with commissioned reports, including Ovum and MJA, and their allegation that "Telstra submits that the TEA model represents its actual existing network".⁹⁵ Both claims are false. Neither Ovum nor MJA allege, suggest or imply that the TEA Model reflects Telstra's actual network in their commissioned reports. And even a casual reading of Telstra's submissions makes Telstra's position clear – the TEA model is a TSLRIC+ model, which produces the cost of a forward-looking, efficient replacement CAN. To claim otherwise is a misrepresentation of the facts.

E.2.3 MJA

227. The ACCC characterises MJA's report as follows:⁹⁶

MJA notes that the methodology used in TEA model is to develop a model of access network costs based on Telstra's existing network design and actual network costs, while allowing for a degree of optimization.

228. MJA actually says:⁹⁷

There are essentially two approaches that could be used to model the access network. The first of these involves developing a theoretical structure reflecting the network within certain geographic areas and using geo-coded data, electronic maps and network design rules to develop the cost of a hypothetical network. The second approach, which is the approach followed by the TEA model, is to develop access network costs based using inputs directly from the Telstra network allowing for certain amounts of optimisation.

There are advantages and disadvantages to each of these approaches. The approach relying on a theoretical structure is closer in spirit to a bottom-up model and will – by nature of being independent of the existing network – not be influenced by any inefficiency that might be present in Telstra's network. On the other hand, the theoretical approach will necessarily utilise fairly strong assumptions that could lead to in [sic] erroneous results. A model using information derived from Telstra's network is unlikely to suffer these problems, but may – depending on the use of the information – incorporate inefficiencies. Clearly, Telstra has sought to remedy this problem by allowing for optimisation of distribution and main cable routes, but, as discussed, we have reservations about the adequacy of the optimisation performed.

229. In its report MJA correctly explains that the TEA Model develops access network costs "using inputs directly from the Telstra network allowing for certain amounts of optimisation". Nowhere in its report does MJA allege, suggest or imply that the TEA model's use of inputs from Telstra's network results in the model producing actual or existing network costs. Indeed, one cannot conclude, as the ACCC erroneously does and MJA clearly does not, that the TEA Model reflects Telstra's actual network or that it estimates actual network costs from the model's use of inputs directly from the Telstra network in the

⁹⁵ ACCC Draft Decision, at page 65

⁹⁶ ACCC Draft Decision, at page 66, emphasis added

⁹⁷ MJA Review of the TEA Model, at page 6, emphasis added

development of access network costs. The TEA model's methodology and its use of Telstra's engineering records are fully explained in Telstra's submissions and summarised below.

230. MJA does not criticise the TEA Model in its report for reflecting the actual network, because this is not the case. In fact, MJA affirms that the TEA model is necessarily based in reality to ensure the results reflect the costs that a new entrant would incur. MJA objects that the TEA Model produces cost of a copper network, rather than incorporating alternative technologies into the network. The use of alternative technologies is discussed below:⁹⁸

MJA appreciates that Telstra wishes to provide a model with a thorough base in reality; indeed "reality" is required in TSLRIC modelling, to ensure the results reflect the costs that a hypothetical new entrant would incur. MJA also appreciates that there is a risk of underestimating costs in a model not based on "real" data. However, by using existing data and neglecting to optimise by considering alternative technological solutions, there is a risk of a suboptimal outcome.

And:⁹⁹

A charge based on the costs of reproducing a copper network which is essentially what TEA does, is useful only to calculate the costs of ULLS based on copper. It is not necessarily capable of providing any useful signals to encourage efficient entry into the access network. To do so the TEA model must make appropriate technological choices, which it does not.

E.2.4 OVUM

231. The ACCC also misrepresents the findings in Ovum's report. The ACCC quotes the following passage from Ovum regarding modelling approach:¹⁰⁰

The TEA model uses a "scorched node" approach. The main nodal locations are fixed, which in this model include: the telephone exchange locations, the Distribution Area ("DA") boundaries, the Pillar locations at the edge of each DA, and the customer locations. The model then dimensions a traditional access network to meet the customer demand using the locations specified. This method is appropriate but its design should be modified. In Europe and across the world many regulators have adopted a modified scorched-node approach.

