Review of the 1997 telecommunications access pricing principles for fixed line services

Submissions on behalf of iiNet, Internode and Adam Internet

October 2010

This is the public version of this submission. Confidential information has been redacted.

1. INTRODUCTION

This submission is on behalf of iiNet, Internode and Adam Internet (collectively, the **Access Seekers**).

In September 2010, the Commission published a draft report regarding pricing principles to apply to declared fixed line services for the period 2011 – 2014. The Commission proposed replacing the traditional and frequently maligned TSLRIC+ costing methodology with a Building Block Model that values Telstra's CAN and Core assets by setting an initial Regulated Asset Base (**RAB**) calculated by a Depreciated Actual Cost (**DAC**) methodology.

The Commission's review is vital to the Access Seekers' business. More importantly, it is vital to ensuring the continuing promotion of competition in telecommunications markets in the transition to the NBN. Without regulated access to declared services, competition in telecommunications markets would not exist. Telstra is simply too dominant and as a fully vertically integrated service provider can and has used its market power to its own competitive advantage. This comes at significant cost to end-users. Without regulated access charges based upon fair principles and thorough economic modelling it is unlikely that competition could flourish. The Access Seekers hope that during the period of the proposed pricing principles, competition is given every chance to grow and that through this Australian consumers reap the benefits of better, more diverse services, at more attractive prices. In the lead-up to the NBN, it is likely that service providers will compete vigorously to win customers and maximise market share prior to transposition from the CAN to the fibre network. The Commission's pricing principles will play a key role in enabling this period of competition, which will establish competitive levels during the initial years of the NBN.

The Access Seekers support the Commission's decision to replace TSLRIC+ with a RAB based on DAC methodology. TSLRIC's constant revaluation of Telstra's aging assets has allowed Telstra to over-recover its costs. Accounting for depreciation of the network is reasonable, both to Telstra and access seekers. The Access Seekers also support the Commission's decision to replace Retail Minus Retail Costs methodology for pricing the WLR and LCS with a RAB methodology, bringing them into line with other fixed services. It is likely that this will encourage competition in voice telephony markets and be a significant benefit to consumers. The Access Seekers do however have several concerns about the manner that the RAB and certain charges have been calculated. These concerns are discussed in this submission.

The Access Seekers have had regard to a report prepared by Frontier Economics for the Competitive Carriers Coalition (**CCC**), which they understand will be provided to the Commission by the CCC. Frontier Economics' report is referred to in this submission. The Access Seekers agree with the views and analysis provided by Frontier Economics and consider that its report should be closely considered when the Commission is finalising its review.

In making its determination under s 152AQA of the *Trade Practices Act 1974* (Cth), the Commission must have regard to the object of Part XIC, namely to promote the long-term interests of end-users (**LTIE**).[1] The Access Seekers agree that cost recovery, incentives for efficiency and innovation, transparency and regulatory

[1] *Trade Practices Act 1974* (Cth), s 152AB(1).

certainty and competitive pricing will promote the LTIE.[2] However, the Access Seekers have concerns about whether the Commission's draft pricing principles and indicative prices possess these features.

2. EXECUTIVE SUMMARY

The Access Seekers submit that:

(a) The Commission's proposed costing methodology meets the objects of Part XIC of the TPA.

(b) It is appropriate to replace TSRIC+ with a RAB costing methodology.

(c) LSS charges should be based on RAB modelled costs. It is inappropriate for the Commission to roll-over the existing rates, which even on the Commission's own TSLRIC+ modelling are grossly inflated.

(d) Calculations behind setting the RAB are not transparent. The RAF data that the Commission has based its calculations on has not been disclosed to access seekers. As such, it is difficult for access seekers to accurately review or verify the RAB. Actual cost based pricing requires accuracy and transparency.

(e) The Commission's calculation of the RAB appears generous to Telstra.

(f) The Commission has overestimated Telstra's Opex and Capex by failing to consider recent trends.

(g) The Commission's forecasts may underestimate demand for declared fixed services.

(h) Given that the RAB favours Telstra, it is not appropriate to round-up modelled costs when setting indicative prices. Collectively, this provides a significant windfall to Telstra.

3. THE PROPOSED LSS INDICATIVE PRICES

The Access Seekers submit that the Commission cannot reasonably justify setting the LSS monthly charge at $2.50. The available evidence shows that this charge should be considerably lower. The Commission's approach to setting the LSS monthly charge does not include a network cost component on the basis that such costs are fully recovered via the WLR for each line that provides a LSS. The Access Seekers agree with this approach as to do otherwise would allow double recovery. The LSS costing approach combines the specific costs shared between LSS, ULLS and ADSL equivalent services over a cost-recovery period, amortises the total cost for that period and allocates an equal annual cost relative to the number of active services.[3] The Access Seekers submit that the Commission has either failed to correctly implement this approach or has failed to explain why it has decided to

[2] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, pp 13-14.
[3] Ibid p 99.

greatly inflate the costs that result from its model when subsequently setting access charges.

