



Australian
Competition &
Consumer
Commission

ULLS and LSS Access Disputes
Chime Communications Pty Ltd / Telstra
Reasons for Final Determinations

November 2012



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Abbreviations and terms

Access Dispute Guidelines	Australian Competition and Consumer Commission, <i>Resolution of telecommunications access disputes — a guide</i> , March 2004 (revised)
Access Seeker	Chime Communications Pty Ltd
Commission	Australian Competition and Consumer Commission
CACS Act	<i>Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Act 2010</i>
CCA	<i>Competition and Consumer Act 2010</i>
CRA	customer relationship agreement
Consultation Paper	Unconditioned Local Loop Service and Line Sharing Service Access disputes Consultation paper on draft final determinations, May 2012
ESAs	exchange services areas
FAD	final access determination
FD	final determination
LSS	line sharing service
LTIE	long-term interests of end-users
MDF	main distribution frame
NBN	national broadband network
SAO	standard access obligation
Telco Act	<i>Telecommunications Act 1997</i>
Telstra	Telstra Corporation Limited
Tribunal	Australian Competition Tribunal
TSLRIC	total service long run incremental cost
ULLS	unconditioned local loop service
WACC	weighted average cost of capital
WLR	wholesale line rental

Currency contained in this report is Australian dollars (AUD) unless otherwise stated.

References to legislation in this document are references to the *Competition and Consumer Act 2010* (CCA) unless otherwise stated.

1 Introduction

1.1 Purpose

Chime Communications Pty Ltd (Access Seeker) and Telstra Corporation Limited (Telstra) (together, the parties) are in dispute over the monthly price of use of the internal interconnection cable (the IIC) in relation to access to the declared services unconditional local loop service (ULLS) and line sharing service (LSS). The disputes between the parties were notified to the Australian Competition and Consumer Commission (Commission) for arbitration.

The Commission considers that the notification of the disputes between the parties are valid and that the Commission has jurisdiction to make final determinations (FDs) for the disputes. Detailed analysis of the Commission's jurisdiction is provided in **Section 3** of this statement of reasons.

In addition to Chime Communications Pty Ltd, disputes were also lodged in relation to the ULLS and/or the LSS by six other access seekers.¹ The Commission decided to hold a joint arbitration hearing for all 13 disputes lodged in respect of the IIC charge.² In this statement of reasons the disputes lodged by these seven access seekers in relation to the IIC charge will collectively be referred to as the 'Access Disputes'.³

All seven of these access seekers are represented by Herbert Geer. When referring to submissions in this statement of reasons, the submissions made by Herbert Geer on behalf of the Access Seeker will be referred to as being made by Herbert Geer.

Submissions were also made by economic advisors (Gibson Quai and Frontier Economics) engaged by the seven access seekers. These submissions will be referred to as being made by 'Gibson Quai' and 'Frontier Economics' respectively.

FDs under repealed section 152CP of the *Competition and Consumer Act 2010* (CCA) have now been made relating to the terms and conditions of access by the Access Seeker to the declared services.⁴ This paper sets out the reasons for making the FDs between the parties and the Commission's views on the submissions received during the arbitration hearing. In making the FDs between the parties and forming its reasons the Commission has had regard to the submissions made by Herbert Geer, Gibson Quai and Frontier Economics on behalf of the Access Seeker, and submissions made by Telstra.

¹ Adam Internet Pty Ltd, Agile Pty Ltd, Network Technology (Aust) Pty Ltd, Wideband Networks Pty Ltd, TPG Internet Pty Ltd and Netspace Networks Pty Ltd.

² Section 152DMA of the CCA.

³ The 13 Access Disputes comprising the joint arbitration hearing were: between Telstra and each of Adam Internet Pty Ltd, Agile Pty Ltd, Chime Communications Pty Ltd, Network Technology (Aust) Pty Ltd, Wideband Networks Pty Ltd and TPG Internet Pty Ltd in relation to the ULLS and LSS (12 disputes); and between Telstra and Netspace Networks Pty Ltd in relation to the LSS only (1 dispute).

⁴ Section 152CV of the CCA was repealed but remained in force for the purpose of arbitration of access disputes. See **Section 1.2** for more details. The same applies to all other repealed provisions in the CCA that are referenced in this paper.

1.2 Relevant legislative framework

The Commission has considered the disputes between the parties under Division 8 of Part XIC of the CCA. The *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Act 2010* (CACS Act) repealed Division 8, however subitems 207 and 208 of Schedule 1 of the CACS Act continues the operation of Division 8 for access disputes notified prior to the Commission making final access determinations (FADs) that cover declared services, in this case the ULLS and LSS. In this statement of reasons, references to sections of the CCA may include references to those repealed sections.

Under Division 8 of Part XIC of the CCA, the Commission must make a written determination relating to the disputes between the parties.⁵

Subitem 207(4) of the CACS Act provides that an FD must specify an expiry date.

Subitem 207(7) of Schedule 1 of the CACS Act provides that an FAD that is inconsistent with an arbitration determination will have no effect to the extent of the inconsistency. The Commission considers that the FDs are consistent with the terms and conditions of the FADs for ULLS and LSS and will not affect the operation of the FADs.

1.2.1 Legislative criteria

Subsection 152CP(2) of the CCA provides that the determination may deal with any matter relating to access by an access seeker to the declared service, including matters that were not the basis for notification of the dispute.

Subsection 152CR(1) of the CCA requires the Commission to take the following matters into account in making a final determination:

- a) whether the determination will promote the long-term interests of end users (LTIE) of carriage services or of services supplied by means of carriage services
- b) the legitimate business interests of the carrier or provider, and the carrier's or provider's investment in facilities used to supply the declared service
- c) the interests of all persons who have rights to use the declared service
- d) the direct costs of providing access to the declared service
- e) the value to a party of extensions, or enhancement of capability whose cost is borne by someone else
- f) the operational and technical requirements necessary for the safe and reliable operation of a carriage service, or a telecommunications network or a facility, and
- g) the economically efficient operation of a carriage service, a telecommunications network or a facility.

Subsection 152CR(2) of the CCA provides that the Commission may take into account any other matters that it thinks are relevant.

Section 152CQ of the CCA sets out restrictions on access determinations.

⁵ Section 152CP(1) of the CCA.

Subsection 152AQA(6) of the CCA requires the Commission to have regard to a pricing principles determination (made in accordance with subsection 152AQA(1)) in the event that the Commission is required to arbitrate an access dispute under Division 8 in relation to the declared service.

There were pricing principles determinations for the ULLS and LLS in force until 31 December 2010.⁶ These determinations specified the monthly charge and various connection and disconnection charges for the ULLS and LSS. The determinations did not specify charges for the IIC service. The principles are not relevant because they do not address the IIC charge. From 1 January 2011, subsection 152AQA(1) of the CCA was repealed by the CACS Act and so there are no pricing principles determinations for the period from 1 January 2011.

Subsection 152CP(4) of the CCA requires the Commission to give a draft determination to the parties before making a determination.

Subsection 152CP(5) of the CCA requires that when the Commission makes a determination it must give the parties to the arbitration its reasons for making the determination.

1.2.2 Notification criteria

Subsections 152CM(1) and 152CM(2) of the CCA (the notification provisions) provide that an access dispute may be notified to the Commission for arbitration if:

- a declared service is supplied by the carrier or carriage service provider,
- one or more standard access obligations (SAOs) apply to the declared service, and
- an access seeker is unable to agree with the carrier or carriage service provider:
 - about the terms and conditions on which the provider is to comply with those SAOs (subsection 152CM(1)), or
 - about one or more aspects of access to the declared service (subsection 152CM(2)).

1.3 Background and consultation process

On 22 December 2010, the Access Seeker notified the Commission of its IIC disputes with Telstra in relation to the ULLS and LSS. These disputes each concerned the IIC charge. The notifications lodged by the Access Seeker stated the parties had commenced negotiations on 2 December 2010 regarding the IIC charge and remain unable to resolve the disputes.⁷

On 14 January 2011, the acting Chairman of the Commission constituted the Commission for the purpose of conducting the arbitration under section 152CV of the

⁶ ACCC, *Pricing Principles for the Unconditioned Local Loop Service (ULLS) Determination 2009*, December 2009. ACCC, *Pricing Principles for the Line Sharing Service (LSS) Determination 2009*, December 2009.

⁷ Chime Communications Pty Ltd, *Notification of an access dispute under Part XIC of the Trade Practices Act 1974 (Act), Unconditioned Local Loop Service (ULLS)*, 22 December 2010, pp. 3-4; Chime Communications Pty Ltd, *Notification of an access dispute under Part XIC of the Trade Practices Act 1974 (Act), Line Sharing Service (LSS)*, 22 December 2010, pp. 3-4.

CCA. This Commission comprised Commissioner Edward Willett and Commissioner Joe Dimasi.

On 14 January 2011, it was also determined that all of the Access Disputes regarding the IIC charges would be heard together in a joint arbitration hearing pursuant to section 152DMA of the CCA.

On 21 January 2011, the Commission issued to the parties a confidentiality order and a direction to produce customer relationship agreement (CRA) documents.⁸ Further directions to produce information were issued to the parties between July 2011 and March 2012.

On 11 May 2012 Telstra provided a submission to the Commission.⁹

On 21 May 2012 the Commission issued a consultation paper seeking submissions on the content of the FD (Consultation Paper).¹⁰ The Commission provided to the parties two draft final determinations with the Consultation Paper, one for the LSS and one for ULLS (the Draft Determinations).

Both parties then provided submissions in response to the Consultation Paper on 18 June 2012 and submissions in reply on 2 July 2012. A full chronology of the consultation process is outlined in Appendix [A].

2 Preliminary matters

2.1 Unconditioned local loop service (ULLS)

The ULLS is the declared service purchased by access seekers to provide voice and/or data services to consumers utilising a Telstra copper pair from an end-user premise to a Telstra exchange building. The copper pair terminates on a main distribution frame (MDF) and is jumpered across to the equipment side of the MDF from where an IIC takes the pair to the access seeker's intermediate distribution frame (IDF).

The service description for the declared ULLS is as follows:¹¹

The ULLS is the use of unconditioned communications wire between the boundary of a telecommunications network at an end-user's premises and a point on a telecommunications network that is a potential point of interconnection located at or associated with a customer access module and located on the end user side of the customer access module.

boundary of a telecommunications network is the point ascertained in accordance with section 22 of the *Telecommunications Act 1997*;

communications wire is a copper based wire forming part of a public switched telephone network;

customer access module is a device that provides ring tone, ring current and battery feed to customers' equipment. Examples are Remote Subscriber Stages, Remote Subscriber Units, Integrated Remote Integrated Multiplexers, Non-integrated Remote Integrated Multiplexers and the customer line module of a Local Access Switch;

⁸ The orders and directions were made pursuant to paragraphs 152DC(1)(a) and (f), subsection 152DC(3) and subsection 152DMA(5) of the CCA.

⁹ This submission was received on May 11 but could not be considered by the Commission prior to the release of the Consultation Paper. As set out below, this submission was considered by the Commission prior to FD's being made in these Access Disputes.

¹⁰ ACCC, *Unconditioned Local Loop Service and Line Sharing Service Access disputes Consultation paper on draft final determinations*, May 2012 (Consultation Paper).

¹¹ ACCC, *Fixed Services Review Declaration Inquiry final decision (July 2009)*, Appendix B, p. 122.

public switched telephone network is a telephone network accessible by the public providing switching and transmission facilities utilising analogue and digital technologies.

The Commission considers that the IIC is not part of the ULLS. However, supply of the ULLS is not possible without the IIC connecting the copper pair to the access seeker's equipment.¹²

The ULLS has been a declared service since 1999. The current ULLS declaration is due to expire on 31 July 2014.

An FAD under section 152BC of the CCA covering the terms and conditions of access to the ULLS came into effect on 20 July 2011 and expires on 30 June 2014. See **Section 2.4** for more information on the ULLS FAD.

2.2 Line sharing service (LSS)

The LSS is the declared service that allows an access seeker to utilise the high frequency (data) segment of the signal over Telstra copper pairs to end-users without using the low frequency (voice) component. In the exchange, a copper pair is typically jumpered to the equipment side of the MDF and then an IIC pair takes the service to the access seeker's IDF. The signal on the copper pair is then split and an additional IIC pair takes the voice component of the service back to the MDF where it can be jumpered to Telstra or other access seekers.

The service description for the declared LSS is as follows:¹³

The High Frequency Unconditioned Local Loop Service is the use of the non-voiceband frequency spectrum of unconditioned communications wire (over which wire an underlying voiceband PSTN service is operating) between the boundary of a telecommunications network at an end-user's premises and a point on a telecommunications network that is a potential point of interconnection located at, or associated with, a customer access module and located on the end-user side of the customer access module.

boundary of a telecommunications network is the point ascertained in accordance with section 22 of the *Telecommunications Act 1997*;

communications wire is a copper or aluminium wire forming part of a public switched telephone network;

customer access module is a device that provides ring tone, ring current and battery feed to customers' equipment. Examples are Remote Subscriber Stages, Remote Subscriber Units, Integrated Remote Integrated Multiplexers, Non-integrated Remote Integrated Multiplexers and the customer line module of a Local Switch;

public switched telephone network is a telephone network accessible by the public providing switching and transmission facilities utilising analogue and digital technologies;

voiceband PSTN service is a service provided by use of a public switched telephone network and delivered by means of the voiceband portion of the frequency spectrum of a metallic line.

The Commission considers that the IIC is not part of the LSS. However, supply of the LSS is not possible without the IIC connecting the copper pair to the access seeker's equipment.¹⁴

The LSS has been a declared service since 2002. The current LSS declaration is due to expire on 31 July 2014.

¹² This view is considered further in section 3.2 below.

¹³ ACCC, *Fixed Services Review Declaration Inquiry final decision (July 2009)*, Appendix C, p. 123.

¹⁴ This view is considered further in section 3.2 below.

An FAD covering the terms and conditions of access to the LSS came into effect on 20 July 2011 and expires on 30 June 2014. See **Section 2.4** for more information on the LSS FAD.

2.3 Internal interconnection cable (IIC)

Telstra describes the IIC as a twisted copper pair cable owned and operated by Telstra (but provided and installed initially by the relevant access seeker) to connect a point of interconnection in the relevant access seeker's equipment space to Telstra's MDF (or its equivalent).¹⁵

The IIC is ultimately used by wholesale customers to connect Telstra's customer access network (CAN) to access seekers' Digital Subscriber Line Access Multiplexers (DSLAMs) and other equipment housed in Telstra's exchanges.¹⁶

2.4 Final access determinations (FADs)

By operation of item 207 of Schedule 1 of the CACS Act, even though provisions including section 152CP are repealed, the Commission can still make FDs in relation to access disputes notified in relation to declared services if they are notified to the Commission prior to FADs for the declared services being made.¹⁷

On 20 July 2011 the Commission made FADs for the ULLS and LSS under section 152BC of the CCA.¹⁸ The disputes between the parties were therefore notified to the Commission in relation to the ULLS and/or the LSS declared services prior to the making of these FADs.

Under subitem 207(12) of Schedule 1 of the CACS Act, when the Commission has commenced a public inquiry into making the FADs, it can terminate access disputes for these services.

The Commission did not terminate the Access Disputes and did not specifically consider the issue of the IIC charge in making the FADs. The Commission has not considered the IIC charge in any other context prior to the notification of these Access Disputes.

The FADs expire on 30 June 2014. The Commission is of the view that 30 June 2014 is also an appropriate date for the final determination of the Access Disputes to expire. The reasons for this view are set out below in **section 5.2**.

In reaching its FDs in the disputes between the parties the Commission has had regard to the content of the FADs for the ULLS and LSS declared services. Unless otherwise stated, a reference to FADs in this statement of reasons refers to both ULLS and LSS FADs.

¹⁵ Telstra, *LSS/ULLS Access Disputes - Internal Interconnection Cable (IIC) charge — Letters to ACCC*, 4 February 2011, p. 4.

¹⁶ Telstra, *Joint arbitration hearing of ULLS and LSS Access Disputes - Internal Interconnection Cable charge – Direction to provide information - letter to the ACCC*, 13 February 2012, p. 3 of Annexure C entitled: Telstra's Internal Interconnection Cable Cost.

¹⁷ Subitem 207(3)(d) of the CACS Act.

¹⁸ See the ULLS and LSS FADs available at:
<http://www.accc.gov.au/content/index.phtml/itemId/998510>.

3 Jurisdiction

The Commission's jurisdiction to arbitrate the disputes between the parties

3.1 Commission's preliminary view

In the Consultation Paper, the Commission expressed the preliminary view that:

- the notification of the disputes by the Access Seeker are valid under subsection 152CM(1) of the CCA as the IIC charge is a price term relating to Telstra's standard access obligations, specifically the IIC relates to the interconnection of facilities obligations under subsection 152AR(5) of the CCA;
or in the alternative
- the notification of the disputes by the Access Seeker are valid under subsection 152CM(2) of the CCA as the IIC charge is an aspect of access to a declared service, because the IIC is a necessary component in the supply of ULLS and LSS; and
- the Commission therefore has jurisdiction under subsection 152CP(2) of the CCA to make FDs in the disputes between the parties.¹⁹

3.2 Issues raised in further submissions and the Commission's final views

Throughout the joint arbitration process, Telstra has maintained that the Commission lacks jurisdiction because the notifications by the Access Seeker under Part XIC of the CCA were invalid for the reasons set out in their submissions considered below. In its further submissions, Telstra also submitted that the Commission does not have jurisdiction to make a determination because the price of the IIC does not 'relate to access' to the ULLS or LSS.²⁰

Does the IIC form part of the ULLS/LSS? Can the notification by the Access Seeker be valid if the IIC does not form part of the ULLS/LSS?

In the Consultation Paper the Commission noted that while the IIC is not included within the service description of ULLS or LSS the IIC is essential to access seekers in being able to provide services using the ULLS and LSS.²¹

Telstra submitted that the IIC does not form part of the ULLS or LSS.²² Telstra's argument that the Commission does not have jurisdiction to make a determination in the disputes between the parties (considered below) rely in part on this submission.

Herbert Geer submitted that while the IIC is not in itself a declared service this did not preclude a dispute being notified to the Commission.²³ It submitted the IIC was

¹⁹ Consultation Paper, p.12-13.

²⁰ Telstra, *Unconditioned Local Loop Service (ULLS) & Line Sharing Service (LSS) Access Disputes – Internal Interconnection Cable (IIC) Charge Submissions of Telstra in response to the Draft Determination - Confidential version*. 18 June 2012, [12].

²¹ Consultation Paper, p.10.

²² Telstra submission, 18 June 2012, [13] & [79].

necessary for the granting of access to the ULLS and LSS and the parties' inability to agree on the charge for the IIC is an inability to agree "about the terms and conditions on which the carrier or provider is to comply with [the SAOs] within s152CM(1)(c)".²⁴

The Commission's final view is that the IIC does not have to be part of a declared service to meet the notification prerequisites set out in subsections 152CM(1) or 152CM(2) of the CCA.²⁵ The Commission's view is that the IIC does not form part of the ULLS or LSS but is necessary in order for access seekers to access the ULLS/LSS and provide services to end users, and the IIC is therefore used in connection with the supply of a declared service. As the IIC is used in order to provide a carriage service, it relates to an aspect of access.

Does the IIC charge relate to access to the ULLS/LSS for the purposes of subsection 152CP(2)? Does the IIC charge meet the notification prerequisite of being an 'aspect of access' to the ULLS/LSS for the purposes of subsection 152CM(2)? Are the notifications by the Access Seeker valid?

Telstra submitted that the IIC does not meet the prerequisite of 'relating to access' or being an 'aspect of access' to the ULLS/LSS and thus the Commission does not have the jurisdiction to arbitrate the disputes between the parties.²⁶

Subsection 152CP(2) limits the extent of matters on which the Commission can make a determination. Subsection 152CP(2) is set out as follows (emphasis added):

152CP(2) The determination may deal with any matter ***relating to access*** by the access seeker to the declared service including matters that were not the basis for notification of the dispute. For example, the determination may:

- (a) require the carrier or provider to provide access to the declared service by the access seeker; or
- (b) require the access seeker to accept, and pay for, access to the declared service; or
- (c) specify the terms and conditions on which the carrier or provider is to comply with any or all of the standard access obligations applicable to the carrier or provider; or
- (d) specify any other terms and conditions of the access seeker's access to the declared service; or
- (e) require a party to extend or enhance the capability of a facility by means of which the declared service is supplied; or
- (f) specify the extent to which the determination overrides an earlier determination relating to access to the declared service by the access seeker.

Telstra submitted that the IIC charge is separate from the ULLS and LSS and the IIC can be provided even if no ULLS or LSS is provided.²⁷ On this basis Telstra

²³ Herbert Geer submission, *ULLS and LSS access disputes concerning the internal interconnect cable charge. Access Seeker submission in response to the ACCC's consultation paper on the draft final determinations*, 18 June 2012, p.5.

²⁴ Herbert Geer Submission 18 June 2012, pp.5-7; Herbert Geer refer to the judgment of Lindgren J in *Telstra Corporation Limited v Australian Competition and Consumer Commission* (2009) 179 FCR 437.

²⁵ The notification prerequisites are set out above in **section 1.2.2**.

²⁶ Telstra submission, 18 June 2012, [13].

²⁷ Telstra submission, 18 June 2012, [79] & [83].

submitted that extending the meaning of ‘relating to access’ to include the IIC stretches the concept too far.²⁸

Telstra submitted that the Federal Court precedent relied on by the Access Seeker is distinguishable from the disputes between the parties on a number of bases.²⁹ In regard to subsection 152CP(2) Telstra’s argument appears to be that the Commission does not have jurisdiction because this precedent establishes that the concept of ‘relating to access’ in subsection 152CP(2) is not broad enough to extend to include the IIC.³⁰

Subsection 152CM(2) is set out as follows (emphasis added):

- (2) If:
- (a) a declared service is supplied, or proposed to be supplied, by a carrier or a carriage service provider; and
 - (b) one or more standard access obligations apply, or will apply, to the carrier or provider in relation to the declared service; and
 - (c) an access seeker is unable to agree with the carrier or provider about one or more *aspects of access* to the declared service;
- then:
- (d) the access seeker; or
 - (e) the carrier or provider;
- may notify the Commission in writing that an access dispute exists.

Telstra submitted that the subject matter of the disputes between the parties is a charge for a facility used in conjunction with the declared service. Telstra argued that if a facility is required in order to supply the ULLS or LSS this does not lead to the conclusion that a charge for the facility is an aspect of access to the declared ULLS or LSS. On this basis Telstra conclude the IIC charge is not an aspect of access to a declared service.³¹

Telstra therefore submitted that the notifications by the Access Seeker were not valid under subsection 152CM(2).³²

Herbert Geer submitted that Telstra incorrectly characterised the IIC as a facility that should be regarded as distinctly separate from the declared services that the IIC is used to supply.³³

Herbert Geer submitted that Telstra’s arguments relied too heavily on this characterisation and Telstra’s submissions referring to terms such as ‘relating to access’ and ‘aspect of access’ were narrow interpretations of provisions of the CCA which were intended to provide the Commission with the power to arbitrate a broad range of disputes.³⁴

²⁸ Telstra submission, 18 June 2012, [83].

²⁹ Telstra submission, 18 June 2012, [81]-[83]; Telstra refer to the judgment of Lindgren J in *Telstra Corporation Limited v Australian Competition and Consumer Commission* (2009) 179 FCR 437 in response to the submissions about this precedent made by Herbert Geer.

³⁰ Telstra submission, 18 June 2012, [81]-[83].

³¹ Telstra submission, 18 June 2012, [84]-[87].

³² Telstra submission, 18 June 2012, [80] and [84].

³³ Herbert Geer Submission, *ULLS and LSS access disputes concerning the internal interconnect cable charge. Access Seekers’ reply to Telstra’s submission of 18 June 2012 that was in response to the Commission’s consultation paper on the draft final determinations*, 2 July 2012, p.2.

