

28 August 2015

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Australian Competition and Consumer Commission
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Dear Mr Wright

Re: ACCC fixed line services final access determination inquiry: adjustments to cost allocators

I refer to the recent discussions between Australian Competition and Consumer Commission (**ACCC**) and Telstra staff regarding possible adjustments to allocators for individual asset classes recommended by Analysys Mason (**AM**) in its June 2015 report to the ACCC.¹

The opportunity to discuss the proposed adjustments with ACCC staff has allowed us to better understand the ACCC's position on these proposed adjustments. Attached to this letter are some further comments on the AM proposed adjustments for five asset classes. These comments have been informed by our recent discussions with ACCC staff.

We would welcome the opportunity to discuss any of the matters raised in this letter and its attachment with you and your team. Should you have any further questions, please do not hesitate to contact Fiona Wade on (03) 8649 2061.

Yours sincerely,



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¹ Analysys Mason, Assessment and verification of inputs into Telstra's Cost Allocation Framework, 16 June 2015 (**AM Report**).

Attachment – Comments on specific recommendations made by Analysis Mason in their report

1. Adjustments to the forecast of duct usage used in the calculation of the CA01 Ducts and pipes allocator

The ACCC states that AM identified some limitations in Telstra's approach to calculation of the allocation factor for ducts and pipes.² Specifically, in National Broadband Network (NBN) areas where FTTP/dP or HFC is deployed, Telstra accounted for an increase in NBN usage of ducts and pipes, but had not accounted for a corresponding decrease in usage by fixed line services.

AM recommend that:

- in NBN areas where FTTP/dP or HFC is deployed, it should be assumed that there will be a reduction in the fixed line usage of ducts and pipes, as well as an increase in NBN usage;³ and
- fixed line service duct usage be reduced by **[Commercial in Confidence commences]** **[Commercial in Confidence ends]** for every 1 metres of duct usage by NBN in FTTN, FTTP/dP and HFC areas, to reflect the larger duct usage requirement for the fixed line network compared to the NBN.⁴

In relation to the first of these recommendations, Telstra agrees that it would be reasonable to assume some reduction in usage of the duct by the fixed line services in FTTP/dP and HFC areas, ***provided that a fully allocated cost framework (without adjustment for NBN-induced loss of economies of scale) is being applied.***

As explained in Telstra's response to the Further Draft Decision, the proposed 'NBN scale adjustment' is fundamentally inconsistent with the Fixed Principles, and will deprive Telstra of a reasonable opportunity to recover its costs.⁵ Telstra considers that in order to comply with the Fixed Principles, the ACCC must adopt a fully allocated cost framework, without any NBN scale adjustment.

If a fully allocated cost framework is applied (without NBN scale adjustments), Telstra accepts that reduced usage of the duct network by fixed-line services in FTTP/dP and HFC areas should be accounted for. This will ensure that the allocation factors for this asset class continue to reflect the relative usage of the duct network, consistent with the Fixed Principles and the principles of a fully allocated cost framework.

However, if the ACCC were to apply its 'NBN scale adjustment' (as proposed in the Further Draft Decision), it would be inappropriate to additionally reduce the fixed-line services share of the cost recovery burden through this adjustment to the ducts and pipes allocator. As explained in Telstra's response to the Further Draft Decision, the effect of the ACCC's 'NBN scale adjustment' is that the share of total costs allocated to fixed-line services is less than the relative usage of the network by these services. As a consequence total revenue that may be recovered from fixed-line services is well below the efficient cost of supplying those services (as those costs have been assessed by the ACCC). Specifically in relation to ducts and

² ACCC, Further Draft Decision on primary price terms, pp 83-84 (Further Draft Decision).

³ AM Report, p 34.

⁴ AM Report, p 32.