When correctly implemented, the Commission's costing approach would allow Telstra to recover its costs in providing access to the LSS and also promote the LTIE. The LSS Specific Costs Model (the **Model**) that the Commission has used estimates a unit cost for LSS monthly charges that is considerably lower than the Commission's proposed indicative price. The Access Seekers agree with the Frontier Economics submissions at Section 8.1 of its report in this regard, and submit that if a specific cost model is used, the LSS monthly charges should accurately reflect the results derived from that model, as this will ensure transparency and regulatory certainty.

It appears that the Commission is simply rolling over the existing indicative price for the LSS monthly charge rather than basing the 2011-2014 charge on current and forecast figures. In December 2009, the Commission rolled over the 2008-09 indicative prices for all fixed services into 2010. Accordingly, the LSS monthly charge remained set at $2.50. This was despite the ACCC having previously stated that the specific costs model results in a LSS price of below $1.00 and showing a declining charge over time.[4] The ACCC stated it was of the view that rolling over the 2008-09 pricing principles and indicative prices would provide certainty regarding access to regulated services in a period of significant regulatory and industry change and is in the LTIE.[5] The Commission has not stated that it is again rolling over the 2008-09 indicative prices for the 2011-14 period, but rather has said that the charge is based on the specific costs model.[6]

The Commission does not specify how it has actually arrived at the proposed monthly charge of $2.50, other than to say:

(a) In the past, the Commission has used this approach in setting a monthly charge of $2.50 in LSS access disputes, and that this approach was endorsed by the Tribunal.[7]

(b) The LSS indicative price should remain at $2.50 per month and be determined outside the BBM framework where there is no additional information on future capital and operating expenditure for the operational support systems required to provide the LSS.[8]

(c) The Model was one factor taken into account, but the Commission was concerned with the accuracy of the estimated costs due to it not having available information to update the Model's inputs.[9] Although it was possible for the Commission to update some inputs, the Commission chose not to as this would raise consistency issues with the remaining inputs.[10]

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[4] ACCC, *Draft Pricing Principles and Indicative Prices for LCS, WLR, PSTN OA, ULLS, LSS*, August 2009, p.43.
[5] ACCC, *Pricing principles and indicative prices for LCS, WLR, PSTN OTA, ULLS, LSS 1 August 2009 to 31 December 2010*, December 2009, p.1.
[6] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, p 99.
[7] Ibid.
[8] Ibid, p 100.
[9] ACCC, *Fixed Line Services Pricing Review Draft Report — Questions and Answers*, "5. Q: How did the ACCC determine the LSS monthly charge of $2.50? What factors were taken into account?", available at: http://www.accc.gov.au/content/index.phtml/itemId/951666.
[10] E-mail from Dr Annette Weier (ACCC) to Tony Dooley (Herbert Geer), dated 15 October 2010.

(d) The Commission also had regard to market conditions, price stability and the reasonableness of the proposed charge.[11]

The Access Seekers submit the following in response to the four points described above:

3.2 Past approach

Although the same approach may have been used by the Commission in the past (and the approach endorsed by the Tribunal[12]), this does not mean that the Commission should necessarily reach the same actual outcome in terms of the price for the LSS monthly charge. Rather, correctly utilising this approach requires that the Commission utilise current inputs in its model. Of particular note is the growing number of LSS, ULLS and ADSL SIOs that the specific cost are shared amongst. Accordingly, a different price outcome is to be expected. By failing to implement updated inputs, the Commission is not adhering to the approach endorsed by the Tribunal.

3.3 Calculation of LSS charges outside BBM framework

The Access Seekers submit that if the indicative price for the LSS monthly charge is determined outside the BBM framework, the Commission must justify with the material or other evidence it has relied on to determine that the LSS indicative price should remain at $2.50 per month. The Access Seekers agree with the Frontier Economics submissions at Sections 8.2-8.5 of its report, in that there is no sound justification for using a TSLRIC based model for the LSS where it is likely that many of the capital costs incurred in the Model have already been recovered by Telstra in the past. The Access Seekers submit that if the Model results in Telstra being overcompensated for its capital expenditure, which is contrary to Telstra receiving a fair rate of return on investment and not in the LTIE.