³⁴ Herbert Geer submission 2 July 2012, pp.2-3

Herbert Geer submitted that whether something was an aspect of access was a simple concept and the IIC was an aspect of access to the ULLS and LSS.³⁵ Its submission noted that the IIC terminated on the exchange MDF for the purposes of providing access and the IIC is required to supply access to these services.³⁶

The ACCC has considered Telstra's submission that the IIC is a facility. The ACCC takes the view that the IIC cable can be characterised as a facility, however, use of the IIC (to provide a communications service) can be characterised as a service.³⁷

The ACCC notes this view is consistent with the submissions made by Herbert Geer.

In terms of the requirements of subsection 152CP(2) of the CCA, the Commission's final view is that the IIC charge relates to the ULLS and LSS because the IIC is necessary to provide access to the ULLS and LSS, which are declared services.³⁸

In relation to subsection 152CM(1) of the CCA, the Commission's final view is that the IIC charge can be characterised as a price term relating to Telstra's standard access obligations, specifically the IIC relates to the interconnection of facilities, which is a standard access obligation under subsection 152AR(5) of the CCA.

In relation to subsection 152CM(2) of the CCA, the Commission's final view is that while the IIC cable can be characterised as a facility the IIC charge can be considered an aspect of access to the relevant declared service because the IIC is a necessary component in the supply of ULLS and LSS.³⁹

Consistent with its view set out in the Consultation Paper, the Commission therefore considers the notifications by the Access Seeker are valid under subsection 152CM(1) or in the alternative subsection 152CM(2) and disagrees with Telstra's submission that the IIC does not relate to access to the ULLS and LSS for the purposes of subsection 152CP(2).

Does the Commission's jurisdiction to make an FD apply where the interconnection SAO in subsection 152AR(5) applies to a facility?

Subsection 152AR(5) contains the interconnection SAO.⁴⁰ Telstra submitted that if subsection 152AR(5) of the CCA applies to the IIC then it applies to the IIC facility and not a declared service. It submitted that as the IIC is a facility properly regulated under the *Telecommunications Act 1997* (Telco Act), the Commission's jurisdiction to make an FD does not apply because the IIC charge does not relate to access to the declared service.⁴¹

³⁵ Herbert Geer submission 2 July 2012, p.3.

³⁶ Herbert Geer submission 2 July 2012, p.3.

³⁷ Section 7 of the Telco Act and section 44B of the CCA.

³⁸ The notification requirement in subsection 152CM(1) is described in section 1.2.2.

³⁹ The notification requirements in subsection 152CM(2) is described in section 1.2.2 and set out in full in section 3.1.

⁴⁰ In general subsection 152AR(5) of the CCA prescribes that an access provider must permit interconnection to its facilities for the purpose of enabling an access seeker to be supplied with the active declared service and take reasonable steps to ensure interconnection is provided such that access seekers are provided a service which is equivalent to what the access provider provides itself.

⁴¹ Telstra submission, 18 June 2012, [88].

Herbert Geer submitted that subsection 152CP(2) of the CCA is broad enough for the Commission to have jurisdiction to make determinations about a facility, as long it relates to access to a declared service.⁴²

Herbert Geer further submitted that the Commission can make determinations dealing with how Telstra complies with its interconnection SAO with regard to the IIC *or* relating to access to the ULLS or LSS, which requires the IIC. In addition, because the disputes between the parties concerned the terms and conditions on which Telstra complies with its interconnection SAO, or alternatively, aspects of access to the ULLS and LSS, Herbert Geer argued that notification under both or either of subsections 152CM(1) and 152CM(2) of the CCA are valid.⁴³

The Commission does not accept Telstra's argument that because the IIC is a facility, the IIC charge does not relate to a declared service. In this regard the Commission considers that it is significant that the IIC is essential to access seekers in being able to provide services using the ULLS and LSS. ULLS and LSS cannot be provided without the IIC. The Commission's view remains that the IIC charge can be considered a price term relating to Telstra's standard access obligations in relation to the declared services, specifically the interconnection of facilities obligations under subsection 152AR(5) of the CCA.

The Commission's final view is that the notifications are valid under subsection 152CM(1) or alternatively subsection 152CM(2) of the CCA and the Commission has jurisdiction to make FDs under subsection 152CP(2) of the CCA.

Does subsection 152CP(3) of the CCA prohibit the Commission from making FDs?

Subsection 152CP(3)(b) of the CCA provides that a determination by the Commission must not require a carrier to provide access to the declared service if the same requirement is already imposed by any other law of the Commonwealth.

Telstra submitted that the facilities access regime under the Telco Act is a more appropriate regime for the resolution of disputes as to the terms and conditions for access to facilities than the arbitration regime of the CCA. It also submitted that subsection 152CP(3) of the CCA prohibits the Commission from making an FD because the facilities access regime in the Telco Act is a law of the Commonwealth that imposes a requirement to provide access to the IIC facility for the purposes of subsection 152CP(3).⁴⁴

Telstra argued that the separate regimes in the Telco Act and the CCA are directed at different subject matters and processes. It further argued that the resolution of disputes about terms and conditions of access to a facility is properly dealt with under the Telco Act, and the legislation should be construed by the Commission to avoid substantial overlap.⁴⁵

Herbert Geer submitted the CCA provided a broader mechanism for resolving access disputes. It noted that a carrier licence was not required to obtain access to the

⁴² Herbert Geer submission 2 July 2012, p.3.

⁴³ Herbert Geer submission 2 July 2012, pp.4-5; Herbert Geer refer to the judgment of Lindgren J in *Telstra Corporation Limited v Australian Competition and Consumer Commission* (2009) 179 FCR 437.

⁴⁴ Telstra Submission 18 June 2012, [13], [89]-[93]; Telco Act Schedule 1, Part 3, Sections 17(1) and 18.

⁴⁵ Telstra Submission 18 June 2012, [89]-[92].

ULLS/LSS.⁴⁶ As a carrier licence is required for the regime under the Telco Act to apply, Herbert Geer submitted that Telstra's interpretation of subsection 152CP(3) of the CCA meant the class of access seekers who do not hold a carrier licence may have no recourse to resolve a dispute over the IIC.⁴⁷

Herbert Geer submitted that 'facility' is defined broadly under the CCA and Telco Act and overlap between the regimes is inevitable. It argued subsection 152CP(3) would not be contravened because the Commission's FDs would not require or enforce access to the IIC, but would set a price for that access.⁴⁸

The Commission does not accept the arguments that either the characterisation of the IIC as a facility, or the existence of the access regime in the Telco Act, precludes the Commission from making FDs under the CCA regime in the disputes between the parties. The Commission agrees with the submission made by Herbert Geer that the nature of the FDs is to set the charge for the IIC and the FDs do not require Telstra to provide access to the declared services or Telstra's facilities.

The Commission notes this interpretation ensures access seekers who do not hold a carrier licence have recourse to resolve disputes under an access regime.

3.3 Conclusion on jurisdiction

The Commission concludes that the notifications by the Access Seeker are valid under subsection 152CM(1) or alternatively subsection 152CM(2) of the CCA.

The Commission considers the FDs fall within the scope of subsection 152CP(2) of the CCA, that is, the FDs relate to access by the Access Seeker to the ULLS and LSS. Specifically, under paragraph 152CP(2)(c) of the CCA the Commission may make an FD specifying terms and conditions on which the carrier is to comply with the SAOs.

4 Pricing

4.1 Price for IIC Charge

4.1.1 Introduction

The appropriate level for the IIC charge is the key area of dispute in this arbitration.

The IIC charge is included in Telstra's relevant Customer Relationship Agreement (CRA) as the Interconnection Cable Annual Charge and is described as a charge for housing, maintenance and management of an Interconnection Cable.⁴⁹

The current IIC charges levied by Telstra are set out in Table 4.1 below. The amounts charged vary slightly between different access seekers. [c-i-c] [c-i-c]

Table 4.1: Current IIC charge per annum (as per latest CRAs provided to the Commission)

⁴⁶ Herbert Geer submission, 18 June 2012. P6-7; Herbert Geer refer to the judgment of Lindgren J in *Telstra Corporation Limited v Australian Competition and Consumer Commission* (2009) 179 FCR 437.

⁴⁷ Herbert Geer Submission 18 June 2012, pp.7-10; In its submissions in reply Herbert Geer reiterates that some Access Seekers acquired the IIC service from Telstra on the basis that they do not hold carrier licenses and therefore may not have access to a dispute resolution regime if Telstra's submissions were accepted, Herbert Geer submission, 2 July, pp.3-5.

⁴⁸ Herbert Geer submission 2 July 2012, p.5.

⁴⁹ For example, CRA 20 or CRA 22.

Adam	Agile	Chime	Netspace	Network Technology	TPG	Wideband
[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]				

According to submissions received by the Commission, the pricing proposals for the IIC charge are as follows:

Table 4.2: Pricing proposals for the IIC charge (as per access dispute notifications)

Access Seeker	Offer from Telstra	IIC charge sought by Access Seeker
Adam	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Agile	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Chime	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Netspace	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Network Technology	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
TPG	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Wideband	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]

Access seekers, including Chime Communications Pty Ltd, have submitted that the IIC charge should be [c-i-c] [c-i-c], citing a number of factors, including that Chime Communications Pty Ltd “pays for the IIC and its installation, it has paid for maintenance which has been at most nominal ... and Telstra has fully recovered its costs associated with the IIC via the network component costs included in charges for services such as ULLS.”⁵⁰

Telstra has submitted that the price should be [c-i-c] [c-i-c] per IIC pair per month. Telstra submitted that Telstra’s charges for the IIC service were and continue to be set at commercially agreed rates and were not set in accordance with any cost model.⁵¹

Telstra has also submitted an IIC cost model (submitted on 13 February 2012) that supports its proposed charge of [c-i-c] [c-i-c]. A detailed description of this model was included in the Commission’s Consultation Paper and is reproduced in Appendix B. The model identifies three cost components for the IIC:⁵²

- The housing of the MDF block and verticals
- Capital and operational and maintenance (O&M) costs for ancillary equipment, and
- Maintenance and management of the IIC.

As stated in the Consultation Paper, Telstra’s proposed approach to estimating the charge is based on a Total Service Long Run Incremental Cost (TSLRIC) -type

⁵⁰ For example, Chime Communications Pty Ltd, *Notification of an access dispute under Part XIC of the Trade Practices Act 1974 (Act), Unconditioned Local Loop Service (ULLS)*, 22 December 2010, pp. 3-4; Chime Communications Pty Ltd, *Notification of an access dispute under Part XIC of the Trade Practices Act 1974 (Act), Line Sharing Service (LSS)*, 22 December 2010, pp. 3-4.

⁵¹ Telstra, Letter to ACCC, Annexure C - Telstra’s Internal Interconnection Cable Cost, 13 February 2012, p. 3.

⁵² Telstra, Letter to ACCC, Annexure C - Telstra’s Internal Interconnection Cable Cost, 13 February 2012, p. 3.

approach, which builds up an estimate of the cost based on the incremental use of relevant assets and other costs to derive a charge for a particular IIC pair.

Telstra estimated a cost of providing land and building facilities for housing blocks and verticals of the MDF used to terminate IIC pairs. Telstra estimated this cost by benchmarking price data it collected from third-party co-location facilities (such as data centres) to determine a value for the monthly land and building facility rental it would apply to this exchange space.

To estimate ancillary equipment costs, the model specified certain equipment (such as cable trays, risers, lighting and safety rails) that are used to support the IIC. Telstra estimated capital costs for this equipment (based on asset values it provided) and used these to derive:

- the annual capital cost attributable to each IIC pair where Telstra has incurred this cost (Telstra estimated the proportion of Exchange Service Areas (ESAs) where the IIC uses Telstra-installed equipment)
- the annual O&M costs (direct and indirect) attributable to each IIC pair using on a O&M cost mark-up based on data from the Commission’s Fixed Line Services Model (FLSM).

The model also estimated the annual O&M costs attributable to IIC cables and MDF blocks by estimating capital costs of this equipment and applying an O&M cost mark-up. As these assets were installed by access seekers, no annual capital costs relating to this equipment were included to be recovered through the IIC.

Below are the outputs of Telstra’s submitted IIC cost model.

Table 4.3: Telstra’s IIC Cost model outputs⁵³

Cost Item	Cost Type	Monthly Per Pair Cost		
		2009_10	2010_11	2011_12
Cable & MDF Block	O&M	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Equipment	Capital	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
	O&M	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Land & Building Accommodation	O&M	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
	Total	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]

The Commission proposed to use Telstra’s IIC model as a starting point for deriving the IIC charge, but make certain adjustments to remove MDF related costs and generally improve consistency with the FLSM. The FLSM is the cost model developed by the ACCC (in consultation with industry) to set prices for the declared fixed line services for the 2011 FADs. Based on this revised model, the Commission’s draft view was that the IIC charge should be \$0.056 per pair per month.

The Commission’s preliminary view regarding MDF costs was that MDF housing costs and other MDF related costs were being recovered via prices for other fixed line services – including for ULLS and the declared wholesale line rental service (WLR) and Telstra retail services – and should be removed from the IIC charge.⁵⁴

⁵³ Telstra, Letter to the ACCC, 13 February 2012, p. 3.

⁵⁴ The WLR recovers network costs associated with the LSS

4.1.2 Commission's approach to pricing the IIC

The Commission notes that the IIC charge relates to access to a small component of Telstra's network and represents a small fraction of Telstra's revenue from regulated services.

For example, Telstra's submissions indicated that the IIC charge (at current commercial charges) generated approximately [c-i-c] [c-i-c] for Telstra during the 2011 calendar year.⁵⁵ To put that in context, the FLSM's revenue requirement for the CAN and Core networks – part of which is allocated to determine the regulated prices for fixed line services – is [c-i-c] [c-i-c] for FY2011/12.⁵⁶ Furthermore, while the current monthly charge for a ULLS service is \$16 (for Bands 1-3), estimates of the IIC charge are considerably smaller – with Telstra proposing [c-i-c] [c-i-c] per pair per month and the ACCC's draft view being \$0.056 per pair per month.

By providing the IIC service, Telstra is providing a capability that allows access seekers to replicate Telstra's 'Tie Cables' that connect an MDF to other communications equipment such as DSLAMs. The access seekers install their own cables and terminating blocks, the ownership of which subsequently passes to Telstra. The IIC charge relates to the ongoing cost "for housing, maintenance and management" of these cables.

Consideration of the legislative matters in subsection 152 CR(1)

As discussed at section 1.2.1, there are certain matters to which the ACCC must have regard in making a determination in relation to these access disputes. Such matters include the promotion of the LTIE, the legitimate business interests of the access provider, and the interests of all persons who have rights to use the declared service.

The Commission has had regard to these matters when developing its approach to pricing the IIC and in considering the various issues raised by parties in respect of the IIC charge.

The Commission notes that, for these access disputes, the key issue can be described as identifying the efficient costs of providing the IIC service, and setting a price for the service that reflects these efficient costs. The Commission is of the view that setting the IIC charge at a level which reflects the efficient costs of providing the IIC service will promote the LTIE and is relevant to a number of matters referred to in s.152CR(1) of the CCA, including satisfying the interests of both the access provider and the access seekers.

A detailed assessment of the Commission's pricing decision against the relevant matters is set out in section 4.2.

Approach to setting the IIC charge

As the Commission noted in the Consultation Paper, it would be desirable that the FLSM be used in the Commission's consideration of the IIC charge. The Commission agrees with the previous submission from Telstra that the initial regulatory asset base (RAB) in the FLSM is likely to include capital costs related to the IIC.⁵⁷ The Commission also agrees with the Frontier Economics report submitted by the Access Seeker that 'cost categories related to the provision of the IIC ... would be part of ...

⁵⁵ Telstra, Letter to the ACCC, 13 February 2012, p. 4.

⁵⁶ ACCC, Fixed Line Services Access Pricing Model, 6. Revenue Requirement.

⁵⁷ Telstra, Letter the ACCC, 19 July 2011, p. 3.

the FLSM.⁵⁸ For clarification, the Commission considers that the IIC service itself does not form part of the declared service (as discussed above) and the IIC service has not been included as part of any declared services (e.g. ULLS) for the purposes of pricing these services in the FLSM.

However, there are difficulties that arise from using the FLSM itself to set a price for the IIC because the FLSM was designed to price the declared fixed line services, and significant additional modelling would be necessary in order to separately price the IIC. In particular, the asset classes used in the FLSM (in its current form) are not sufficiently disaggregated to readily derive IIC costs based on specific assets used to provide the IIC service. For this reason, the Commission considers that it is not appropriate to use the FLSM by itself to establish the IIC charge. However, the Commission considers that it would be reasonable to adopt an approach to pricing the IIC that recognises the cost allocations used in the FLSM and that seeks greater consistency with the FLSM than is in Telstra's submitted cost model. There are a number of reasons for seeking consistency with the FLSM.

Firstly, the FLSM's approach to pricing Telstra's network services estimates prices that reflect efficient costs. The Commission considers that setting prices that reflect efficient costs will promote the LTIE because it promotes competition in the market for carriage services and encourages efficient use of and investment in infrastructure. This accords with the Commission's view from the fixed line services FAD final report. Further, given that Telstra uses the same general asset classes for providing the declared services and the IIC (as well as other retail and wholesale services), setting prices in a way that does not recognise the use of such assets and cost recovery via the declared could lead an over (or under) recovery of costs.

Furthermore, given the FLSM has been developed in consultation with Telstra and industry and has been used by the Commission to determine prices in the fixed line services FADs, the FLSM is an appropriate reference point for the Commission to consider in determining the level of the IIC charge.

Another challenge in setting a charge for a relatively minor service such as the IIC is the lack of specific information about relevant costs. Telstra has stated that charges for the IIC were based on commercial considerations and were not set in accordance with any cost model.⁵⁹ Telstra has itself acknowledged that it does not record specific costs in relation to the IIC, including O&M and particular capital equipment costs.⁶⁰ In relation to ancillary equipment capital costs, Telstra has stated that it "keeps records of the historical costs by Asset Category only and not by individual equipment type ... thus has no costs of its own on which to base an estimate."⁶¹ The Commission has sought to adopt a pricing approach to the IIC that is appropriate in these circumstances.

The Commission's view on the appropriate approach to setting the IIC charge is to use Telstra's IIC cost model as a starting point for deriving the charge, but to make adjustments to the model to more closely align the model with the pricing approach from the FLSM. Telstra's IIC cost model is a useful starting point because it identifies

⁵⁸ Frontier Economics, *Telstra's recovery of internal interconnection cable costs*, March 2012, p. iii.

⁵⁹ Telstra, Letter to the ACCC, 13 February 2012, p. 3.

⁶⁰ Telstra, *Unconditioned Local Loop Service (ULLS) & Line Sharing Service (LSS) Access Disputes – Internal Interconnection Cable (IIC) Charge Reply Submissions of Telstra*, 2 July 2012, p. 13; Telstra submission, 18 June 2012, p. 15.

⁶¹ Telstra submission, 18 June 2012, p. 15.

specific assets used to provide the IIC service and includes estimates of the costs associated with these assets.

However, the Commission has identified a number of elements of Telstra's IIC cost model that it does not consider appropriate. The Commission will address each of these issues individually in the sections that follow.

4.1.3 MDF housing costs

Telstra's IIC cost model proposed that the costs to be recovered through the IIC charge include costs for housing the blocks and verticals on the MDF that are used to connect the IIC pairs to the copper lines that connect to the end-user premises.

Telstra submitted that an MDF housing cost is incurred by Telstra in making land and building facilities available for use by access seekers to house blocks on an MDF vertical. Telstra proposed to calculate this component of the charge based on benchmark survey data of third-party co-location facilities (sometimes referred to by Telstra as its Facilities Access Service (FAS) benchmarking methodology).⁶²

Telstra's IIC cost model assumed average monthly rental of [c-i-c] [c-i-c] per [c-i-c] [c-i-c] for land and building rental.

In Telstra's IIC cost model, this cost component amounted to [c-i-c] [c-i-c] per pair per month.

Commission's preliminary view

The Commission's Consultation Paper proposed to remove MDF housing and all MDF related costs from the IIC model and hence the IIC charge.

This position was based on a consideration that, in accordance with the ULLS (and WLR) service descriptions and the cost allocation rules used in the Commission's FLSM, all MDF related costs were already being recovered through the fixed line services – including ULLS, WLR and other Telstra retail and wholesale services. The Commission noted that WLR is important in this context because the WLR services (or Telstra retail voice line) recovers network costs associated with the LSS.⁶³

Specifically, the Commission cited the Communications Alliance ULLS Network Deployment Code and the Commission service description for the ULLS.⁶⁴⁶⁵

The use of unconditioned communications wire between the boundary of a telecommunications network at an end user's premises and a point on a telecommunication network that is a **potential point of interconnection located at or associated with a CAM [customer access module] and located on the end user side of the CAM.** [Emphasis added]

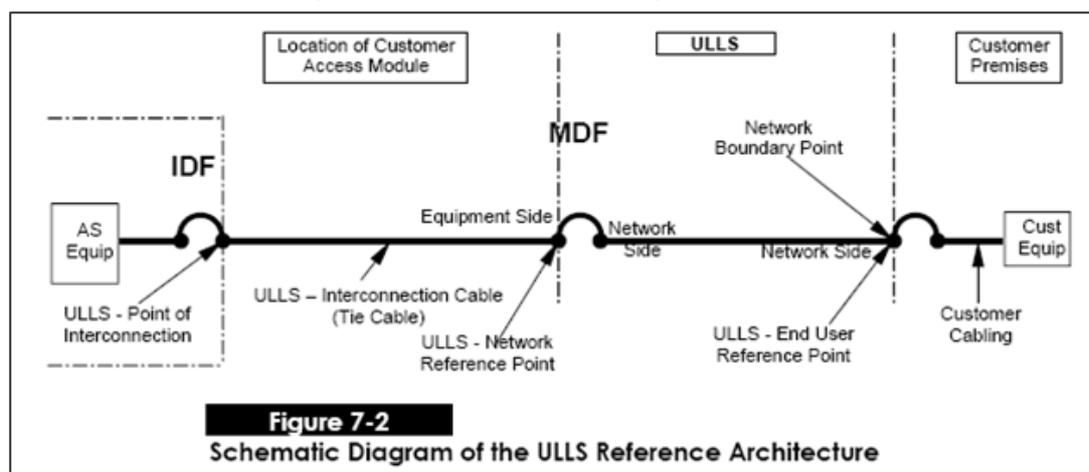
⁶² Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, pp. 3-5.

⁶³ It was noted in the declared fixed line services FAD that '*the LSS can only be provided on a line that is already carrying a voice service (for example through a WLR service or a retail line rental service provided by Telstra). The end-user currently pays the network costs associated with the line through the voice service charges*'. (ACCC, Inquiry to make final access determinations for the declared fixed line services – Final Report, July 2011, p. 87).

⁶⁴ Communications Alliance, C559:2012 Unconditioned Local Loop Service (ULLS) Network Deployment..

⁶⁵ ACCC, Fixed Services Review Declaration Inquiry for the ULLS, LSS, PSNT OA, PSTN TA, LCS and WLR, Appendix B Service Description for the ULLS.

Figure 4.1: ULLS Architecture (Communications Alliance)



Also, the Commission cited the definition of the ULLS from the ACCC’s 2008 Fixed LRIC cost model developed by Analysys (the Analysys model), on which the FLSM cost allocation factors were based:⁶⁶

The unconditioned copper pair runs between the NTP [Network Termination Point] at the customer’s premises and a customer access module (a concentrator at the MDF or a CMUX/MSAN [Customer Multiplexer/Multi-Service Access Node] deployed closer to the customer) – the copper pair terminates at a potential point of interconnection located at or associated with a CAM. **The service includes the use of the equipment side of the MDF.** [Emphasis added]

The Commission noted that MDF assets are **[c-i-c] [c-i-c]**. However the Commission noted that the assets relevant to the provision of the MDF and MDF housing would be spread across a number of FLSM asset classes:

- “Other Communications Plant and Equipment”
- “Network Land”, and
- “Network Buildings and Support Assets.”⁶⁷

The Commission noted that in the FLSM both the ULLS and WLR are allocated a proportion of the costs associated with the asset classes listed above, using allocation factors based on the Analysys model.⁶⁸ This approach to cost allocation applies to the MDF itself and to the Network Land and Network Buildings and Support Assets costs associated with the provision of the MDF.

