**Access Dispute Between**
**Chime Communications Pty Ltd (Access Seeker)**
**and**
**Telstra Corporation Limited (Access Provider)**
**Line Sharing Services (LSS)**
**Publication of Final Determination and associated statement of reasons under Section 152CRA of the *Trade Practices Act 1974***

## INTRODUCTION

On 12 July 2007, the Australian Competition and Consumer Commission made a final determination in this dispute (copy appended). Having consulted the parties, the Commission has decided to publish this Final Determination and the reasons for making it. At the request of a party, commercial-in-confidence information has been redacted prior to the publication of this statement of reasons for decision.

## STATEMENT OF REASONS

## EXECUTIVE SUMMARY

The Commission has specified certain of the terms on which Telstra supplies the Line Sharing Service ('LSS') to Chime Communications. These are LSS annual charges, and the terms on which wholesale ADSL services are migrated to the LSS. This follows the parties being unable to agree on them, and Chime notifying the dispute for Commission arbitration.

The Commission has specified a LSS annual charge of $2.50 per service per month, and has reduced the charges and timeframes to migrate in bulk wholesale ADSL services to the LSS. The specified charges are to apply for the period from 1 June 2004 until 31 December 2007.

The charges result from applying the Commission's long–standing pricing principles for the LSS (August 2002) and, in respect of LSS annual charges, the ruling of the Australian Competition Tribunal (June 2006).

Telstra proposed in previous regulatory proceedings an LSS annual charge of $9 per service per month, which was opposed by access seekers, and considered not to be reasonable by both the Commission (December 2005) and the Australian Competition Tribunal (June 2006). Following these rulings, Telstra continued to require access seekers to pay a $9 per month charge.

A key issue in this arbitration was whether a contribution to the costs of the line over which the LSS is supplied should be included in the LSS annual charges to apply until 31 December 2007. The Commission decided against doing so.

The Commission has for some time recognised that economic efficiency can be enhanced by the inclusion of an appropriate contribution to line costs in LSS annual charges. However, where line rental charges fully recover line costs, the inclusion of such a contribution in LSS annual charges would lead to an over-recovery of cost. In these circumstances, reductions in charges for other network services, such as wholesale line rental, are needed in order to avoid any such 'double dipping'.

Rebalancing charges in this way may take time, has the potential to disrupt competition in DSL services if done too quickly, and is dependent upon Telstra restructuring its existing charges for other services.

# 1. INTRODUCTION

*1.1 Purpose*

Chime and Telstra have been in dispute over certain terms of access to the Line Sharing Service ('LSS'). This dispute was notified to the Commission for arbitration, and the Commission has made a final determination in that arbitration. This document sets out the reasons for making this final determination.

*1.2 Background to arbitration and final determination*

Chime notified the Commission of a dispute with Telstra on 28 November 2005. The notification was amended on 3 February 2006. A case management meeting between the parties followed on 16 February 2006, and on 15 March 2006 the parties were advised of the Commission's views on the preliminary matters discussed at the meeting.

After consulting the parties, the Commission issued an interim determination on 2 November 2006 that dealt with charges for disconnection of the LSS done as part of a managed network migration. On 21 December 2006, this interim determination was replaced with an interim determination that also dealt with LSS annual charges and additional disputed terms relating to managed network migrations.

The parties have been able to resolve some aspects of the dispute through additional negotiations conducted concurrently with the arbitration. However, a number of terms of access remained in dispute, and the Commission commenced consultation on the making of a final determination to resolve the dispute.

The terms of access that were raised for consideration in the final determination are as follows:

1. LSS Annual charges
2. Terms and conditions relating to Managed Network Migrations (MNM) as follows:
   (a) LSS Connection charges for MNMs involving 50 or more services
   (b) LSS Connection charges for MNMs involving up to 20 services and between 20 and 49 services
   (c) LSS Disconnection charges where the disconnection occurs as part of a MNM
   (d) Minimum number of LSS connections as a precondition for requesting a MNM
   (e) Minimum MNM charge per exchange
   (f) MNM migration plan terms including forecasting timeframes, migration plan amendment terms, and cancellation charges (which are referred to in the interim determinations as 'standard cancellation charges' and 'pre-jumpering cancellation charges' (also known as 'pre-wiring charges).
3. Network modernisation terms and notice periods relating to the LSS

*1.3 Current Consultation Process*

On 2 February 2007, the Commission commenced consultations on the making of a final determination.

The Commission first sought the parties' submissions on procedural matters, which were received on 9 February 2007 and 16 February 2007. On 6 March 2007, the Commission provided its views on these procedural matters, and also sought parties' views on further procedural matters. These submissions were received on 9 March 2007, 12 March 2007 and 14 March 2007. On 12 April 2007, the Commission notified the parties of its decision on the additional procedural matters.

Other access disputes had been notified in respect of the LSS, and there was overlap in the terms of access that were disputed. After seeking the parties' views, the Commission held a joint hearing to consider the terms of access that were commonly disputed in three LSS access disputes. This was done as it was considered that holding a joint hearing on these matters was likely to result in the disputes being resolved in a more efficient and timely manner. And so, these reasons for decision on occasion refer to submissions that were advanced by other LSS access seekers in the joint hearing. Terms of access that were in dispute in a single arbitration only were dealt with in a separate hearing involving the relevant parties.

The Commission provided to the parties a draft final determination, and an accompanying discussion paper to assist the parties in providing their submissions, on 30 March 2007. The draft final determination reflected the Commission's preliminary views pending consideration of the parties' submissions.

Following a request from Telstra, the timetable for parties' submissions was extended to 4 May 2007 (for principal submissions) and 14 May 2007 (for response submissions). Chime was subsequently allowed additional time (to 18 May 2007) to provide its response submission, following the late receipt of materials from Telstra. Telstra also provided additional material to the Commission dated 30 May 2007, 5 June 2007, 6 July 2007 and 10 July 2007.

## 2. PRELIMINARY MATTERS

*2.1 The Line Sharing Service ('LSS')*

The LSS allows two carriers to provide separate services over a single metallic pair or line. The higher frequency part of the line is used by the access seeker to supply broadband (DSL) services, while the access provider supplies a PSTN voice service over the same line.

The LSS is a declared service. The Commission declared the LSS on 30 August 2002, pursuant to subsection 152AL(3) of the Act. A copy of the declaration was published in the *Commonwealth of Australia Gazette* No. GN41, 16 October 2002.

The LSS declaration is currently due to expire in October 2007, although the Commission may, after holding a public inquiry, determine to extend the expiry date or make a new declaration or let the declaration lapse (section 152ALA of the TPA). A public inquiry has commenced.

*2.2 Access obligations and existence of dispute relating to access*

The Commission sought the parties' views on whether access obligations are owed and whether a dispute exists in relation to access.

Chime is of the view that access obligations are owed, and that an access dispute exists. [Chime, 14/5, p.1]

Telstra disputes that it owes access obligations on the basis of its view that Part XIC of the TPA is invalid. Subject to this claim, Telstra acknowledges that access obligations would otherwise exist, and that there is a dispute over access to the LSS. [Telstra 14/5, Pt 1, p.8].

The Commission has formed the view that, with respect to the access dispute, the requirements of subsection 152CM(1) of the Act are satisfied. That is:

- Telstra is a carrier;
- Telstra supplies the declared LSS;
- Telstra has an obligation under subsection 152AR(3) of the Act to supply the LSS to the access seeker; and
- The access seeker is unable to agree with Telstra about the terms and conditions of access to the LSS addressed in the final determination.

*2.3 Whether the Commission has jurisdiction to arbitrate the access dispute*

Telstra refers to previously-expressed views that, although it accepts an access dispute exists between Chime and Telstra, the Commission does not have jurisdiction to arbitrate it. [Telstra 14/5, Pt 1, p8]

Telstra's views concern whether or not a notification could be amended (in this case to remove iiNet as a party), and whether the form in which the notification was made meant it was invalid. Regulation 28T of *Trade Practices Regulations* 1974 ('the Regulations') specifies certain requirements as to the form of a notification. [Telstra, 23 December 2005; Telstra, 15 February 2006].

The Commission responded to these views on 15 March 2006. The Commission advised the parties that it had determined to accept the amended notification that removed iiNet as a party, and would continue with the arbitration of the notified dispute.

The Commission also advised the parties that it was satisfied that the form of the notification was appropriate. In this regard, the Commission considered that Chime had satisfied each of the formal requirements in full, or substantially satisfied them. A failure to comply with the Regulations does not prevent the arbitration continuing, unless the Commission made a direction that it should not continue. [Regulation 26(1) of the Regulations] In this regard, the Commission advised the parties that in its view the nature and scope of the dispute was clear, and that the Commission would proceed on the basis that the Regulations were complied with.

The Commission continues to hold these views.

*2.4 Whether to proceed to make a final determination*

Telstra submits that the Commission should not at this time make a final determination in the arbitration, and should instead await decisions in other proceedings Telstra has commenced. These proceedings concern:

- A legal challenge to the validity of Part XIC of the *Trade Practices Act 1974* (High Court of Australia, proceedings s.42 of 2007); and,
- A review of the Commission decision to reject Telstra's most recently proposed access undertaking for the Unconditioned Local Loop Service (Australian Competition Tribunal, No.8 of 2006). [Telstra 14/5, Pt 1, p7, 14]

Chime submits that the Commission should continue with the arbitration and not await the outcome of High Court proceedings. [Chime 18/5, p.2]

The Commission is of the view that it is appropriate for it to proceed to make a final determination in this arbitration. As previously advised to the parties, the Commission considers that it is entitled to proceed on the basis that the legislation is validly enacted. Further, the Commission considers that the consequences of suspending the arbitration (including the impact delays would be likely to have on end-users) make it inappropriate not to proceed on the basis that Telstra has commenced proceedings challenging the validity of relevant legislative provisions.

Further, the Commission does not consider that it should defer making a final determination on the terms of access to the LSS because of the ULLS proceedings commenced in the Tribunal. The Tribunal handed down its decision in the ULLS proceeding on 17 May 2007. Views expressed in those proceedings could have had some implications for the LSS also. However, in this instance, the Tribunal has provided recent views specifically on access to the LSS, and this decision has informed the Commission's approach. [*Re Telstra Corporation Ltd* [2006] ACompT 4]

## 3. General approach

### *3.1 Use of pricing principles*

*Introduction*

The Commission has determined pricing principles for the LSS under section 152AQA of the TPA. This determination, as well as reasons for making it, is contained in ACCC, *Final Decision on whether or not a Line Sharing Service should be declared under Part XIC of the Trade Practices Act 1974*, August 2002.

The pricing principles require that prices reflect the Total Service Long Run Incremental Cost (plus a contribution to indirect cost) ('TSLRIC+) of providing access to the LSS. (ACCC, *Final Decision on whether or not a Line Sharing Service should be declared under Part XIC of the Trade Practices Act 1974*, August 2002, pp 83-84). They also require that LSS access prices should not include a contribution to costs that are recovered in other charges. (ACCC, August 2002, at pp 97-98)

The Commission is required to apply these long-standing pricing principles in determining prices to apply in respect of the LSS unless it would not be appropriate to do so. [Sub-section 152AQA(6) of the TPA] The Commission sought the parties' views on whether it should apply the LSS pricing principles.

*Parties' submissions*

The parties are generally supportive of the use of the LSS pricing principles. Access seekers support their use. [Chime 14/5, p.1] [Primus 14/5, p.1] [Request 14/5, p.3] Telstra also supports their use, except that it considers that LSS access prices should be averaged, and should not in any circumstances be de-averaged. That is, the same charges should always apply in each of the four geographic bands. Telstra also confirms its view that LSS access prices should include a contribution to the recovery of indirect and overhead costs. [Telstra 14/5, Part 1, pp.8-9]

*Commission's views*

The Commission is required to have regard to the LSS pricing principles, and considers that it should in this arbitration determine access prices for the LSS that reflect the Total Service Long Run Incremental Cost (plus a contribution to indirect cost) ('TSLRIC+') of providing access to the LSS.

A detailed discussion of the TSLRIC+ methodology, can be found in ACCC, *Access Pricing Principles – Telecommunications - a guide*', 1997.

The Australian Competition Tribunal expressed its general agreement with the approach to applying the long term interests of end-users ('LTIE') test (established by the Commission in its *Access Pricing Principles, Telecommunications – a guide*)[1] and the Commission's use of TSLRIC pricing. In the Tribunal's view, the key principles include:

> *The price of a service should not exceed the minimum costs that an efficient firm will incur in the long-run in providing the service.*
>
> *The costs are the forward-looking costs, including a normal return on efficient investment (which takes into account the risk involved).*
>
> *Forward-looking means prospective costs using best-in-use technology. The access provider should only be compensated for the costs it would incur if it were using this technology, not what it actually incurs, for*

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[1] ACCC, *Access Pricing Principles, Telecommunications – a guide* (*Access Pricing Principles Guidelines*), July 1997.