3.4 Accuracy of specific costs model data

The Commission has used the Model with outdated data. For example, the Commission has forecast demand for 2009/10, when actual data for this period is available.[13] The Access Seekers agree with the Frontier Economics submissions at Section 8.4 of its report in this regard. The Commission has also raised concerns with relying on the accuracy of the estimated costs. Nevertheless, the Commission has taken the Model into account in determining the LSS indicative price but has not justified or explained the extent to which it has done so. The Commission has indicated that this Model is the same model that was used in the last consultation on fixed services in 2009.[14] The Commission did not raise any concerns with the accuracy of the Model in the previous consultation process. Since the Commission has reached the same LSS price outcome as the earlier 2007 consultation, it is necessary for the Commission to adequately set out its reasoning and calculations.

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[11] Ibid.

[12] The approach was also supported by the Federal Court of Australia in appeals of the Commission's final determinations of access disputes: *Telstra Corporation Ltd v Australian Competition & Consumer Commission* (2008) 171 FCR 174; and *Telstra Corporation Ltd v Australian Competition & Consumer Commission* (2009) 179 FCR 437.

[13] ACCC, *Snapshot of Telstra's customer access network as at 31 December 2009*, Table 1: SIO, DSL, ULLS and LSS information by ULLS band, available at: http://www.accc.gov.au/content/item.phtml?itemId=853523&nodeId=9c449f79162e87d69259ba2beb7818e0&fn=Snapshot%20of%20Telstra's%20customer%20access%20network%E2%80%94Dec%202009.pdf.

[14] E-mail from Dr Annette Weier (ACCC) to Tony Dooley (Herbert Geer), dated 15 October 2010.

Otherwise there is the presumption that the Commission has given equal regard to the Model as in the previous consultations, which it should not do without updating the inputs to the Model.

The Model provides the following results:

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The Model's results clearly do not correspond to the ACCC's proposed $2.50 charge. Rather, the ACCC's proposed monthly charge appears to be inflated as follows:

[start c-i-c] table redacted **[end c-i-c]**

The adverse effect that this will have on access seekers and on their ability to compete in broadband markets is clearly demonstrated by calculating the extra annual amount that access seekers will be paying to access the LSS in excess of Telstra's costs. This can be calculated by multiplying the difference between the inflated LSS charge of $2.50 and the results from the specific costs model with the number of LSS SIOs. The most recent available data states that there are 734,155 LSS SIOs[15]. This shows that the excessive $2.50 rate results in a annual windfall to Telstra of **[start c-i-c]** redacted **[end c-i-c]** or **[start c-i-c**] redacted **[end c-i-c]** over the four year time frame of the proposed indicative prices. This figure is conservative, as the ACCC has forecast the number of LSS SIOs to grow to **[start c-i-c]** redacted **[end c-i-c]** by 2011/12[16], at which time the unit cost of a LSS is estimated to be **[start c-i-c]** redacted **[end c-i-c].** This figure is also conservative as the report prepared by Frontier Economics finds at Section 8.5 that with appropriate adjustments and a reasonable cost-based price for the LSS, the monthly charge could fall to less than $0.50 per service per month.

Given that the proposed rates are inflated by more than **[start c-i-c]** redacted **[end c-i-c]** over the Model's results, it appears that the Commission has not utilised the Model at all in its proposal to determine LSS charges. Further, although the Commission has indicated that it is concerned with the accuracy of the Model by not having available information to update the inputs, it has nevertheless proceeded to propose LSS indicative prices for the next four years (i.e. for the period 2011-14), when the Model only outputs unit cost figures up until 2011/12. Therefore, the Commission's proposed LSS monthly charge for the period 1 July 2012 to 31 December 2014 is not supported by any cost methodology whatsoever. The Access Seekers submit that such lack of transparency and regulatory certainty is contrary to promoting the LTIE, and therefore:

(a) The Commission should use an appropriate cost model with up to date inputs to determine LSS monthly charges.

(b) Alternatively, if the Commission continues to use the Model to determine LSS monthly charges, the Commission should at least obtain updated information to input into the Model and ensure that unit costs are forecast up until 31 December 2014.

(c) If the Commission cannot obtain updated information to input into the Model, then it must set out the steps it has taken to obtain that information,

[15] ACCC, *Snapshot of Telstra's customer access network as at 30 June 2010*, Table 1: SIO, ULLS and LSS information by ULLS band.
[16] ACCC, Specific cost model.

why it could not obtain it, and why the figure of $2.50 per month is justified when on the available evidence that has been supplied by the Commission, it appears grossly inflated.