The Commission concluded that the use of the Analysys cost allocation factors and their application to the relevant asset classes in the FLSM means that the costs relating to the MDF are being recovered through charges relating to access services, including the ULLS and WLR. Therefore, to avoid double recovery of these costs, the

⁶⁶ Analysys, Model documentation for the Australian Competition and Consumer Commission’s, *Fixed LRIC cost model documentation*, 17 December 2008; Analysys was commissioned by the ACCC to develop a bottom-up engineering-economic approach of estimating the long run efficient cost of providing services on the Australian fixed network over 2007-2012.

⁶⁷ The minor asset class “Other CAN” may also contain assets relevant to the MDF although this is not clear from the level of detail provided by Telstra in the RAF. Like the other asset classes described above, the “Other CAN” costs are also allocated to the fixed line services based on the Analysys cost allocation factors.

⁶⁸ ACCC, Declared fixed line services FAD final report, July 2011, p. 96.

Commission's preliminary view was to not include MDF housing (and other MDF related costs) as a component of the IIC charge.⁶⁹

The Commission also considered that other MDF-related capital and O&M costs identified by Telstra in its IIC model should be removed to avoid double-recovery. This is discussed further at section 4.1.4.

Submissions

Telstra May 2012 submission

In regards to MDF housing, Telstra submitted that land and building costs 'recorded in the Telstra Economic Model (TEM) and FLSM ... are not at their competitive economic value and require benchmarking to calculate the appropriate economic value.'⁷⁰

Telstra submitted that [c-i-c] [c-i-c] per month for housing costs is [c-i-c] [c-i-c]. Telstra further submitted that benchmarking housing costs is likely 'to [understate] the true opportunity cost of Telstra's land and building' because of the unique characteristics of Telstra's land and buildings.⁷¹ Telstra included an annexure entitled 'FAS benchmarking methodology and results' that provided a detailed description of its third-party co-location benchmarking survey to price its FAS which was used to calculate the MDF housing component of its IIC charge.⁷²

Telstra submitted that the Gibson Quai report (submitted by Access Seekers) has 'no bearing on the housing costs' of the IIC service because Gibson Quai '[considered] the costs of housing the IIC itself' but not 'the costs of housing the MDF blocks and verticals'.⁷³

Responses to the Consultation Paper

In its June 2012 submission in response to the Commission's Consultation Paper, Telstra submitted that MDF housing costs should be included in the IIC cost model because there is no 'double counting of these costs'.⁷⁴ Telstra submitted that in the FLSM 'all MDF housing costs are allocated to the Core network ... despite product descriptions (and architecture diagrams) of the ULLS and WLR including the MDF and MDF housing'.⁷⁵

Telstra submitted that 'the process of allocation of the FLSM asset base for "Network Land" and "Network Buildings and Support" ... into proportions for the Core and CAN [was] achieved by making use of the Telstra Efficient Access model (TEA) and Analysys Models to calculate the efficient proportion of costs of the total FLSM asset base of Telstra's Customer Access Network (CAN).'⁷⁶

Telstra submitted that the allocations made to the CAN in the FLSM 'exclude MDF housing' because of the allocations made in the TEA model.⁷⁷ Telstra submitted that

⁶⁹ Consultation Paper, p. 33.

⁷⁰ Telstra, *Unconditioned Local Loop Service (ULLS) & Line Sharing Service (LSS) Access Disputes – Internal Interconnection Cable (IIC) Charge Submissions of Telstra*, 11 May 2012, Annexure B – FAS benchmarking methodology and results, p. 3.

⁷¹ Telstra submission, 11 May 2012, p. 7.

⁷² Telstra submission, 11 May 2012, Annexure B – FAS benchmarking methodology and results.

⁷³ Telstra submission, 11 May 2012, p. 8.

⁷⁴ Telstra submission, 18 June 2012, p. 15.

⁷⁵ Telstra submission, 18 June 2012, p. 9.

⁷⁶ Telstra submission, 18 June 2012, p. 9.

⁷⁷ Telstra submission, 18 June 2012, p. 11.

‘the TEA model does not include the cost of MDF housing’ but rather it is ‘Telstra Exchange Building Access (TEBA) charges [that] compensate Telstra for ... MDF floor space (equipment side of the MDF) used by the access seekers to allow them to connect to the CAN.’⁷⁸ Telstra cited its response to the Commission’s draft decision on Telstra’s 2008 ordinary access ULLS undertaking to support this submission.⁷⁹ Telstra stated that ‘the TEA and Analysys model do not in practice model or include...costs of the MDF-related or MDF housing costs’.⁸⁰

Telstra submitted that in the FLSM ‘all MDF housing costs are implicitly included in the Core network [and are] allocated to the Core TEBA service platforms’.⁸¹ Telstra submitted ‘therefore, MDF housing costs should be recovered within Telstra’s IIC Cost Model.’⁸²

Telstra also made further submissions in support of its benchmarking approach (which estimates Telstra’s MDF housing costs based on a survey of commercial prices for third party co-location facilities). Telstra submitted that ‘the Commission has endorsed the approach to estimating MDF housing using a market rental proxy [and] Telstra’s FAS benchmark of [c-i-c] [c-i-c] is conservative relative to the market rental proxies calculated by the Analysys model and the FLSM.’⁸³ Telstra submitted a comparison of its estimated land and building accommodation costs which produced [c-i-c] [c-i-c] per pair using the Analysys model and [c-i-c] [c-i-c] per pair using the FLSM.⁸⁴

Herbert Geer submitted that ‘the Access Seekers agree with and support the Commission’s pricing methodology and its reference to Telstra network costs that are already allocated to services via the FLSM.’⁸⁵ Herbert Geer stated that ‘[t]o allow these costs to be included in the IIC charge would result in double recovery by Telstra, which reduces the Access Seeker’s competitiveness and is contrary to the LTIE.’⁸⁶

Frontier Economics, on behalf of the Access Seeker, submitted that they ‘agree that MDF housing costs appear to be specifically attributed to ULLS and WLR services in FLSM’ and ‘should not be included as a component of the IIC charge’.⁸⁷

Frontier Economics submitted that ‘it is by no means obvious that [Telstra’s benchmarking approach] will identify a suitable land valuation...because it is difficult to find appropriate benchmarks’.⁸⁸ Frontier Economics further noted that ‘many of the collocation providers assessed by Telstra offer services in high land value locations like CBD areas, whereas most exchanges in which the IIC service is acquired are in suburban locations’. Frontier Economics submitted that the differential in land values

⁷⁸ Telstra submission, 18 June 2012, p. 11.

⁷⁹ Telstra, Telstra’s ordinary access undertaking for the unconditioned local loop service: Response to the ACCC’s draft decision, 23 December 2008.

⁸⁰ Telstra submission, 18 June 2012, p. 9.

⁸¹ Telstra submission, 18 June 2012, pp. 11-12.

⁸² Telstra submission, 18 June 2012, p. 12.

⁸³ Telstra submission, 18 June 2012, p. 15.

⁸⁴ Telstra submission, 18 June 2012, p. 14.

⁸⁵ Herbert Geer submission, 18 June 2012, p. 13.

⁸⁶ Herbert Geer submission, 18 June 2012, p. 13.

⁸⁷ Frontier Economics, *Telstra’s recovery of internal interconnect cable costs – A report prepared for Herbert Geer*, June 2012, p. 6.

⁸⁸ Frontier Economics report, June 2012, p. 4.

for high land value locations and lower value locations need to be accounted for in any benchmarking analysis.⁸⁹

In its June 2012 report, Frontier Economics stated that ‘the FLSM already provides [Telstra] with a reasonable return on land and building assets ... and the Commission clearly intended for land values in the FLSM to reflect their competitive economic value’.⁹⁰ Frontier Economics submitted that ‘it is not clear what the benefit in applying a different approach would be’.⁹¹

Frontier Economics noted that cost allocation factors that capture ‘other platforms’ apply to the exchange building costs allocated to the Core network in the Analysys model, but these factors are not used for the purpose of allocating ‘other communications plant and equipment’, ‘network land’ and ‘network buildings and support assets’ in the FLSM. Frontier Economics noted that ‘it is therefore untenable for Telstra to argue that the cost of housing the IICs has...been allocated outside of the FLSM by making reference to the particular Analysys cost allocation factors that it has’.⁹²

Reply submissions

Telstra submitted that it disagrees with Frontier Economics’ statement that ‘unless there was no specific carve out or attribution, [MDF housing costs] could ... reasonably be expected to be recovered from all of Telstra’s fixed line services priced within the FLSM’.⁹³

Telstra submitted that it disagrees with Frontier Economics’ view on the benchmarking approach to estimating housing and land cost as being:⁹⁴

- Inconsistent with the FLSM
- Of no benefit from an approach applied via the FLSM
- Not necessarily providing a suitable housing and land cost valuation

Telstra also submitted that ‘it is reasonable to conclude that the IIC is captured within the ‘Other platform’ service within the Core network of the FLSM’.⁹⁵ Telstra noted that ‘the FLSM clearly applies the Analysys model allocators to [asset classes relevant to the provision of the IIC]’ and is not ‘exhaustive of the services that comprise ‘Other platforms’’.⁹⁶

Telstra submitted that ‘prior to 1 January 2011...the Commission’s price for ULLS were based on costs estimated from the PIE II model⁹⁷...[which] did not allocate MDF

⁸⁹ Frontier Economics report, June 2012, p. 4.

⁹⁰ Frontier Economics report, June 2012, p. 3.

⁹¹ Frontier Economics report, June 2012, p. 3.

⁹² Frontier Economics report, June 2012, p. 9.

⁹³ Telstra submission, 2 July 2012, p. 5.

⁹⁴ Telstra submission, 2 July 2012, p. 6.

⁹⁵ Telstra submission, 2 July 2012, p. 11.

⁹⁶ Telstra submission, 2 July 2012, p. 11.

⁹⁷ The PIE II model is a model developed by Telstra and was intended to estimate network and associated costs. The ACCC has previously noted its concerns about the accuracy of results generated by the model: see ACCC, *Assessment of Telstra’s ULLS monthly charge undertaking, Draft Decision*, June 2006, p. 37.

housing costs to ULLS'.⁹⁸ Telstra also stated that, based on the PIE II model, 'MDF housing costs were...recovered from the IIC charge'.⁹⁹

Frontier Economics submitted that MDF housing and other costs are included in the cost of the [FLSM].¹⁰⁰ Frontier Economics noted that 'even if TEA and Analysys cost model allocations may have been formulated without land and building asset, as Telstra claims, it does not mean that these costs have not been suitably allocated using the allocation factors for other related network costs'.¹⁰¹

Frontier Economics submitted that '[housing costs] should not be recovered outside [the FLSM] via the IIC model' because 'they are already actually being recovered from regulated services using the Core network'.¹⁰²

Frontier Economics submitted that '[it does] not agree that the Analysys model does not describe or calculate land and building costs for the CAN'.¹⁰³ Frontier Economics noted that the Analysys model 'allocates 50% of such costs to the CAN'.¹⁰⁴

Commission's final view

Attributing costs to the declared services

These arbitrations are the first time the Commission has considered setting a price for the IIC service. Although the IIC is not itself a declared service, and does not form part of the ULLS or LSS, it is used in connection with the supply of those declared services. The IIC is necessary in order for access seekers to access the ULLS/LSS and provide services to end users. The Commission considers that the charge for the IIC, and the allocation of costs to this service, should therefore be determined with regard to the declared services, including the service descriptions and pricing of those services.

As stated in the fixed principles provisions of the July 2011 FADs 'direct costs should be attributed to the service to which they relate [and] the cost allocation factors for shared costs should reflect causal relationships between supplying services and incurring costs'.¹⁰⁵

As the Commission stated in its Consultation Paper, the service description for the ULLS (and WLR which recovers the network costs of an access line when used in combination with the LSS) implies the use of the equipment side of the MDF (and therefore the housing of the MDF). Furthermore, this is supported by the Analysys model, the basis for a number of cost allocations in the FLSM, which explicitly states that 'the equipment side of the MDF is included in the Access network, consistent with industry specification' (referencing the industry code ACIF C559:2006 unconditioned local loop service (ULLS) network deployment).¹⁰⁶ As previously

⁹⁸ Telstra submission, 2 July 2012, p. 5.

⁹⁹ Telstra submission, 2 July 2012, p. 5.

¹⁰⁰ Frontier Economics, *IIC access dispute – response to Telstra's submission of 18 June 2012*, June 2012, p. 1.

¹⁰¹ Frontier Economics response to Telstra, June 2012, p. 1.

¹⁰² Frontier Economics response to Telstra, June 2012, p. 3.

¹⁰³ Frontier Economics response to Telstra, June 2012, p. 2.

¹⁰⁴ Frontier Economics response to Telstra, June 2012, p. 2.

¹⁰⁵ ACCC, Final Access Determinations No.s 1-6 of 2011, 20 July 2011, clause 6.14(b).

¹⁰⁶ Analysys, *Fixed LRIC cost model documentation*, 17 December 2008, p. 38.

noted, the model's definition for the ULLS also states that 'the service includes the use of the equipment side of the MDF.'¹⁰⁷

Therefore, it is clear that the intention of the FSLM was to set a price for the ULLS (and WLR) that included the costs relating to the MDF and MDF housing. Therefore, on this basis, neither the Analysys model nor the FLSM imply that MDF housing costs should be attributed to the IIC service.

Telstra has previously acknowledged the significance of the Analysys model definition of the ULLS for the Commission's FLSM, having cited the Analysys model definition of the ULLS in its submission of 19 June 2011 as the basis of the FLSM's cost allocations for the ULLS.¹⁰⁸

It is the Commission's view that the FLSM has produced appropriate prices for the declared fixed line services, in accordance with these service descriptions. In the FAD, the Commission stated that 'the Commission has utilised its FLSM which estimates prices based on the efficient costs of providing the declared fixed line services.'¹⁰⁹ The Commission also considered that 'the prices included in the FADs reflect efficient costs and will promote competition in the market for carriage services, thereby promoting the LTIE.'¹¹⁰ The Commission stated that 'the cost allocation factors used in the FLSM to derive wholesale access prices will enable the access provider to recover its efficient costs of supplying access to the declared fixed line services.'¹¹¹

This was the Commission's stated position on how the FAD prices generated by the FLSM were reflective of the costs of supply of the declared fixed line services, and hence promoted the LTIE, and it remains the view of the Commission.

The FLSM process for allocating land and building costs

The FLSM is a building block model initially developed by the ACCC and industry as part of the ACCC's 2009-10 Access Pricing Principles review and finalised as part of the 2011 fixed line FADs. The FLSM is a different cost modelling approach to the previous TSLRIC cost models, which are designed to estimate the forward-looking costs of an efficient network. TSLRIC models were developed by both the ACCC (i.e. the Analysys model) and Telstra (e.g. the TEA model). In contrast a BBM, such as the FLSM, estimates a revenue requirement based on (among other things) historically incurred costs and forecasts of future capital and operating costs. While employing an entirely different approach, the FLSM does draw on aspects of other models, in particular the Analysys model on which the FLSM bases a number of its cost allocations. In general, the FLSM does not draw significantly from the TEA model although, as described below, the ACCC used data from the TEA model to inform its approach to establishing a value of the land and building assets for the CAN.

As part of the fixed line service FAD process, the Commission took the following approach to valuing and allocating land and building (L&B) costs (which fall into the FLSM asset classes of "Network Land" and "Network Buildings and Support"):

¹⁰⁷ Analysys, Fixed LRIC cost model documentation, 17 December 20008, p. 11.

¹⁰⁸ Telstra, Letter the ACCC, 19 July 2011, p. 5.

¹⁰⁹ ACCC, *Inquiry to make final access determinations for the declared fixed line services, final report*, July 2011, p. 143.

¹¹⁰ ACCC, Declared fixed line services FAD final report, July 2011, p. 143.

¹¹¹ ACCC, Declared fixed line services FAD final report, July 2011, p. 140.

- The Commission used Telstra supplied data for the valuation of L&B assets. This information was specifically sought from Telstra because, unlike for other network asset classes, these asset classes are not sufficiently reported on in the RAF data for the purposes of the FLSM. The Commission did not seek to make adjustments to the valuations or scope of assets provided by Telstra under these asset classes.
- Telstra provided these numbers in an aggregated fashion, and did not make a division between costs that related to the CAN or Core, or provide means by which the Commission could make such an allocation. The Commission therefore needed to determine how to allocate these costs.
- The Commission decided to use Telstra's figures from the older TEA model (a TSLRIC pricing model that Telstra had submitted to support its 2008 ULLS undertaking) to ascribe a value of L&B assets for the CAN.¹¹²
- The Commission allocated costs from these CAN asset classes to the declared services based on the allocation factors in the Analysys model. In allocating CAN costs to services such as ULLS and WLR, the Analysys model derived cost allocations that were reflective of the demand for these services relative to other CAN services (such as Telstra retail lines and ISDN lines).¹¹³ The Analysys model and its allocation factors were built on the assumption of full cost recovery of the network.¹¹⁴ The FLSM applied these cost allocation factors (adjusted for changes in demand between the models) to the annualised cost of the network (the revenue requirement), which allow Telstra to recover the share of costs incurred in supplying a particular service.¹¹⁵ The remainder of these costs are able to be recovered through other declared and non-declared services.
- The Commission considered that this approach resulted in an appropriate allocation of costs (including common costs for L&B assets) to the declared fixed line services as per the service descriptions.

The Commission recognises Telstra's submission that the TEA model has been partially used to identify certain land and building costs for the purposes of the FLSM. However, the Commission does not consider that this particular detail of the FLSM modelling therefore requires the Commission to agree with Telstra's conclusions that MDF housing costs should therefore be included as part of the IIC charge. This is because:

- The FLSM is a new model which sets afresh the prices for the declared services based on a different cost modelling approach to the previous TSLRIC models, some of which (such as the TEA model) have never, in practice, been used by the Commission to set access prices.
- The costs Telstra has referred to as MDF housing costs relate to a portion (or allocation) of the network land and building costs, and should not be considered independently from the use of, and allocation of the costs for, Telstra's land and building more generally.

¹¹² The TEA model was used to derive an allocation to the CAN for Bands 1-3, but as the TEA model did not model Band 4, the ACCC used the L&B value relativities from the Analysys Cost model to estimate an L&B RAB value for Band 4 (given the TEA model valuations for Bands 1-3).

¹¹³ Analysys Model Cost Allocation Module.

¹¹⁴ Analysys, Fixed LRIC cost model documentation, 17 December 2008, p. 119.

¹¹⁵ ACCC, Declared fixed line services FAD final report, July 2011, p. 140.

- The Commission has considered Telstra’s submissions that certain MDF housing costs were not included in the TEA model. Having reviewed the available TEA model documentation, it is not clear as to whether, in practice, such costs have been either accurately included or excluded in the TEA model. This was also the view of the Commission when considering Telstra’s submissions at the time of the 2008 ULLS undertaking – that despite Telstra’s submissions, it was not clear whether land and building costs included in the TEA model were accurately being recovered and not recovered elsewhere.¹¹⁶ Telstra has not supplied further information on the TEA model to demonstrate to the Commission how land and building costs were allocated. The Commission considers therefore that there remains a lack of clarity about how these costs were allocated in the TEA model. The Commission also notes that the costs at issue (identified by Telstra as MDF housing costs) would represent a very small fraction of total network land and building costs.
- The Commission undertook extensive consultation in relation to its development of the FLSM during the inquiry into making the 2011 fixed line services FAD. Telstra was aware of the allocation factors and data input used for that modelling and did not raise any concerns about the treatment of MDF related costs at that time.
- The FLSM modelling primarily used the Analysys model cost allocation factors (where appropriate) to set prices for the declared services. These explicitly state that costs for the equipment side of the MDF form part of the ULLS and therefore the costs should be allocated to the ULLS. The basis for the cost allocations was clearly explained by the Commission during the FAD process.
- The ULLS and WLR service descriptions indicate that the equipment side of the MDF forms part of these services. This indicates that the equipment side of the MDF and MDF housing costs form part of the ULLS and WLR, and not the IIC service. On this basis, it would not be appropriate for the Commission to decide that MDF housing costs should be recovered as part of the IIC service instead of the ULLS and WLR services.
- Telstra submissions indicate that it accepts that ‘the product descriptions (and architecture diagrams) of the ULLS and WLR services include[d] the MDF and MDF housing.’¹¹⁷ Furthermore, Telstra’s submissions indicate that it accepts that the Analysys model definitions and allocation factors for the ULLS were used in the FLSM.¹¹⁸
- In any event, the Commission considers that any questions about how MDF housing costs have or have not been accounted for in the TEA model or the FLSM should not lead the Commission to allocate MDF housing costs to the IIC in this decision.

¹¹⁶ The Commission stated that ‘whilst Telstra, in response to the ACCC’s Draft Decision [regarding Telstra’s 2008 ULLS Undertaking], have submitted further information regarding the nature of entrance facility costs, the ACCC considers this information is insufficient to determine whether entrance facility costs are being accurately recovered and not recovered elsewhere’; ACCC, Assessment of Telstra’s Unconditioned Local Loop Service Band 2 monthly charge undertaking, final decision, public version, April 2009, p. 153.

¹¹⁷ Telstra submission, 18 June 2012, p. 9.

¹¹⁸ Telstra, Letter the ACCC, 19 July 2011, p. 3.

- If Telstra considers that the allocations for the ULLS and WLR do not allow it to recover MDF and MDF housing costs for the equipment side of the MDF, the appropriate forum for debating the merits of revisiting the cost allocations is the 2014 review of the FADs for the next regulatory period.

Commission's final view on MDF housing costs for the IIC

The Commission's final view on this issue is that MDF housing does not form part of the IIC service and its cost should therefore not be recovered through the IIC charge. The Commission's view is that these assets are used in providing the ULLS and WLR (as well as other fixed line services, such as Telstra retail lines) and therefore the ULLS price (and WLR price) should recover an appropriate share of the costs associated with the MDF. This view is supported by the service description for ULLS (and the other declared services), the Communications Alliance documentation of the ULLS, and the modelling and cost allocation factors from the Analysys model and the FLSM. Furthermore, based on the information available, it is the view of the Commission that the current allocations of common costs, including L&B costs, to the declared services and to other services is also appropriate.

The Commission considers that allowing Telstra to recover MDF housing costs via the IIC charge is likely to result in over-recovery or double-recovery of costs. Recovery of costs that are not efficient costs incurred in supplying the relevant service could undermine competition and discourage efficient use of and investment in infrastructure and, hence, and would not satisfy the legislative criteria, including promoting the LTIE and the interests of access seekers. Consequently, the Commission considers that MDF housing costs should not be included in the IIC charge.

The Commission's views on other specific issues on MDF housing raised in submissions

As the Commission considers that MDF housing costs should not form part of the IIC charge, it is not necessary for the Commission to make any conclusions about Telstra's proposed MDF housing costing approaches. However, the Commission has noted that the methodologies proposed by Telstra are not appropriate to calculate such costs (in the case of Telstra's proposed co-location benchmarking approach) and/or erroneous (in the case of Telstra's submissions regarding MDF housing costs in the FLSM and the Analysys model).