> *example in using out-of-date technology which is more costly. Of course, a firm may be using older technology because it was the best available at the time the investment was made and replacing it cannot be justified commercially. In a competitive market, however, that firm would only be able to charge on the basis of using the most up-to-date technology because, if it did not (in this hypothetical competitive market) access seekers would simply take the service from an alternative service provider.*
>
> *The cost of providing the service should be the cost that would be avoided in the long-run by not having to provide it. Thus, it is the additional or incremental costs necessarily incurred, assuming other production activities remain unchanged.*[2]

Further, the Tribunal noted that '… in the general case where access prices need to be regulated, unless pricing is on a TSLRIC basis, efficient investment is unlikely to be encouraged.'[3] The Commission notes that the Tribunal went on to state that:

> *This discussion should not be taken to suggest that TSLRIC pricing should be imposed at every opportunity. It will often be the case that regulation, including regulated pricing, is not appropriate in given circumstances. It does mean, however, that, in our view, it would generally not be in the LTIE to depart from TSLRIC pricing where access is regulated. Accordingly, where an access regime requires, or creates an unacceptable risk, of non-TSLRIC pricing, the Tribunal considers that such a regime is unlikely to encourage the efficient use of, and investment in, infrastructure.*[4]

Similarly, the Tribunal has also stated that, in respect of the LSS, a proper application of the criteria relevant to the assessment of an access undertaking (and which significantly overlap with the section 152CR(1) criteria) would require that prices reflect the efficient costs of providing access to the LSS:

> *. . . we would point out that whenever an access provider seeks approval of an access undertaking from the Commission which involves a consideration of a price term by comparing it with costs, it would be necessary, in order to satisfy the statutory framework, that the access provider establish that its costs are efficient costs.*[5]

The LSS pricing principles require that access prices should be de-averaged. In considering LSS access prices in other regulatory decisions, the Commission has acknowledged that, in practice, an average access price can be appropriate where the distortionary effect of averaged prices is not likely to be material. That is, where the TSLRIC+ of supplying the LSS does not vary materially between geographic bands. [ACCC, *Assessment of Telstra's LSS undertaking relating to connection and disconnection charges, Final decision*, April 2006, at pp: 56-57]

The Commission remains of the view that LSS access prices should be de-averaged except where the distortionary effect of an average LSS access price is not likely to be material. Whether an averaged access price is likely to cause a material distortion is a matter discussed below in considering LSS connection and disconnection charges, and charges associated with LSS managed network migrations.

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2 *Seven Network Limited (no 4)* [2004] ACompT 11 at [135].

3 ibid., at [136].

4 ibid., at [137].

5 *Re Telstra Corporation Ltd* [2006] ACompT 4 at para 46

### *3.2 Relevant legislation*

#### *Introduction*

The Commission sought the parties' advice on legislation that is relevant to the making of the final determination.

#### *Parties' submissions*

The parties identify Part XIC of the TPA, and Division 8 of this Part in particular, as relevant to the making of the final determination.

Telstra submits that the Utilities (Network Facilities Tax) Act 2006 (ACT), and any legislation of a similar purpose that may be passed in future in other states, is also relevant to the final determination. [Telstra 14/5, Pt 1 page 14]

Chime submits that it is not aware of other States passing an Infrastructure Tax Act, and disputes that the ACT legislation is relevant to the final determination. Chime also points to the existence of carrier immunities from certain State laws under the Telecommunications Act as providing a possible shield from the ACT charges.

#### *Commission's views*

The Commission considers that Part XIC of the TPA is relevant to the making of the final determination. The Commission considers that the following sections are of direct relevance to the making of a final determination:

- Section 152CP(1) of the Act, which provides that unless the Commission terminates the arbitration, the Commission must make a written determination on access by the access seeker to the declared service.
- Section 152CP(2) of the Act, which provides that 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.
- Section 152CP(4) of the Act, which requires that before making a determination, the Commission must give a draft determination to the parties.
- Section 152CP(5) of the Act, which requires that when the Commission makes a determination it must give the parties to the arbitration its reasons for making the determination.
- Section 152CQ of the Act, which sets out restrictions on access determinations.
- Section 152CR(1) of the Act, which requires that in making a final determination, the Commission must take certain matters into account. :
- Section 152CR(2) of the Act, which provides that the Commission may take into account any other matters that it thinks are relevant.
- Section 152DNA of the Act, which concerns backdating and interest.
- Section 152AQA(6) of the Act, which requires that the Commission must have regard to a pricing principles determination (made in accordance with section152AQA(1)) if the Commission is required to arbitrate an access dispute under Division 8 in relation to the declared service.

The Commission considers that the *Utilities (Network Facilities Tax) Act* 2006 (ACT) could potentially be relevant to the setting of LSS access prices, to the extent that Telstra is liable to a charge under that Act, and that any such cost relates to Telstra's supply of the LSS. However, it is uncertain that these conditions are satisfied.

Further, Telstra has not made a cost claim in respect of any liability arising under this Act, but rather seeks the ability to require access seekers to make unspecified contributions should a liability accrue in future. The Commission does not consider that this would be appropriate, as it denies access seekers certainty as to the charges that they face for using the LSS and impedes competition, and is unnecessary to ensure cost recovery. Accordingly, the Commission has not specified in the final determination that liabilities under the ACT Act should be passed-through.

Further, given that the expiry date of the final determination is relatively soon (as discussed below), the Commission does not consider that it is necessary to make allowance for the possible introduction of other laws to which Telstra may become liable in respect of its supply of the LSS.

### *3.3 Section 152CR(1) criteria*

#### *Introduction*

The Commission must have regard to the criteria specified in section 152CR(1) of the TPA in making a final determination. These criteria are:

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;

g. the economically efficient operation of a carriage service, a telecommunications network or a facility.

The Commission provided the parties with draft views on how these criteria should be interpreted and sought the parties' comment.

*Section 152CR(1)(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*

#### *Parties' submissions*

Telstra considers that in order for the final determination to promote the long term interests of end-users (LTIE), the final determination should ensure that Telstra's costs will be recovered in both the short-term and long-term. Telstra considers that access prices that are too low would also fail to promote the LTIE, as they would deter Telstra from investing in its facilities, and will also deter carriers from investing in competing facilities where it would be efficient to do so. Telstra also cautions that prices for the LSS can affect demand for the ULLS, and lead to carriers choosing the LSS in circumstances where this will lead to higher costs of supply. [Telstra 14/5, Part 1, pp.10-11] Telstra also submits that incentives for it to invest in a fibre to the node network (FTTN) should also be considered. [Telstra, 14/5, Part 2, p.2]

Access seekers consider that charges that reflect the efficient cost of supplying the LSS will best promote the LTIE, and consider regard should be had to the likely effect of access charges on the supply of downstream services.

Each access seeker identifies broadband (DSL) services as a relevant downstream service. Chime also refers to the possible effect of LSS access prices on downstream voice services (voice over internet protocol supplied over an LSS).

Access seekers consider regard should be had to investment in DSLAM networks [Primus 14/5, p.2] [Request 14/5, pp.3-7] [Chime pp.2-3, 9], and for efficient use of and investment in access networks. Access seekers contend that LSS access charges that are too high could lead to inefficient duplication of access networks (such as would be the case if suppliers were required to deploy a by-pass access network, or use an entire copper pair to supply DSL to end-users). [Chime 18/5, p.3] [Primus 14/5, p.3] [Request 21/5, p.6]

*Commission's views*

The Commission has published a guideline explaining what it understands by the phrase 'long-term interests of end-users' in the context of its declaration responsibilities.[6] The Commission considers that a similar interpretation is appropriate to making a final determination in this arbitration.

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, higher quality or towards the provision of greater diversity of goods and services.

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

> *Having regard to the legislation, as well as the guidance provided by the Explanatory Memorandum, it is necessary to take the following matters into account when applying the touchstone – the long-term interests of end-users:*
>
> **End-users: "end-users" include actual and potential [users of the service] ...*
>
> **Interests: the interests of the end-users lie in obtaining lower prices (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings. ...[T]his would include access to innovations ... in a quicker timeframe than would otherwise be the case ...*
>
> **Long-term: the long-term will be the period over which the full effects of the ... decision will be felt. This means some years, being sufficient time for all players (being existing and potential competitors at the various functional stages of the ... industry) to adjust to the outcome, make investment decisions and implement growth – as well as entry and/or exit – strategies.*[7]

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6 ACCC, *Telecommunications services — Declaration Provisions: A Guide to the Declaration Provisions of Part XIC of the Trade Practices Act*, July 1999.

7 *Seven Network Limited (no 4)* [2004] ACompT 11 at [120].

As explained further below, the Commission considers that LSS access prices that reflect the efficient (as opposed to actual) cost of supplying the LSS will best promote the LTIE.

To consider the likely impact of particular terms and conditions on the LTIE, the Act 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.[8]

In determining the extent to which terms and conditions are likely to result in the objective of promoting competition, regard must be had to the extent to which the terms and conditions will remove obstacles to end-users of gaining access to listed services.[9]

The Commission considers that, in assessing whether particular terms and conditions will promote competition, it is relevant to consider markets in which DSL services are supplied (retail and/or wholesale), and to consider whether the terms and conditions will remove obstacles to end-users gaining access to DSL services.

This is because the LSS is an input to the provision of carriage services on the non-voiceband frequency spectrum of the line, and this spectrum is typically used to provide DSL services. This approach is consistent with the approach adopted by the Australian Competition Tribunal. (Re Telstra Corporation Ltd ACompT 4 [2006] at [97], [149])

Obstacles to accessing DSL services could be in the nature of DSL infrastructure not being available in the end-user's area, or the price of services that are available being too high, or their quality (measured by reference to, for instance, data transfer rates) being too low.

It is also possible that service providers will offer voice over internet protocol services over an LSS. However, the Commission does not consider that, over the period to which the final determination relates, the LSS will be commonly used in order to supply voice over internet protocol services. This is due to the specification that Telstra is only obliged to supply the LSS where a PSTN voice service is already being supplied on the line. While this does not preclude a VoIP service also being supplied to the end-user, it does limit the value to end-users of competing VoIP services supplied over the LSS, and reduces the class of end-users for whom such services would be attractive. This is because line rental charges would not be avoided.

The Commission considers that prices that reflect efficient forward-looking costs of supply will best promote effective competition in the supply of broadband/DSL services. This is because such prices best enable access seekers to compete on an equal footing with other suppliers, including the access provider, in the supply of downstream DSL services.

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8 *Trade Practices Act 1974*, section 152AB(2).

9 ibid., section 152AB(4).

The Commission considers that the terms of access addressed in this final determination do not directly affect the objective of achieving any-to-any connectivity.

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

- 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; and the costs involved in supplying and charging for, the services that are reasonable or likely to become reasonable; and 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 likely to become capable of being supplied; and
- the risks involved in making the investment.[10]

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

The Commission considers that it is relevant to here consider use of, and investment in, infrastructure used to supply the LSS (e.g, ordering and provisioning systems and access networks), as well as infrastructure used to supply carriage and/or content services over the LSS, e.g., DSL access multiplexers ('DSLAMs'). This is consistent with the approach adopted by the Australian Competition Tribunal. (Re Telstra Corporation Ltd ACompT 4 [2006] at [104])

Again, the Commission considers that access charges that reflect the efficient, forward-looking costs best meet these considerations. Such charges are consistent with the access provider's legitimate commercial interests and, in particular, enable access providers to exploit economies of scale and scope. These charges also provide correct incentives for the access provider and access seekers to make efficient investments in infrastructure used to supply the LSS and downstream services. By promoting competition, these charges also encourage dynamic efficiency.

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10 *Trade Practices Act 1974*, section 152AB(6) and (7A).

*3.3.2 Section 152CR(1)(b) The legitimate business interests of the access provider, and the carrier's or provider's investment in facilities used to supply the declared service*

*Parties' submissions*

Telstra emphasises that it is legitimate for it to seek to earn a normal commercial return on its investment, and that this requires that access prices enable cost recovery plus a return on investment that is commensurate with risk. [Telstra 14/5, Part 1, p.11]

Access seekers submit that it is a legitimate interest for the access provider to receive a normal commercial return, but that higher returns would not be legitimate. [Primus 14/5, p.3] [Chime 14/5, p.3] Request also submits that, under this criterion, it is only forward-looking efficient costs that should be considered. [Request 14/5, p.8]

*Commission's views*

As outlined in the Commission's *Access Dispute Guidelines*, the Commission considers it is a legitimate interest for an access provider to earn a normal commercial return on its investment.[11] In this regard, 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 TPA.

For completeness, the Commission notes that it would be a legitimate interest for an access provider to seek to recover its costs as well as a normal commercial return on investment having regard to the relevant risk involved.

The Commission further notes that an access price should not be inflated to recover any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access.[12]

Similarly, the Australian Competition Tribunal has stated that:

> *The expression "legitimate business interests" is a general expression and is somewhat open-textured. What is "legitimate" conduct or a "legitimate" interest in business may be open to a number of differing interpretations. We consider that a carrier's "legitimate business interests" is a reference to what is regarded as allowable and appropriate in commercial or business terms. In the context of s 152AH(1)(b), the expression connotes something which is allowable and appropriate when negotiating access to the carrier's infrastructure. When looked at through the prism of a charge term and condition of access and its relationship to a carrier's cost structure, it is a reference to the interest of a carrier in recovering the costs of its infrastructure and its operating costs and obtaining a normal return on its capital. (Re Telstra Corporation Ltd [2006] ACompT 4 at [89])*

*3.3.3 Section 152CR(1)(c) the interests of all persons who have the right to use the service*

*Parties' submissions*

In Telstra's view, the class of persons who have rights to the LSS includes persons with 'indirect rights' to use the LSS such as end-users that purchase a

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11 ACCC, *Resolution of telecommunications access disputes – a guide (Access Dispute Guidelines)*, March 2004 (Revised), p. 56.