3.5 Market conditions

The Access Seekers submit that the Commission must specify the market conditions that it has had regard to, and why the Commission considers the proposed charge of $2.50 to be reasonable. The Access Seekers agree with the Frontier Economics submission at Section 8.5 of its report in this regard. The Access Seekers submit that $2.50 per month is not a reasonable charge for the LSS if:

(a) the monthly charge, being a price figure, does not reflect actual cost estimates;

(b) the Commission has not taken adequate steps to obtain the information that it needs to make a determination; and/or

(c) the Commission makes a determination where the material or evidence does not support that determination,

as this will result in a lack of transparency and will be contrary to the LTIE.

4. SETTING THE INITIAL RAB

The Access Seekers submit that the Commission cannot reasonably justify its valuation of $7.5 billion for CAN assets and $5.8 billion for Core Assets. The Commission does not specify in detail how these figures have been determined, other than to say:

(a) These figures have been derived from RAF data, and represent a fair value for these assets.[17]

(b) A depreciated actual cost (**DAC**) valuation methodology has been used.[18]

(c) Adjustments were not made to take into account inefficient assets, different remaining asset lives and fully depreciated assets.[19]

(d) Telstra's own valuation of its CAN assets implied from the non-binding Financial Heads of Agreement between Telstra and NBN Co, of 20 June 2010 (**FHOA**) would be close to the Commission's calculation of $7.5 billion, and that this is likely to satisfy Telstra's commercial interests.[20]

The Access Seekers submit the following in response to the four points described above:

4.2 The Commission's reliance on Telstra's RAF data

The Access Seekers are unable to verify the underlying material that the Commission has reached its conclusions on, because despite requests to both Telstra and the Commission by their legal representatives, the Access Seekers were unable to obtain access to Telstra's RAF data. The time frame for submissions in this review did not allow time for the access seekers to formally request disclosure of the RAF data under the relevant provisions of the TPA. Though understanding that the December 2010 expiry of the current pricing principles and indicative prices places the Commission's review under considerable time constraints, the Access Seekers are concerned about the reliability of the RAF data, especially given that the Commission has indicated that:

(a) The RAF data is only an approximation of the actual costs incurred by Telstra.[21]

(b) The RAF data is likely to be incomplete because the assets that they relate to were put in place many years ago and Telstra was not subject to the same accounting obligations and disclosure rules as it is today.[22]

The Access Seekers submit that it is unreasonable for the Commission to rely on approximate and incomplete data when adopting a cost-based approach to valuing assets, and that reliance on this data is inconsistent with the depreciated *actual* cost methodology. At the very least, the Commission should have disclosed the RAF data that it has relied on so that its suitability in setting the initial RAB could have

[17] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, p 28.
[18] Ibid pp 25-27.
[19] Ibid p 28.
[20] Ibid p 29.
[21] Ibid p 28.
[22] Ibid.

been appropriately reviewed by parties other than Telstra. In failing to do so, it is questionable whether the Commission's determination of the RAB can be regarded as promoting the LTIE, if transparency and regulatory certainty is lacking.

The Access Seekers further question the procedural fairness of the consultation process in responding to the Draft Report. The Access Seekers were unable to obtain access to Telstra's RAF data for the purpose of making submissions, even though the Access Seekers' representatives had already executed individual confidentiality undertakings that would have sufficiently protected the sensitive nature of the data. The Commission noted that it could not release the RAF data without an extensive consultation process, and that Division 6 of Part XIB of the TPA contains a provision for parties to formally request access to the RAF data.[23] However, the time period that the Commission set for consultation on the Draft Report denied any interested party the opportunity to seek access to the RAF data within that timeframe. The Commission released its Draft Report on 17 September 2010, with submissions due on 22 October 2010, i.e. a period of 35 days. Under s 151BUB(2) of the TPA, the Commission may have given Telstra a written direction to release its RAF data, but the direction must allow Telstra 28 days[24] to comply. However, such a direction cannot be given without a prior consultation process that runs for at least 28 days after notice is given to Telstra.[25] Therefore, an interested party requires at least 56 days to obtain access to Telstra's RAF data. Disclosure of this data was procedurally impossible under the Commission's 35 day consultation period for the Draft Report.

4.3 The Commission adopting the DAC methodology

The Access Seekers submit that the DAC methodology is a desirable valuation approach. However as submitted above, the Access Seekers consider that the data relied on must be accurate and verifiable. The Commission describes its preference for the DAC approach on the basis that:

> *Values for actual gross historic costs for fixed network assets can be derived from regulatory and/or general ledger accounts. As this information comes from audited accounts prepared by the regulated entity, there is less scope for dispute over the cost information compared to the hypothetical and subjective replacement costs. A DAC approach is based on the best available objective and independently verified information.*[26]

As submitted above, the Commission has indicated that the RAF data is an approximation of actual costs and likely to be incomplete. The Access Seekers submit that reliance on this data without any further qualification by the Commission is inconsistent with the DAC approach. The Access Seekers consider reliance on approximate and incomplete data in a DAC valuation will produce results that are no more reliable than the results of a hypothetical and subjective revenue-based asset valuation.