Telstra's proposed benchmarking approach seeks to revalue Telstra land and building facilities in order to identify an MDF housing cost. This approach seeks to substantially increase the value of Telstra's land and building facilities compared with the valuation established in the FLSM through the FAD process. For example, Telstra's estimates of MDF housing of [c-i-c] [c-i-c] per pair per month for IIC would result in annual revenue to Telstra (on current demand for IIC) significantly greater than the revenue to be generated for all network land and building costs associated with the provision of the ULLS.¹¹⁹ Despite Telstra's submissions to the contrary,¹²⁰ Telstra's land and building assets have been valued at the appropriate economic value in the FLSM RAB. It would be appropriate to use those values and a revaluation as proposed by Telstra is likely to lead to an over-recovery of costs. Furthermore, as

¹¹⁹ ACCC, Fixed Line Services Access Pricing Model, 6. Revenue Requirement.

¹²⁰ For example, Telstra, May 2012 submission, Annexure B – FAS benchmarking methodology and results, p. 5.

Telstra's benchmarking approach ignores how the land and building common costs are being recovered by other services, this also would likely lead to an over-recovery or double-recovery of costs. Accordingly, the Commission considers that estimating land and building costs for network services should use an approach that is based on the land and building valuations and allocations included in the FLSM.

Secondly, Telstra's benchmarking approach relies on opportunity cost assumptions that appear tenuous. Telstra estimates the land and building rental charge for the approximately 580 local exchanges where IIC is provided based on price information from 14 third-party co-location facilities located in and around CBD areas.¹²¹ In practice, there are number of reasons why this benchmark would be inappropriate and the opportunity cost assumptions would be unlikely to hold due to comparability issues between the exchange space used for the MDF and the facilities used in the benchmark (including the comparative size of the market for co-location services, the geographic location of such facilities and the cost structures of these third-party operators).

As an alternative estimate of MDF housing costs, Telstra provided submissions regarding how costs could be allocated from the Core network land and building asset classes to the IIC service for MDF housing using the FLSM and the Analysys models.¹²² Consistent with the Commission's view that such costs should not be included in the IIC charge, the Commission does not endorse this approach to allocating costs from the Core network. Also, the calculations provided by Telstra substantially over-estimate the size of any such allocations. Specifically these estimates:

- Use total RAB values, rather than annualised revenue requirements, for estimating the annual cost to be recovered.
- Have no regard to any allocation of local exchange costs to other platforms such as Mobiles, digital data access service (DDAS) or TEBA. Telstra's methodology does not consider how these common costs would be appropriately allocated between the various services which also use exchange space for other platforms.

Therefore, in addition to the Commission view that MDF housing costs should not form part of the IIC charge, the Commission considers that there are significant problems with the Telstra's approaches to estimating such costs in its IIC model in any event.

4.1.4 Cost of MDF related assets

Telstra's IIC cost model proposed that the IIC charge recovers costs for MDF related assets that are used to supply the IIC service. These costs include capital costs related to MDF verticals and MDF ladders, and O&M costs related to MDF verticals, MDF ladders and MDF blocks.¹²³

In Telstra's IIC cost model, these cost components amounted to [c-i-c] [c-i-c] per pair per month.

¹²¹ Telstra submission, 11 May 2012, Annexure B – FAS benchmarking methodology and results, p. 7.

¹²² Telstra submission, 18 June 2012, p. 14.

¹²³ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, p. 7.

Commission's preliminary view

The Commission's preliminary view was that operating expenses and capital costs relating to the MDF blocks, MDF verticals and MDF ladders should not be recovered through the IIC charge and were removed from the IIC cost model.¹²⁴

Based on the Commission's preliminary views on MDF housing costs, the Commission considered that it is not appropriate for Telstra to recover costs relating to MDF verticals and MDF ladders through the IIC charge as this would result in double recovery of these costs.

Submissions

Telstra May 2012 submission

Telstra submitted that '[it] pays for the capital costs of [MDF related] equipment except when the current capacity of any such equipment is not sufficient to cater for Telstra's and the access seekers' current and future requirements'.¹²⁵ Telstra also submitted that '[it] bears all of the direct and indirect operational and maintenance costs of [MDF related assets] once an IIC is installed in Telstra's exchange'.¹²⁶

Responses to the Consultation Paper

Telstra submitted that its 'operational costs relating to MDF verticals, MDF blocks and MDF ladders are not being recovered by Telstra through its charges for fixed line services and should be included in the IIC charge'.¹²⁷ Telstra noted that, similar to the MDF housing costs, 'MDF related costs ... are all allocated to the Core ... specifically ... the 'Other Platform' service, which includes the IIC/TEBA platform' according to the Analysys cost model. Telstra therefore submitted that 'the [Commission] is incorrect in excluding MDF related costs as all MDF related costs are correctly allocated and recovered through Telstra's IIC Cost Model and should be included'.¹²⁸

Herbert Geer submitted that the Access Seekers agree with and support the Commission's pricing methodology and that including MDF and MDF related costs 'would result in double recovery by Telstra'.¹²⁹

On behalf of the Access Seeker, Frontier Economics submitted that they agree with 'the Commission that the costs of other MDF related assets are included in the FLSM and will be recovered from ULLS and WLR charges in similar fashion to how MDF housing costs are recovered'.¹³⁰

Reply submissions

Parties made similar submissions on the issue of MDF related costs to their submissions relating to the issue of MDF housing costs (see section 4.1.3)

Commission's final view

As outlined in section 4.1.3 for MDF housing costs, the Commission is of the view that the MDF housing does not form part of the IIC service and therefore such costs should not be included in the IIC charge. The Commission considers that the ULLS

¹²⁴ Consultation Paper, p. 43.

¹²⁵ Telstra submission, 11 May 2012, p. 9.

¹²⁶ Telstra submission, 11 May 2012, p. 11.

¹²⁷ Telstra submission, 18 June 2012, p. 18.

¹²⁸ Telstra submission, 18 June 2012, p. 19.

¹²⁹ Herbert Geer submission, 18 June 2012, p. 13.

¹³⁰ Frontier Economics report, June 2012, p. 10.

and WLR prices (and/or charges for other retail/wholesale lines) should account for all relevant costs associated with the MDF, including any MDF housing costs or MDF related costs.

Based on this view, the Commission maintains that it is not appropriate for Telstra to recover capital costs and O&M costs relating to MDF verticals, MDF blocks and MDF ladders through the IIC charge as this would likely result in double recovery of these costs.

Recovery of costs that are not efficient costs incurred in supplying the relevant service could undermine competition and discourage efficient use of and investment in infrastructure and, hence, would not be consistent with the matters in section 152CR(1) of the CCA, including promoting the LTIE and the interests of access seekers. Therefore, the Commission's final view is that operating expenses and capital costs relating to the MDF blocks, MDF verticals and MDF ladders should not be recovered through the IIC charge and therefore should be removed from the IIC cost model.

4.1.5 Ancillary equipment capital costs

Telstra's IIC cost model proposed that the IIC charge recovers Telstra's proportion of ancillary equipment capital costs used in the supply of the IIC service. The calculation of this proportion is discussed at section 4.2.6.

Telstra submitted that ancillary equipment capital costs are incurred by Telstra for equipment that is needed to facilitate the installation and operation of the IIC. Telstra proposed to calculate these costs based on **[c-i-c] [c-i-c]**.¹³¹ This implies that Telstra has used different cost estimates to its own historic costs in making its capital cost calculations in the IIC model.

Telstra's model also uses the calculations of ancillary equipment capital costs in estimating O&M costs for all ancillary equipment (for equipment installed by Telstra as well as by access seekers).

Commission's preliminary position

The Commission noted that it would be appropriate to use access seeker costs where access seekers are the parties that incurred these costs, and to use Telstra's costs where Telstra has incurred the relevant ancillary costs. However, the Commission noted that it currently does not possess specific, disaggregated information on the ancillary equipment costs incurred by Telstra or those incurred by access seekers.

The Commission's preliminary view was therefore to use the ancillary equipment capital cost estimates submitted by Telstra to estimate the capital costs of this equipment where it has been installed by either Telstra or access seekers.¹³²

Submissions

Telstra May 2012 submission

Telstra submitted that '[it] pays for the capital costs of [ancillary] equipment except when the current capacity of any such equipment is not sufficient to cater for Telstra's

¹³¹ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, p. 7.

¹³² Consultation Paper, p. 34.

and the access seekers' current and future requirements'.¹³³ Telstra also submitted that '[it] bears all of the direct and indirect operational and maintenance costs of [ancillary equipment] once an IIC is installed in Telstra's exchange'.¹³⁴

Responses to the Consultation Paper

Telstra submitted that [c-i-c] [c-i-c] were used to estimate capital costs because they are more recent, and therefore 'more accurate than Telstra's historical data'. Telstra further submitted that it has 'no costs of its own on which to base an estimate' because Telstra records 'historical costs by asset category only and not by individual equipment type'.¹³⁵

On behalf of the Access Seeker, Frontier Economics submitted that 'the ultimate test for whether any other non-MDF related costs should be recovered in IIC charges is whether or not they are incremental to the IIC, and if not, they will already be allocated in part to ULLS, WLR and possibly other wholesale services.' Frontier Economics noted that 'it is not evident...that the Commission has applied this test to the remaining non-MDF equipment costs it has retained in the modified IIC cost model'.¹³⁶

Reply submissions

Telstra and Herbert Geer did not make further submissions on ancillary equipment capital costs.

Commission's final view

The Commission considers that certain ancillary capital costs for equipment must be incurred (by either Telstra or access seekers) to facilitate the installation and operation of the IIC. The Commission notes that the IIC cost model currently uses average [c-i-c] [c-i-c] ancillary equipment capital costs submitted by Telstra to estimate the capital costs of equipment where it has been installed by either Telstra or access seekers.

The Commission understands that, in order to most accurately estimate the actual costs incurred in providing the ancillary equipment, it would be appropriate to use access seeker costs where access seekers have been the parties to incur these costs, and Telstra's costs where Telstra has incurred the relevant ancillary costs.

However, the Commission reiterates that it currently does not possess any alternative disaggregated information on the ancillary equipment costs incurred by Telstra or those incurred by access seekers. In the absence of alternative cost estimates from Telstra and the Access Seeker, the Commission considers that the IIC cost model's use of ancillary equipment capital cost is appropriate.

In response to Frontier's submission, the Commission is of the view that it is appropriate to allow Telstra to recover costs that may be included in the FLSM through the IIC charge, provided that these costs are not already being allocated to other services. The Commission considers that it is reasonable for Telstra to recover some ancillary equipment costs through the IIC charge, where these relate to the provision of the IIC service.

¹³³ Telstra submission, 11 May 2012, p. 9.

¹³⁴ Telstra submission, 11 May 2012, p. 11.

¹³⁵ Telstra submission, 18 June 2012, p. 15.

¹³⁶ Frontier Economics report, June 2012, p. 11.

As per the Commission's approach in the Consultation Paper, and given that the FLSM does not provide a sufficient level of disaggregation to readily identify the costs relating to IIC, the Commission considers that Telstra's IIC cost model is a reasonable approach to estimating these costs.

The Commission's final view is therefore to use the cost estimates submitted by Telstra to estimate the efficient capital costs of this equipment where it has been installed by either Telstra or access seekers. The Commission considers that setting prices for the IIC based on efficiently incurred costs in supplying the IIC promotes competition in the relevant markets and thereby promotes the LTIE and is in the interests of the carrier and all persons who have the right to use the service.

4.1.6 The proportion of capital costs borne by Telstra

Telstra's IIC cost model proposed that the IIC charge recover Telstra's share of the capital cost of ancillary equipment used to supply the IIC service.

Telstra submitted that the proportion of capital costs borne by Telstra is an input for calculating the monthly capital cost component of the IIC charge.¹³⁷ With the exception of MDF verticals, Telstra proposed to estimate its share of ancillary equipment capital cost as the 'proportion of equipment borne by Telstra'. This proportion is calculated using the number of exchange service areas (ESAs) with spare infrastructure capacity as compared to the number of ESAs with ULLS or LSS access seekers as at June 2010 – resulting in a figure of [c-i-c] [c-i-c] per cent.

For MDF verticals, Telstra proposed to estimate its share of capital costs as the 'proportion of equipment borne by Telstra for MDF verticals'. This proportion is calculated using the number of ESAs with spare MDF vertical capacity as compared to the number of ESAs with ULLS or LSS access seekers as at June 2010 – resulting in a figure of [c-i-c] [c-i-c] per cent.

Commission's preliminary view

The Commission's preliminary view was to use the 'proportion of equipment borne by Telstra' to calculate the monthly capital cost of all ancillary equipment in the IIC cost model with the exception of MDF verticals.¹³⁸ The Commission considered that capital costs relating to MDF verticals should not be recovered through the IIC charge; therefore calculating the proportion of these costs borne by Telstra is not necessary.

The Commission also noted that there may be a more direct measure of calculating the number of exchanges where access seekers have been required to build IIC-related ancillary equipment. The Commission stated that it would consider submissions as to whether Telstra's methodology was likely to be appropriate for estimating the proportion of ancillary equipment costs borne by Telstra.

¹³⁷ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, p. 9.

¹³⁸ Consultation Paper, p. 41.

Submissions

Telstra May 2012 submission

Telstra submitted that its IIC cost model estimates the percentage of ancillary equipment capital costs borne by Telstra ‘and seeks only to recover those costs’.¹³⁹ Telstra noted that ‘[its] systems do not record information which would enable it to ascertain the actual proportion of capital costs of ancillary equipment borne by Telstra across the exchanges in which IIC is provided’.¹⁴⁰

Telstra further submitted that it does not seek to recover any capital costs borne by access seekers in the IIC model, but rather that it reimburses access seekers where access seekers have to install additional ancillary equipment.¹⁴¹ Telstra noted that ‘given that Telstra incurs costs for reimbursing access seekers, Telstra may seek to recover those costs in the future’.¹⁴²

Responses to the Consultation Paper

Telstra submitted that ‘it is not aware of any other practical way of calculating the proportion of equipment borne by Telstra other than the methodology provided’.¹⁴³ Telstra noted that the ‘most accurate way of calculating this proportion would be to conduct an audit of capital costs incurred both by Telstra and access seekers [but] such information is not available to Telstra for any significant period of time’.

Further, Telstra submitted that its use of a [c-i-c] [c-i-c] spare capacity buffer in calculating the proportions ‘allows for inaccurate forecast demands made by access seekers’. Telstra further noted that a spare capacity buffer is ‘advantageous to access seekers’ because the proportion of equipment costs borne by Telstra is decreased.¹⁴⁴

Telstra also noted that, based on its analysis of [c-i-c] [c-i-c], ‘almost [c-i-c] [c-i-c] of ESAs had spare capacity and did not require additional ancillary equipment and [c-i-c] [c-i-c] did not require additional MDF verticals to be built by access seekers’.¹⁴⁵

Telstra submitted that its estimates of Telstra’s share of costs ‘[establishes] a far lower figure’ and is ‘advantageous to access seekers’.

In light of the above, Telstra submitted that ‘its previously submitted methodology for calculating the proportion of capital costs is the most practical approach available’.¹⁴⁶ In addition, Telstra submitted data used to calculate the ‘proportion of equipment borne by Telstra’ and the ‘proportion of equipment borne by Telstra for MDF verticals’ to support its position.¹⁴⁷

Herbert Geer did not make submissions on the proportion of capital costs borne by Telstra.

Reply submissions

Telstra and Herbert Geer did not make further submissions on the proportion of capital cost borne by Telstra.

¹³⁹ Telstra submission, 11 May 2012, p. 3.

¹⁴⁰ Telstra submission, 11 May 2012, p. 10.

¹⁴¹ Telstra submission, 11 May 2012, p. 9.

¹⁴² Telstra submission, 11 May 2012, p. 9.

¹⁴³ Telstra submission, 18 June 2012, p. 17.

¹⁴⁴ Telstra submission, 18 June 2012, p. 17.

¹⁴⁵ Telstra submission, 18 June 2012, p. 17.

¹⁴⁶ Telstra submission, 18 June 2012, p. 17.

¹⁴⁷ Telstra, Submission of Telstra in response to the Draft Determination – Annexure C, 18 June 2012.

Commission's final view

Given the lack of alternative information available to the Commission, Telstra's estimation of 'the proportion of equipment costs borne by Telstra' is likely to remain the only available method to estimate Telstra's share of capital costs.

As the Commission noted in its Consultation Paper, the Telstra's IIC cost model appears to have mistakenly used the 'proportion of equipment borne by Telstra for MDF verticals' [c-i-c] [c-i-c] in place of 'the proportion of equipment borne by Telstra' [c-i-c] [c-i-c], when estimating Telstra's share of certain capital costs. The Commission has adjusted the IIC cost model for this inconsistency.

As noted above and discussed at section 4.1.4, the Commission is of the view that costs relating to MDF verticals should not be recovered through the IIC charge and should be removed from the model; therefore it is not necessary to calculate the proportion of these costs borne by Telstra in the IIC cost model.

4.1.7 Asset life assumptions

The IIC cost model uses the asset life of each asset as part of the calculations for the annualised capital cost of the ancillary equipment – i.e. the time period over which Telstra will recover its capital costs for a given asset.

Telstra's IIC cost model assumed the economic life of all assets to be [c-i-c] [c-i-c] years but did not provide evidence to support this assumption.

Commission's preliminary view

The Commission noted that, to maintain consistency with the FLSM, the asset life of 'Other Communications Plant and Equipment' from the FLSM should be used as the relevant asset life for the ancillary equipment.¹⁴⁸

The Commission's preliminary view was to apply an asset life of [c-i-c] [c-i-c] years implied by the FLSM for 'Other Communications Plant and Equipment' to annualise capital costs of the ancillary equipment.

Submissions

Telstra May 2012 submission

Telstra did not submit on the matter of asset life assumption.

Responses to the Consultation Paper

Telstra has submitted that its asset life assumption of [c-i-c] [c-i-c] years is based on assets relevant to the supply of IIC services listed in its Integral Report.¹⁴⁹ Telstra submitted that 'its asset life assumption [c-i-c] [c-i-c] is more accurate than [the Commission's] estimate and should be preferred'.¹⁵⁰ Telstra noted that its estimate 'targets the assets which are relevant to the provision of the IIC service, and excludes those assets which have no bearing on the provision of that service'.¹⁵¹

¹⁴⁸ Consultation Paper, p. 35.

¹⁴⁹ Telstra submission, 18 June 2012, p. 15.

¹⁵⁰ Telstra submission, 18 June 2012, p. 15.

¹⁵¹ Telstra submission, 18 June 2012, p. 15.

Frontier Economics stated that they ‘agree with the Commission’s approach of using an asset life that is consistent with that used in the FLSM’.¹⁵²

Reply submissions

Telstra submitted that its position on asset lives in its June submission is preferable to the Commission’s preliminary position because Telstra calculated the weighted average asset life based on the ‘true asset lives...for the assets that related to the IIC only’.¹⁵³ Telstra submitted that ‘the sources of the individual asset lives presented by the Commission in the FLSM are unclear; and Telstra is therefore unable to confirm the values of the Commission’s proposed asset lives’.¹⁵⁴

Frontier Economics submitted that ‘[Telstra’s approach of estimating asset lives for assets specifically used to supply the IIC is] not desirable within the overall framework of cost recovery proposed by the FLSM’.¹⁵⁵ Frontier Economics noted that Telstra’s approach would result in IIC prices that are ‘based on [a] [c-i-c] [c-i-c] year asset life, and prices for the five fixed line services which are derived from asset lives measured across all assets’.

Frontier Economics further submitted that it supports the Commission’s approach of using average asset lives across the [entire asset class] because it is consistent with the FLSM.¹⁵⁶

Commission’s final view

The Commission notes that Telstra has submitted that its asset life assumption of [c-i-c] [c-i-c] years is based on assets relevant to the supply of IIC services listed in its Integral Report.¹⁵⁷

However, Telstra has not provided any material to support its position that the [c-i-c] [c-i-c] year asset life is appropriate. Further, Telstra has not outlined explicitly which assets are used in estimating this figure.

Given the absence of verifiable information, the Commission does not have confidence in Telstra’s asset life assumption for ancillary equipment asset lives. The Commission is of the view that there is no reasonable basis to adopt an alternative asset life assumption for ancillary equipment to that applying to ‘Other Communications Plant and Equipment’ in the FLSM. Consequently, the Commission considers that the asset life of [c-i-c] [c-i-c] years proposed in its Consultation Paper remains appropriate.

The Commission also notes that Telstra’s IIC cost model used the aggregate direct O&M costs of the FLSM asset class ‘Other communications plant and equipment’ when calculating the direct O&M costs of ancillary equipment. The Commission therefore considers that using the asset life of ‘Other Communications Plant and Equipment’ from the FLSM is preferable for reasons of consistency within the IIC cost model.

¹⁵² Frontier Economics report, June 2012, p. 9.

¹⁵³ Telstra submission, 2 July 2012, p. 12.

¹⁵⁴ Telstra submission, 2 July 2012, p. 12.

¹⁵⁵ Frontier Economics response to Telstra, June 2012, p. 4.

¹⁵⁶ Frontier Economics response to Telstra, June 2012, p. 4.

¹⁵⁷ Telstra submission, 18 June 2012, p.15.

The Commission's final view is to apply an asset life of [c-i-c] [c-i-c] years implied by the FLSM for 'Other communications plant and equipment' to annualise capital costs of the ancillary equipment.

4.1.8 WACC

A pre-tax weighted average cost of capital (WACC) is used in Telstra's IIC cost model to calculate the annualised capital costs of ancillary equipment. Telstra's IIC cost model proposed a pre-tax WACC of [c-i-c] [c-i-c] per cent. However, Telstra did not provide further details regarding the calculation of this WACC value or information to support its use.

Commission's preliminary view

The Commission's preliminary view was to use a nominal pre-tax WACC as per the Commission's understanding of Telstra's IIC cost model.¹⁵⁸

The Commission considered that in calculating the WACC value, the Commission should use the parameters specified in the Commission's FLSM. This would align with the approach used to calculate the WACC, and its parameters, in the FLSM and provide an appropriate risk-adjusted rate of return to Telstra.

The Commission proposed the only adjustments needed to the WACC parameters used in the FLSM for the IIC costing were to update the risk-free rate, the nominal debt risk premium (DRP) and the debt issuance costs. This is because these parameters are estimated based on 20-day averages of the relevant securities from the period immediately prior to the relevant Commission decision.¹⁵⁹

In updating the risk free rate, the Commission proposed to maintain the methodology used to estimate the risk free rate in the FLSM for the declared fixed line services FADs. The Commission thus updated its estimate of the risk free rate by taking the 20 business day average for the period ending 30 April 2012 which gives a nominal risk free rate of 3.86 per cent.¹⁶⁰

In updating the nominal DRP, the Commission proposed to use an arithmetic average of nominal DRPs derived from two relevant Telstra bonds; the nominal DRP for each Telstra bond was derived based on the methodology used in the FLSM for the declared fixed line services FADs.¹⁶¹ This approach reflected that both Telstra bonds could serve as potential proxies for estimating the nominal DRP and led to a nominal DRP of 2.39 per cent.¹⁶²

The Commission proposed to maintain the use of the methodology developed by the Allen Consulting Group for estimating debt issuance costs as per the FLSM.¹⁶³ This approach estimates the debt issuance costs on the basis of the relevant nominal vanilla WACC. The Commission noted that updating the risk free rate and the nominal DRP resulted in a nominal vanilla WACC of 7.37 per cent and yielded a debt issuance cost of 7.71 basis points.

¹⁵⁸ Consultation Paper, p. 39.

¹⁵⁹ ACCC, Declared fixed line services FAD final report, July 2011, pp. 34-35.

¹⁶⁰ Consultation Paper, p. 37.

¹⁶¹ Consultation Paper, p. 38.

¹⁶² Consultation Paper, p. 38.

¹⁶³ ACCC, Declared fixed line services FAD final report, July 2011, p. 98; The Allen Consulting Group, Debt and Equity Raising Transactions Costs – Final Report, December 2004.