⁵ Telstra, Public inquiry into final access determinations for fixed line services—primary prices: Response to ACCC further draft decision, 17 July 2015, section 1.

pipes, an increasing proportion of the cost attributable to the supply of fixed-line services is allocated away from these services for the purposes of pricing [Commercial in Confidence commences] [Commercial in Confidence ends]. If the ACCC were to additionally make an adjustment to the ducts and pipes allocator with the effect of allocating more costs away from fixed-line services, the effect of the NBN scale adjustment would be exacerbated, in that the share of costs allocated to fixed-line services would be further reduced below the share that reflects the relative usage of the network by these services.

Telstra submits that the correct approach (and indeed the only approach consistent with the Fixed Principles) would be to remove the NBN scale adjustment and adjust the ducts and pipes allocator to reflect the expected reduction in duct usage by fixed-line services in FTTP/dP and HFC areas. For reasons set out above, it would be inappropriate to apply the NBN scale adjustment and then make the further adjustment to the ducts and pipes allocator recommended by AM.

In relation to AM's second recommendation – that fixed line service duct usage be reduced by [Commercial in Confidence commences] [Commercial in Confidence ends] for every 1 metre of duct usage by NBN – Telstra considers that the basis for this recommendation is flawed.

AM's recommendation is based on a comparison of actual duct usage and duct route length, and assumes that:

- all current usage of the duct network is use by fixed-line services – it is from this assumption that AM concludes fixed line usage of ducts is [Commercial in Confidence commences] [Commercial in Confidence ends] duct route length;⁶
- NBN fibre usage of ducts will be less than fixed line usage. Specifically, AM assumes that NBN fibre usage will be only 1 times duct route length; and
- the NBN rollout will be entirely fibre-based (meaning that NBN usage generally will reflect NBN fibre usage).

The first of these assumptions is incorrect. As the ACCC is aware, not all use of the duct network is by fixed-line services. Rather, there is significant amount of use by third parties (e.g. access seekers acquiring duct space from Telstra) and increasingly, by NBN Co. It is for this reason that Telstra allocates costs in the ducts and pipes asset class between fixed-line services and other uses, based on data from Telstra's Physical Network Plant Inventory (TPNI) database.⁷

Further, it is not clear on what basis AM assumes that NBN fibre usage will be equal to duct route length. AM does not explain the basis for this important assumption. Telstra considers that there is no evidence to support this second assumption.

The third assumption is also incorrect. As the ACCC would be aware, a significant proportion of the NBN rollout will rely on non-fibre technology, including copper (in FTTN areas) and HFC – NBN Co's 2014-17 Corporate Plan indicates that only 25% of the rollout will be FTTP, with 29% to be accounted for by FTTN, 11% will be FTTP/B and 27% HFC.⁸ Evidently, where

⁶ AM calculate the ratio of [Commercial in Confidence commences] [Commercial in Confidence ends] by comparing the total route length less the length used by lead-ins with the sum of conduit and subconduit use (AM report, p 32). By using this ratio to draw a conclusion as to usage of the duct network by fixed-line service, AM must assume that all conduit and sub-conduit use is by fixed-line services.

⁷ Telstra, Cost Allocation Framework for the ACCC Fixed Line Services Model: Framework and Model Guide, Version 1, July 2014 pp 19-20.

⁸ NBN Corporate Plan 2014-17, p 13.

NBN Co is using legacy copper (e.g. in FTTN areas) or HFC, its use of the duct network will be no different to current use.

Telstra therefore considers that it would be unreasonable for the ACCC to make an adjustment to the ducts and pipes allocator based on the assumed ratio of fixed-line / NBN usage calculated by AM. At a minimum, AM's calculation would need to be adjusted to remove usage by non-fixed-line services (i.e. NBN and other third party uses), and would need to account for the fact that much of the NBN rollout will rely on existing copper or HFC.

The above discussion demonstrates the complexity potentially involved in seeking to account for differences in duct usage between fixed line services and NBN services. Given the issues discussed above with the AM analysis, and the late stage at which the AM adjustments have been proposed (i.e. almost a year after Telstra put forward its allocation framework) Telstra considers that it would be unreasonable for the ACCC to now adopt the adjustment proposed by AM.