12 ACCC, *Access Pricing Principles Guidelines*, p. 10.

retail service from Telstra. [Telstra 14/5, Part 1, p.12] Telstra further submits that it is the interests of the entire class, and not those of a single acquirer of LSS, that should be had regard to. [Telstra 14/5, Part 1, p.3]

Request submits that the main interest of persons with rights to use the LSS is their interest in being able to compete in the supply of downstream services. Request considers this interest is best served by access prices that reflect efficient, forward-looking costs. [Request 14/5, p.8] Chime and Primus also submit that such pricing will promote the interests of these persons. [Chime 4/5, p.3] [Primus 4/5 p.3]

Primus further submits that the criterion calls for a consideration of the rights of access seekers. However, in its view, proper regard for these rights would also promote the interests of all retail customers of downstream services. [Primus 14/5, Part 1, p.4]

*Commission's views*

The Commission notes Telstra's submission concerning Telstra's retail customers having rights to indirectly use line sharing by acquiring a retail service. While the Commission agrees that retail services supplied to end-users involve the use of line sharing, it does not consider that this gives them a right to use the LSS. The Commission considers that it is only LSS access seekers that the criterion contemplates. The interests of end-users are already to be considered under other criteria.

The Australian Competition Tribunal has also provided views on this criterion (in assessing whether an approach that led to a higher LSS Annual Charge should be adopted):

> *s 152AH(1)(c) requires us to have regard to the interests of persons who have rights to use Telstra's LSS, that is, access seekers. . . A higher monthly charge would not be in the interests of an access seeker because it would raise its costs and inhibit its ability to compete with Telstra over the provision of retail services to end-users that could be provided using the LSS. (Re Telstra Corporation Ltd [2006] ACompT 4 at [91])*

As noted in the *Access Dispute Guidelines,* people who have rights to currently use a declared service will generally use that service as an input to supply carriage services, or a service supplied by means of carriage services, to end-users. In the case of the LSS, the access service could also be used to provide a wholesale service to another service provider.

The Commission considers that this class of persons has an interest in being able to compete for the custom of end-users on the basis of their relative merits. Terms and conditions that favour one or more service providers, including the access provider, over others and thereby distort the competitive process may prevent this from occurring and consequently harm those interests.[13]

*3.3.4 Section 152CR(1)(d) the direct cost of providing access to the declared service*

*Parties' submissions*

Telstra refers to the Tribunal's views expressed in *Re Telstra Corporation Ltd* [2006] ACompT 4 and *Application by Optus Mobile Pty Limited and Optus Networks Pty Limited* [2006] ACompT 8 that this criterion is concerned with ensuring that the costs of providing the service are recovered. Further, that the

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[13] ACCC, *Resolution of telecommunications access disputes – a guide,* (*Access Dispute Guidelines*), p. 57.

term ‘direct costs’ includes a contribution to the indirect costs associated with providing access, i.e., fixed and common costs, Lastly, the appropriate cost concept to have regard to here is the long-run, such that distinctions between fixed and variable cost are not relevant. [Telstra 14/5, Part 1, p.13]

Request submits that cost-based access prices are consistent with the criterion, and that it is long-run costs that should be considered. Request is of the view that efficiently incurred costs should be considered, arguing that TSLRIC methodology is the best way to derive cost-based charges. [Request 4/5, p.9] Primus is also of the view that prices should reflect the costs of an efficient operator. [Primus 4/5, p.3] Chime identifies incremental costs only as being relevant under this criterion. [Chime 4/5, p.3]

*Commission’s views*

The Commission considers that the direct costs of providing access to a declared service are those incurred (or caused) by the provision of access, and includes the incremental costs of providing access.

Consistent with the Tribunal’s view, the Commission has interpreted this criterion, and the use of the term ‘direct costs’, as not excluding consideration being given to a contribution to indirect costs. (*Application by Optus Mobile Pty Limited and Optus Networks Pty Limited* [2006] ACompT 8 at [137]) A contribution to indirect costs can be supported by other of the criteria also.

However, the criterion does not extend to permitting compensation for loss of any ‘monopoly profits’ that occurs as a result of increased competition.

In this regard, the *Explanatory Memorandum for the Trade Practices Amendment (Telecommunications) Bill 1996* states:

> *... the ‘direct’ costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market.*[14]

The Commission also notes the Tribunal considers the direct costs criterion ‘is concerned with ensuring that the costs of providing the service are recovered.’[15]

More recently, the Tribunal has noted that direct costs could conceivably be allocated (and hence recovered) in a number of ways, and that adopting any of those approaches would be consistent with this criterion.

> *Telstra’s approach to estimating a per unit cost is likely to be consistent with ensuring recovery only of direct costs. However, while direct costs will be incurred by Telstra in order to provide the declared service, there are a number of cost allocation methods other than that adopted by Telstra (including those suggested by the Commission and other interveners in this matter) that would enable it to recover the direct costs of investment in infrastructure necessary to provide a LSS. (Re Telstra Corporation Ltd [2006] ACompT 4 at [139]*

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

15 *Telstra Corp Ltd [2001]* ACompT 4 (7 Dec 2001) at paragraph 92.

### *3.3.5 Section 152CR(1)(e) the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else*

*Parties' submissions*

Telstra and Primus raised this criterion as relevant to certain costs associated with the LSS. The other parties did not comment on this criterion.

Primus considers that correction of Telstra's cable records was of value to Telstra, but that Primus was bearing the cost of making these corrections. [Primus 4/5, p.4] Telstra considers that the development of different procedures for the connection or disconnection of LSS as part of a managed network migration was of value to access seekers, and it had borne this development cost. [Telstra 14/5, Part 1, p.3]

*Commission's views*

The Commission has previously noted its view that:

> *This criterion requires that if an access seeker enhances the facility to provide the required services, the access provider should not attempt to recover for themselves any costs related to this enhancement. Equally, if the access provider must enhance the 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.*[16]

The Commission remains of this view, and has applied this approach in setting access prices in the final determination.

### *3.3.6 Section 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*

*Parties' submissions*

Telstra considers that this criterion can be relevant to setting access prices as operational and technical requirements can have cost implications, and access prices should permit the recovery of costs that are necessarily incurred to meet these requirements. [Telstra 14/5, Part 1, pp.12-13] Primus is also of the view that terms of access should reflect safe and reliable work practices. [Primus 4/5, p.4]

*Commission's views*

The Commission considers that this criterion requires that terms of access should not 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 suggested to the parties that this criterion is generally unlikely to be relevant to disputes relating only to the price of access to a service. This is because the access price will have little direct bearing on the adoption of operational and technical requirements necessary for the safe and reliable operation of a carriage service, or a telecommunications network or a facility. However, this criterion may be more relevant to non-price terms and conditions attaching to the supply of the LSS that are in dispute (if any).

That said, the Commission acknowledges that, in the long-run, access prices that are persistently below the efficient costs of supplying a service can, indirectly, compromise the safe and reliable supply of the service. Accordingly, the

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[16] ACCC, *Access Pricing Principles Guidelines*, p. 11.

Commission considers that efficient costs should be based upon a method of supply of the LSS that meets the relevant operational and technical requirements necessary for the safe and reliable operation of the LSS and facilities used to supply the LSS.

### *3.3.7 Section 152CR(1)(g) the economically efficient operation of a carriage service, a telecommunications network or a facility*

*Parties' submissions*

Telstra submits that the criterion requires a balancing of interests, and that proper regard to this criterion means that access prices should not be set at a level that is below cost. [Telstra 4/5, Part 1, p.13] Telstra considers that investment in the infrastructure that underlies the LSS is promoted by access charges that are based on efficient costs, but cautions that access charges that do not permit it to recover its costs will deter it from making investments. [Telstra 14/5, Part 1, p.5]

Access seekers raise for consideration the services, networks and facilities of both the access provider and the access seeker. They also conclude that access prices based on forward-looking efficient costs are required by this criterion. [Chime 4/5, p.4] [Primus 4/5, p.4]

Chime and Primus submit that access charges that are too high will impede efficient investment by both Telstra and access seekers, and lead to under-utilisation of infrastructure used to supply services. [Chime 18/5, p.4] [Primus 14/5, Part 1, p.5]. Chime states that the LSS annual charges that applied up until the making of the interim determination contributed to it being unable to invest more in the network it uses when supplying DSL and VoIP over the LSS. [Chime 18/5, pp.6-7]

*Commission's views*

As noted in the Commission's *Access Dispute Guidelines,* the phrase 'economically efficient operation' embodies the concept of economic efficiency as discussed earlier under the LTIE. That is, it calls for a consideration of dynamic, productive and allocative efficiency. [17]

Further, 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 LSS, or by Telstra itself in competition with those access seekers; and,
- the telecommunications networks and infrastructure used to supply these services. (Re Telstra Corporation Ltd [2006] ACompT 4 [94-95])

The *Access Dispute Guidelines* note that in the context of a determination, the Commission may consider whether particular terms and conditions enable a carriage service, telecommunications network or facility to be operated efficiently. The Commission considers that, in the context of access prices, prices that reflect the efficient forward-looking costs of the service best meet this criterion.

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17 ACCC, *Access Dispute Guidelines*, p. 57.

### 3.4 Additional matters and information to which the Commission intends to have regard in making the final determinations

Section 152CR(2) of the TPA allows the Commission to have regard to additional matters. The Commission sought the parties' views on whether it should have regard to additional matters.

The parties nominated decisions of the Australian Competition Tribunal, the pricing principles, previous decisions made by the Commission in respect of Telstra's LSS access undertakings and the ACT Infrastructure Tax Act and the possibility of similar legislation eventuating in other jurisdictions. [Telstra 4/5, Part 1, p.14] [Request 4/5, p.10] [Primus 4/5, p.4] [Chime 4/5, p.4]

The Commission has had regard to these additional matters. For completeness, the Commission also has had regard to the various documents and matters that are referred to in this statement of reasons.

### 3.5 Period to which the final determination should apply

#### 3.5.1 Commencement date

*Introduction*

The provisions of a final determination (either all or some) may be expressed to take effect earlier than the date on which the determination takes effect, provided that this date is no earlier that the date on which the parties commenced negotiations with a view to agreeing on the terms and conditions of access (s. 152DNA(2)).

The Commission proposed to backdate certain of the terms of access in dispute to the date of notification of the access dispute. The Commission advised the parties that it would consider backdating to an earlier time where it could be established that the parties commenced negotiations at a time materially earlier than the date of notification. The Commission sought the parties' views.

*Parties' submissions*

Telstra submits that backdating is not appropriate because:

(a) it would not promote the rationale for backdating (which it describes as removing incentives to delay arbitrations), as Telstra's conduct has not been a cause for delay in the arbitration;

(b) an interim determination was made in the dispute, negating the need for backdating; and

(c) backdating would otherwise not be in the LTIE. [Telstra 4/5, Part 3, p 14]

Further, Telstra submits that its LSS annual charges were in accordance with determinations that the Commission previously made. Telstra points to references to a $7 to $9 range in the Commission's August 2004 decision,[18] and the $3.20 interim determination. [Telstra 4/5, Part 2, p.20]. Telstra submits prices should not be backdated in such circumstances, as it:

- would discourage efficient investment in infrastructure as the provider faces the risk that the prices previously set by the Commission will be retrospectively changed; and
- is contrary to the legitimate business interests of Telstra and the interest of access seekers, who have made plans having regard to the Commission's determination.

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[18] Commission, *A final report on the assessment of Telstra's undertaking for the Line Sharing Service*, August 2004, Public Version.

In the alternative, Telstra submits that the commencement date should be no earlier than the date of notification because:

(a) it would be impossible to determine with certainty the dates on which negotiations between Telstra and each of the parties began in respect to each of the different issues, and

(b) it would be highly unfair to backdate to an earlier date in light of the lengthy arbitrations which have ensued due to delays which have not been in Telstra's control.

Telstra claims that some of the issues in dispute were not included in a party's notification, and that it would be contrary to section 152DNA(2) to backdate related terms and conditions to a time earlier than the date on which such issues were introduced into the dispute. [Telstra 4/5, Part 3, p 15]

Chime submits that it is appropriate to backdate the determination because, in its view:

(a) Telstra was reluctant to negotiate reasonable terms of access; and,

(b) backdating would provide incentive for Telstra to negotiate reasonable price and non-price terms and conditions of access in the future.

Chime submits that the Commission should backdate the monthly charges and MNM connection charges to 1 June 2004. It submits that negotiations between the parties commenced earlier than 1 June 2004.

Chime does not request backdated determinations for MNM disconnections, cancellation charges, pre-wiring charges or minimum exchange charges [Chime 4/5, pp 4-6].

In response, Telstra contends that negotiations relevant to the current monthly charges dispute *[c-i-c redaction]* could not have begun any earlier than the most recently signed Customer Relationship Agreement. Telstra submits that earlier negotiations culminated in a variation to the Customer Relationship Agreement.

Telstra submits that LSS MNM charges should not be backdated at all, or any earlier than when a schedule setting out arrangements for MNMs between Telstra and Chime was introduced into the CRA. *[end c-i-c redaction]* Telstra contends that, in effect, there were no or few LSS MNMs prior to this time. Telstra also submits that it had made sensible commercial offers to Chime in relation to MNM charges and that it would be contrary to the objects of sections 152DNA and 152AB of the TPA to backdate in such circumstances [Telstra 14/5, Response to Chime, Part 1, Annexure 1, pp 4-10].

In response, Chime disputes that the commencement of negotiations cannot be established with certainty. Chime also submits that Telstra has incentives to delay arbitrations, and that as a result Chime has had to engage in a long-running and costly arbitration [Chime 14/5, pp 5-6].