The WACC and WACC parameters which the Commission proposed to use were as follows:

Table 4.3: WACC parameters used in the IIC Consultation Paper

WACC parameter	Value for IIC determination
Nominal risk-free rate	3.86%
Nominal debt risk premium	2.39%
Debt issuance cost	0.0771%
Nominal market risk premium	6%
Equity beta	0.7
Debt gearing	40%
Gamma	0.45
Equity issuance costs	0%
Nominal vanilla WACC	7.37 %
Pre-tax nominal WACC	8.33%

Using these WACC parameters and the following pre-tax WACC formula, the Commission calculated a nominal pre-tax WACC of 8.33 per cent.¹⁶⁴

$$WACC_{pre-tax} = \frac{D}{V} \times E[K_d] + \frac{E}{V} \times \frac{E[K_e]}{1 - T_c(1 - \gamma)}$$

Submissions

Telstra May 2012 submission

Telstra did not make a submission on the WACC.

Responses to the Consultation Paper

Telstra submitted that ‘[it] does not take issue with the Commission’s proposed use of a 20 business day averaging period to estimate the risk free rate’.¹⁶⁵ However, Telstra noted that the Commission ‘should give consideration to the point in time over which the averaging period takes place, to ensure that the estimated risk free rate does not lead to [a WACC] that is unrepresentative of the required rate of return over the

¹⁶⁴ D = The market value of debt

E = The market value of equity

V = The market value of debt plus the market value of equity

$E[K_d]$ = risk free rate + DRP + debt issuance costs = The expected return on debt

$E[K_e]$ = risk free rate + equity beta * MRP + equity issuance costs = The expected return on equity

T_c = The corporate tax rate

γ = The market value of imputation credits

¹⁶⁵ Telstra submission, 18 June 2012, p. 16.

regulatory period'. Telstra submitted that this was 'particularly relevant given the current economic uncertainty associated with the European debt crisis.'¹⁶⁶ Telstra cited its October 2010 submission to the Commission's review of the pricing principles for the fixed line services regarding a longer averaging period.¹⁶⁷

Telstra also submitted that the Commission should estimate the nominal DRP based 'on the average Telstra corporate bond rate sourced from eight independent banks. Alternatively...the Commission should rely on the Bloomberg A-rated fair value curve extrapolated from 7 to 10 years'.¹⁶⁸ Telstra noted that its proposals are likely to represent a 'more accurate estimate of the DRP than the [Commission's approach which is based on two observable Telstra bond yields]'.¹⁶⁹

Frontier Economics submitted that they 'agree with the Commission's approach to WACC'.¹⁷⁰

Reply submissions

Telstra and Herbert Geer did not make further submissions on the WACC.

Commission's final view

As per the Commission's Consultation Paper, the Commission will maintain the IIC cost model's use of a nominal pre-tax WACC.

The Commission did not receive any further submissions on the following inputs:

- the pre-tax WACC formula used to estimate the pre-tax WACC in the IIC cost model
- the FLSM WACC parameters the Commission proposed to maintain in the Consultation Paper and the approach to estimate these parameters.

Therefore, the Commission's final view is to maintain the use of the above WACC parameters (except for the risk free rate, DRP and debt issuance costs) to calculate the WACC in the IIC cost model.

In the Consultation Paper, the Commission noted that the risk free rate, the nominal DRP and the debt issuance costs need to be updated using the approach outlined in the FLSM for the declared fixed line services FADs.¹⁷¹ This was because they were based on 20 day averages of the relevant securities used to estimate them. These parameters are discussed below.

Updating the risk free rate

The Commission notes that Telstra has asked the Commission to consider a longer averaging period than the 20-day period currently proposed.¹⁷² However, the Commission notes that Telstra itself has submitted that '[it] does not take issue with...a 20 business day averaging period'¹⁷³ and advocated a 20-trading day average

¹⁶⁶ Telstra submission, 18 June 2012, p. 16.

¹⁶⁷ Telstra, Pricing principles for fixed line services – Response to the ACCC's Draft Report, October 2010, paras [323]-[333].

¹⁶⁸ Telstra submission, 18 June 2012, p. 16.

¹⁶⁹ Telstra submission, 18 June 2012, p. 16.

¹⁷⁰ Frontier Economics report, June 2012, p. 9.

¹⁷¹ Consultation Paper, p. 36.

¹⁷² Telstra submission, 18 June 2012, p. 16.

¹⁷³ Telstra submission, 18 June 2012, p. 16.

to be applied in its submission to the Access Pricing Principles Draft Report.¹⁷⁴ Further, the Commission considers that a 20-day averaging period is consistent with the approach used in the FLSM to estimate the risk free rate.

Regarding Telstra's submissions as to the point in time over which the averaging period should take place, the Commission notes the recent analysis undertaken by the Australian Energy Regulator on estimating the risk free rate.¹⁷⁵ The Commission notes that the prevailing 10 year Commonwealth Government Securities (CGS) yield is a rate that is set in a liquid market and such markets are likely to reflect the actions of many market participants at each point in time. Therefore, market determined CGS yields are likely to reflect prevailing conditions in the market for risk-free returns. The Commission's proposed approach of estimating the average using the period just prior to the decision removes incentives for regulatory gaming that would exist if it were open to parties to select an estimation period of their choosing. Therefore, the Commission considers a 20-business day averaging period just prior to making the regulatory decision minimises the likelihood of bias.

The Commission's final view is therefore to maintain the methodology used to estimate and update the risk free rate used in the Consultation Paper.¹⁷⁶ The Commission also notes that, as for the Consultation Paper, the risk free rate requires updating for the Final Determinations. The Commission has therefore updated its estimate of the risk free rate by taking the 20 business day average for the period ending 2 November 2012 which gives a nominal risk free rate of 3.13 per cent.

Nominal debt risk premium

In relation to the nominal DRP, the Commission proposed to calculate it as the simple average of the nominal DRPs from relevant Telstra bonds. The nominal DRPs are calculated using the method used to calculate the nominal DRP in the FLSM.¹⁷⁷ This method derived the DRP as the difference between the 20-business day average of the yield to maturity (YTM) on the chosen debt proxy (10 year A-rated corporate bond) and the 20 business day average of the YTM on the chosen risk-free proxy (10 year CGS bond yield).

The Commission used a Telstra AUD-denominated corporate bond maturing on 15 July 2020 to estimate the DRP for use in the FLSM.

At the time of the Consultation Paper, Telstra had issued A-rated AUD-denominated, bullet or non-callable, corporate bonds maturing on 15 July 2020 (Telstra bond 1)¹⁷⁸ and 19 December 2023 (Telstra bond 2).¹⁷⁹ Since the Consultation Paper, Telstra has also issued another A-rated AUD-denominated, bullet corporate bond maturing on 5 May 2022 (Telstra bond 3).¹⁸⁰ The Commission notes that the addition of this third bond does not materially change the estimated DRP calculations, or indeed the WACC calculations which only have a minor impact on the IIC charge in any event.

¹⁷⁴ Telstra, Pricing principles for fixed line services – Response to the ACCC's Draft Report, October 2010, p. 83.

¹⁷⁵ AER, Access arrangements draft decision – APA GasNet Australia (Operations) Pty Ltd 2013-17: Part 2 attachments, September 2012.

¹⁷⁶ Consultation Paper, p. 37.

¹⁷⁷ Consultation Paper, p. 38.

¹⁷⁸ Bloomberg ticker, EI2917587 Corp.

¹⁷⁹ Bloomberg ticker, EI9022241 Corp.

¹⁸⁰ Bloomberg ticker, EJ1949316 Corp.

The Commission considers that these three bonds are relevant for the estimation of the DRP for the purposes of this IIC arbitration, given their relevance to the approach proposed in the Consultation Paper and used in the fixed-line FADs to estimating the efficient costs of debt. Further, the Commission considers that it is reasonable to use a simple average of the yield to maturity of each of these bonds, averaged over 20 business days, in order to estimate the DRP. This is consistent with the approach proposed in the Consultation Paper.

The Commission does not agree with Telstra's proposal for calculating the DRP based on average Telstra bond yields sourced from eight independent banks:

- Telstra did not provide details about how its proposed alternative approach would be implemented.
- The Commission considers that it is most appropriate to calculate DRP in a manner consistent with the FLSM, which uses market rates for existing bonds rather than bank estimates.

Further, the Commission notes that Telstra has proposed the option of extrapolating the Bloomberg A-rated fair value curve from 7 to 10 years in order to calculate the nominal DRP. However, consistent with the Commission's position in the 2011 fixed line services FAD final report, the Commission remains of the view that the difficulties in extrapolating the Bloomberg A-rated fair yield curve warrant the use of a more reliable methodology.¹⁸¹

The Commission's final view is therefore to maintain the approach used to update the nominal DRP in the Consultation Paper. With the issuance of Telstra bond 3 since the Consultation Paper, this approach calculates the nominal DRP as the simple average of the nominal DRPs from relevant Telstra bonds. The Commission also notes that, similar to the Consultation Paper, the nominal DRP requires updating for the Final Determination. The Commission has therefore updated its estimate of the nominal DRP by taking the 20 business day average for the period ending 2 November 2012 which gives an average nominal DRP for Telstra bond 1 of 1.43 per cent, Telstra bond 2 of 1.75 per cent and Telstra bond 3 of 1.66 per cent. This leads to an average nominal DRP of 1.61 per cent.

Debt issuance costs

The Commission notes that Telstra and Herbert Geer did not submit on debt issuance costs. The Commission's final view is therefore to maintain the approach used in the Consultation Paper to estimate and update the debt issuance costs.¹⁸² The Commission also notes that, as for the Consultation Paper, the nominal DRP requires updating for the Final Determinations. The Commission has therefore updated its estimate of the debt issuance costs to 7.4 basis points.

Commission's final view on WACC

The Commission's final view is to continue to use a nominal pre-tax WACC. The Commission considers that in calculating the WACC, the Commission should use the parameters used in the Commission's FLSM, except for the risk free rate, the nominal DRP and debt issuance costs for the reasons outlined above and in the Consultation Paper. The Commission considers that this would align the approach to the WACC

¹⁸¹ ACCC, Declared fixed line services FAD final report, July 2011, p. 68.

¹⁸² Consultation Paper, p. 39.

and the calculation of its parameters with the FLSM and provide an appropriate risk adjusted rate of return to Telstra.

The Commission’s final view is that the following WACC parameters should be used in the IIC determinations:

Table 4.4: WACC parameters for use in the IIC final determination

WACC parameter	Value for IIC determination
Nominal risk-free rate	3.13%
Nominal debt risk premium	1.61%
Debt issuance cost	0.074%
Nominal market risk premium	6%
Equity beta	0.7
Debt gearing	40%
Gamma	0.45
Equity issuance costs	0%
Nominal vanilla WACC	6.33%
Pre-tax nominal WACC	7.20%

Using the pre-tax WACC formula described earlier in this section, the Commission calculates a nominal pre-tax WACC of 7.20 per cent. The Commission’s final view is to use this WACC in the calculations to determine the IIC charge.

4.1.9 Operating and maintenance costs

Telstra’s IIC cost model proposed that the IIC charge should recover costs for operating and maintaining ancillary equipment used to supply the IIC service.

Telstra submitted that it bears all of the direct and indirect O&M costs for the ancillary equipment, including corporate overhead, project management and product management.¹⁸³ Telstra noted that its ‘financial systems are not set up to identify the specific O&M costs of the IIC’ so it has used the Commission’s FLSM to calculate a direct O&M factor of [c-i-c] [c-i-c] per cent.

Telstra estimated the cost of ongoing direct O&M by applying the direct O&M factor to the total per pair capital costs of the ancillary equipment. This cost component amounted to [c-i-c] [c-i-c] per pair per month in the IIC cost model.

Telstra also calculated the indirect O&M cost relating to the ancillary equipment by [c-i-c] [c-i-c]. This cost component amounted to [c-i-c] [c-i-c] per pair per month in the IIC cost model.

¹⁸³ Telstra submission, 11 May 2012, p. 10.

Commission's preliminary view

The Commission's preliminary view was to adopt the methodology used to estimate the direct O&M factor in Telstra's IIC cost model. However, the Commission disagreed with Telstra's calculation of the O&M mark-up factor. The Commission considered that the correct mark-up factor from the FLSM is [c-i-c] [c-i-c] per cent. The Commission also proposed to maintain the methodology used to estimate the indirect O&M costs in Telstra's IIC cost model.

Submissions

Telstra May 2012 submission

Telstra submitted that it rejects the Access Seeker's assertion that Telstra's maintenance costs are 'inexplicably high' and 'not a reasonable estimate'.¹⁸⁴ Telstra submitted that '[it] bears all of the direct and indirect operational and maintenance costs...of the ancillary equipment once an IIC is installed in Telstra's exchange'.

Telstra noted that there is an 'absence of information identifying the specific O&M costs incurred for the purpose of supplying the IIC'. However, Telstra submitted that it has estimated direct O&M costs by calculating a direct O&M factor and then applying the factor to the capital costs of the ancillary equipment.¹⁸⁵ Telstra also noted that the indirect O&M costs are estimated by applying the FLSM's indirect O&M factor of 80 per cent to the direct O&M costs.

In addition, Telstra submitted that 'its determination of the O&M factor is consistent with the approach in the FLSM'.¹⁸⁶

Telstra submitted a statement from its Product Manager for the IIC and co-location to support its submissions regarding management and maintenance of the IIC.¹⁸⁷

Responses to the Consultation Paper

Telstra submitted that its approach to calculating the direct and indirect O&M factors should be adopted by the Commission.¹⁸⁸ Telstra noted that its approach 'relies on the actual historic value of the assets which are relevant to the provision of the IIC service, rather than on an implied historical value from the FLSM'.

Herbert Geer submitted that the 'O&M component of the proposed IIC charge...should be removed from the Commission's cost modelling' because Telstra does not...incur [operation and maintenance (O&M) costs] as it does not carry out any O&M work on the IICs'.¹⁸⁹

Herbert Geer noted that 'it is easier and cheaper for [access seekers] to replace a faulty pair with an unused installed pair, rather than attempt maintenance' and that 'each access seeker has a large number of unused IIC pairs installed'.¹⁹⁰ Further, Herbert Geer noted that 'IIC O&M costs are at most nominal and usually non-existent, with Telstra's cost being lower if anything'.¹⁹¹ In addition, Herbert Geer

¹⁸⁴ Telstra submission, 11 May 2012, p. 10.

¹⁸⁵ Telstra submission, 11 May 2012, p. 11.

¹⁸⁶ Telstra submission, 11 May 2012, p. 12.

¹⁸⁷ Telstra submission, 11 May 2012, Annexure A – Statement of [c-i-c] [c-i-c], 11 May 2012.

¹⁸⁸ Telstra submission, 18 June 2012, p. 17.

¹⁸⁹ Herbert Geer submission, 18 June 2012, pp. 13-14.

¹⁹⁰ Herbert Geer submission, 18 June 2012, p. 13.

¹⁹¹ Herbert Geer submission, 18 June 2012, p. 13.

provided a witness statement which supported the Access Seekers' position that little or no maintenance is undertaken in relation to the IIC.¹⁹²

Frontier Economics submitted that they 'concur with the Commission's view on the appropriate mark-up ratio for O&M costs' and 'agree that the appropriate percentage mark-up on the basis of Telstra's own methodology should be... [c-i-c] [c-i-c]'.¹⁹³

Frontier Economics also noted that they have 'been informed...that [the Access Seekers] are not aware of any maintenance being undertaken by Telstra on the IIC assets, and [the Access Seeker] question [the inclusion of maintenance] in an IIC specific cost model'.¹⁹⁴ Frontier Economics further submitted that, if the asset classes used to supply the IIC service are already included in the FLSM and allocated to the four declared fixed line services, then the O&M costs for the IIC may already be included in the FLSM.¹⁹⁵

In addition, Frontier Economics submitted that 'it is...inappropriate to include an allowance for O&M if access seekers are already paying for, or undertaking at their own expense, the relevant maintenance activities'.¹⁹⁶ Frontier Economics noted that 'this could result in less entry by access seekers and higher prices for consumers' from access seekers 'being charged twice (or even up to three times) for the same activity'.¹⁹⁷

Reply submissions

Telstra submitted that Frontier Economics 'misunderstands the inputs and assumptions used to calculate the...O&M mark-up'. Telstra noted that Frontier Economics is 'incorrect in advocating the Commission's preliminary position' because it is 'based purely on a mechanical check of the Commission's calculation' and does not '[rely] on the actual historic value of [assets relevant to the provision of the IIC]'.¹⁹⁸

Telstra referred to its May 2012 submission and noted that 'access seekers and Frontier Economics are incorrect in asserting that Telstra does not incur O&M for the IIC'. Telstra also noted that 'IIC faults are not reported within its systems as IIC faults' because 'numerous alternative identifiers' are being used.¹⁹⁹

Telstra further submitted that access seekers will have limited visibility of any O&M because 'Telstra does not impose a separate charge for a repair event as a result of faults that are directly identified as IIC faults to the access seeker, but are related to a broader investigation of services and assets within Telstra exchange buildings'.²⁰⁰

Telstra also submitted that 'IIC costs are not recovered from the...four services modelled by the FLSM' and referred to sections of its June and July submissions for support.²⁰¹

¹⁹² Herbert Geer submission, 18 June 2012, Annexure 8 – Statement of Jamie Hall, 15 June 2012.

¹⁹³ Frontier Economics report, June 2012, pp. 9-10.

¹⁹⁴ Frontier Economics report, June 2012, p. 10.

¹⁹⁵ Frontier Economics report, June 2012, p. 10.

¹⁹⁶ Frontier Economics report, June 2012, p. 10.

¹⁹⁷ Frontier Economics report, June 2012, p. 10.

¹⁹⁸ Telstra submission, 2 July 2012, pp. 12-13.

¹⁹⁹ Telstra submission, 2 July 2012, pp. 13-14.

²⁰⁰ Telstra submission, 2 July 2012, pp. 13-14.

²⁰¹ Telstra submission, 2 July 2012, p. 14.

Frontier Economics submitted that Telstra's approach to O&M mark-ups 'generates a higher mark-up for the IIC [than the Commission's approach] and to be cost neutral this should be reflected in a lower O&M mark-up for other services priced using the FLSM which also use those assets'.²⁰² Frontier Economics also submitted that it supports the Commission's approach of using...O&M mark-ups across the [entire asset class] because it is consistent with the FLSM.²⁰³

Commission's final view

The Commission considers that its preliminary approach towards direct O&M costs proposed in the Consultation Paper remains appropriate.

The Commission notes that Telstra's IIC cost model calculates the direct O&M factor using the following formula:²⁰⁴

$$\text{Total Direct O\&M factor} = O\&M_{TD} / HV$$

Where:

$O\&M_{TD}$ = Total Direct O&M expenditure allocated to "Other Communications Plant and Equipment" in the ACCC's FLSM;

[c-i-c] [c-i-c]

Telstra estimates the cost of on-going O&M by applying the direct O&M factor calculated above to the capital cost of the ancillary equipment.

The formula uses the aggregate direct O&M expenditure allocated to 'Other communications plant and equipment' from the FLSM, as opposed to direct O&M expenditure that relates specifically to assets used to provide the IIC service. The Commission considers that, to remain consistent with this approach, the aggregate undepreciated value of the FLSM asset class 'Other communications plant and equipment' should be used. This yields a direct O&M factor of [c-i-c] [c-i-c] per cent, which was proposed by the Commission in the Consultation Paper.

The Commission notes that Telstra has submitted that its approach to calculating the direct O&M factor should be adopted by the Commission because it 'relies on the actual historic value of the assets which are relevant to the provision of the IIC service'.²⁰⁵ The Commission takes this to mean that the HV parameter should only relate to the undepreciated value of assets used to provide the IIC service in calculating the direct O&M factor.

Telstra has not supplied any material in support of its HV figure or material that would demonstrate to the Commission that Telstra's figure is more appropriate than the figures used in the FLSM for calculating O&M for the "Other communications plant and equipment" asset class. Therefore, the Commission considers it appropriate to continue to use the figures from the FLSM to calculate the O&M mark-up as per the Commission's Consultation Paper.

The Commission notes, however, that even if Telstra's approach was used, it could still lead to a direct O&M factor of [c-i-c] [c-i-c] per cent. This is because in setting

²⁰² Frontier Economics response to Telstra, June 2012, p. 3.

²⁰³ Frontier Economics response to Telstra, June 2012, p. 4.

²⁰⁴ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, p. 9.

²⁰⁵ Telstra submission, 18 June 2012, p. 17.

the HV in terms of “IIC-specific” assets, the O&M_{TD} parameter would need to be set in similar “IIC-specific” terms – rather than using the FLSM’s total value for O&M for ‘Other communications plant and equipment’.

Telstra’s IIC cost model sets the undepreciated value of assets used to provide IIC as [c-i-c] [c-i-c] which Telstra states is based on Telstra’s Integral Report.²⁰⁶ This is approximately [c-i-c] [c-i-c] per cent of the aggregate undepreciated asset value for ‘Other communications plant and equipment’ from the FLSM of [c-i-c] [c-i-c].

The Commission currently does not have specific information on the proportion of direct O&M costs for ‘Other communications plant and equipment’ that is used to provide the IIC service nor has Telstra submitted this information. However, the Commission could assume that these ‘IIC specific’ assets attract a share of O&M in proportion to their share of historic cost (i.e. [c-i-c] [c-i-c] per cent) and therefore reduce the direct O&M expense to [c-i-c] [c-i-c] per cent of the FLSM aggregate O&M figure of [c-i-c] [c-i-c]. Using Telstra’s direct O&M factor formula, these figures would still lead to a factor of [c-i-c] [c-i-c] per cent.

As stated in the Consultation Paper, the Commission notes the arguments from the Access Seekers that, when viewed in isolation, it may be found that the actual maintenance and management costs relating to the IIC may not be considerable. The Commission has considered both Telstra’s and Access Seekers’ submissions regarding the degree of management and maintenance that may or may not be involved in providing the IIC service.

However, the Commission’s view is that it is important to consider the IIC charge in the context of the other services (especially the declared services) supplied using Telstra’s network assets. That is, in order to promote consistency in pricing and avoid cost over- or under-recovery by Telstra, the IIC charge should be calculated in the context of the broader recovery of Telstra’s costs via the regulated charges, specifically with reference to the Commission’s FLSM.

For example, in determining the prices for the ULLS, the Commission was not able to precisely identify the O&M activities and costs that are specifically related to ULLS services and allocate O&M accordingly. Recognising this, the FLSM (predominantly) takes the approach of allocating O&M expenditure ‘to each asset class according to its share of the total undepreciated asset value.’²⁰⁷ Given the information before the Commission, and the complexities of alternatives, the Commission considers that this is a reasonable approach to allocating O&M costs.

Therefore, to ensure consistency with the FLSM, the Commission considers that the direct O&M costs in relation to the IIC should be calculated as set out above. This approach uses FLSM figures to estimate an O&M cost mark-up which is then applied to the relevant asset values in Telstra’s IIC cost model. It is also reasonable to use the indirect O&M mark-up rule used in the FLSM to estimate indirect O&M for the IIC service.

The Commission’s final view is to adopt the direct O&M factor implied by the FLSM of [c-i-c] [c-i-c] per cent and [c-i-c] [c-i-c] to the direct O&M cost of the equipment.

²⁰⁶ Telstra IIC Cost Model, February 2012; Telstra submission, 11 May 2012, p. 10.

²⁰⁷ ACCC, Declared fixed line services FAD final report, July 2011, p. 80.

4.1.10 Cost of the internal interconnection cable

Telstra's IIC cost model proposed that the IIC charge recovers costs related to the maintenance and management of internal interconnection cables. The capital cost of the cable is not recovered because Telstra noted that access seekers must supply and install the cable.²⁰⁸

The IIC cost model calculates a value for the capital cost of these assets in order to calculate direct and indirect O&M figures using the direct and indirect O&M factors. In calculating the capital cost for the cables, the model used Telstra's own cost of supplying and installing an average [c-i-c] [c-i-c] length of a [c-i-c] [c-i-c] pair cable-[c-i-c] [c-i-c].