A modified scorched-node approach takes the existing topology as a starting point, but then modifies the network by eliminating inefficiencies. The technology between the existing nodes is optimised to meet the demands of a forward-looking efficient operator. There is little evidence of the network being optimised and the design is inefficient in some aspects.

232. In its reports, Ovum criticises Telstra for providing little evidence to support the level of optimisation in the TEA model's network design; but nowhere does Ovum allege, suggest or imply that the model reflects Telstra's actual network or produces actual, existing network costs. To the contrary, Ovum cites a number of examples where the TEA model produces an efficient, forward

⁹⁸ MJA Review of the TEA Model, at page 2

⁹⁹ MJA Review of the TEA Model, at page 5, emphasis added

¹⁰⁰ Ovum economic review, at page 5; ACCC Draft Order, at page 67

looking design; and, as is seen in the passage above, which is quoted in the Draft Decision, Ovum finds the TEA Model's scorched node approach to be appropriate. It is also instructive to note that Ovum prepared its reports prior to Telstra's submission of the *TEA Model Route Optimisation Process* documentation. This report addresses Ovum's complaint regarding lack of evidence.

233. Rather than suggesting the TEA Model reflects Telstra's actual network and produces cost of the actual existing network, Ovum supports many of the model's optimisation and efficiency measures, in section 2 of their report - *Optimisation and Efficiency*.¹⁰¹

The main optimisations and efficiencies built into the engineering rules of the TEA model are:

- The provision of a single cable route from each customer premises to the exchange;*
- The placement of pits and manholes to minimise their use;*
- The sizing of cables in the distribution and feeder networks;*
- The placement of cable joints to optimise the jointing of cables;*
- The sizing of pillars.*

This chapter considers each of these items in turn.

234. Ovum's findings in each for these items are as follows. With regard to cable routes and distribution areas, Ovum states:¹⁰²

The Telstra documentation indicates that two network designs are not used in the model:

- Cabinet-fed pillar;*
- Customer fed directly from branch cable.*

These are non-standard designs that lead to operational complexity. It is appropriate that they should be eliminated.

235. Ovum finds fault with the way the model implements the elimination of duplicate cable runs and the choice of shortest-path routes. These criticisms are addressed in Telstra's response to the Ovum submission.

236. With regard to pits and manholes, Ovum states:¹⁰³

The pits and manholes are laid out according to the diagram and rules in section 3.2 of Access Network Dimensioning Rules. The description is of a very clean, efficient design and layout in the default case. This represents best practice in laying out a Distribution network.

Section 3.3.4.1 of Access Network Dimensioning Rules suggests that manholes may be placed at "severe changes of direction" in the Distribution network. This is a good design rule. There appears to be no provision for this rule in the model itself, as changes of direction are not

¹⁰¹ Ovum review of network design, at page 6

¹⁰² Ovum review of network design, at page 6

¹⁰³ Ovum review of network design, at page 10

indicated in the base data. This could lead to an underestimate in the number of manholes placed by the TEA model.

237. With regard to cables and cable sizing, Ovum states:¹⁰⁴

A key issue in the design of cables for the distribution and main-cable networks is the assumed maximum transmission distance for each cable gauge. The transmission limits for the default case are given in a table in section 3.1.1.1 of Access Network Dimensioning Rules. The maximum distances given are not conservative but, rather, permit suitable transmission losses.⁷ Thus, if anything, the cable gauges and hence the cost of cables will be underestimated.

238. With regard to cable jointing, Ovum states:¹⁰⁵

The jointing rules for Distribution cables are described in section 3.2 of Access Network Dimensioning Rules, particularly in section 3.2.3. The jointing of cables, as described in the documentation, is efficient. Joints are only included where necessary: where cable connections are required or where the maximum cable lengths require a joint in a long network branch.