*Commission's views*

The Commission is required to formulate guidelines about its approach to backdating (s. 152DNA(8)), and to have regard to those guidelines, as well as any such matters as the Commission considers relevant (s.152DNA(7)).

The guidelines are set out in sections 7.4.2 to 7.4.6 of the Commission's Telecommunications Dispute Resolution Guidelines.

As noted in the explanatory memorandum the backdating provisions are intended to:[19]

[19]Supplementary explanatory memorandum for the Telecommunications Legislation Amendment Bill 1998, p. 33.

> *...encourage commercial agreement and co-operation during access arbitrations by removing incentives for delay and to ensure a considered and reasonable outcome is ultimately applied to the interim period which may otherwise be covered by an interim determination or a commercial agreement which one or more parties may be disputing.*

Consistent with this, the guidelines aim to improve incentives to reach commercial agreement and co-operate during access arbitrations.

The guidelines provide that the Commission will, in general, be inclined to backdate determinations. However, each case will be considered on its merits. In particular, the Commission is likely to consider whether the manner in which the parties have conducted themselves before and during the arbitration provides grounds for not backdating the determination.

If, for example, prior to the notification of the dispute the access provider offered the access seeker price and non-price terms and conditions that are substantially similar to those determined by the Commission and the access seeker refused, then it may not be appropriate to backdate. Similarly, if the access seeker has been tardy in responding to offers put forward by the access provider, then it may not be appropriate to backdate to the start of negotiations.

After reviewing the materials provided by the parties (and annexed to their submissions), the Commission considers that Telstra and Chime have been in dispute regarding the notified terms and conditions since (at least) June 2004. The earliest written communication in this regard is sent in July 2003. [Chime, 4/5, Annexure A]

The Commission does not consider that the CRA *[c-i-c redaction]* later signed by the parties indicates that the dispute over access to the LSS had been resolved. Having regard to all the information provided by the parties, the Commission considers this agreement represented a narrowing of the scope of the dispute rather than a resolution of it. The price specified in the agreement was not close to the price that Chime had sought in negotiations, and Chime wrote to Telstra soon after escalating its dispute over what it described as unresolved matters. *[end c-i-c redaction]* [Chime letter to Telstra; Telstra 14/5, Response to Chime, Annexure 2]

Prior to the notification of the dispute (or anytime since) Telstra did not offer Chime terms of access substantially similar to those that have now been determined by the Commission. Nor does the Commission consider that Chime delayed in responding to offers put forward by Telstra, or acted to delay the arbitration.

The Commission does not consider that the interim determination terms and conditions, or the Commission's August 2004 decision to reject Telstra's then proposed LSS access undertaking, mean that it should not backdate in this instance.

The Commission's guidance in August 2004 was that an access price of around $7-9 per SIO per month is more reflective of the efficient costs of supplying the LSS than Telstra's (then) proposed access price. This was made in the context of explaining the Commission's decision to reject a LSS annual charge of $15 per month. It was not a determination that such a LSS annual charge would be specified by the Commission.

*[c-i-c redaction]* Telstra's pricing of the LSS annual charges following the Commission subsequently rejecting a $9 per month charge (December 2005), or the Tribunal confirming that rejection (June 2006), and Telstra's current claims that a price no less than $9 is necessary to protect its interests, calls into question the extent to which Telstra in fact relied upon this decision. *[end c-i-c redaction]*

The interim determination prices were clearly to apply on an interim basis. It was noted at the time that prices could be revised for the final determination.

Consequently, the Commission has determined to backdate the LSS annual charges and MNM connection charges to 1 June 2004, when Telstra first supplied the LSS service to Chime.

It is not clear on the information that has been made available to the Commission when the initial managed network migrations to the LSS occurred. Chime's submission refers to migrations at individual exchanges from *[c-i-c redaction]* an earlier time,. [Chime, 4/5, Annexures O, U] while Telstra states it was later. It is not necessary for the Commission to reach a concluded view on this. If any LSS MNMs occurred during this period, the backdated prices will apply to those MNMs. *[end c-i-c redaction]*

*3.5.2 Expiry date*

*Introduction*

A provision of a determination may be expressed to terminate on a specified date (s. 152DNA(4)). Although not currently a requirement of the legislation, the Commission would usually expect to limit the duration of a determination to a certain period in this way. The Commission proposed to the parties an expiry date for the final determination of 31 December 2007, and sought the parties' views.

*Parties' submissions*

Chime seeks an expiry date of 30 June 2008, noting that sufficient source information is available to set prices to apply until this time. Chime anticipates that commercial terms may be unable to be agreed for the period from 1 January 2008, and if so they would need to notify another access dispute. [Chime 4/5, p.7]

In response, Telstra submits that the expiry date should not extend beyond the current expiry date of the LSS declaration (31 October 2007), but if it does, then it should not extend beyond 31 December 2007. [Telstra 14/5, Response to Chime, Part 1, p 11].

*Commission's views*

The Commission has decided to maintain the position proposed to the parties, and to specify an expiry date for the final determination of 31 December 2007.

Section 152DNC of the Act provides that a final determination can continue to operate notwithstanding the expiry of a declaration. Further, the LSS declaration could be extended, or the LSS could be re-declared. As such, the Commission does not consider that it should restrict the expiry of the final determination to no later than the current expiry date of the LSS declaration.

The Commission considers that an expiry date of 31 December 2007 will provide an adequate overlap between the finalisation of the inquiry into the future regulation of the LSS (that the Commission is conducting ahead the 31 October 2007 expiry date of the LSS declaration).

The terms of this final determination, and the Commission's finding in the LSS inquiry should provide a reasonable basis for the parties to reach a negotiated outcome for access to the LSS from 1 January 2008.

The Commission does not consider that a later expiry date would be appropriate as there is the potential for the outcome of this inquiry (which will include a review of the associated pricing principles) to suggest that the current regulatory approach to LSS pricing may not remain appropriate for the period beyond 31 December 2007.

### *3.5.3 Interest*

*Introduction*

Section 152DNA(6) of the TPA 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 proposed to the parties that interest should be included on under or over payments, and suggested this be at the Reserve Bank of Australia (RBA) Large Business Variable Indicator Rate. The Commission sought the parties' views.

*Parties' submissions*

Consistent with its views on backdating, Telstra submits that interest should not be imposed [Telstra 4/5, Part 1, p 15].

Telstra further states that in regards to connections and disconnections, Telstra has made several attempts to negotiate with the parties on a commercial level and that the only purpose of interest charges would be to 'punish' Telstra. Telstra also claims that the opportunity cost to access seekers associated with any overpayments would be minimal, as the costs to access seekers of connecting the LSS have decreased over the period the dispute has continued. [Telstra 4/5, Part 4, p 14]

In its response submission, Telstra submits that a backdated payment that includes interest would be inappropriate, as Telstra did not fail to negotiate acceptable charges reflective of cost. In the alternative, Telstra submits:

- the 90-day bank bill rate is the appropriate rate,
- interest should be payable from the interim determination date of 2 November 2006, and
- interest should not be compounded. [Telstra 14/5, Response to Chime, Part 1, pp 10-11]

Chime submits that interest should be charged, so as to ensure that Telstra does not benefit from the delays in this dispute. Chime considers that interest should be calculated on all overpayments, commencing on the date of the overpayment and finishing 21 days after the final determination is made, and compounded daily. [Chime 4/5, pp 6-7]

Initially, Chime sought that the interest rate will be that applicable to debt financing, as determined by the Reserve Bank of Australia Large Business Variable Indicator Rate. In response, Chime suggested that a higher interest rate should apply; either an internal rate of return of around 15%, or else *[c-i-c redaction]* the rate specified in the customer relationship agreement with Telstra for late payments, or overpayments. *[end c-i-c redaction]* [Chime 14/5, pp 6-7].

*Commission's views*

Under section 152DNA(7) of the TPA, the Commission is required to have regard to its guidelines and such other matters as it considers relevant in determining whether or not interest should be charged.

The *Access Disputes Guidelines* provide that the Commission 'will generally' provide for the payment of interest on 'backdated amounts' (the amounts underpaid or overpaid by an access seeker having regard to the charges and the period of backdating that are specified in the final determination).[20] The interest component is used in conjunction with backdating to remove the incentive for delay.

However, the Commission evaluates interest on a case-by-case basis and does not consider that interest is automatically payable in every circumstance in which backdating of a final determination occurs.

As specified in the Guidelines, where interest is to be paid, it will be calculated on the amounts of money that have been overpaid (or underpaid), and will usually be calculated by reference to;

- the volume of services supplied by the access provider to the access seeker over the backdating period; and,
- the charges that that are specified in the final determination.

Further, the rate of interest should reflect the opportunity cost of the overpayment (or underpayment) and, in general, daily compounding will be appropriate. Lastly, the guidelines also suggest that the opportunity cost could be assessed by reference to the rate applicable to debt financing.

In the current arbitration, the Commission considers that it is appropriate to specify that interest is charged on the overpayments that have occurred. Given the time value of money, the access seeker would be denied the full benefit of the determination in the absence of an award of interest.

Consistent with the approach suggested by the guidelines, the Commission has specified that the RBA's Large Business Variable Indicator Rate should be used to calculate interest, and interest shall be charged on a daily basis and compounded. Interest is to be paid from the date of each overpayment, and ending 21 days after the final determination is made.

The Commission considered the parties alternative rates of interest. The Commission was not satisfied that all overpayments would necessarily have been used to fund long-held investments, as opposed being used to meet expenses or retire existing debt, or that any such investments would in fact yield a rate of return of around 15% per annum. The 90 day bank bill rate does not represent the opportunity cost of money to the access seeker.

Use of the contractually agreed rate (which would have *[c-i-c redaction]* resulted in a higher rate being specified *[end c-i-c redaction]*) was considered, but on balance was not adopted, as the information before the Commission did not suggest that Chime was in default, or that its cost of debt was of this order.

### *3.5.4 Specification of settlement amounts*

Chime submits that the Commission should specify the exact amounts owing in the determination, inclusive of interest, in order to avoid potential for dispute over these calculations. [Chime, 4/5, p.7] Telstra opposes the Commission doing so. [Telstra, 14/5, Response to Chime, Part 2, pp.4,11]

The Commission has chosen not to specify the settlement amounts to be paid by Telstra. The Commission considers that the parties should be able to agree the outstanding amounts themselves, given that the Commission has specified the charges to apply, the period to which they are to apply, and provided particulars regarding how interest is to be calculated (i.e, daily interest rates to apply, on a daily compounding basis). The Commission also considers that specifying the

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[20] ACCC, *Access Dispute Guidelines*, p. 63.

settlement amount in the determination could be problematic, and has the potential to delay the making of the final determination.

## 4. TERMS AND CONDITIONS ADDRESSED IN JOINT HEARING

### 4.1 LSS annual charges

#### *4.1.1 Background to dispute over LSS annual charges and overview of approach*

Telstra proposed in previous regulatory proceedings an LSS annual charge of $9 per month, which was opposed by access seekers, and considered not to be reasonable by both the Commission (December 2005) and the Australian Competition Tribunal (June 2006). Following these rulings, Telstra continued to require access seekers to pay a $9 per month charge.

In December 2006, the Commission issued interim determinations in these access disputes reducing the LSS annual charge paid by Chime and Request to $3.20 per month. These charges reflected an estimate of Telstra's incremental costs of supplying line sharing to access seekers and to itself that results from applying the approach outlined in Australian Competition Tribunal's ruling. The Commission foreshadowed that further analysis may result in these charges being revised.

When making the interim determination, the Commission encouraged the parties to conduct further negotiations to see if they could reach a commercial agreement on LSS annual charges. The Commission delayed the conduct of these arbitrations to allow time for these negotiations to occur.

As the parties have been unable to reach agreement, the Commission provided to the parties a draft final determination specifying an LSS annual charge of $2.50 per month to apply up to 31 December 2007.

The Commission proposed this level of charge as a result of further analysis of Telstra's incremental costs of supplying line sharing to access seekers and itself consistent with the Tribunal's ruling. Consistent with the LSS pricing principles that have been in place since 2002, the proposed $2.50 per month charge did not include a contribution to the costs of the line over which line sharing is supplied.

The Commission has for some time recognised that economic efficiency can be enhanced by the inclusion of an appropriate contribution to line costs in LSS annual charges. However, where line rental charges fully recover line costs, the inclusion of such a contribution in LSS annual charges would lead to an over-recovery of cost. In these circumstances, reductions (rather than conditional rebates) in charges for other network services, such as wholesale line rental, are needed in order to avoid any such 'double dipping'.

However, The Commission recognises that rebalancing charges in this way may take time, has the potential to disrupt competition in DSL services if done too quickly, and is dependent upon Telstra restructuring its existing charges for other services.

Accordingly, the Commission consulted the parties on whether there is a real prospect for rebalancing to take effect before 31 December 2007, which was the proposed date on which the final determinations would expire. And, if so, whether a contribution to line costs should be considered for inclusion within the LSS annual charges to be specified in the final determination.

The Commission also consulted the parties on the appropriate charge to reflect the incremental (specific) costs of supplying the LSS.

*4.1.2 Participants*

Telstra, Chime and Request participated in the joint hearing on this issue.

*4.1.3 Current charges*

Chime and Request are each in dispute with Telstra over LSS annual charges. The charges are addressed in CRA Table 191.10. The charge currently applying is specified in an interim determination.