In Telstra's IIC cost model, this cost component amounted to [c-i-c] [c-i-c] per pair per month.

Commission's preliminary view

The Commission's preliminary view was to use Telstra's estimate of the capital cost for an average [c-i-c] [c-i-c] length of a [c-i-c] [c-i-c] pair cable - [c-i-c] [c-i-c] - as the capital cost for the IIC.

The Commission noted that the use of Telstra's capital cost estimates for the IIC cables is not consistent with the fact that access seekers supply and install the cables. However, after considering the limited access seeker data available to the Commission on the cost of supply and installing cables, the Commission took the view that Telstra's estimate may be a useful proxy for access seeker costs for the purpose of the model.

The Commission also proposed to use Telstra's approach to calculate the direct O&M cost for internal interconnection cables using the FLSM's direct O&M factor for 'Other communications plants and equipment' (of [c-i-c] [c-i-c] per cent) and to calculate indirect O&M using the [c-i-c] [c-i-c] per cent uplift on direct operational expenditure.

Submissions

Telstra May 2012 submission

Telstra submitted that '[it] bears all of the maintenance and management costs associated with the IIC once it is installed in Telstra's exchange'.²⁰⁹

In addition, Telstra made the following submissions in response to the Gibson Quai report:

- Telstra does not impose a separate charge for switching a customer from a faulty copper pair to a new pair in the IIC.²¹⁰
- The IIC would be replaced by Telstra at its own cost if 'too many pairs in the IIC were recorded as faulty'.²¹¹

Telstra noted that 'neither Telstra's financial systems nor the Commission's FLSM are set up to identify the specific costs associated with maintenance and management

²⁰⁸ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, p. 10.

²⁰⁹ Telstra submission, 11 May 2012, p. 11.

²¹⁰ Telstra submission, 11 May 2012, p. 11.

²¹¹ Telstra submission, 11 May 2012, p. 12.

of the IIC'. Telstra submitted that '[it therefore] calculates the ongoing O&M costs of the IIC by applying the [ancillary equipment] direct and indirect O&M factors to the [capital cost] of an IIC pair'.²¹²

Telstra noted that 'its determination of the O&M factor is consistent with the approach in the FLSM'. Telstra therefore submitted that Frontier Economics' claim of 'a mixture of replacement cost and historic cost is incorrect'.²¹³

In addition, Telstra noted that there is on-going management of IIC information after cable installation, and ULLS/LSS connection and disconnection.²¹⁴ Telstra has also submitted an expert witness statement from [c-i-c] [c-i-c] in support of its views on this issue.²¹⁵

Responses to the Consultation Paper

Telstra submitted that the 'capital cost of the cable used in the IIC cost model is appropriate'.²¹⁶

Herbert Geer did not submit on the cost of the internal interconnection cable.

Reply submissions

Telstra and Herbert Geer did not make further submissions on the cost of the internal interconnection cable.

Commission's final view

The Commission notes that a more relevant basis for the estimation of the capital cost of internal interconnection cables would likely be to use the costs incurred by access seekers for this equipment. Given the limited information before the Commission, the Commission considers that Telstra's estimation is a reasonable proxy for access seeker costs.

The Commission's final view is therefore to use Telstra's estimate of [c-i-c] [c-i-c] adopting an average [c-i-c] [c-i-c] length of a [c-i-c] [c-i-c] pair cable, as the capital cost of internal interconnection cable for the purpose of the IIC cost model.

In terms of the O&M costs of the internal interconnection cable, the Commission's final view is to maintain the approach proposed in the Consultation Paper for reasons outlined in section 4.19. The Commission notes that this approach is consistent with the overall approach towards O&M costs in the IIC cost model.

4.1.11 Other pricing issues

The submissions raised other issues regarding the pricing of the IIC, including:

- whether the IIC charge should be levied on a 'pairs in use' or a 'pairs installed' basis, and
- whether the TEBA charges already recover IIC costs.

These issues are discussed below.

Pairs in use or pairs installed

²¹² Telstra submission, 11 May 2012, p. 12.

²¹³ Telstra submission, 11 May 2012, p. 12.

²¹⁴ Telstra submission, 11 May 2012, p. 12.

²¹⁵ Telstra submission, 11 May 2012, Annexure A.

²¹⁶ Telstra submission, 18 June 2012, p. 18.

Telstra's IIC cost model proposed to levy the IIC charge on a per-pair basis but did not specify if it was in terms of 'pairs-in-use' or 'pairs installed'.

Herbert Geer has raised the issue of whether the IIC charge should be levied for pairs 'in-use' rather than for the number of pairs installed. The Commission has also noted that [c-i-c] [c-i-c].

Commission's preliminary view

The Commission's preliminary view was to allow Telstra to levy the IIC charge on the number of pairs installed based on the following considerations:²¹⁷

- it is more consistent with approach adopted in the FLSM;
- a 'pairs in use' approach may create incentives for over provisioning of IIC by the access seekers, possibly leading to higher costs and implications for the use of shared facilities by other access seekers and Telstra; and
- it is more consistent with the current IIC charge regime. Based on Access Seeker submissions, IIC charges are currently levied on the majority of Access Seekers on a [c-i-c] [c-i-c].

Submissions

Telstra May 2012 submission

Telstra submitted that the IIC charge should be 'levied on pairs installed'.²¹⁸ Telstra noted that Frontier Economics' and Herbert Geer's suggestion of a pairs-in-use approach 'would prevent Telstra from recovering the full extent of its efficient costs in providing the IIC'. In addition, Telstra submitted that it has taken 'a conservative approach by not including the cost of housing the copper pairs installed on Telstra's MDFs (as distinct from access seekers' MDFs)'.²¹⁹

Responses to the Consultation Paper

Telstra did not submit on whether the IIC charge should be levied on 'pairs in use' or 'pairs installed' in its response to the Consultation Paper.

In responses to Telstra's comments that 'use of a pairs in use method would not allow it to recover its costs', Frontier Economics submitted that 'more than the costs of maintaining the cable could be recovered if there were more pairs installed (and being charged for) than could...be used on the MDF'. Frontier Economics also noted that 'it would be more conventional...to derive prices by dividing costs by a measure of asset usage rather by a measure of capacity'.²²⁰

Frontier Economics noted that if access seekers do connect all IIC pairs to the MDF as the Commission has noted, then the pairs in use will be very similar to the pairs installed.²²¹

Reply submissions

Telstra noted that it disagrees with Frontier Economics' view that there is 'a risk of...cost over recovery' with a pairs installed approach.²²² Telstra submitted that 'there

²¹⁷ Consultation Paper, pp. 44-45.

²¹⁸ Telstra submission, 11 May 2012, p. 13.

²¹⁹ Telstra submission, 11 May 2012, p. 13.

²²⁰ Frontier Economics report, June 2012, p. 11.

²²¹ Frontier Economics report, June 2012, pp. 11-12.

is no risk in cost-over-recovery' because 'the maximum number of pairs that can be installed on any MDF (128) is equal to the maximum number of pairs that can be connected (128)'.

Telstra submitted that the IIC charge 'should be levied on the basis of IIC pairs installed'.²²³ Telstra also submitted that it agrees with the 'Commission's view that a pairs installed method...is consistent with the FLSM'.

Herbert Geer did not make further submissions on whether the IIC charge should be levied on 'pairs in use' or 'pairs installed'.

Commission's final view

The Commission maintains that a 'pairs installed' approach for levying the IIC charge is appropriate.

The Commission notes Access Seeker submissions that the IIC charge should be levied on 'pairs in use' rather than 'pairs installed'. However, given that the IIC service requires the use of Telstra's exchange facilities for every pair installed in an exchange, the Commission considers that it is reasonable for Telstra to charge for the IIC on a 'pairs installed' basis.

The Commission maintains that a 'pairs in use' approach may create incentives for over provisioning of IIC by the access seekers, possibly leading to higher costs and implications for the use of shared facilities by other access seekers and Telstra. Also the Commission notes that the pairs-installed approach is more consistent with the current IIC charge regime.

IIC costs being recovered by TEBA charges

In the Consultation Paper, the Commission noted that Herbert Geer and Gibson Quai-AAS have submitted on IIC costs being recovered via Telstra's TEBA charges.²²⁴

Commission's preliminary view

The Commission's preliminary view was that the scope of this arbitration is to determine a level for the IIC charge that meets the legislative criteria. The Commission noted that it had not considered the reasonableness or otherwise of TEBA related charges more generally.

Submissions

Telstra May 2012 submission

Telstra submitted that '[its] costs of providing the IIC are not negligible and they are not recovered elsewhere, contrary to the Herbert Geer Submission and the Gibson Quai report'.²²⁵

Responses to the Consultation Paper

Telstra did not make a submission on this matter in its response to the Consultation Paper.

²²² Telstra submission, 2 July 2012, p. 14.

²²³ Telstra submission, 2 July 2012, p. 14.

²²⁴ Herbert Geer, Joint arbitration hearing of ULLS and LSS access disputes –Internal interconnection cable (IIC) charge, 30 March 2012, p. 8.

²²⁵ Telstra submission, 11 May 2012, p. 13.

Herbert Geer submitted that TEBA charges ‘should be considered, at least generally, in setting the IIC’.²²⁶ Herbert Geer submitted that, similarly to the Commission’s consideration of cost recovery via the regulated services in this arbitration, ‘the rack charges paid by the Access Seekers should be considered in deciding whether it is reasonable for Telstra to apply any charge for the IIC at all.’²²⁷

Herbert Geer submitted that ‘the Access Seekers consider that other TEBA charges, such as external interconnect charges and rack charges should also be reviewed at the same time ... as the review of the fixed line FADs prior to the end of the regulatory period.’²²⁸

Herbert Geer submitted that the Commission should consider TEBA charges in assessing the IIC charge against the legislative criteria for this arbitration decision.²²⁹

On behalf of the Access Seeker, Frontier Economics submitted that ‘it would be desirable to incorporate calculation of TEBA charges, including IIC charges, within the broader FLSM and pricing of declared fixed line services’.²³⁰

Reply submissions

Telstra and Herbert Geer did not make further submissions on this matter.

Commission’s final view

The Commission remains of the view that this arbitration is for the purpose of determining an IIC charge that addresses the relevant legislative matters. Therefore, Commission has not considered the reasonableness or otherwise of TEBA-related charges more generally.

4.1.12 Conclusions on pricing

The Commission’s final view regarding the pricing of the IIC charge is in line with the views presented in the Commission’s Consultation Paper. That is, the Commission will use Telstra’s IIC cost model with certain adjustments, such as the removal of MDF costs from the model.

Table 4.5 sets out the changes that the Commission considers it is appropriate to make to the IIC charge proposed by Telstra.

²²⁶ Herbert Geer submission, 18 June 2012, p. 18.

²²⁷ Herbert Geer submission, 18 June 2012, p. 18.

²²⁸ Herbert Geer submission, 18 June 2012, p. 19.

²²⁹ Herbert Geer submission, 18 June 2012, p. 19 ff.

²³⁰ Frontier Economics report, June 2012, p. 5.

Table 4.5: Effect of proposed change on Telstra's IIC charge

IIC charge submitted in Telstra's IIC cost model		[c-i-c] [c-i-c]
Cost item	Commission's proposed change	Change in monthly per-pair IIC charge (\$)
<i>Housing of the MDF blocks and vertical</i>	Removal of the MDF housing costs	[c-i-c] [c-i-c]
<i>Ancillary equipment capital costs</i>	Maintain the use of the cost estimates submitted by Telstra	N/A
<i>Asset life assumption</i>	Asset life of [c-i-c] [c-i-c] years instead of [c-i-c] [c-i-c] years	[c-i-c] [c-i-c]
<i>Pre-tax WACC</i>	Updated the FLSM's implied nominal pre-tax WACC (with updated RFR & DRP) to 7.20 per cent. Adopt this instead of Telstra's proposed pre-tax WACC of [c-i-c] [c-i-c] per cent	[c-i-c] [c-i-c]
<i>The proportion of cost borne by Telstra</i>	Use the appropriate proportion of costs borne by Telstra to calculate the monthly capital costs of ancillary equipment	[c-i-c] [c-i-c]
<i>Mark-up ratio for direct operating and maintenance (O&M) costs</i>	Adopt the FLSM's implied direct O&M ratio of [c-i-c] [c-i-c] per cent instead of [c-i-c] [c-i-c] per cent	[c-i-c] [c-i-c]
<i>Cost of the internal interconnect cable</i>	Maintain use of the cost estimates submitted by Telstra	N/A
<i>Cost of other MDF-related assets</i>	Removal of costs associated with MDF blocks, MDF verticals and MDF ladders	[c-i-c] [c-i-c]
Total effect of the Commission's proposed changes on the initial IIC charge specified by Telstra's IIC cost model		[c-i-c] [c-i-c]
The Commission's proposed IIC charge		\$0.056 per pair per month

* The figures for the individual changes have been calculated independently of each other.

** **[c-i-c] [c-i-c]** represents the combined effect of all the individual changes applied to Telstra's IIC model. This is different to adding up the individual changes proposed by the Commission. The difference between the combined effect and the sum of individual changes accounts for overlap between the effects of individual changes.

Based on the approach described above, the Commission has made adjustments to Telstra's IIC cost model. The adjusted IIC model produces a monthly cost of approximately \$0.056 per pair, or an annual cost of \$0.672 per pair. The Commission notes that this charge will be excluding GST.

Table 4.6 compares the breakdown of the IIC charge between Telstra's original IIC cost model and the Commission's adjusted model.

Table 4.6: IIC cost model comparison – Telstra model and ACCC adjusted

Cost Item	Cost Type	Monthly Per Pair Cost	
		Telstra's IIC model	ACCC adjusted model
Cable & MDF Block			
	O&M	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Equipment			
	Capital	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
	O&M	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Land & Building Accommodation			
	O&M	[c-i-c] [c-i-c]	\$0.000
TOTAL		[c-i-c] [c-i-c]	\$0.056

It is the Commission’s final view that the IIC charge proposed by Telstra be amended in line with the factors detailed above. These changes are necessary to avoid over recovery of costs, and to make the pricing methodology consistent with the FLSM in key respects. In coming to its final view, the Commission has had regard to the matters in s 152CR(1) of the CCA as discussed in the following section.

4.2 Consideration of the pricing approach against the matters in subsection 152CR(1) of the CCA

Introduction

The Commission must have regard to the matters specified in subsection 152CR(1) of the CCA when making a final determination. These are outlined in section 3.2 above.

The Commission provided the parties with its preliminary views on how these criteria should be interpreted in the Consultation Paper and sought the parties’ comments.

The Federal Court has recognised the potential tension between each of the matters in subsection 152CR(1) of the CCA, and the need for the Commission to give each of them varying weight in the decision making process.²³¹

As discussed in section 4.1.2, the Commission has had regard to these matters when developing its approach to pricing the IIC and in considering the various issues raised by parties in respect of the IIC charge. This section contains a detailed consideration of how the pricing approach in this final determination addresses the specified matters.

The parties’ submissions on the criteria, and the Commission’s views on those criteria, are set out below.

²³¹ Lindgren J in *Telstra Corporation Ltd v Australian Competition and Consumer Commission* [2008] FCA 1436 at [311]-[312]; Rares J in *Telstra Corporation Ltd v Australian Competition and Consumer Commission* [2008] FCA 1758 at [108] – [112].

General submissions on the mandatory considerations

Telstra submitted that ‘the IIC price determined by the Commission should reflect all of Telstra’s direct costs in providing the IIC which are not recovered elsewhere (s 152CR(1)(d)).’²³² Telstra submitted that ‘this would ensure the legitimate business interests of Telstra are protected (s 152CR(1)(b)), promote the long term interests of end users (s 152CR(1)(a)) and provide for ongoing efficient investment in facilities by Telstra and other providers and carriers (s 152CR(1)(b)).’

Telstra submitted that it ‘disagrees with the Access Seeker’s submissions regarding the promotion of legislative criteria.’²³³ Telstra submitted that ‘access prices should not be set below efficient cost recovery levels [and that] while below cost or arbitrary pricing may stimulate competition in the short term, the LTIE is served by a price that accurately reflects the cost of providing the service.’²³⁴

Herbert Geer submitted that while ‘the promotion of the LTIE is the Commission’s only *objective* as it is Part XIC’s only object, the LTIE is not, when setting the terms and conditions in determinations, the Commission’s only *consideration*.’²³⁵ Herbert Geer submitted that ‘this is because in addition to consideration of whether the objective of promotion of the LTIE is achieved, the Commission must also consider the ... mandatory criteria.’²³⁶ Herbert Geer submitted that ‘these considerations are not in any way at odds with promoting the LTIE because they feed in to what is the correct approach to promoting the LTIE.’²³⁷

Herbert Geer submitted that the Commission should consider the following ‘fundamental question’ when setting the IIC charge:²³⁸

‘What is the lowest price that can be set which will allow Telstra to recover its reasonable costs in providing the IIC service (including capital costs – i.e. return on, and of, capital)?’

Herbert Geer submitted that ‘the Access Seekers accept Telstra’s submission with regard to the Commission having an obligation to have regard to each of the mandatory criteria, however, Telstra’s submission is of little use when evaluating the competing ‘interests’ of the criteria in making a final determination.’²³⁹

Herbert Geer submitted that ‘in making its decision, the Commission will be required to accord greater weight to certain criteria over others in order to reach a final position.’²⁴⁰ Herbert Geer submitted that in *Telstra v ACT*, ‘the Court makes it clear that in evaluating legislated mandatory criteria that must be considered in making a decision it is necessary to assess how best to achieve the object of Part XIC, i.e. in having regard to the weight to be given to each mandatory criterion an assessment of whether it promotes the LTIE must be made.’²⁴¹ Herbert Geer submitted that ‘though the Commission must show it had regard to each mandatory criterion in determining

²³² Telstra submission, 18 June 2012, p. 19.

²³³ Telstra submission, 2 July 2012, p. 4.

²³⁴ Telstra submission, 2 July 2012, p. 4.

²³⁵ Herbert Geer submission, 18 June 2012, pp. 15-16.

²³⁶ Herbert Geer submission, 18 June 2012, p. 16.

²³⁷ Herbert Geer submission, 18 June 2012, p. 16.

²³⁸ Herbert Geer submission, 18 June 2012, p. 17.

²³⁹ Herbert Geer submission, 2 July 2012, pp. 7-8.

²⁴⁰ Herbert Geer submission, 2 July 2012, pp. 7-8.

²⁴¹ *Telstra Corporation Limited v Australian Competition Tribunal* [2009] FCAFC 23 at [256] to [278], and particularly [259] to [261].

these disputes, that regard must also be inclined towards achieving the object of Part XIC.²⁴²

4.2.1 Paragraph 152CR(1)(a) - LTIE

Submissions

Telstra submitted that ‘in having regard to each objective of the LTIE criteria outlined in section 152AB, the Commission must direct its attention to the “long-term”, which is “the period over which the full effects of the ... decision will be felt, with players adjusting to the decision, including by entering or exiting the relevant markets.”’²⁴³ Telstra submitted that ‘what is required is not some balancing between the short-term and the long-term, and a misplaced focus on the short-term may again lead the Commission into error.’²⁴⁴

Telstra stated that it ‘contends that the critical issue is that an efficient provider of access must recover its costs from the prices of access services, given the constraints imposed upon it.’²⁴⁵ Telstra submitted that ‘while prices that do not recover cost or are arbitrary may stimulate short-term but inefficient competition, such below-cost or arbitrary pricing necessarily has an adverse impact on long-term investment, and hence on long-term competition’.²⁴⁶ Telstra stated that ‘this is clearly not in the LTIE, the interests of access providers or of access seekers’.²⁴⁷

Herbert Geer submitted that ‘the Access Seekers agree with the Commission’s view that the relevant markets for the supply of the IIC are identical to the relevant markets for the LSS and ULLS, i.e. the markets for the retail and wholesale supply of fixed voice and broadband services; and the market for the retail supply of a bundle of fixed voice and broadband services’.²⁴⁸

Herbert Geer submitted that ‘changes in the IIC charge are likely to have a flow on effect in the relevant retail markets, and as such an IIC charge that reflects efficient costs will assist in achieving the LTIE objective.’²⁴⁹ Herbert Geer stated that ‘decreasing the IIC charge will lower the costs that the Access Seekers incur in providing retail services and promote the Access Seekers’ competitiveness, thereby promoting competition in downstream markets.’²⁵⁰

Herbert Geer submitted that ‘the Access Seekers agree with the Commission’s interpretation regarding the manner that access terms and conditions may encourage economically efficient use of, and investment in, infrastructure [and] that pricing reflecting the efficient costs incurred in supplying the IIC must have regard to Telstra’s broader recovery of network costs through the pricing of other services, including the pricing of the declared fixed line services.’²⁵¹

²⁴² Herbert Geer submission, 2 July 2012, pp. 7-8.

²⁴³ Telstra submission, 2 July 2012, p. 15.

²⁴⁴ Telstra submission, 2 July 2012, p. 15.

²⁴⁵ Telstra submission, 2 July 2012, p. 15.

²⁴⁶ Telstra submission, 2 July 2012, p. 15.

²⁴⁷ Telstra submission, 2 July 2012, p. 15.

²⁴⁸ Herbert Geer submission, 18 June 2012, p. 17.

²⁴⁹ Herbert Geer submission, 18 June 2012, p. 17.

²⁵⁰ Herbert Geer submission, 18 June 2012, p. 17.

²⁵¹ Herbert Geer submission, 18 June 2012, p. 18.

Commission's view

In the Commission's view, particular terms and conditions promote the interests of end-users if they are likely to contribute towards the provision of:

- goods and services at lower prices
- goods and services of a high quality, and/or
- a greater diversity of goods and services.

The Commission also notes that the Australian Competition Tribunal (Tribunal) has provided guidance in its interpretation of the phrase 'long-term interests of end-users' (in the context of access to subscription television services).²⁵²

To consider the likely impact of particular terms and conditions on the LTIE, the CCA requires the Commission to have regard to whether the terms and conditions are likely to result in:

- promoting competition in markets for carriage services and services supplied by means of carriage services
- achieving any-to-any connectivity, and
- encouraging the economically efficient use of, and economically efficient investment in:
 - the infrastructure by which listed carriage services are supplied, and
 - any other infrastructure by which listed services are, or are likely to become, capable of being supplied.²⁵³

Promoting competition

The Commission considers it relevant, in assessing whether particular terms and conditions (in particular setting the level of the IIC charge) will promote competition, to analyse the relevant markets in which the IIC is supplied (retail and wholesale) and to consider whether the prices set in those markets will remove obstacles to end-users gaining access to telephony and broadband services.²⁵⁴

The IIC is integral to the ULLS and LSS, without which the supply of either declared services is impossible. It is the Commission's final view that the relevant markets for the supply of the IIC will be identical to the relevant markets identified for the ULLS and LSS in the 2011 fixed line services FAD.²⁵⁵ Specifically:

- the market for the retail and wholesale supply of fixed voice services
- the market for the retail and wholesale supply of broadband services; and
- the market for the supply of a bundle of fixed voice and broadband services.

In the Final Access Determinations for the declared fixed line services (including the ULLS and LSS) the Commission considered that the prices for ULLS and LSS included in the FADs reflected the efficient costs and will promote competition in the

²⁵² *Seven Network Limited (No 4)* [2004] ACompT 11 at [120].

²⁵³ Subsection 152AB(2), CCA.

²⁵⁴ Subsection 152AB(4), CCA. This approach is consistent with the approach adopted by the Tribunal in *Telstra Corporations Limited (No 3)* [2007] A CompT 3 at [92]; *Telstra Corporation Limited* [2006] A CompT at [97], [149].