Rather, Telstra considers that it would be more reasonable to assume that NBN and fixed-line usage of the duct network is approximately equivalent on a per-service basis.

2. Adjustments to the allocators for CA08 Network Land and CA09 Network Buildings/Support based on land value

AM have recommended that the modifications made to the allocators for CO08 and CO09 to take into account higher land valuations also be applied to the allocators for CA08 and CA09 given that these are the corresponding assets in the CAN.

Telstra agrees that this adjustment should be made, to ensure consistency between the allocators for CO08 / CO09 and the corresponding CAN asset classes.

Telstra notes that if the land valuation modifiers are applied to CA08 and CA09, the resulting allocators for ULLS are slightly higher, with WLR receiving a slightly lower allocation.

3. Adjustments to the CO01 Switching Equipment - Local allocator

AM have recommended, and the ACCC has agreed, that the split between port and traffic driven local switching assets should be amended to exclude the asset which has negative value in the asset register at June 2014.

Telstra agrees that this adjustment should be made.

AM state that the split was 36.63% port and 63.37% traffic; however, this was based on the asset register as at June 2013. Telstra had updated the Cost Allocation Framework to use the values from the June 2014 asset register and the splits were adjusted to 31.3% and 68.7%.

The asset type which is noted to have a large credit value was included in the total value of traffic driven assets. Removing it from the calculation would result in the split based on the June 2014 asset register changing to 28.8% port and 71.2% traffic.

4. Adjustments to the CO02 Switching Equipment - Trunk and CO03 Switching Equipment – Other allocators

AM have recommended that the CO02 allocator should be based on “a more stable forecast for PSTN traffic”. It is suggested that the “pre-NBN” (i.e. hypothetical “without NBN”) forecasts could be used for this purpose.⁹

Telstra understands that the rationale for this adjustment is similar to the rationale for the ACCC’s ‘NBN scale adjustment’. As AM notes, there is forecast to be a significant decline in usage of trunk switching as customers migrate to the NBN, since this asset class is only used if at least one party to a call is still on Telstra’s network (i.e. a call between two end-users on the NBN will not use Telstra’s trunk switching infrastructure).¹⁰ AM expresses concern that this will lead to “diseconomies of scale”, and it is argued that this “diseconomies of scale” should be allocated away from fixed line users.¹¹

As explained in Telstra’s response to the Further Draft Decision, the ‘NBN scale adjustment’ is fundamentally inconsistent with the Fixed Principles. For the same reasons, the adjustment proposed by AM for the trunk switching asset class would also be inconsistent with the Fixed Principles. This adjustment would require the use of an entirely unrealistic forecast of demand, with the result that Telstra would be unable to recover the costs associated with maintaining its trunk switching infrastructure. AM acknowledges that usage of this asset class will decline significantly¹², and yet proposes to ignore this decline in usage for the purposes of allocating costs.

Telstra notes that the ACCC does not intend to implement to adjustment to the CO02 allocator proposed by AM. The ACCC states that, since it will apply the NBN scale adjustment, it is appropriate to maintain Telstra’s forecasts (i.e. real world, with NBN, forecasts) for the purposes of calculating the CO02 allocator.¹³

However, Telstra considers that both the NBN scale adjustment, and the AM alternative adjustment to the CO02 allocator, would be inappropriate and inconsistent with the Fixed Principles. Both would necessarily be based on an unrealistic forecast of demand and would result in an allocation of costs for this asset class that does not reflect relative usage.

5. Adjustments to the allocator for CO04 Inter-exchange Cables using updated information

Telstra notes that the ACCC does not intend to adopt AM’s recommendation to update the platform allocators for the CO04 asset class to include information from March 2015.

Telstra considers that this is a reasonable and practical approach.

⁹ AM Report, p 51.

¹⁰ AM Report, p 51.

¹¹ AM Report, p 51.

¹² AM Report, p 51.

¹³ Further Draft Decision, p 85.