*4.1.4 Prior consideration*

LSS Annual charges have been considered by the Commission in a number of proceedings – ACCC, *Final report on the assessment of Telstra's undertaking for the Line Sharing Service (confidential version)*, August 2004; ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings (confidential version)*, December 2005; ACCC, *Reasons for interim determination*, 21 December 2006. These charges have also been considered by the Australian Competition Tribunal – Re Telstra Corporation Ltd [2006] ACompT 4.

*4.1.5 Other regulatory consideration of LSS annual charges*

The Commission is conducting a declaration inquiry in respect of the LSS, ahead of the October 2007 expiry of the current declaration. This inquiry is also considering appropriate pricing principles for the LSS in the event that the declaration is continued. The pricing principles will address access charges for the LSS on a forward-looking basis.

*4.1.6 Principles to apply*

The Commission proposed to the parties that LSS annual charges should be determined having regard to the LSS pricing principles. The parties' submissions regarding the use of these principles are discussed previously. The parties are supportive of the use of the LSS pricing principles.

Under the LSS pricing principles, two components are considered in calculating the LSS annual charge: (i) a contribution to the efficient costs of the line over which the LSS is supplied ('line costs'); and (ii) the efficient incremental (or 'specific') costs associated with the LSS. Efficient costs are measured by means of a TSLRIC+ methodology. This methodology is discussed previously.

*4.1.7 Contribution to line costs*

*Introduction*

The Commission has considered, but not previously recognised, a contribution to line costs in LSS annual charges. This is because line costs are being recovered through other charges, and in particular line rental (LR) charges.

The Commission advised the parties of its preliminary view that, if any such contribution is to be recognised in LSS charges, it should only be recognised prospectively from the time following a rebalancing of LSS and wholesale line rental (WLR) charges.

The Commission sought the parties' submissions on:

(i) Whether, at a practical level, a rebalancing of LSS and WLR charges could be implemented during the period of the final determination.

(ii) The likely effect on the LTIE, and the other section 152CR(1) criteria, of implementing a rebalancing of LSS and WLR charges during the period of the final determination, including the consequences for the LTIE of not adopting a transition path approach.

The Commission did not seek submissions on how any such contribution should be calculated. Rather, parties were advised that those submissions would be sought only if the Commission forms a view that such a contribution should be recognised in the LSS annual charges to apply within the period of the final determination.

*Parties' submissions*

Telstra submits that LSS and WLR charges could be rebalanced within a matter of weeks of the Commission advising its view on the amount of line cost that should be allocated to each service. The minimum period would be two weeks from this date, although six weeks would be preferable to better allow wholesale customers to understand and plan for the change in arrangements. Telstra further advised that it would initially apply rebalanced charges for Chime and Request only. [Telstra 4/5, Part 2, pp.9-10]

Telstra submits that a rebalancing of LSS and WLR charges should be implemented during the period of the final determination. Telstra submits that not including a line contribution would be detrimental to the promotion of ULLS-based competition, and detrimental to the efficient use of and investment in infrastructure. Telstra also states that including a contribution to line costs is consistent with the recovery of its direct costs of providing the LSS, and its other legitimate interests, and with the access seekers' legitimate business interests. [Telstra 4/5, Part 2, pp.3-8]

Telstra points to other business models open to LSS-based service providers to avoid increased LSS access charges to say that a transition approach would not be necessary. In particular, access seekers could increase their bundling of PSTN voice services, which (under Telstra's proposed approach to rebalancing) would earn rebates on LSS access charges. Telstra says there is no effective barrier to access seekers modifying their businesses in this way. [Telstra 4/5, Part 2, pp.8-9]

Telstra makes a number of particular submissions in support of its position:

- An access charge for the LSS of less than $9 per month makes the business case for an investment in new broadband infrastructure (including a fibre to the node (FTTN) network) impossible. [Telstra 4 May 2007, Part 2, page 2]
- ULLS-based competition provides more benefit to end-users than LSS-based competition. Further, use of the ULLS involves more service differentiation and product development than use of the LSS, and represents more efficient use of and investment in infrastructure. Hence access prices should be set in a way that makes ULLS acquisition more attractive than LSS acquisition. [Telstra 4 May 2007, Part 2, pp.2-5]
- LSS access seekers have been on notice of the probability of having to make a contribution to line costs, through the Commission's signalling in the LSS pricing principles. [Telstra 4/5, Part 2, p.7]

Telstra disputes that a LSS annual charge in the order of $9 per month would compromise the ability of Chime and Request to compete, as they successfully competed when paying those charges previously. [Telstra 14/5, Response to Chime, Pt 2, p.2; Response to Request, pp.1-2] In a late submission, Telstra restated its contentions, and pointed to aspects of a special access undertaking lodged by a consortium of carriers (including Chime) as possibly supporting Telstra's position. [Telstra, 5/6]

Chime and Request submit that a contribution to line costs should not be included in the LSS annual charges to be specified in these proceedings.

Chime focuses on the supply of broadband and VoIP solutions, and resells PSTN voice services to around half the end-users it supplies by means of the LSS.

Chime submits that introducing a contribution to line costs would require altering its business plans. Chime anticipates that under the illustrative rebalancing scenario the Commission outlined, it would be required to pay an additional *[c-i-c redaction]* amount per month *[end c-i-c redaction]* to Telstra above what it currently pays in access charges.

Chime submits that introducing a contribution to line costs in LSS annual charges would require it to become a 'full service provider', but it is not possible for it to make this change immediately. In Chime's view, doing so would necessitate switching to ULLS-based supply, but there is currently no viable means by which to migrate existing services from the LSS to the ULLS.

(Telstra acknowledges there are impediments to efficiently migrating existing services from the LSS to the ULLS, and *[c-i-c redaction]* these impediments cannot be immediately overcome. *[end c-i-c redaction]* [Telstra, Response to Chime, 14/5, Part 2, p.2] [Telstra e-mail to Chime, 10 May 2007 (Chime 18/5, Annexure A)])

Chime accepts that ULLS-based supply could be adopted for new services, but considers this is problematic except for those end-users that select one service provider to supply both voice and data. Spare copper paths may not be available to other customer locations. [Chime 4/5, pp.9-12]

Chime disputes many of Telstra's contentions. It is of the view that LSS charges of $9 per month are not necessary to facilitate an investment in a FTTN; LSS-based competition represents facilities-based competition, and rebalancing represents facilities-based (LSS) competitors subsidising resale (WLR) competitors. Chime also submits that implementing rebalanced LSS prices for only itself and Request would put it at a competitive disadvantage to other LSS-based suppliers. [Chime 18/5, pp.8-12]

Request submits that implementing rebalancing would potentially require substantial planning and changes to Request's business plans, and without giving a reasonable adjustment period would potentially cause regulatory shock. Request anticipates that an immediate change would jeopardise its interests, and in this regard points to fixed-term contracts with end-users. [Request 4/5, page 15]

Request also disputes that LSS does not represent facilities-based competition, or that ULLS should be the preferred means to access copper pairs. In Request's view, the decision to acquire the LSS or ULLS will depend upon the preferences of the end-user, and that the LSS makes efficient use of a scarce resource (copper pairs). Request also submits that there is no information available to substantiate the contention that LSS annual charges of less than $9 per month compromise investment in broadband infrastructure. [Request 21/5, pp.5-7]

*Commission's views*

No party suggests that a contribution to line costs should be considered other than to apply prospectively and following rebalancing. The present decision concerns whether, for the period commencing proximate to the date of the final determination and ending on its expiry, Chime and Request should make a contribution to line costs in the LSS annual charges they pay to Telstra.

There are two options open to the Commission: (i) consider further the inclusion of a line cost contribution in LSS annual charges to apply to these parties until 31 December 2007 (which would necessitate further consulting the parties and reaching a view on the quantum of the contribution to be included in these proceedings); or, (ii) not to consider further the inclusion of a line cost contribution in LSS annual charges to apply to these parties until 31 December 2007.

The Commission has not previously recognised a contribution to line costs in LSS annual charges. On those occasions when the Commission has altered its regulatory approach to access prices, it has adopted a transition path approach, so as not to harm competition or efficient investment incentives. See ACCC, *Mobile Terminating Access Service, Final Decision*, June 2004 pp 214-222; ACCC, *Final determination for model price terms and conditions of the PSTN, ULLS and LCS services*, October 2003, pp 60-66.

The first matter on which the Commission sought the parties' views is entirely practical. If there is no prospect of implementing the rebalanced charges ahead of 31 December 2007, then there is little practical benefit in considering the issue further in these proceedings. The Commission is conducting a separate, industry-wide inquiry into LSS regulation for the period following October 2007.

Based upon Telstra's advice that WLR charges could unilaterally be varied by altering standard terms, the Commission accepts that a rebalancing of costs could be implemented in a number of weeks following determination of how and by how much to rebalance, and the corresponding increment and decrement to LSS and WLR charges. However the timing of this determination remains problematic, without a consensus from industry as to how to rebalance.

On the basis that it may be practical to implement a rebalancing ahead of 31 December 2007, the Commission sought parties' views on whether or not, under the section 152CR(1) criteria, a line cost contribution should be included in the LSS annual charges to apply to Chime and Request up until 31 December 2007. The Commission's views on how these criteria should be interpreted are provided above.

The first of these criteria concerns the promotion of the long-term interests of end-users (LTIE) of carriage services or of services supplied by means of carriage services. The Commission is directed to a number of subsidiary matters. The particular matters that the parties have raised for consideration are the likely effect of each approach on:

(i) competition in markets for carriage services, and in particular broadband/DSL services, VoIP services and PSTN access services;

(ii) efficient use of and investment in infrastructure by which services are supplied (including the access network, and DSLAMs) or by which services are capable of being supplied (including a FTTN); and,

(iii) legitimate commercial interests of the supplier of the service.

The Commission considers that an immediate introduction of a contribution to line costs would impede competition in downstream broadband markets.

Such a change in approach to regulatory pricing of the LSS would require significant changes to LSS-based service providers' businesses. Without providing an appropriate transition period to make these changes, LSS-based service providers will be less able to continue supply, or commence supply, such as in additional service areas. LSS-based supply has to date brought benefits to end-users in relevant service areas, in particular, by supporting higher quality (ADSL2+) services.

This disruption would likely lead to a lessening of competition, in markets for downstream broadband/DSL services, in particular. In contrast to LSS and ULLS based services, the Optus access network does not pass the majority of end-user premises, and does not support DSL or wholesale services.

It will likely take the access seekers time to implement necessary changes, as they would need to consider altering input services, and retail systems, and/or winning end-user PSTN voice business. The impediment to efficient migration of existing services from the LSS to ULLS exacerbates this. To switch between platforms, the LSS disconnection and ULLS connection cannot currently be completed in a single step. This necessitates loss of service to the end-user, and additional cost to the access provider.

More generally, making fundamental changes in approach to regulatory pricing without adequate warning and transitional arrangements would likely deter competitive entry or further investment in competitive infrastructure, as higher regulatory risk is perceived. The current LSS pricing principles do not signal a probability that a line cost contribution would be required, or mean that competitors should have been alive to the prospect that any change in approach would take effect immediately.

These competition concerns are not overcome by the possible promotion of competition in PSTN access markets that would accompany a reduction in WLR prices.

Turning to efficient investment in and use of infrastructure, the Commission firstly considers that efficient investments in, and use of the access network, and the LSS ordering system, will be made provided Telstra is making a normal commercial return on its capital employed.

Telstra is recovering these costs, including a normal return on its capital employed, and the Commission considers this will continue at least until 31 December 2007. Whether a contribution to line costs is included in the LSS annual charges to be paid by Request and Chime until then is unlikely to materially affect this. However, should an immediate implementation of rebalancing dampen LSS demand, efficient use and investment in the LSS ordering system would likely follow, with flow on consequences for efficient use and investment in downstream services.

The Commission also considers consequences for efficient investment by access seekers in the DSL access multiplexer (DSLAM) infrastructure used to supply downstream DSL services. Higher access charges for LSS-based competitors, which would necessarily result from an immediate introduction of rebalanced LSS and WLR charges, would have the effect of discouraging efficient investment in this infrastructure. Use and investment in downstream services would likely be below efficient levels as a result.

The Commission notes Telstra’s claims regarding investment in other broadband infrastructure, such as a FTTN, but does not consider on the information before it that the LSS prices to apply to Request and Chime until 31 December 2007 will materially impact these investment decisions.

Telstra’s legitimate commercial interests include its ability to recover its costs and make a normal commercial return on capital employed. The Commission considers that these interests will be satisfied by either approach.

The next criterion concerns the legitimate business interests of the access provider, and the carrier’s or provider’s investment in facilities used to supply the declared service. The Commission’s views on the effect of this decision on these matters are discussed as part of the first criterion.

The third criterion is the interests of all persons who have the right to use the service. The Commission considers that access seekers’ interests lie in being able to compete for the custom of end-users on the basis of their relative merits. It is in the interests of Chime and Request for the LSS annual charges they are to pay until 31 December 2007 to not include a contribution to line costs without a transition period. As well as the impact on their businesses of introducing the increment to the LSS charge, it would not be in their interests to pay the higher charge while other service providers are not required to pay similar charges.

The fourth criterion is the direct cost of providing access to the declared service. These are the LSS incremental costs and a contribution to indirect costs. It calls for consideration to be given to Telstra's ability to recover these costs. The Commission considers that Telstra will recover the direct cost of providing the LSS regardless of the approach taken to this issue.