²⁵⁵ ACCC, Declared fixed line services FAD final report, July 2011, p. 20.

markets for carriage services, thereby promoting the LTIE.²⁵⁶ The Commission stated that ‘by setting wholesale access prices ... based on efficient costs, access seekers will be able to provide competitive services in retail markets.’²⁵⁷ The Commission also considered that the prices for the declared services in the FAD ‘will provide appropriate pricing signals for access seekers’ decisions on market entry and infrastructure investments (such as investment in DSLAMs).’²⁵⁸

The Commission considers that these views on efficiently incurred costs and the LTIE are equally relevant for the IIC final determination. The Commission considers that setting prices for the IIC based on efficiently incurred costs in supplying the IIC promotes competition in the relevant markets, by encouraging further ULLS and LLS based competition through prices that reflect costs.

Given the Commission’s views regarding prices in the FADs, and as stated in the Consultation Paper, the Commission approach to setting the IIC charge is to calculate the charge in the context of the broader recovery of Telstra’s costs via the regulated charges, specifically with reference to the Commission’s FLSM.²⁵⁹

For the reasons detailed in section 4.1, the Commission considers that it is appropriate to set an IIC charge using Telstra’s IIC model as a starting point and to make adjustments to this model. The Commission considers that these adjustments will i) avoid double recovery of costs being recovered through prices for the declared fixed lines services; and ii) make the IIC cost model’s parameters more consistent with those in the FLSM, which the Commission considered reflected Telstra’s efficient costs during the FAD process.

The Commission considers that using this adjusted model will lead to an IIC charge that is more reflective of the efficient costs incurred by Telstra in providing the IIC service, and is more reflective of the broader cost recovery of Telstra’s fixed line network costs via the regulated charges.

Therefore, it is the Commission’s view that the pricing approach taken to set the IIC charge is a reasonable estimate of the efficiently incurred costs of supplying the IIC service. As such, the Commission considers that the IIC charge of \$0.056 per pair per month will promote competition in the relevant markets (described above) for the supply of voice and/or broadband services.

Any-to-any connectivity

The Commission generally considers that price terms that closely reflect the efficient cost of supplying services will remove price obstacles to access seekers that are seeking any-to-any connectivity for downstream services. The cost based pricing approach for the IIC, as described in section 4.1, will likely have a positive effect on the acquisition of ULLS and LSS. It will have flow on benefits to downstream services as the costs of supplying retail voice and broadband services will likely decrease. The Commission is of the view that the IIC charge of \$0.056 per pair per month will indirectly promote any-to-any connectivity.

²⁵⁶ ACCC, Declared fixed line services FAD final report, July 2011, p. 143.

²⁵⁷ ACCC, Declared fixed line services FAD final report, July 2011, p. 143.

²⁵⁸ ACCC, Declared fixed line services FAD final report, July 2011, p. 143.

²⁵⁹ Consultation Paper, p. 28.

Efficient investment in and use of infrastructure

In determining the extent to which terms and conditions are likely to encourage the economically efficient use of and investment in infrastructure, regard must be had to:²⁶⁰

- whether it is technically feasible for the services to be supplied and charged for with regard to technology that is in use, available or likely to become available
- whether the costs involved in supplying and charging for the services are reasonable or likely to become reasonable
- the effects or likely effects that supplying and charging for the services would have on the operation or performance of telecommunications networks
- the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope
- incentives for investment in the infrastructure by which services are supplied, and any other infrastructure by which services are or are likely to become capable of being supplied, and
- the risks involved in making the investment.

In the Commission's view, the phrase 'economically efficient use of, and economically efficient investment in...infrastructure' refers to the concept of economic efficiency that consists of three components:

- productive efficiency – achieved where individual firms produce the goods and services that they offer at least cost
- allocative efficiency – achieved where the prices of the resources reflect their underlying costs so that resources are allocated to their highest valued uses (i.e. those that provide the greatest benefit relative to cost)
- dynamic efficiency – the need for industries to make timely changes to technologies and products in response to changes in consumer tastes and productive opportunities.

In the FAD final decision, the Commission considered that 'setting prices that allow the access provider to recoup its efficiently incurred costs, including a commercial return on its investments, will ... encourage the efficient use of, and investment in, the infrastructure used to provide the declared fixed line services.'²⁶¹

As discussed under the promotion of competition criterion above, the Commission considers that the IIC charge derived using the adjusted IIC cost model produces an appropriate estimate of the efficiently incurred costs of supplying the IIC service. The Commission considers that this IIC charge will allow Telstra to recover its efficiently incurred costs, including a commercial return on its investments. However, it will not allow Telstra to over recover its costs, having regard to broader cost recovery of its network costs through the pricing of other services, including the declared fixed line services. Having regard to the matters outlined above, the Commission considers this IIC charge will not only encourage efficient use of current infrastructure to supply the

²⁶⁰ Subsections 152AB(6) and (7A) of the CCA.

²⁶¹ ACCC, Declared fixed line services FAD final report, July 2011, p. 143.

IIC, but should also encourage efficient investment over time in IIC cables, and the equipment used to provide the IIC service, and DSLAM infrastructure investment more generally.

The Commission considers that, by promoting competition in the downstream markets, overall dynamic efficiency is encouraged as technological and product changes are encouraged in response to productive opportunities.

4.2.2 Paragraph 152CR(1)(b) – legitimate business interests of the carrier or provider

Submissions

Telstra submitted that the IIC price determined by the Commission should reflect all of Telstra's direct costs in providing the IIC which are not recovered elsewhere and that this would ensure the legitimate business interests of Telstra are protected (s 152CR(1)(b)).²⁶²

Herbert Geer submitted that 'the Access Seekers agree with the Commission's view that cost based IIC charges allow Telstra to recover costs consistent with its legitimate commercial interests.'²⁶³

Commission's view

The Commission is of the view that the concept of legitimate business interests should be interpreted in a manner consistent with the phrase "legitimate commercial interests" used elsewhere in Part XIC of the CCA. Accordingly, it covers the access provider's interest in recovering its cost, including earning a normal commercial return on its investment.

The Commission further notes that the cost of maintaining the IIC 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.²⁶⁴

The Commission's view is that the IIC charge set out in section 4.1 will allow Telstra to recover its costs and earn a commercial return on its investments, without allowing Telstra to over recover costs or recover any lost profits. The Commission considers that this is consistent with the Telstra's legitimate business interests.

4.2.3 Paragraph 152CR(1)(c) – the interests of all persons who have the right to use the service

Submissions

Telstra has not made a specific submission on this criterion.

Herbert Geer submitted it agreed with the Commission's views on this criterion in the Consultation Paper.²⁶⁵ It submitted that 'as the review of the fixed line FADs will take account of the outcome of these access disputes, access seekers other than those involved in these disputes have an interest in ensuring that the final determinations set an IIC charge that considers all relevant aspects of Telstra's cost recovery.'²⁶⁶

²⁶² Telstra submission, 18 June 2012, p. 19.

²⁶³ Herbert Geer submission, 18 June 2012, p. 19.

²⁶⁴ ACCC, *Access pricing principles – telecommunications*, July 1997, p. 9.

²⁶⁵ Herbert Geer submission, 18 June 2012, p. 19.

²⁶⁶ Herbert Geer submission, 18 June 2012, p. 19.

Commission's view

The Commission considers that in having regard to this matter it is required to consider the interests of access seekers.

The Commission's final view is that the IIC charge set out in section 4.1 reflects the efficient cost of supplying the IIC service. The Commission considers that this charge will not disadvantage the interests of access seekers.

The Commission notes that other access seekers who have not notified a dispute prior to the Commission making its ULLS and LSS FADs will not be able to notify access disputes in relation to the IIC charge. The Commission notes that the ULLS and LSS FADs do not set out the cost of the IIC charge. It is the Commission's view that the IIC charge will likely be considered in the review of the fixed line FADs prior to the end of the regulatory period in 2014, taking into account the outcomes in these access disputes.

4.2.4 Paragraph 152CR(1)(d) – the direct cost of providing access to the declared service

Submissions

Telstra submitted that the Commission correctly states that, “*the direct costs of providing access to a declared service are those incurred (or caused) by the provision of access*” [and] this is consistent with the judgement of Rares J in *Telstra Corporation v ACCC*.²⁶⁷ Telstra submitted that ‘Telstra’s IIC Cost Model accurately models the direct costs of providing access to the IIC service, and Telstra submits that the final determinations should take account of all cost components in that model.’²⁶⁸

Herbert Geer submitted that ‘the Access Seekers agree with the Commission’s views, particularly that the cost of providing the IIC is a direct cost of providing access to the declared services, the LSS and ULLS.’²⁶⁹ Herbert Geer submitted that the same points made in regards to the efficient investment in infrastructure regarding Telstra’s over recovery of TEBA rack costs apply to the Commission’s consideration of the criterion, on the basis that if Telstra’s direct efficient costs are otherwise recovered via excessive rack charges, it should not be able to over-recover through imposing a separate IIC charge.²⁷⁰

Commission's view

In this context the phrase ‘direct costs’ is interpreted to mean that an access price should cover the costs of access. This does not, however, extend to receiving compensation for loss of any ‘monopoly profits’ that occurs as a result of increased competition.²⁷¹ In this regard, the explanatory memorandum for the *Trade Practices Amendment (Telecommunications) Bill 1996* states:²⁷²

... 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

²⁶⁷ Telstra submission, 2 July 2012, p. 15.

²⁶⁸ Telstra submission, 2 July 2012, p. 16.

²⁶⁹ Herbert Geer submission, 18 June 2012, p. 19.

²⁷⁰ Herbert Geer submission, 18 June 2012, p. 19.

²⁷¹ ACCC, *Resolution of telecommunications access disputes – a guide*, March 2004 (revised), p. 56.

²⁷² See *Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996*, p. 44.

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.

The Commission also notes that the Tribunal is of the view that consideration of the direct costs 'is concerned with ensuring that the costs of providing the service are recovered.'²⁷³ The Tribunal has also noted that the direct costs could conceivably be allocated (and hence recovered) in a number of ways and that adopting any of those approaches would enable it to recover direct costs of investment in infrastructure.²⁷⁴

The Commission notes that although the IIC is not itself part of the declared services, it is necessary in order to provide access to the declared services. This would make the cost of providing the IIC a direct cost of providing access to the declared services.

In having regard to this matter the Commission has formed the view that the IIC charge set out in section 4.1 is an appropriate estimate of the efficient costs of supplying the IIC service, and hence compensates Telstra for the direct cost of providing access to the declared services. The Commission has removed elements from the IIC cost model, such as the MDF housing and other costs, where the Commission considers these costs are already being sufficiently recovered through other services (such as the ULLS, WLR and Telstra retail lines).

4.2.5 Paragraph 152CR(1)(e) – the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else

Submissions

Telstra did not submit directly on the paragraph 152CR(1)(e) criterion.

Herbert Geer agreed with the Commission's view that it is appropriate to take into account the costs that access seekers incur to install the IIC and other enhancements to Telstra's exchanges for housing of interconnection equipment.²⁷⁵ Herbert Geer submitted the Access Seekers' view that Telstra does not undertake maintenance of the IIC and that it does not incur costs in this regard.²⁷⁶

Commission's view

The Commission stated in its *Access pricing principles – telecommunications 1997* that if an access seeker enhances the facility to provide the required services, the access provider should not attempt to recover any costs related to this enhancement for themselves. Equally, if an access provider must enhance a facility to provide the service, it is legitimate for the access provider to incorporate some proportion of the cost of doing so in the access price.²⁷⁷

The Commission notes that the costs for installing equipment relating to the IIC have been borne by the access seekers or Telstra depending on the circumstances of a particular exchange. In having regard to this matter the Commission formed the view that the value to parties of these installations is confined to the provision of the IIC service by Telstra to the access seekers and that the pricing appropriately accounts for the costs borne by the different parties. The Commission is therefore of the view that

²⁷³ *Telstra Corporation Limited* [2006] ACompT at [92].

²⁷⁴ *Telstra Corporation Limited* [2006] ACompT 4 at [139].

²⁷⁵ Herbert Geer submission, 18 June 2012, p. 19.

²⁷⁶ Herbert Geer submission, 18 June 2012, p. 19.

²⁷⁷ ACCC, *Access pricing principles – telecommunications*, July 1997, p. 11.

the charge set out in section 4.1 adequately considers the value of extensions or enhancements whose cost has been borne by someone else regarding the provision of the IIC service.

4.2.6 Paragraph 152CR(1)(f) – the operational and technical requirements necessary for the safe and reliable operation of a carriage service, or a telecommunications network or a facility

Submissions

Telstra did not submit directly on the paragraph 152CR(1)(f) criterion. Herbert Geer submitted that ‘this criterion is unlikely to be relevant to these Access Disputes.’²⁷⁸

Commission’s view

The Commission considers that this matter requires regard should be had to whether the terms of access compromise the safety or reliability of carriage services and associated networks or facilities, and that this has direct relevance when specifying technical requirements or standards to be followed. The Commission considers that its decision does not compromise the safe and reliable operation of any carriage service, network or facility.

4.2.7 Paragraph 152CR(1)(g) — the economically efficient operation of a carriage service, a telecommunications network, or a facility

Submissions

Telstra submitted that ‘access prices should not be set below efficient cost recovery levels [and that] if they are, this will lead to long-term economic inefficiencies’.²⁷⁹

Telstra submitted that ‘both the object of Part XIC and the specific mandatory considerations outlined above will not be adequately addressed if the Commission’s final determinations fail to take into account all of Telstra’s efficient costs of providing the IIC service which are not recovered elsewhere’.²⁸⁰ Telstra stated that ‘in particular, these efficient costs include MDF housing and other related MDF costs, as well as the maintenance and management costs of providing the IIC service’.²⁸¹

Herbert Geer submitted that it agrees with the Commission’s views that an efficient cost based charge will promote the economically efficient operation of a carriage service, a telecommunications network or a facility.²⁸²

Commission’s view

The Commission’s Access Disputes Guidelines noted that the phrase ‘economically efficient operation’ embodies the concept of economic efficiency as discussed earlier in subsection 4.2.1.²⁸³ The Access Disputes Guidelines also noted that the Commission may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated efficiently.²⁸⁴ The

²⁷⁸ Herbert Geer submission, 18 June 2012, p. 19.

²⁷⁹ Telstra submission, 2 July 2012, p. 15.

²⁸⁰ Telstra submission, 2 July 2012, p. 15.

²⁸¹ Telstra submission, 2 July 2012, p. 15.

²⁸² Herbert Geer submission, 18 June 2012, p. 20.

²⁸³ ACCC, *Resolution of telecommunications access disputes – a guide*, March 2004 (revised).

²⁸⁴ ACCC, Access Dispute Guidelines, p. 57.

Commission has more recently restated these views in the 2011 declared fixed line services FAD.²⁸⁵

Consistent with the approach adopted by the Tribunal, the Commission considers that in applying this criterion, it is relevant to consider:

- the economically efficient operation of downstream services provided by access seekers using Telstra's WLR and LCS, or by Telstra itself in competition with those access seekers, and
- the telecommunications networks and infrastructure used to supply these services.²⁸⁶

The Commission considers that the IIC charge it has determined reflects the efficient costs of supplying the IIC service. Therefore, for similar reasons outlined at section 3.3.1 in relation to criterion 152 CR(1)(a), the Commission is of the view that the cost based charge for the IIC set out in this determination will encourage the economically efficient operation of the relevant carriage services, networks and facilities.

5 Additional Matters

5.1 Commencement date and backdating

Introduction

Under subsection 152DNA(1) of the CCA, any or all provisions of an FD may be expressed to take effect on a specified date that is earlier than the date on which the FD takes effect. The specified date (commencement date) must not be earlier than the date on which the parties to the FD commenced negotiations with a view to agreeing on the terms and conditions of access (subsection 152DNA(2)).

The Commission notes its preliminary view was that backdating was appropriate and the proposed commencement dates for each of the Access Disputes were the dates parties commenced negotiating with a view to agreeing the relevant terms and conditions.²⁸⁷ For the Access Seeker, the Commission proposed a commencement date of 2 December 2010.²⁸⁸

Submissions

Telstra submitted that the commencement date should be 21 days after the making of the FD in order to allow it sufficient time to effectively implement the FD.²⁸⁹ Should the Commission be inclined to backdate the provisions of the FD, Telstra submitted that there are no policy based reasons or other reasons why backdating should extend

²⁸⁵ ACCC, Inquiry to make final access determinations for the declared fixed line services - Final report, July 2011, p. 23.

²⁸⁶ *Telstra Corporation Limited* [2006] ACompT at [94]-[95].

²⁸⁷ Consultation Paper, p.52.

²⁸⁸ Consultation paper, p.52.

²⁸⁹ Telstra Submission, *Unconditioned Local Loop Service (ULLS) & Line Sharing Service (LSS) Access Disputes – Internal Interconnection Cable (IIC) Charge Submissions of Telstra*, 11 May 2012, p. 14. As previously noted this submission was received after the Commission finalised the Consultation Paper. It has been subsequently considered by the Commission in making the FDs.

beyond the notification date of the disputes between the parties (being 22 December 2010).²⁹⁰

Telstra reiterated this position in its 18 June 2012 submission.²⁹¹ In addition, Telstra submitted that several access seekers party to the Access Disputes over the IIC charge had demonstrated an unwillingness to actively negotiate by insisting on unreasonably low rates for the IIC.²⁹² Having regard to the principles in the Access Dispute Guidelines, Telstra submitted that the Commission should not backdate the provisions of the FD.²⁹³

Herbert Geer submitted that the Commission's approach to backdating in the Consultation Paper was appropriate.²⁹⁴ Having regard to the Access Dispute Guidelines and the Commission's decision in an access dispute between Primus and Telstra in 2007, Herbert Geer submitted that backdating is appropriate in the disputes between the parties because:

- the Access Seeker responded promptly to correspondences from the Commission and Telstra but Telstra had not made any reasonable settlement offers;
- Telstra did not comply with the Commission's time frames for submissions;
- backdating is important to redress the harm done by Telstra's unreasonable pricing of the IIC; and
- backdating strengthens the incentive for access providers to set reasonable prices in the future.²⁹⁵

On behalf of the Access Seeker, Herbert Geer submitted evidence of Chime Communications Pty Ltd's negotiations with Telstra in 2010 and proposed that the commencement dates in the FDs be backdated to 2 December 2010.²⁹⁶

Herbert Geer submitted that the Commission should reject Telstra's proposal for a commencement date 21 days after the making of the FDs with no backdating of the provisions of the FDs because:

- the proposal is contrary to the reasoning set out in the Access Dispute Guidelines which the Commission has followed in numerous FDs concerning Telstra's overcharging for access to declared services;
- the implementation of the FD is not an onerous task to complete; and
- the proposal would allow Telstra to retain many months of excessive payments which would hinder the Access Seeker's ability to compete with Telstra.²⁹⁷

Herbert Geer submitted the Commission should also reject Telstra's claim that the Access Seeker made unreasonable claims in negotiation. It submitted that:

- the Access Seeker had evidenced its attempts to negotiate with Telstra while Telstra had not provided evidence to support its claim;

²⁹⁰ Telstra Submission, 11 May 2012, p. 14.

²⁹¹ Telstra Submission, 2 July 2012, p.17.

²⁹² Telstra, Submission, 18 June 2012, p. [69]; Telstra, Submission, 2 July 2012, p. 17.

²⁹³ Telstra, Submission, 18 June 2012, p. [70].

²⁹⁴ Herbert Geer, Submission, 18 June 2012, p. 20.

²⁹⁵ Herbert Geer, Submission, 18 June 2012, pp. 20–22.

²⁹⁶ Herbert Geer, Submission – backdating annexure 1, 18 June 2012, p. 1.

²⁹⁷ Herbert Geer, Submission, 2 July 2012, p.10.

- the Access Seeker had explained the basis of its calculations of the IIC charges while Telstra had refused to do so;
- the claim by Telstra that its IIC charges are based on commercially agreed rates rather than any cost models demonstrates its continuing unwillingness to negotiate reasonably about the IIC charges; and
- the IIC charges offered by the Access Seeker were substantially closer to the proposed rates in the Draft Determinations than Telstra's current IIC charges.²⁹⁸

Commission's view

The Commission has determined that in the disputes between the parties backdating is appropriate from the date the Access Seeker commenced negotiation with Telstra. As set out above in the disputes between the parties the Commission considers the relevant date to be 2 December 2010.

The Commission's view is that backdating the commencement date to 2 December 2010 for the disputes between the parties is appropriate, and consistent with the approach followed in the Access Dispute Guidelines.

Commission's reasons

The Commission considers the evidence provided in by Herbert Geer on behalf of the Access Seeker has established that the Access Seeker commenced negotiations with a view to agreeing the relevant terms and conditions on 2 December 2010.

In reaching this determination, the Commission has considered Telstra's argument that it will require 21 days to implement the FD. The Commission does not accept that the argument raised by Telstra is relevant to the commencement date but has considered this submission below in relation to the settlement period for overpaid amounts.

5.2 Expiry date

Introduction

The transitional provisions contained within the CACS Act provide that an FD must specify an expiry date for the determination.²⁹⁹

In the Consultation Paper, the Commission proposed that the FD should expire on 30 June 2014. This is consistent with the expiry date of the ULLS and LSS FADs.

Submissions

Telstra submitted before the release of the Consultation Paper that the FD should expire on 31 July 2014 to align with the reassessment of the regulation of fixed line services.³⁰⁰ However, in response to the Consultation Paper, Telstra agreed with the Commission's proposed expiry date of 30 June 2014.³⁰¹

Herbert Geer submitted that the expiry date should align with the designated date for Telstra's Structural Separation Undertaking (SSU), being 1 July 2018. Herbert Geer

²⁹⁸ Herbert Geer, Submission, 2 July 2012, p.11.

²⁹⁹ Subitem 207(4) of the CACS Act.

³⁰⁰ Telstra, Submission, 11 May 2012, p. 14.

³⁰¹ Telstra, Submission, 18 June 2012, p. 19.

submitted the extra 4 years are needed to provide a greater degree of pricing certainty.³⁰²

Herbert Geer submitted that the Access Seeker was concerned that the Commission's FAD inquiry into fixed line services may not be concluded before the proposed expiry date of the IIC FDs. If this occurred, Herbert Geer submitted Telstra would be able to raise the price of access to the IIC and access seekers would have no regulatory recourse.³⁰³

Herbert Geer submitted that were the Commission to adopt the 30 June 2014 expiry date, the Commission should consider the IIC charge in its review of ULLS and LSS FADs. Herbert Geer noted that in such a case, those reviews should be commenced well in advance of the expiry of the FADs. Herbert Geer noted that adopting this approach would provide cost based access to the IIC for all future access seekers.³⁰⁴

Herbert Geer reiterated the Access Seeker's position regarding the expiry date in its reply submission.³⁰⁵ It submitted that due to Telstra's unwillingness to accept the IIC price reduction, it was important for the replacement FADs incorporating IIC charges to be implemented before the expiry of the current FADs.³⁰⁶

Commission's view

The Commission's determination is that the expiry date should align with the expiry date of the ULLS and LSS FADs, being 30 June 2014.

Commission's reasons

The Commission does not accept the arguments raised by Herbert Geer have established a need to extend the expiry date beyond 30 June 2014.

The Commission notes that no decisions have been made in regard to the future review of FADs for the ULLS and LSS services. Given that the IIC is necessary for the provision of the ULLS and LSS upon expiry of the FADs, the Commission may consider the IIC as part of any future review.

5.3 Interest

Introduction

Subsection 152DNA(6) of the CCA provides the Commission with a discretion to require interest to be paid in instances of backdating at a rate specified in the determination. The Commission must have regard to the Access Dispute Guidelines under subsection 152DNA(8) of the CCA.