[23] ACCC, *Fixed Line Services Pricing Review Draft Report — Questions and Answers*, "7. Q: Is Telstra's RAF data publicly available?", available at: http://www.accc.gov.au/content/index.phtml/itemId/951666.
[24] *Trade Practices Act 1974* (Cth), s 151BUB(3).
[25] *Trade Practices Act 1974* (Cth), s 151BUB(6).
[26] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, p 27.

4.4 The Commission's failure to make appropriate adjustments to the DAC valuation method

The Commission has indicated that it considered adjusting the DAC methodology to:

(a) remove or discount assets that are determined to be inefficient and imprudent;[27] and

(b) use different estimates for the remaining asset lives of the existing CAN assets, given that much of the existing network would have already been fully depreciated.[28]

The Commission acknowledged that making these adjustments would likely reduce the DAC value of Telstra's existing assets, yet the Commission has not done so because reliable information was not available.[29] Instead, the Ovum BBM uses average total and remaining asset lives for each asset class.[30] The Access Seekers submit that it is not reasonable to use averaged data in this regard, especially where the Commission recognises that Telstra's assets have been put in place over a number of years, with some being relatively new and others much older.[31] Even if Telstra does not consider the numbers referred to by its ex-Chairman Donald McGauchie as accurate numbers for regulatory purposes, the fact that a public statement was made that approximately one-third of copper pairs were more than 30 years old by the early part of this century[32] warrants further investigation by the Commission into determining accurate asset lives and not adopting averaged figures that are likely to distort the outcome of the DAC valuation. Given the importance of this review, it would be possible for the Commission to undertake an audit of a statistically valid percentage of the CAN and Core networks to provide an accurate estimate of the remaining life of Telstra's assets.

Further, the Commission has indicated that:

> *the asset lives included in Telstra's RAF are those assumed for depreciation purposes and are not necessarily consistent with actual asset lives. For example, some assets such as ducts and pipes may continue in use after they have been fully depreciated in Telstra's accounts.*[33]

As previously submitted, the Access Seekers consider reliance on approximate data inconsistent with the DAC methodology.

The Access Seekers therefore submit that:

(c) The Commission should obtain the information that it requires to make these appropriate adjustments. For example, the Commission could

[27] Ibid, p 28.
[28] Ibid.
[29] Ibid.
[30] ACCC, *Fixed Line Services Pricing Review Draft Report — Questions and Answers*, "6. Q: How did the ACCC estimate the asset life inputs to the RAB?", available at: http://www.accc.gov.au/content/index.phtml/itemId/951666.
[31] Ibid.
[32] Business Spectator, *Donald McGauchie's speech: 'It's Time To Get Serious about Australia's Next Generation Network'*, published 23 June 2008 at: http://www.businessspectator.com.au/bs.nsf/Article/Donald-McGauchies-speech-FVSM7?OpenDocument.
[33] ACCC, *Fixed Line Services Pricing Review Draft Report — Questions and Answers*, "6. Q: How did the ACCC estimate the asset life inputs to the RAB?", available at: http://www.accc.gov.au/content/index.phtml/itemId/951666.

conduct an audit of Telstra's underground infrastructure to confirm the total and remaining asset lives for those assets.

(d) Alternatively, the Commission must set out the steps it has taken to obtain the information it requires, its assessment of that information as to why it is not reliable to adjust the DAC valuation method, and why no adjustments as described above are justified, when on the available evidence that has been supplied by the Commission, much of the existing network would have been fully depreciated.

4.5 The Commission's reliance on the FHOA

The Access Seekers submit that the Financial Heads of Agreement between Telstra and NBN Co (**FHOA**) is an irrelevant consideration to take into account and does not reasonably assist the Commission in justifying its DAC valuation of $7.5 billion for CAN assets. This is largely due to the vague information that exists on the FHOA, and the fact that it is simply a heads of agreement with insufficient detail that one would require to reasonably compare asset valuations.