The next two criteria are the value to a party of extensions, or enhancement of capability, whose cost is borne by someone else; and the operational and technical requirements necessary for the safe and reliable operation of a carriage service, or a telecommunications network or a facility. The cost of extensions to Telstra's ordering systems necessary to supply the LSS or ULLS have been taken into account. The Commission does not consider that the 'operational and technical requirements' criterion materially contributes to this decision.

The last criterion is the economically efficient operation of a carriage service, a telecommunications network or a facility. The Commission recognises that there is the potential for rebalancing to lead to more efficient operation of services, as a proportion of line costs are allocated to the full range of services that make use of the line. However, the Commission has not reached a view on the appropriate principles for, or the extent of, the rebalancing of charges that would be likely to lead to efficiency gains.

That said, the method of implementation would have a significant effect on the economic efficiency of associated services, networks and facilities. The Commission considers that the higher access charges that would result from an immediate rebalancing, and the associated heightening of perceived risk of regulatory intervention, would impede competition. In particular, competition in the provision of downstream services supplied by means of the LSS, particularly DSL services, would be impeded.

In these circumstances, Telstra would be able to set above-cost prices for its services, leading to a reduction in the consumption of these services below efficient levels, and consequential allocative inefficiencies.

In summary, the Commission doubts that rebalancing could occur before 31 December 2007. If it could, the Commission considers that an immediate implementation of rebalancing within this period would be contrary to the section 152CR(1) criteria. Having regard to these matters, the Commission has determined not to further consider in these proceedings the inclusion of a contribution to line costs in LSS annual charges payable by Chime and Request for the period up until 31 December 2007. The Commission will give further consideration to this matter during the separate, industry-wide inquiry into LSS regulation for the period following October 2007.

*4.1.8 'Specific costs'*

The term 'specific costs', in respect of the LSS, refers to the incremental cost of providing the LSS, and includes the costs associated with ordering, provisioning and qualifying a line sharing service. Relevant cost categories could include IT system development and operational costs; connection costs; wholesale management costs; and, indirect costs (ACCC, *Final Decision on whether or not a Line Sharing Service should be declared under Part XIC of the Trade Practices Act 1974*, August 2002, at page 85).

Some of these cost categories are recovered through LSS connection charges, and so are not relevant to the calculation of LSS annual charges.

As per the LSS pricing principles, LSS prices should be cost based, with necessary cost estimates derived from a TSLRIC+ methodology. There are a number of matters that need to be considered in implementing the TSLRIC+ methodology, and views reached on a number of such matters have the potential to influence (to varying degrees) the measurement of TSLRIC+. These are discussed in turn below.

For those matters considered to have a material bearing on TSLRIC+, and hence the LSS annual charges set in this arbitration, and where alternative approaches that could be practically implemented have been advanced, the Commission has considered these approaches against the section 152CR(1) criteria.

The Commission then assesses against the section 152CR(1) criteria the LSS annual charges that would follow from the adoption of the various approaches to these particular issues.

*Cost allocation*

*Introduction*

Consistent with the Tribunal's views, the Commission proposed an approach to cost allocation that, firstly, pooled the 'specific costs' associated with (i) the LSS and (ii) the ULLS, and (iii) Telstra's own internal costs of a nature equivalent to the specific costs of the LSS and ULLS; and secondly, to allocate this pool to a demand base including all downstream ADSL services.

*Parties' submissions*

Telstra opposes pooling. It maintains its position that cost allocation should be made at a more granular level, whereby costs are allocated only to the LSS. Telstra argues that this approach would not lessen competition, as it is constrained by a full facilities-based competitor (Optus), and it should be entitled to the full benefit of any greater cost efficiency in ordering and provisioning systems over those available to LSS-based service providers. [Telstra, 14/5, Part 2, p.18, Annexure 14]

Request supports pooling, and submits that the pooled cost base should be allocated across all copper lines, not only ADSL lines. Request argues that LSS-based competition enables voice over DSL competition as well as competing ADSL services, and hence incremental costs should be recovered from all end-users. Request submits this will best promote competition and efficient investment in and use of infrastructure. Further, allocating incremental costs only to LSS is unnecessary to meet Telstra's legitimate interests. [Request 4/5, pp.16-24]

Chime supports pooling. [Chime 4/5, p.12] Chime endorses the use of an all-lines approach to allocating the cost pool. [Chime 18/5, p.17]

*Commission's views*

The approach the Commission proposed is the approach adopted by the Commission previously (ACCC, *Assessment of Telstra's ULLS and LSS monthly charge undertakings (confidential version)*, December 2005, Appendix A, at pages 45 to 62). It is also consistent with the reasoning of the Australian Competition Tribunal, which in finding that Telstra's more granular approach to cost allocation was not reasonable (under section 152AH of the TPA), adopted a pooling approach as the comparator. In discussing the likely effect on competition of these two approaches to cost allocation, the Tribunal stated that:

> *. . . it is helpful in the present analysis to note that spreading the LSS-specific costs over a broader range of services would be more likely to promote competition between providers of those services, subject to those costs being pooled with other specific costs relevant to the provision of DSL services in downstream markets (eg Telstra's own internal costs of a nature similar to those of providing the LSS and ULLS-specific costs). This will ensure that all providers of DSL services using Telstra's CAN would face the same non-retailing costs of providing their services. (Re Telstra Corporation Ltd ACompT 4 [2006] at [150])*

The Tribunal concluded that costs should be pooled, although it was not necessary for the Tribunal to express a concluded view on the demand base over which these costs should be spread. In its view, the demand base comprised at least downstream DSL services.

Adopting Telstra's position on this issue would lead to a higher access charge than what was proposed; while adopting the access seekers' position would result in a lesser access charge.

The Commission has considered the views the parties have advanced, but remains of the view that the approach it proposed is to be preferred having regard to the section 152CR(1) criteria.

The Commission considers that its proposed approach, as compared to the Telstra approach, promotes competition, by better enabling LSS and ULLS based service providers to compete on an equal footing with Telstra's wholesale and retail DSL services. This supply has to date brought benefits to end-users in relevant service areas, in particular, by supporting higher quality, ADSL2+, services.

The Commission considers that this will promote competition in broadband/DSL markets. In contrast to LSS and ULLS based services, the Optus access network does not pass the majority of end-user premises, and does not support DSL broadband or wholesale services.

It is possible that the access seekers' approach could further promote competition, should it lead to conditions that were more conducive to competitive entry by LSS and ULLS based suppliers in both DSL and voice markets. However, at the present time, it is considered unlikely that downstream voice services would be supplied to a significant extent by means of the LSS.

The Commission does not consider that the different level of unit costs that would be allocated to Telstra and access seekers respectively under Telstra's proposed approach would represent the relative efficiency of Telstra to LSS access seekers. The incremental costs are those of internal Telstra systems, which are passed through to access seekers, and do not reflect decisions or practices of access seekers.

The Commission considers that Telstra's approach would tend towards encouraging less efficient use of and investment in ordering systems used to supply the LSS and ULLS, as well as infrastructure used to supply downstream DSL services. As associated costs would only be met from access seekers, Telstra would have less incentive to ensure that investments were necessary and implemented at efficient cost levels. Higher resulting unit costs for access seekers would discourage use of LSS and ULLS below efficient levels. These inefficiencies would flow through to downstream services.

Telstra's legitimate commercial and business interests in this context involve it being able to recover its costs, including the direct costs associated with the LSS, and a normal return on its capital employed. Theses interests are currently being met, and there is little if any potential that adopting any of the three proposed approaches would prevent Telstra from continuing to do so.

The access seekers interest lies in being able to enter markets and compete on their relative merits. The Commission considers that in this context it is access seekers' ability to enter downstream DSL markets that should be assessed. The Commission considers that its approach satisfies these interests. Telstra's proposed approach would not, as it would necessarily inflate LSS access seekers' cost base relative to Telstra's. The approach advanced by access seeker's would also be consistent with their interests, but the Commission considers moving to this position is unnecessary to ensure those interests are met.

The cost of extensions to Telstra's ordering systems necessary to supply the LSS or ULLS have been taken into account. The Commission does not consider that the 'operational and technical requirements' criterion materially contributes to this decision.

The Commission has considered which approach should be favoured in terms of enabling a carriage service, telecommunications network or facility to be operated efficiently. The criterion calls for consideration to be given, in this instance, to services, networks and facilities associated with the LSS and downstream DSL services, of the access provider, the access seeker, and any other downstream service providers.

The Commission considers that its proposed approach, which results in outcomes between those advocated by Telstra and access seekers, strikes the best balance. It will lead to conditions that make competition in downstream DSL services more likely, which will in turn encourage efficiencies in markets for these services. It is possible that allocative efficiency in the upstream supply of LSS would be reduced to a small extent. However, the efficiencies in the downstream DSL markets would far outweigh this.

In summary, the Commission considers that incremental costs should be pooled and allocated over downstream DSL services. A key consideration has been the services that are typically supplied by means of the LSS and ULLS. The Commission has not adopted an 'all-lines' allocation as it understands that, currently, the LSS and ULLS are used mainly where the end-user requires a DSL service, and that LSS and ULLS based supply is driving competition in DSL services.

It is important to note that the costs to pool and allocate are limited to the like-for-like incremental costs associated with:

- a Telstra internal request for line sharing (when a retail or wholesale ADSL service is requested); or
- a request for line sharing, or access to the full spectrum on the line, from an external service provider (LSS or ULLS);

Costs associated with the conversion of line sharing into a downstream service are not included in the cost pool to be allocated.

*Weighted average cost of capital ('WACC')*

*Introduction*

The weighted average cost of capital is used to calculate a normal return on capital employed. The Commission proposed using a 'post-tax vanilla' WACC ranging from around 8.5% to 9.5% for each relevant year. The Commission sought the parties' views.

The subsidiary matters that the Commission drew to the parties' attention were:

- whether the asset beta should be the asset beta observed for a business supplying PSTN services, or some other business;
- whether the risk free rate should be based upon a five year or ten year bond; and,
- the date upon which the relevant observations of the risk free rate should be made for the financial years commencing after the date to which the final determination is to be backdated.

*Parties' submissions*

Telstra submits that the Commission should use a WACC specific to the capital employed in Telstra's ordering and provisioning systems, and other non-network assets, relating to the LSS. In Telstra's view, the WACC of these assets is higher than for other capital Telstra has employed, such as network assets.

Telstra acknowledges that it is not possible to directly estimate the systematic risk for the LSS specific assets, as a separate listed company for LSS does not exist. Consequently, it argues that it is necessary to use either first principles or benchmarking to estimate the asset beta for the LSS specific assets. In using these approaches it proposes that companies with the following characteristics be considered: moderate to high sunk costs and operating leverage; developing technologies; little or no benefit of long term contracts; high growth; beginning to mature as service and size.

Telstra estimates the WACC that would be incurred on these assets by a stand-alone provider of the LSS, and considers that this WACC is *[c-i-c redaction]* higher than the WACC the Commission proposed. *[end c-i-c redaction]*

Telstra submits that there is a risk that WACC estimates may be incorrect, and that the social consequences of under-estimating the WACC would be greater than the consequences of over-estimating it. Telstra considers that the WACC used should be above its estimate. [Telstra, 4/5, Pt 2, paragraph 83, Annexures 8, 15.]

In the alternative, Telstra submits that a WACC for assets associated with services Telstra supplies over the CAN should be used. Telstra considers this WACC is *[c-i-c redaction]* higher than the WACC the Commission proposed, but below what would result from basing the WACC on a stand-alone provider of the LSS. Again, Telstra considers that the WACC used should be above its estimate. *[end c-i-c redaction]* [Telstra, 8/5, Annexure 1.]

Request supports the Commission's proposed WACC. [Request 4/5, p.26] Chime claims Telstra's proposed rate of return on capital is well above a normal rate. [Chime 18/5, p.4]

*Commission's views*

There are a number of issues to resolve in estimating a WACC. Each of which will influence to varying degrees the overall estimate. In this case, the issues that have a greater influence on the WACC estimate are (i) whether to estimate the WACC of a CAN services provider, or of a 'stand-alone provider of a LSS' (which principally affects the estimation of the Asset Beta); and (ii) whether to provide for a higher WACC value on the basis of Telstra's 'asymmetry argument'. The subsequent approach to individual CAPM inputs has a lesser influence.

*– WACC to estimate and appropriate asset beta*

The Commission has estimated a WACC for a business of providing access to a fixed-line customer access network; either to itself or to other service providers.

Due to vertical integration and expansion into additional services such as mobiles, direct observations are unavailable for this business. In these circumstances, the Commission has used the observed asset beta of a business of supplying voice services on a fixed-line customer access network, before the relevant business diversified into other services, such as mobiles.

It is likely that this approach could slightly overstate the asset beta that would now be observed for these companies' fixed-line business. The introduction of DSL supply over the CAN has given rise to new revenue streams, and will tend towards lessening systematic risk of the fixed-line business.

It was proposed that the asset beta, and other CAPM inputs, should be adjusted in an attempt to more precisely estimate the WACC for a business of only providing an external line sharing service. Providing line-sharing on a stand-alone basis is not a realistic business model, as there is little rationale to provide access to higher spectrum only. Further, it is only arguable that the systematic risk for the underlying business of providing line-sharing (and/or other 'unbundled' access to the CAN) would differ materially from the WACC of the downstream business of providing managed retail and wholesale services. This is because demand for the upstream service is derived from downstream demand, and many of the risks will be similar.