In its Consultation Paper, the Commission expressed its view that having regard to the Access Disputes Guidelines interest should be payable in the disputes between the parties. Although not explicitly proposed, the Commission specifically noted the previous use of the Reserve Bank of Australia (RBA) Small Business Variable Other Overdraft Indicator Rate (the small business rate).

³⁰² Herbert Geer, Submission, 18 June 2012, p.23.

³⁰³ Herbert Geer, Submission, 18 June 2012, p.23.

³⁰⁴ Herbert Geer, Submission, 18 June 2012, p. 23.

³⁰⁵ Herbert Geer, Submission, 2 July 2012, p. 11.

³⁰⁶ Herbert Geer, Submission, 2 July 2012, p. 11.

The Access Dispute Guidelines specify where interest is to be paid, it will be calculated on the amounts of money that have been overpaid (or underpaid).³⁰⁷ The rate of interest should reflect the opportunity cost of the overpayment (or underpayment) and generally, daily compounding will be appropriate. The Guidelines also suggest that the opportunity cost could be assessed by reference to the rate applicable to debt financing.³⁰⁸

Submissions

Telstra submitted that interest should not be charged on backdated amounts given the lack of genuine negotiation by the Access Seeker. Telstra submitted that should the Commission decide to backdate and charge interest on the backdated amounts, the use of the small business rate would not be appropriate because:

- the parties to the current disputes are likely to be regarded as a large rather than small businesses;
- small business lending rates are generally higher than large business lending rates; and
- the use of the small business rate would overcompensate relative to the true opportunity cost incurred.³⁰⁹

Telstra submitted that the Large Business, Weighted-Average Rate on Credit Outstanding Variable Rate (the large business rate), which is published quarterly by the RBA is the most appropriate interest rate applicable to large businesses.³¹⁰

Telstra submitted that this rate is equivalent to the RBA Large Business Variable Indicator Rate which the Commission has applied in previous arbitrations.³¹¹

Herbert Geer submitted that under the Access Dispute Guidelines the interest rate applied on backdated amounts should reflect the opportunity cost of the overpayments, and argued that this can be assessed by using an appropriate measure of the cost of debt financing.³¹² Herbert Geer also submitted that:

- interest should be charged and compounded daily;
- interest should be paid from the date of each overpayment until the day that final settlement is paid by Telstra; and
- backdated payments should be paid to the Access Seeker, not credited towards future invoices, unless otherwise agreed.³¹³

³⁰⁷ Access Dispute Guidelines, p.63-64.

³⁰⁸ Access Dispute Guidelines, p.63-64.

³⁰⁹ Telstra, Submission, 18 June 2012, [78].

³¹⁰ Telstra, Submission, 18 June 2012, p. [79]-[81]; Telstra refer to the following arbitrations: Unconditioned Local Loop Service Access Dispute Between Telstra Corporation Limited and Primus Telecommunications Pty Ltd (monthly charges), December 2007; ACCC, Line Sharing Service Access Dispute Between Telstra Corporation Limited and Chime Communications Pty Ltd, August 2007 [sic].

³¹¹ Telstra, Submission, 18 June 2012, p. 22; Telstra refer to the following arbitrations: Unconditioned Local Loop Service Access Dispute Between Telstra Corporation Limited and Primus Telecommunications Pty Ltd (monthly charges), December 2007; ACCC, Line Sharing Service Access Dispute Between Telstra Corporation Limited and Chime Communications Pty Ltd, August 2007 [sic].

³¹² Herbert Geer, Submission, 18 June 2012, p. 23.

³¹³ Herbert Geer, Submission, 18 June 2012, p. 24.

Herbert Geer submitted that the difference between the small business rate and large business rate reflected the size of the relevant loan and not the size of the business obtaining the loan. It argued the small business rate was a better measure of the cost of debt financing as it more accurately reflected the monthly opportunity cost to the Access Seeker. It argued use of the small business rate was more in line with the Access Dispute Guidelines than the proposed rate submitted by Telstra.³¹⁴

Commission's view

The Commission's determination is that interest should be payable on any overpaid amounts in the disputes between the parties and that the small business rate is the appropriate rate. The Commission's determination is the small business rate is the appropriate rate because it most closely reflects the opportunity cost to the Access Seeker.

The Commission's determination is that interest should be calculated on a daily basis and compounded.

Commission's reasons

The Commission notes the arguments of both parties in relation to the appropriate interest rate. It also notes the Access Dispute Guidelines suggest that the opportunity cost could be assessed by reference to the rate applicable to debt financing.³¹⁵

In assessing the appropriate measure of the opportunity costs faced by the Access Seeker, the Commission considers the size of likely overpayments in the disputes is a more relevant factor than the size of the Access Seeker's business. Therefore, the small business rate is more appropriate as the loan size would be quite small.

The Commission is of the view the small business rate should apply as it is an approximate measure of the costs of financing debts of equivalent size to the overpayments in the disputes between the parties. The Commission considers the small business rate is representative of the actual financing costs which corporations (such as the parties to these disputes) would typically incur when undertaking commercial transactions.

5.4 Length of the Settlement Period

Introduction

Under the CCA an FD has effect 21 days after the determination is made. Any interest required to be paid will be calculated up to that date.³¹⁶

Submissions

Telstra submitted that the commencement date should be 21 days after the making of the FD in order to allow it sufficient time to effectively implement the FD.³¹⁷ As described above the Commission did not accept Telstra's argument when determining the commencement dates for the disputes between the parties.

³¹⁴ Herbert Geer, Submissions, 2 July 2012, pp. 12-13.

³¹⁵ Access Dispute Guidelines, p.63-64.

³¹⁶ Subsections 152DN(1) and 152DNA(6)(d) of the CCA.

³¹⁷ Telstra, Submission, 11 May 2012, p. 14. This submission was received after the Commission finalised the Consultation Paper. It has been subsequently considered by the Commission in making the FD.

Herbert Geer submitted backdated payments should be paid to the Access Seeker and not credited towards future invoices but did not make submissions that addressed the length of the settlement period.³¹⁸

Commission's view

The Commission has determined that settlement of overpaid amounts and interest should occur within 42 days after the date on which the FD is made.

Commission's reasons

The Commission is of the view that a settlement period of 42 days will allow Telstra sufficient time to effectively implement the FD as per its submission and then a further 21 days to settle payment of any overpaid amounts with the Access Seeker.

5.5 Glidepath

Submissions

Telstra submitted the Commission has utilised glidepaths in other regulatory processes such as the Mobile Terminating Access Service FAD for the period 2012-2014. Telstra submitted that if the IIC charge is to be substantially reduced, the reduction should be implemented as a glidepath rather than a step change.³¹⁹

Herbert Geer submitted that the glidepath approach would be inappropriate as it would allow Telstra to reap excessive charges for longer period, which would be contrary to the LTIE.³²⁰

Commission's view

The Commission's view is that it is not appropriate to set a glidepath for the IIC charge in FDs for the disputes between the parties.

Commission's reasons

The Commission is of the view that it is in the LTIE that amounts payable for access to the IIC that have exceeded the price set out in the FDs should be lowered immediately rather than lowered in steps.

³¹⁸ Herbert Geer, Submission, 18 June 2012, p 24.

³¹⁹ Telstra, Submission, 18 June 2012, p. [76].

³²⁰ Herbert Geer, Submission, 2 July 2012, p. 12.

Appendix A: Consultation process chronology

The following details the consultation process undertaken by the Commission:

22 December 2010	Adam Internet, Agile, Chime and Netspace make the first notifications of access disputes in regard to the IIC charge.
14 January 2011	The Commission is constituted of Commissioner Willett and Commissioner Dimasi. The acting Chairman determined that access disputes are to be heard as a joint arbitration hearing.
21 January 2011	Confidentiality orders and directions to produce customer relationship agreement documents issued to the initial parties.
11 March 2011	Network Technology and Wideband notify access disputes in regard to the IIC charge.
25 March 2011	The disputes notified by Network Technology and Wideband were added to the joint arbitration hearing.
19 April 2011	Updated confidentiality orders issued and final directions to produce customer relationship documents issued to Network Technology, Wideband and other parties to the Access Disputes.
12 May 2011	TPG notifies the last disputes in the arbitration hearing.
10 June 2011	The disputes notified by TPG were added to the joint arbitration hearing.
5 July 2011	Updated confidentiality orders issued and final directions to produce customer relationship documents issued to TPG and other parties to the Access Disputes.
5 July 2011	Directions to provide information about the class of assets used to provide the IIC issued to all parties.
19 July 2011	Submissions received in relation to directions dated 5 July 2011 to provide information.
20 July 2011	The ACCC makes final access determinations for LSS and ULLS (no further disputes can be notified).
5 August 2011	The access seekers make a request for RAF RKR data under sections 151BUA, 151BUB and 151BUC of the CCA.
16 November 2011	The Commission issues draft direction on providing information on the costs of providing the IIC to Telstra.
23 and 28 November 2011	Submissions received in response to draft direction dated 16 November 2011.
10 January 2012	Direction issued to Telstra to provide information and draft direction for access seekers to provide information.
20 January 2012	Access seekers provided comments on draft directions dated

	10 January 2012.
3 February 2012	Direction to access seekers to provide information issued.
13 February 2012	Telstra provided costing information and IIC pricing model as per directions dated 10 January 2012.
17 February 2012	Access seekers provided cost information as per directions dated 3 February 2012.
21 February 2012	Access seekers made confidentiality requests regarding the information they provided on 17 February 2012.
22 February 2012	Telstra made a confidentiality request regarding information it provided on 13 February 2012.
15 March 2012	Letter to parties requesting submissions on each others' confidentiality request and any further information prior to making a draft final determination.
22 March 2012	Parties' submissions regarding other parties' confidentiality requests.
30 March 2012	Parties' submissions regarding further information as the ACCC requested on 15 March 2012.
11 May 2012	Telstra submitted further information to ACCC.
21 May 2012	Draft final determinations and consultation paper sent to parties.
18 June 2012	Submissions from parties on draft final determinations and consultation paper.
2 June 2012	Submissions in reply from parties on draft final determinations and consultation paper.
18 July 2012	Telstra made confidentiality requests regarding materials in its submissions and submissions in reply on the draft final determinations.
31 July 2012	Letters to access seekers requesting submissions on Telstra's confidentiality requests.
3 August 2012	The ACCC is informed by a number of access seekers that they do not object to Telstra's confidentiality requests of 18 July. No objections were received.
21 November 2012	The Commission issued FDs and statements of reasons to the parties.

Appendix B: Description of Telstra's IIC cost model

On 10 January 2012 the ACCC issued a direction to Telstra to provide information regarding the costs of providing the IIC service. On 13 February 2012 Telstra submitted an IIC pricing model and produced a cost of [c-i-c] [c-i-c] per pair per annum, or [c-i-c] [c-i-c] per pair per month. This appendix reproduces the Commission's description of Telstra's IIC cost model from the Consultation Paper. Telstra has identified three major cost components in its IIC cost model.³²¹

- a) the housing of the MDF blocks and verticals,
- b) capital, and operational and maintenance (O&M) costs for ancillary equipment, and
- c) maintenance and management of the IIC.

The outputs of Telstra's IIC cost model are expressed on a per monthly per pair basis as follows:

Table A: Telstra's IIC Cost model outputs³²²

Cost Item	Cost Type	Monthly Per Pair Cost		
		2009_10	2010_11	2011_12
Cable & MDF Block	O&M	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Equipment	Capital	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
	O&M	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
Land & Building Accommodation	O&M	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]
	Total	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]	[c-i-c] [c-i-c]

Each of these components is described below.

Housing of the MDF blocks and verticals

Telstra submitted that this cost is incurred by Telstra in making land and building facilities available for use by access seekers to house blocks on an MDF vertical.

The cost of housing the MDF infrastructure is calculated by Telstra according to the following formula.³²³

$$MDF_Housing = ((L\&B_r \div AF_{er}) \times MDF_f) \div [c-i-c] [c-i-c]$$

Where:

- $L\&B_r$ = monthly land and building facility rental ([c-i-c] [c-i-c])
- AF_{er} = average footprint of an equipment rack ([c-i-c] [c-i-c])
- MDF_f = MDF vertical footprint ([c-i-c] [c-i-c]), and
- [c-i-c] [c-i-c] = the total number of pairs per MDF vertical.

³²¹ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, p. 3.

³²² Telstra, Letter to the ACCC, 13 February 2012, p. 3.

³²³ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, pp. 3-5.

Essentially, this formula:

- took a monthly land and building facility rental charge ($L\&B_r$) that is calculated on a basis of a standard equipment rack size
- divided it by the standard rack size ([c-i-c] [c-i-c]) to produce a per metre squared price
- multiplied this by the average footprint of an MDF vertical (which it calculates as [c-i-c] [c-i-c]), and
- divided this price across its estimation of the standard number of cable pairs per MDF vertical.

This cost component amounts to ([c-i-c] [c-i-c]), per pair per month.

Telstra's IIC cost model assumed average monthly rental of [c-i-c] [c-i-c] per [c-i-c] [c-i-c] for land and building rental. Telstra submitted that this is based on the market value of traded land and building facilities with characteristics similar to those required for the provision of IIC.³²⁴ To support the use of this figure, Telstra submitted that:

- Neither Telstra's financial accounting system nor the ACCC's FLSM calculates Telstra's land and building facilities at their competitive economic value, meaning that another estimate of economic value is needed.
- The competitive economic value of Telstra's land and building facilities can be estimated by using the market value of traded land and building facilities with characteristics similar to those required for the provision of IIC (security, safety, power, lighting, air-conditioning, fire protection, de-staticised flooring, standardised rack size etc).
- Colocation facilities are substitutes for Telstra's land and building facilities. They are physical facilities where space for telecommunications equipment (and bandwidth) is available for rental.
- The range of competitive colocation prices surveyed by Telstra show that the approximate average market price for access to Telstra's land and building facilities is representative of the economic value of the relevant land and building cost.

Telstra supplied survey results of colocation land & building facility rental prices for a range of colocation providers for ¼, ½, ½ and full rack facilities. The prices range from \$400 for ¼ rack colocation per month to \$2,400 for full rack colocation per month. Telstra states that the range of competitive colocation prices surveyed shows that the approximate average market price for access to Telstra's land and building facilities is representative of the economic value of the relevant land and building

³²⁴ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, p. 4.

cost.³²⁵ Telstra's IIC cost model applies a monthly price of [c-i-c] [c-i-c] for Telstra's land and building facilities rental.³²⁶

Capital and O&M costs for ancillary equipment

Telstra submitted that it incurs both capital and operations and maintenance (O&M) costs for ancillary equipment needed to facilitate the installation and operation of the IIC.³²⁷

Telstra submitted a list of the types of ancillary equipment included in estimating these capital and O&M costs:

- MDF vertical – a structural frame for the installation of MDF blocks
- MDF Blocks – terminating cables and jumpers
- Cable Riser – allows cables to be run vertically in an equipment building between floors
- Wall penetration for cable runs – allows cables to be passed from one room to another
- Floor penetration for cable runs – allows cables to be passed from one floor to another
- Cable tray – provide support paths for cables (signal, power and fibre) above equipment area
- Planar tray – provide support for cables (signal, power and fibre) above equipment area
- Teltray platform – provide a workable platform for technicians to work above the equipment area
- MDF Ladder – allows safe access to the highest block on the end vertical
- Safety mesh – required directly above rack bays to reduce risk of injury
- Lighting – general lighting
- Ladder (Access) – allows safe access to the equipment on higher level, and
- Safety Rail – safety handrail for ascending or descending a ladder for working above rack level on Teltray platform.

Ancillary equipment - capital costs

Telstra submitted that it generally pays for the capital costs of this ancillary equipment, except when the current capacity for any such equipment in the Telstra exchange building is not sufficient to cater for Telstra's current and future requirements plus the Access Seeker's requirements.

However Telstra's IIC cost model did not include the capital costs of the MDF blocks as access seekers supply and install their own MDF blocks.

³²⁵ *ibid* p. 5.

³²⁶ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, p. 5.

³²⁷ Telstra, Letter to ACCC, Annexure C - Telstra's Internal Interconnection Cable Cost, 13 February 2012, pp. 7-10.

The model used Telstra's estimates of the capital costs for the ancillary equipment, then divides these by the number of pairs which each item of equipment can service, in order to establish a per pair capital cost.

In order to determine this monthly capital cost component for the IIC charge, Telstra's model used the following approach:

$$\text{Monthly capital costs} = \frac{\text{Annualised capital costs of equipment} \times \text{Proportion of equipment borne by Telstra}}{12}$$

The annualised capital cost in this formula is derived using a tilted annuity formula (with a tilt = 0).³²⁸ The IIC model uses the following tilted annuity formula:

$$\text{Annualised capital cost} = \frac{\text{Cost} * (\text{Pretax WACC} - \text{Price Trend}) * (1 + \text{Price Trend})^t}{(1 - ((1 + \text{Price trend}) / (1 + \text{Pretax WACC}))^{\text{asset life}})}$$

The pre-tax WACC used by Telstra is [c-i-c] [c-i-c] per cent. Telstra assumed the asset lives for the ancillary equipment to be [c-i-c] [c-i-c].

In order to ascertain the proportion of these capital costs borne by Telstra, Telstra adopted two different methodologies – one for MDF verticals and another methodology for other ancillary equipment.

In summary, Telstra's model estimated the proportion of Exchange Service Areas (ESAs) where Telstra may have spare ancillary equipment capacity and therefore where this spare capacity is used to provide the IIC, rather than access seekers having to install new ancillary equipment. These calculations estimated the spare capacity in each ESA by comparing access seekers' Services in Operation (SIOs) (plus a buffer for spare capacity) against the number of spare SIOs (the difference between historic and 2009-10 PSTN SIOs).

For the general ancillary equipment, Telstra has calculated the proportion of this equipment borne by Telstra using the following assumptions and method. An access seeker is required to build additional infrastructure such as ladders, lighting, cable riser etc. only when there is insufficient capacity available to cater for their requirements. Telstra estimated that the spare capacity that would have been available in each relevant ESA by comparing the number of spare PSTN lines in an ESA (that is, the number that were used at one point in time but were no longer used in the ESA at the time the ULLS and LSS was first purchased) and the number of ULLS plus LSS lines that would be needed in the same ESA (plus a 10 per cent spare capacity buffer). The ACCC notes that the spare capacity of 10 per cent is likely to be shared between Telstra and Access Seekers as Telstra did not specifically state the allocation of the spare capacity to any particular party.

The formula used by Telstra for this calculation is:

³²⁸ The ACCC notes that there is a minor difference between Telstra's formula and other general tilted annuity formula, such as that proposed by Henry Ergas. This minor difference lies in the numerator where the IIC model has its (1+Price Trend) to the power of t and Ergas' formula has its (1+Price Trend) to the power of (t-1). As Telstra's model uses a Price Trend of 0 (tilt=0) there is no practical effect from this difference in the formula, however if the Price Trend did not equal zero there would be an effect.

Proportion of equipment borne by Telstra

$$= \frac{\Sigma (\text{ESA with spare infrastructure capacity as at June 2010})}{\Sigma (\text{ESA with Access Seekers (ULLS \& LSS) as at June 2010})}$$

Where:

An ESA is an ESA with spare infrastructure capacity when the [SIOs (ULLS + (2 × LSS)) as at June 2010] > 0

And

the [SIOs (ULLS + (2 × LSS)) as at June 2010 + additional 10%] ≤ [difference in demand (PSTN SIOs) between 2001_02 and 2009_10]

Note that Telstra's formula multiplies by two the number of LSS SIOs, as the provision of the LSS requires two IIC copper pairs.

Telstra's calculations yielded the results in Table 4.4. This shows that Telstra estimated that it bears [c-i-c] [c-i-c] per cent of the IIC capital costs relating to general ancillary equipment.

Table 4.4: Telstra's estimation of ESA's with spare infrastructure

[c-i-c] [c-i-c]

Telstra followed a similar approach for calculating whether MDF vertical capacity is available at an exchange.

Telstra assumed that an access seeker is required to build a new MDF vertical (capable of serving [c-i-c] [c-i-c] pairs) only if there is insufficient existing MDF block spare capacity available to cater for Telstra's and the Access Seeker's requirements. Telstra assumed that there is spare MDF vertical capacity if the number of spare MDF blocks available plus the MDF blocks freed due to a fall in the number of PSTN lines exceeds the number of MDF blocks required for ULLS and LSS SIO (plus 10 per cent to allow for ULLS and LSS spare capacity). The ACCC notes that, as in the case of the ancillary equipment, the spare capacity of 10 per cent is likely to be shared between Telstra and access seekers as Telstra did not specifically state the allocation of the spare capacity to any particular party.

Telstra assumed that the maximum number of pairs that can be terminated on an MDF is 128. Rounding is required as an MDF block cannot be shared with other access seekers.

The formula used by Telstra is:

Proportion of MDF verticals borne by Telstra

$$= \frac{\Sigma (\text{ESA with spare MDF vertical capacity as at June 2010})}{\Sigma (\text{ESA with Access Seekers (ULLS \& LSS) as at June 2010})}$$

Where:

An ESA is an ESA with spare MDF vertical capacity when the [SIOs (ULLS + (2 × LSS)) as at June 2010] > 0

And

the [SIOs (ULLS + (2 × LSS)) as at June 2010 + additional 10%] ÷ [c-i-c] [c-i-c] (rounded up to next whole number) ≤ [difference in demand (PSTN SIOs) between 2001_02 and 2009_10] ÷ [c-i-c] [c-i-c] (rounded down to last whole number)

Telstra’s calculations yielded the results in Table 4.5. This shows that Telstra estimated that it bears [c-i-c] [c-i-c] per cent of the IIC capital costs relating to MDF verticals.

Table 4.5: Telstra’s estimation of ESA’s with spare infrastructure

[c-i-c] [c-i-c]

The ACCC notes that Telstra has not provided evidence to support the use of 10 per cent as an appropriate figure to represent ULLS and LSS spare capacity requirements.

Telstra’s IIC cost model determined a monthly capital cost for ancillary equipment by using [c-i-c] [c-i-c] to estimate the total ancillary equipment capital costs. The proportion of the total ancillary equipment capital costs borne by Telstra is estimated, using the above methodology, and converted to a monthly per pair capital cost of [c-i-c] [c-i-c] which is recovered through the IIC charge.

Ancillary equipment – O&M costs

Telstra’s IIC cost model assumes that Telstra bears all of the direct and indirect O&M costs for the ancillary equipment, including corporate overhead, project management and product management costs.

Telstra has used the ACCC’s FLSM to calculate the direct O&M factor.

$$\text{Total Direct O\&M factor} = O\&M_{TD} / HV$$

Where:

O&M_{TD} = Total Direct O&M expenditure allocated to “Other Communications Plant and Equipment” in the FLSM, and

[c-i-c] [c-i-c]

Telstra’s IIC cost model calculates a direct O&M factor of [c-i-c] [c-i-c] per cent.

Telstra estimated the cost of ongoing O&M by applying the direct O&M factor to the total per pair capital costs of the ancillary equipment –the capital costs borne by both Telstra and the access seekers.

Telstra also calculated an indirect O&M cost related to the ancillary equipment by [c-i-c] [c-i-c]. The indirect O&M factor used in the FLSM is 80 per cent of the direct O&M costs.

The total direct and indirect O&M costs for the ancillary equipment calculated by Telstra are [c-i-c] [c-i-c] per pair per month.

O&M costs for cable and MDF blocks

Telstra submitted that it is responsible for the O&M of the IIC once the IIC has been installed. Therefore, Telstra’s model includes an estimate of the on-going O&M costs in respect of the cable and MDF blocks by applying the same direct and indirect O&M factors as used for the ancillary equipment to the cable and MDF block capital costs.

Telstra assumed the use of a [c-i-c] [c-i-c] cable with [c-i-c] [c-i-c] pairs.

These O&M costs are then allocated to individual pairs by dividing them by the maximum number of pairs per cable/per MDF block.

Telstra's model calculated these costs to be [c-i-c] [c-i-c] per pair per month.