The Commission has only referred to a media release from the Minister for Broadband, Communications and the Digital Economy on the details of the FHOA.[34] No relevant figures have been released with respect to the FHOA that the Commission could reasonably rely upon. The Commission notes that the $9 billion payment from NBN Co to Telstra includes payment for backhaul infrastructure and access to Telstra's exchanges, which are not part of the CAN.[35] The Commission reaches the conclusion that deducting the value of these assets from the $9 billion payment would be close to the Commission's $7.5 billion DAC valuation for CAN assets, and that this is likely to satisfy Telstra's commercial interests.[36]

However, the Commission has not specified how it has valued backhaul infrastructure and exchange buildings to be approximately $1.5 billion. Further, although the Commission is required to consider Telstra's commercial interests,[37] it must also have regard to promoting competition and removing obstacles to end-users gaining access to the services.[38] The Access Seekers submit that the Commission's consideration of the FHOA in an uncertain context does not promote the LTIE.

The Access Seekers submit that:

(a) The Commission should not have regard to the FHOA for the purposes of justifying its $7.5 billion figure as a result of its DAC valuation of CAN assets.

(b) Alternatively, the Commission should at least set out in detail the material or other evidence it has relied on to determine that the value of backhaul infrastructure and exchange buildings is approximately $1.5 billion.

(c) If the Commission is of the view that the FHOA is relevant, then a portion of the price that NBN Co will pay Telstra for the use of CAN assets should be

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[34] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, pp 28-29.
[35] Ibid p 29.
[36] Ibid.
[37] *Trade Practices Act 1974* (Cth), s 152AB(6)(b).
[38] *Trade Practices Act 1974* (Cth), ss 152AB(2)(c) and (4).

deducted from the RAB, as to do otherwise, allows Telstra to recover its costs twice.

5. TRANSPARENCY AND REGULATORY CERTAINTY

The Commission has indicated that the LTIE will be promoted where transparency and regulatory certainty is one of the features of its pricing principles.[39] The Access Seekers agree. However, the Access Seekers note a number of instances in the Draft Report where transparency to some of the Commission's decisions is lacking. These are addressed below. In each instance, the Access Seekers request that the Commission supplies in its final report the additional information that is required to sufficiently make the determinations transparent.

5.1 Allocation of revenue requirement to specific services

In setting the initial RAB, the Commission proposes to include CAN Assets and Core Assets which are also used to provide services to non-declared services.[40] The Commission has indicated that "Only a proportion of the cost of these shared assets is allocated to the declared fixed line services."[41] The Commission has adjusted the cost allocation factors from the Analysys Cost Model to remove the effects of optimisation and accommodate for changes in the pattern of demand.[42] Although the Commission outlines generally its approach to adjusting the cost allocation factors from the Analysys Cost Model,[43] it does not specifically detail the calculations that have been applied to derive its adjusted cost allocation factors used to calculate the draft indicative prices. The cost allocation factors have been directly input into the Model, but the underlying worksheets that derive these figures are not transparent. The Access Seekers request that the Commission details in its final report the calculations that have been applied to adjust the cost allocation factors from the Analysys Cost Model. In this regard, the Access Seekers agree with the Frontier Economics submissions at Section 6.2 of its report.

5.2 Forecasting demand

The Commission has indicated that "Reliable demand forecasts are essential in order to calculate accurate cost based unit prices."[44] The Access Seekers agree with the Frontier Economics submissions at Sections 4.1.2 and 4.2 of its report, that the Commission has not disclosed the data that it relies on to forecast PSTN OTA demand, and that it does not have recent actual data for the LCS.[45] The Access Seekers submit that:

(d) The Commission should further detail why it "has assumed that recent trends in PSTN OTA demand will stabilise" and the basis for the rates of decline in demand.

[39] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, pp 13-14.
[40] Ibid p 22.
[41] Ibid.
[42] Ibid p 44.
[43] Ibid pp 88-94.
[44] Ibid p 45.
[45] Ibid p 97.

(e) The Commission should detail the steps it has taken to obtain actual usage data for the LCS and why, if it could not obtain this data, it has chosen to resort to its alternative approach to estimating LCS demand.

Contrary to the Commission's views, the Access Seekers consider that ULLS growth rates will continue or increase. Consumer demand for high speed broadband is growing and will continue to grow as consumers embrace new technology and applications, such as IPTV which each of the Access Seekers are either implementing or exploring. IPTV uses a lot of bandwidth. High backhaul charges mean that access seekers can only provide IPTV to customers on their own DSLAMs. Further, Telstra's WLR, LCS and PSTN exemptions comes into effect in January 2011, and will require implementation of an efficient LSS to ULLS migration process for Telstra to obtain the full benefit of the exemptions. This could add to ULLS SIOs as LSS services are migrated to ULLS. There is also potential that Telstra's actions in implementing these exemptions, e.g. higher WLR, LCS and PSTN prices, may push end-users on to the ULLS in affected exchange service areas.