Moreover, if a higher asset beta was to be allocated to a specific set of assets, then, in principle, this requires a compensating reduction in the WACC that is applied to other fixed-line services. This is because a generally applicable fixed-line WACC represents the sum of the different risks (and asset betas) associated with Telstra's different component fixed-line network services; an increase in the WACC to one set of services necessitates a reduction in the WACC applied to another set of services.

Finally, making adjustments of this type in an effort to more precisely estimate the WACC for a business of proving line sharing and 'unbundled access' would introduce many sources of potential error, and would require robust and extensive data. The Commission does not consider that such data are available.

*– Asymmetry of social losses*

On previous occasions that Telstra has raised this matter, the Commission did not accept that there is an asymmetry in the social consequences of over- or under-estimating the WACC.[21] Having considered Telstra's submissions in this arbitration, the Commission remains of this view.

This position, in large part, is based on the absence of any quantitative evidence presented by Telstra in support of this claim of an asymmetry in consequences.

However, at a conceptual level, the proposition that there could be an asymmetry in the social consequences of under- or over-estimating the WACC is unclear.

The conceptual argument presented appears to be that if the regulatory regime results in an access price which is too low then this will, with a high likelihood, have long-term effects in terms of under-investment and welfare. On the other hand, should the regulatory regime result in an access price which is too high then it is *highly unlikely* that this will result in over-investment in the network, and even where there this does occur, the effects on related markets and welfare will be minimal.

This raises two related questions, which have not been satisfactorily addressed:

1. Why would an access provider who has an opportunity to obtain an access price higher than the efficient level decide not to invest?
2. Why are the assumed costs of under-investment in terms of dynamic efficiency losses considered to be greater than the potential costs associated with over-investment in terms of static efficiency losses?

Implicit in the argument is the assumption that Telstra perceives that there are increasing marginal returns to investment in incremental capacity up to a point of efficient capital investment, and for some reason after this point that there will be decreasing marginal returns to investment. However, it is not at all clear why, in principle, this should be the case.

In any event the approach proposed by Telstra to address the perceived asymmetry in social consequences – allowing for a one standard deviation increase in each parameter – is in itself arbitrary and conceptually un-developed. In particular, it is unclear how this approach would address the perceived *effects* of any social asymmetry. If the essence of the concern is that only a high WACC

[21] ULLS decision page 125

will guarantee investment and service quality, why should we assume that a (marginal) one standard deviation increase in the WACC parameters will achieve the desirable levels of investment and service quality? That is, it is unclear why Telstra, or any other profit maximising firm, would be more likely to invest or to provide a higher level of service quality where it was being offered a one standard deviation adjusted rate of return, compared to the situation in which its rate of return was not adjusted.

Accordingly, the Commission has not included an increment above the estimated WACC values to reflect this argument.

*– Other CAPM inputs*

The Commission's views on the other CAPM inputs are as follows:

*Risk-free rate:* For this decision, the Commission considers that the risk-free rate should be the 10 year government bond rate, averaged in the period leading up to the relevant observation date rather than a point estimate. Averaging is done to lessen volatility.

The observations should be taken on an ex ante basis for financial years commencing after the date from which these determinations will have effect. In this case, the average value for the period leading up to 30 June 2004 has been applied to 2004-05, and following years. This increases the values slightly from those used in the draft determination, but not to an extent that influences the efficient forward-looking cost estimate.

The risk free rates are sourced from Reserve Bank of Australia (Reserve Bank of Australia, *F02 Capital Market Yields - Government Bonds,* www.rba.gov.au).

*Market risk premium:* The Commission estimates a forward-looking market risk premium by adjusting historically observed values. Adjustments are made to reflect that markets are becoming more integrated and efficient. The Commission chose a value of six per cent, which is at the lower end of the range of historically observed values. This value is generally consistent with regulatory practice and market participant survey results.

*Debt ratio:* The Commission has used a target debt ratio of 40 per cent. It considers that this is reflective of the target debt ratio for a company that provides line sharing and unbundled-access to a customer access network to itself and others.

*Asset beta:* The asset beta used is 0.5, which is leveraged to provide an equity beta of 0.83. The basis for these values is discussed above.

*Debt premium:* The Commission uses a debt premium of 0.8 per cent, as it considers this is reflective of a company that provides line sharing and unbundled-access to a customer access network to itself and others.

*Issuance cost:* A value of 0.2 per cent is used for debt issuance, as this is considered reflective of a company that provides line sharing and unbundled-access to a customer access network to itself and others. Equity issuance costs are not included in the WACC. Should such costs be relevant, they can be considered for inclusion within the efficient cost pool as an operating-type expense.

*Gamma*: The possible values range from 0 to 1. The Commission has adopted a value of 0.5, as this is the midpoint of the range. The final WACC value is not materially sensitive to the value chosen.

*– Resulting WACC values*

| | **2000-01** | **2001-02** | **2002-03** | **2003-04** | **2004-05** | **2005-06** | **2006-07** | **2007-08** |
|---|---|---|---|---|---|---|---|---|
| D/V ratio | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| E/V ratio | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 |
| Risk-free (rf) | 0.0623 | 0.0587 | 0.0590 | 0.0483 | 0.0582 | 0.0582 | 0.0582 | 0.0582 |
| Risk premium | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 | 0.06 |
| Asset beta | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Equity beta | 0.8311 | 0.8312 | 0.8312 | 0.8315 | 0.8312 | 0.8312 | 0.8312 | 0.8312 |
| Tax rate (e) | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 |
| Debt premium | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| Issuance cost | 0.002 | 0.002 | 0.002 | 0.002 | 0.002 | 0.002 | 0.002 | 0.002 |
| Gamma | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| | | | | | | | | |
| Return on equity | 0.1122 | 0.1086 | 0.1089 | 0.0982 | 0.1080 | 0.1080 | 0.1080 | 0.1080 |
| Return on debt | 0.0723 | 0.0687 | 0.0690 | 0.0583 | 0.0682 | 0.0682 | 0.0682 | 0.0682 |
| | | | | | | | | |
| WACC (post-tax vanilla) | 9.62% | 9.26% | 9.30% | 8.23% | 9.21% | 9.21% | 9.21% | 9.21% |
| WACC (pre-tax exclusive of imputation benefit) | 10.37% | 9.99% | 10.02% | 8.88% | 9.93% | 9.93% | 9.93% | 9.93% |

*Levelisation period*

*Introduction*

Levelisation refers to setting a charge to recover the costs of providing a service over a given timeframe, so that the charge does not vary from one period to the next within that timeframe. The Commission proposed that a levelisation period should be adopted commencing on 1 July 2000 and ending on 30 June 2008.

*Parties' submissions*

Telstra does not oppose levelisation, but submits that the levelisation period should not extend beyond 30 June 2008. [Telstra, 14/5, Response to Chime, Part 2, p.3]

Request supports the use of the proposed levelisation period. [Request 4/5, p.26] Chime also supports its use, but suggests that the levelisation period be extended until 2011. Chime considers that demand for LSS would not mature as an access service before then. [Chime 4/5, pp.13-14]

*Commission's views*

Levelisation can be appropriate for the period following the introduction of a service, or in other circumstances where demand levels are changing, and annualised costs attributed to various periods differ significantly. In these circumstances, the choice of timeframe over which to levelise costs can have a significant bearing on the per unit cost estimate.

This issue was considered by the Tribunal, which concluded that a levelisation period of four years for the LSS was too short. (Re Telstra Corporation Ltd ACompT 4 [2006] at [120])

Adopting Chime's suggestion would likely tend towards a lower access charge, but the amount of any reduction is not known. Implementing this approach would require more data.

The Commission remains of the view that it is appropriate to levelise over the period from 1 July 2000 to 30 June 2008. A number of factors inform this approach:

- It draws upon the available data (as forecasts are available for the prospective period);
- The access charge is reflective of charges expected in a reasonably mature market for line sharing, as a longer period is allowed for demand to mature; and,
- It better ensures that costs can be recovered – for instance, if a previously proposed levelisation period of 5 years was adopted for incremental costs, it is possible that Telstra may not have recovered its costs due to lower than expected demand materialising.

While the demand for the LSS itself may not mature for some time after 30 June 2008, the approach to cost allocation that has been adopted means that it is total demand for LSS, ULLS and downstream DSL services that informs incremental unit costs. While this total demand base is likely to continue to grow beyond 30 June 2008, these services as a whole have reached a significant level of penetration, and it is likely that the rate of growth in this total demand base will reduce. In these circumstances, there would be less reason to continue to levelise costs over multiple years.

As a result, a single LSS annual charge has been specified for the entire period of the final determination (including any backdated operation).

A full analysis of this issue has not been recorded in these reasons, as in this instance it is not considered practicable to implement the only alternative approach that has been advocated.

It is not necessary to reach a concluded view on the approach to take for future pricing. On the information before the Commission, the need for an extensive levelisation period, or for an adjustment for under (or over) recoveries in prior years, is less likely for future pricing decisions.

*Efficient costs (including efficient indirect capital costs)*

*Introduction*

The Commission proposed to adopt (for the purpose of these arbitrations) Telstra's previously claimed costs as being efficiently incurred costs. This claim addressed direct capital, O&M and indirect O&M costs. The Commission sought the parties' views.

*Parties' submissions*

Telstra provided estimates of its total factor productivity (TFP) over time and compared to other carriers. Telstra submits that this data demonstrates that its actual costs are efficient, forward-looking costs. [Telstra 4/5, Part 2, pp.13-14, Annexure 11]

Telstra also revised it cost claim to reflect balances recorded and attributed to the LSS in Telstra's accounting systems. These accounts are prepared under a current cost accounting framework. Telstra notes that its previously claimed costs are below the level of costs allocated in these accounts, due, at least in part, to the inclusion of indirect capital costs. [Telstra 4/5, Part 2, pp.10-12, 20, Annexures 6, 7]

On the other hand, Telstra advises the average asset life of capital equipment used to supply the LSS (and hence the period over which capital costs should be depreciated), is *[c-i-c redaction]* longer than the asset life previously claimed. *[end c-i-c redaction]* [Telstra 4/5, Part 2, Annexures 6, p.3]

Chime disputes that Telstra's TFP study demonstrates that its LSS costs are efficiently incurred. Chime states that international comparisons need to be approached with caution. [Chime 4/5, Part 2, p.12]

Request submits that the Tribunal did not consider Telstra's claimed costs as having been demonstrated as efficiently incurred. [Request 4/5, p.16] Request disputes that Telstra's productivity study provides evidence of cost efficiency. It claims that the conclusions reached in it are unable to be tested. [Request 21/5, p.8]

Request also questions Telstra's decision to construct different systems for ordering and provisioning line sharing when supplied to LSS, ULLS and internal use. Request claims that the actual costs are as a result higher than efficient cost. [Request 4/5, p.18] Telstra disputes that its decision to invest in a separate ordering system for the ULLS was inefficient. [Telstra, 14/5, Response to Request, Part 2, p3, Annexures 1, 2, 3]

*Commission's views*

Telstra points to a TFP study to establish that its actual costs were efficiently incurred. However, the Commission does not consider that a TFP study provides persuasive evidence that these costs were efficiently incurred. TFP is the ratio of the change of outputs to inputs over time. And so, high TFP growth can be influenced either by cost efficiency or scale economies from demand surges, or by reductions in inefficiencies over time. In this instance, a business-wide TFP value affords little assistance in assessing the efficiency of a relatively small capital investment, and modest O&M expenses.

The Commission paid close attention to Telstra's claim for indirect capital costs. As Telstra withheld from access seekers the balances of individual asset categories, they were not able to scrutinise the claim in detail.

Three asset categories represent *[c-i-c redaction]* a more significant proportion of the claimed indirect capital base. The first of these asset categories is net (accounts) receivables, which is a current asset. *[end c-i-c redaction]* The balance of accounts receivable will be a factor of the level of charges, whether they are payable in advance or arrears, and diligence in collecting amounts that fall due. The claimed amount appears high, and is informed by the level of LSS charges that have applied (and which have given rise to a large number of access disputes). No evidence is provided of the efficiency of Telstra's collections. The Commission does not accept that the claimed balance represents the efficient forward-looking balance for accounts receivable, or could be considered to be a reasonable estimate of it.

The *[c-i-c redaction]* next account balance is for the asset category described as 'other assets not expected to be developed, utilised or received within the next twelve months and which have not already been included'. *[end c-i-c redaction]* It could include (i) net long term inventories; (ii) provisions for future income tax benefit; and (iii) deferred research and development expenditure. It is not known what the claimed assets actually comprise, whether an efficient access provider would carry them, and if so, whether it would hold them at the level the allocation suggests.

The *[c-i-c redaction]* third account balance is for long-term investments, i.e., investments in shares, options and other financial instruments intended to be held for over twelve months. *[end c-i-c redaction]* There is no requirement for an access provider to hold such investments, and it would be unusual for them to be included in an efficient forward-looking cost base.

Telstra has also proposed that a longer asset life should be adopted, on the basis that this is the average life of the organisational assets used to supply the LSS.

Adopting this approach would tend to reduce the annual capital cost, as the asset is depreciated over a longer period.