239. With regard to pillars, Ovum states:¹⁰⁶

The "sizing" of pillars consists of choosing either a 900-type pillar or an 1800-type pillar, depending on how many pairs are to be terminated. The sizing algorithm leaves some spare capacity in the pillar. The effect of this oversizing of pillars is likely to be small.

240. Further, with regard to provisioning rules, Ovum finds:¹⁰⁷

The engineering rules described in the documentation are extensive and detailed and, on the whole, represent good engineering practice.

241. From this reading of the Optimisation and Efficiency section of Ovum's report, it is not possible to reach logically the conclusion that Ovum agrees with the ACCC's opinion that "the TEA Model reflects Telstra's actual network" (or to the extent that it does so, is inefficient).

242. The ACCC's claim that it "agrees with commissioned reports, including from Ovum and MJA that as the TEA model reflects Telstra's actual network" is specious. There is no evidence in the record to support a finding that the TEA model reflects Telstra's actual network, or that it costs the actual, existing network where doing so would embody inefficiencies. Neither Ovum nor MJA support this finding in their respective reports.

E.2.5 Telstra

243. The ACCC also misconstrues Telstra's position with respect to the TEA model:¹⁰⁸

¹⁰⁴ Ovum review of network design, at page 10

¹⁰⁵ Ovum review of network design, at page 12

¹⁰⁶ Ovum review of network design, at page 12

¹⁰⁷ Ovum review of network design, at page 4

¹⁰⁸ ACCC Draft Decision, at page 65

Telstra submits that the TEA model represents its actual existing network, which is based upon Telstra's records of the locations of its equipment and customers, rather than a hypothetical lay-out of its network.

244. The ACCC repeat this allegation in section B.4.¹⁰⁹

The ACCC notes that when Telstra developed the TEA model it sought to use actual costs incurred as a basis for determining efficient forward looking costs.

245. Telstra does not claim that the TEA model represents its actual existing network, nor has it ever made such claims. Telstra's advocacy is clear and unambiguous from even a casual reading of its submissions - the TEA Model estimates the forward looking cost of building a replacement Customer Access Network.

The model estimates the cost a new entrant would incur to supply the ULLS product. Since ULLS is provisioned over the Customer Access Network (CAN) and defined as unconditioned copper facilities, the TEA model estimates the cost of a forward-looking, replacement CAN comprised of unconditioned copper facilities.¹¹⁰

The replacement network design follows best practices and forward-looking provisioning rules, as if the network had been constructed with perfect foresight in a single day. The model only includes costs that an efficient company would incur in building a new CAN.¹¹¹

The TEA model applies best-in-use and forward-looking engineering practices and determines the efficient quantities of plant and equipment that are necessary for a ULLS network. The engineering rules applied in the design of the efficient network are set out in the Access Network Dimensioning Rules and the application of those rules is documented in TEA Model Documentation.

In addition to the above mentioned submissions, accompanying this submission is the statement of [REDACTED]. That statement shows, by detailed reference to each of the engineering rules, that those rules reflect a best practice, forward-looking engineering approach that would be adopted by a network constructor building such a network today.¹¹²

246. While the TEA Model does not represent Telstra's actual existing customer access network, it does incorporate real world conditions in its network design process. The model produces a realistic Total Service Long Run Incremental Cost of ULLS, which reflects the conditions and constraints an efficient provider would face today in constructing an alternative to Telstra's access network.¹¹³

The concept of TSLRIC+ is meaningless in any practical sense unless it takes into account the unchangeable physical constraints within which the service must be provided and which any competitor or network builder would undoubtedly face. A CAN must reach end-user customers in fixed locations across the network. It must do so taking its

¹⁰⁹ ACCC Draft Decision, at page 80

¹¹⁰ Telstra Efficient Access (TEA) Model Overview, at page 3, emphasis added

¹¹¹ Telstra Efficient Access (TEA) Model Overview, at page 4, emphasis added

¹¹² Telstra response to Discussion paper, at page 10, emphasis added

¹¹³ Telstra response to Discussion paper, at page 10, emphasis added