It is also likely that the proposed significant reductions in WLR and LCS rates will increase demand for those services and, if not reverse, at least slow the switch from fixed line to mobile telephony.

5.3 Rolling forward the RAB and financing capital expenditure

As part of its method of rolling forward the RAB, the Commission incorporates the previous year's capital expenditure plus the half-year WACC adjustment into the RAB.[46] The Commission has indicated that this may overcompensate Telstra for its actual capital costs,[47] and states that "While [it] has not comprehensively investigated the potential impact on the access provider's cashflows in this review, it considers that any potential over-compensation is likely to be minor."[48] The Access Seekers submit that the question of whether Telstra has been appropriately compensated for its actual capital costs is a relevant consideration to take into account. Also the Commission should explain why it considers any over-compensation to be minor.

Further, the Access Seekers agree with the Frontier Economics submissions at Section 2.2 of its report and request that the Commission undertakes an investigation into past compensation recovered by Telstra with respect to its CAN and Core network assets.

5.4 Capital expenditure forecasts

The Access Seekers submit that the Commission's approach of assuming capital expenditure over the regulatory period being approximately the same as the five year average of Telstra's past capital expenditure,[49] is questionable. The Commission has not sufficiently justified why this assumption has been made, other than to say that Telstra could not provide suitable forecasts.[50] The Access Seekers submit that forecasts for capital expenditure are unlikely to be the same as in the past, given Telstra's increasing focus on mobile broadband, the FHOA, the impending NBN rollout, and Telstra's plans to decommission copper in the CAN.

[46] Ibid p 62.
[47] Ibid.
[48] Ibid.
[49] Ibid p 63.
[50] Ibid.

The Access Seekers support the Frontier Economics submissions at Sections 3.2.1-3.2.3 of its report in this regard and consider that Capex will fall.

5.5 Asset lives

The Commission has indicated Telstra was unable to provide reliable information on total and remaining asset lives for CAN and Core assets.[51] As a result, the Commission estimated the asset lives it input into the BBM by using a more conservative average of the figures used in the Analysys Cost Model.[52] The Access Seekers agree with the Frontier Economics submissions at Section 5.2, that the Commission's "conservative" approach is not sufficiently justified. Further, the Access Seekers submit that it is unusual that Telstra was not able to provide reliable information on asset lives, when its corporate accounting instructions would presumably require it to review its asset's lives annually. For example, as part of its submissions in 2006 for the PSTN OTA access undertaking, Telstra submitted a witness statement from the person responsible for conducting asset life reviews of Telstra's assets. The public version of the witness statement indicates that a consultation process is conducted every year[53] whereby Telstra sets the service lives of its various assets as required by Telstra's Corporate Accounting Instructions and in compliance with Accounting Standard ASRB 1021.[54] Further, the asset lives that are determined by this process are used by Telstra for both internal and external reporting purposes,[55] and reviewed by the Australian National Audit Office.[56] The Access Seekers submit that it is likely Telstra continues to conduct this consultation every year, as it also publicly releases financial statements that give some indication of the service life of its assets. Given that Telstra's own published estimates of the 'remaining' service life of its assets in 2009, and in particular the remaining life of its cables and ducts actually exceeds the Commissions figures for 'total' estimated asset life, it appears clear that the Commission is being unduly conservative and favourable to Telstra in its estimate of average asset lives.[57] In light of the apparent inconsistent information provided by Telstra regarding the reliability of the information concerning asset lives, the Access Seekers submit that the Commission should conduct its own audit of Telstra's underground infrastructure to confirm the total and remaining asset lives for those assets.

[51] Ibid p 79.
[52] Ibid.
[53] Undertaking dated 22 March 2006 by Telstra to the ACCC in respect of PSTN OTA, *Telstra asset witness statement*, 15 September 2006, available at: http://www.accc.gov.au/content/index.phtml/itemId/768275, para 5.
[54] Ibid para 6.
[55] Ibid para 5.
[56] Ibid para 10.
[57] For example, Telstra's most recent financial results for the year ended 30 June 2010 give a broad range of 4-30 years as the remaining service life of fixed communication assets (see: Telstra Corporation Limited Financial Results for the Year ended 30 June 2010, Notes to the Financial Statements, available at: http://www.telstra.com.au/abouttelstra/download/document/tls734-telstra-financial-results-for-the-year-ended-30-june-2010.pdf, p 12). These figures are compared to the 2009 figures, which has a range of 4-25 years. Interestingly, Telstra was previously more specific when classifying its assets for depreciation purposes, as the 2009 report specifically lists the service life of cables as 2-30 years, and the service life of main cable ducts and pipes as 31 years (see: Telstra Corporation Limited Financial Results for the Year ended 30 June 2009, Notes to the Financial Statements, available at: http://www.telstra.com.au/abouttelstra/download/document/tls685-fyr2009esultsannouncement.pdf, p 13).

5.6 Operational expenditure forecasts

The Access Seekers submit that in forecasting operational expenditure, the Commission should provide more detail in the following regard:

(a) The Commission has not provided any justification for increasing the average RAF values by 10 percent to reflect an allocation of corporate overheads, nor has it explained why it can assume that Telstra's past operating expenditure reflects efficient levels of expenditure, and why it can be assumed to remain constant over the forecast period.[58] The Access Seekers submit that operational expenditure is unlikely to remain constant over the forecast period, especially in circumstances where it is proposed that the USO Co will pay Telstra a share of up to $100 million per annum to maintain and operate the CAN during transition to the NBN.[59] The Access Seekers also agree with the Frontier Economics submissions under Section 3.3 of its report generally.

(b) As submitted above, it is unreasonable for the Commission to rely on approximate and incomplete RAF data[60] without its disclosure to interested parties. In failing to do so, it is questionable whether the Commission's determination of operational expenditure can be regarded as promoting the LTIE, if transparency and regulatory certainty is lacking.

(c) In late September 2010, it was reported that Telstra intends cutting 6000 staff.[61] This continues Telstra's trend in reducing staff and Opex costs, demonstrated by Telstra reducing its overall workforce by over 12,000 staff in the 5 years to 30 June 2010.[62] It therefore appears likely that Telstra's labour costs will continue to fall and that the Commission's Opex forecasts should rely upon the most recent data available in order to accurately capture this trend.

5.7 Rounding of indicative prices

The Commission has indicated that it has rounded the averaged prices estimated by the Ovum BBM to compensate for the lack of precision in the inputs, and so has taken a conservative approach by rounding up the prices.[63] The Access Seekers agree with the Frontier Economics submissions at Section 9.1 of its report in this regard, and submit that rounding prices in this manner is not justified and is inconsistent with transparency and regulatory certainty in promoting the LTIE.

Taking the ULLS as an example, the table below indicates that Telstra will receive an annual windfall of over $8 million purely as a result of the Commission unnecessarily rounding up its prices. Over the four year time frame of the proposed indicative prices this equates to a windfall of over $32 million for the ULLS, and this

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[58] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, p 81.

[59] Policy Statements: *Department of Broadband, Communications and the Digital Economy: USO policy framework*, 17 September 2010, available at: http://www.dbcde.gov.au/broadband/national_broadband_network/policy_statements.

[60] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, p 81.

[61] See: http://www.brisbanetimes.com.au/business/telstra-shares-plumb-new-low-amid-job-cut-talk-20100930-15y2a.html

[62] Telstra Corporation Limited, Full year results and operations review - June 2010, p.20.

[63] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, p 101.

figure is conservative as the Commission has forecast the total number of ULLS SIOs to grow to **[start c-i-c]** redacted **[end c-i-c]** by 2013/14.[64] Additional windfalls to Telstra are expected, since the prices for WLR, LCS and PSTN OTA have also been significantly rounded up, and this does not even take into account the grossly exaggerated monthly charge for the LSS.

Impact of rounding indicative prices

ULLS Band	Unit cost from BBM	Rounding applied	Draft indicative price	SIOs[65]	Annual windfall to Telstra
1	$6.26	+$0.24	$6.50	35,061	$100,975.68
2	$15.17	+$0.83	$16.00	780,459	$7,773,371.60
3	$29.67	+$1.33	$31.00	11,689	$186,556.44
4	$94.81	+$5.19	($100.00)	124	$7,722.72
Totals:				827,333	$8,068,626.44

5.8 Draft indicative connection and disconnection charges

The Commission has indicated that it has already conducted a detailed review of the appropriate indicative connection and disconnection charges in previous consultations.[66] As such, the Commission's proposed indicative prices simply adopt the Commission's previous approach whilst taking into account the likely change of labour costs and contractor charges over time, wage growth in the communications sector and inflation.[67] The Access Seekers submit that for the purposes of ensuring transparency and a fair rate of return on investment to promote the LTIE, the Commission should provide more detail on how its indicative prices have been derived. For example, the Commission should clearly set out the actual data that it has relied on and the calculations that have been applied to the current indicative prices.

[64] Ovum BBM.

[65] ACCC, *Snapshot of Telstra's customer access network as at 30 June 2010*, Table 1: SIO, ULLS and LSS information by ULLS band.

[66] ACCC, *Review of the 1997 telecommunications access pricing principles for fixed line services*, Draft report, September 2010, p 105.

[67] Ibid.