Telstra does not explain this position in detail, and it could be that a longer average asset life results only where other contentions it has advanced are also adopted, such as if the indirect capital base is accepted. For the purpose of this arbitration, the Commission has *[c-i-c redaction]* chosen to adopt a five-year asset life for the relevant (computer-based) ordering systems. *[end c-i-c redaction]*

Adopting Telstra's cost claims in full could increase the access charge. This would depend upon the net effect of (i) increasing the capital base by accepting the claimed indirect capital costs, while (ii) depreciating this capital base over a much longer period. On the other hand, adopting Request position would lessen the access charge, to some extent, as compared to the approach the Commission proposed to the parties. The proposed approach is effectively to accept Telstra's previously claimed costs, which were for direct capital, direct O&M and indirect O&M costs, in full; and to not accept Telstra's claims in respect of indirect capital or its proposed asset life.

The Commission considered the various approaches and submissions advanced by the parties, but after having regard to the section 152CR(1) criteria as discussed below, has decided to adopt the position it proposed to the parties.

As discussed previously, the Commission considers that access charges that represent the forward-looking costs of an efficient provider best promote competition. This is because over the long run they lead to conditions which allow the access provider and access seekers to compete in downstream markets on their relative merits. The Commission considers that its option is more consistent with this outcome, and so would better promote competition.

An efficient access provider would incur direct capital, direct O&M and indirect O&M costs of the type Telstra has claimed; the question is whether the level of costs are those of an efficient operator. The Commission considers that Telstra's original cost claim for the LSS, which was used in proposing the draft final determination, is a reasonable estimate of the efficiently incurred costs for these cost categories. Although there is the potential for some inefficiencies to have occurred, the limited scale of the overall cost base means that only a small downward revision would likely result if a detailed analysis of these cost categories was undertaken.

On the other hand, the Commission is not satisfied that all asset categories included in the indirect capital base that Telstra has sought to be included would be held by an efficient provider of the LSS. Similarly, the Commission is not satisfied that the associated cost claim would represent what an efficient provider would incur on a forward-looking basis in respect of this cost category.

Accordingly, the Commission considers that its proposed approach would better promote competition.

The Commission considers that accepting Telstra's claimed costs in full is unnecessary to meet its legitimate commercial or business interests, including its interest in recovering its direct costs. The Commission considers its proposed approach is sufficient to meet these interests, as the level of costs that Telstra will incur in future is likely to be less than those claimed. Further, Telstra can meet these costs regardless of the position taken here. For instance, Telstra can meet the holding costs of its claimed indirect financial assets from associated dividends, or on a future realisation of them.

The access seekers' interests lie in being able to compete on their relative merits. The Commission considers its approach best meets this criterion, as access seekers are not required to pay access charges based on costs that can be avoided, at least in the long run.

The cost of extensions to Telstra's ordering systems necessary to supply the LSS or ULLS have been taken into account. The Commission does not consider that the 'operational and technical requirements' criterion materially contributes to this decision.

The Commission has considered which approach should be favoured in terms of enabling a carriage service, telecommunications network or facility to be operated efficiently. The criterion calls for consideration to be given, in this instance, to services, networks and facilities associated with the LSS and downstream DSL services, of the access provider, the access seeker, and any other downstream service providers. The Commission considers that its proposed approach, which results in outcomes between those advocated by Telstra and access seekers, strikes the best balance. It will lead to conditions that make competition in downstream DSL services more likely, which will in turn encourage efficiencies in markets for those services.

*Telstra's internal equivalent costs*

*Introduction*

The Commission noted to the parties that Telstra has not made a cost claim for its internal equivalent costs, and invited Telstra to make such a claim. The Commission proposed that if Telstra was unable to provide information regarding its internal equivalent costs, these would be estimated based upon the data that had been provided in respect of the ULLS. In particular, the Commission proposed to estimate these costs on the basis that:

- the efficient internal equivalent operating (opex) costs per line that Telstra incurs are the same as those that Telstra has claimed for the ULLS.
- the efficient internal equivalent capital costs that Telstra incurs are double the capital costs that Telstra has claimed for the ULLS, and incurred at the same time as the ULLS capital costs.

*Parties' submissions*

Telstra referred to previously supplied ADSL costs drawn from its accounting systems, and did not provide any data relating to its internal equivalent costs of line sharing. [Telstra, 4/5, Part 2, p.16]

Chime submits that the allowance for Telstra's internal equivalent capital and operating costs is too high. [Chime, 4/5, p.16] Request also considers the allowance to be too generous. [Request, 4/5, p.28]

*Commission's views*

ADSL is the supply of a managed service over a line sharing arrangement; whereas the LSS and ULLS are services of a lower layer. Different cost categories and elements are associated with 'unbundled' line sharing, and managed services. Accordingly, the 'ADSL costs' that Telstra claims are not the internal equivalent costs of line sharing.

Chime's proposed approach, would reduce the capital cost base and result in a lesser LSS annual charge, of around $2.25.

The Commission has considered the parties' views, but on balance considers it is appropriate to maintain the capital cost base as it originally proposed, rather than to reduce it as the access seekers suggest.

Telstra would incur equivalent costs when it shares a line, such as in order to qualify a line for line sharing, process line sharing requests, and arrange for exchange-based work to establish a line sharing arrangement. The question is what allowance would be reasonable.

The Commission considers its proposed allowance (based upon claimed ULLS costs) is appropriate, having regard to the section 152CR(1) criteria, and taking a conservative approach reflecting that only limited information regarding these costs is available.

As discussed previously, the Commission considers that access charges that represent the forward-looking costs of an efficient provider best promote competition. This is because over the long run they lead to conditions which allow the access provider and access seekers to compete in downstream markets on their relative merits. The Commission considers that its option is more consistent with this outcome, and so would better promote competition.

On the limited information available, there would be a risk of under-estimating Telstra's equivalent internal line-sharing costs if Chime's approach was adopted. Adopting the approach Telstra implies would require LSS and ULLS-based suppliers to contribute to the capital costs of its supply of higher level, managed services. Each outcome would lessen competition over the long run.

The Commission considers that its approach satisfies Telstra's legitimate commercial or business interests, including its interest in recovering its direct costs. This is because an allowance is made for Telstra's capital and operating costs when supplying line sharing to itself or access seekers in the form of the LSS and ULLS. Hence, Telstra will be able to recover its costs, including a normal return on investment, from its supply of LSS, ULLS and wholesale and retail services downstream from internal line-sharing.

The access seekers' interests lie in being able to compete on their relative merits. The Commission considers its approach best meets this criterion, in the present circumstances where information is limited. Chime's approach runs the risk of access seekers gaining a cost advantage in downstream markets. Telstra's approach would necessarily lead to Telstra gaining a significant cost advantage over access seekers, and hence would be contrary to access seekers' interests.

The cost of extensions to Telstra's ordering systems necessary to supply the LSS or ULLS have been taken into account. The Commission does not consider that the 'operational and technical requirements' criterion materially contributes to this decision.

The Commission has considered which approach should be favoured in terms of enabling a carriage service, telecommunications network or facility to be operated efficiently. The criterion calls for consideration to be given, in this instance, to services, networks and facilities associated with the LSS and downstream DSL services, of the access provider, the access seeker, and any other downstream service providers. The Commission considers that its proposed approach, which results in outcomes between those advocated by Telstra and access seekers, strikes the best balance. It will lead to conditions that make competition in downstream DSL services more likely, which will in turn encourage efficiencies in markets for those services.

*Demand measures*

*Introduction*

The Commission proposed to adopt the demand measures that Telstra provided in prior regulatory proceedings which were compiled in around August 2006. These are recorded in Telstra, *Statement of Telstra employee*, 11 August 2006. The Commission proposed to source ADSL demand for 2000-01 to 2004-05 from the Commission's Snapshot of Broadband Deployment. (ACCC, *Snapshot of*

*Broadband Deployment as at 30 June 2005*) The Commission sought the parties' views.

*Parties' submissions*

Telstra submits that the most up-to-date demand data should be used, and supplies more recent demand data (actual and forecast) for the LSS and ULLS. *[c-i-c redaction]* These data were compiled between December 2006 and February 2007. *[end c-i-c redaction]* [Telstra, 4/5, Part 2, pp.18-19, Annexure 9] Revised data for ADSL services are not supplied.

Telstra objects to basing early period demand for ADSL on ABS data. [Telstra, 14/5, Response to Chime, Part 2, p.4]

Request submits that demand data should be measured on an ex ante, and not ex post, basis. [Request, 4/5, pp.27-28].

Chime suggests using ABS data for early period ADSL demand. [Chime, 4/5, p.15]

*Commission's views*

Adopting Telstra's revised demand data would *[c-i-c redaction]* not increase the capital unit cost enough to increase the rounded LSS annual charge. *[end c-i-c redaction]* As the operating costs are largely variable, adopting Telstra's revised demand data would not be expected to influence unit operating costs. Similarly, adopting Chime's position would be unlikely to change the rounded charge.

The Commission considers that the earlier compiled demand data should be used in preference to Telstra's more recent data. The earlier compiled demand data are more complete than this alternative data set, as they contain DSL demand data. Demand data for DSL, LSS and ULLS are required to calculate the TSLRIC+ measure.

Importantly, Telstra's earlier compiled data were prepared at the same time as the cost data that have been used, and so there is consistency between the entire data set that has been used to derive the TSLRIC+ measure. That is, Telstra has calculated and provided the operating cost associated with the earlier compiled demand data. If the more recent demand data were to be adopted, these cost data would need to be revised accordingly.

The parties have not claimed that the methods used to prepare the earlier data set were flawed, and no such errors are apparent to the Commission.

The earlier compiled demand data are also more consistent with the data that would have been available (in a competitive market) when the parties were negotiating access to the LSS. This is because these data were prepared more proximate to the time of the negotiations. As such, use of these data is more likely to result in access charges that would have been agreed in a competitive market.

The Commission has decided not to use the ABS data in this instance, as the dates at which the measures were made do not align with the other observation dates that have been used.

A full analysis of the differences in approach against the section 152CR(1) criteria is not provided here, as adopting one or other would not lead to a material change in the LSS annual charge in this instance.

*Staff costs, IT O&M, and Tilting of annuity*

*Introduction*

The Commission proposed adopting the approach that Telstra adopted to these issues in prior regulatory proceedings. The Commission sought the parties' views.

*Parties' submissions*

Telstra submits that network (line) O&M costs *[c-i-c redaction]* should be considered. *[end c-i-c redaction]* [Telstra, 4/5, Part 2, p.16]

Request does not object to this approach, although it considers that access charges will tend to be biased upwards as a result. [Request, 4/5, pp.26, 28]

Chime also queries whether a material increase in access charges results from the decision to forward-tilt the annuity. [Chime, 4/5, p.15]

*Commission's views*

The Commission has considered the parties' submissions and has decided to proceed as it proposed to the parties.

As discussed above, the Commission has decided not to include a contribution to line costs in the LSS annual charges to apply until 31 December 2007. This includes associated O&M costs.

The Commission accepts that an efficient provider of the LSS would incur staff costs and IT operational and maintenance costs. While the claimed costs have not been demonstrated as efficiently incurred, the Commission has chosen to adopt the cost claim in full in this arbitration.

The Commission notes that Telstra does not tilt the annuity that is used in its newly-developed cost model (discussed below). However, the rounded LSS annual charge does not vary where the annuity is tilted as per Telstra's previous position, or not tilted. This can be observed by inputting '0' into relevant cells at row 3, of worksheet 'General data', in the LSS annual charges cost model that the Commission provided to the parties.

*Proposed cost model*

*Introduction*

The Commission provided to the parties a cost model that implemented its preliminary view. The structure of the cost model generally reflects the discrete cost models that Telstra has developed in previous regulatory proceedings for (i) 'LSS-specific costs', and (ii) 'ULLS-specific costs; but combines data from the two. The Commission sought the parties' views on use of this cost model.

*Parties' submissions*

Telstra advocated a newly-developed cost model, populated with its preferred approach and inputs, in preparing its submissions. [Telstra, 4/5, Part 2, p.10, Annexures 6, 7] Telstra did not supply this model to the Commission or to the parties.

Telstra submits that if the Commission continues to use the model it provided to the parties, it should adjust its modelling assumption to restate the capital values each year. [Telstra, 4/5, Part 2, pp.15-16] Further, Telstra opposes using the cost estimate derived from the model without rounding. [Telstra, 14/5, Response to Chime, Part 2, p.5]

Request supports the use of the Commission's model, although it repeats its view that some of the inputs used in the model tend towards a cost estimate above what it would consider appropriate. [Request 4/5, p.26, 28]

Chime supports the Commission's model, and submits that the actual cost estimate be used as the basis for the access charge rather than a rounded value. [Chime 4/5, p.16]]

Chime objects to a new cost model being considered in preference to a model of the same structure as used in previous regulatory proceedings. Chime considers that it would be inappropriate to adopt a completely new cost model without first subjecting it to industry scrutiny. [Chime, 18/5, p.8]

*Commission's views*

A cost model is a tool to convert assumptions and input values to a cost measure. The cost model structure proposed by the Commission in respect of LSS annual charges works, is relatively well understood, and is transparent and flexible.

Two amendments to the model were suggested. Adopting Telstra's suggestion, to restate capital values for each year in the model, would increase the resulting cost measure, while adopting Chime's suggestion to remove rounding would reduce it.

The Commission has considered these submissions, but does not consider that either approach is reasonably open to it to adopt. Restating the capital base at the commencement of each regulatory period can assist in sending correct build-buy signals. However, in this instance, the Commission's approach to levelisation means there is a single regulatory period being considered, and it is therefore not appropriate to restate the capital values each year within that regulatory period.

Rounding of cost estimates is the usual approach and recognises that there is a degree of imprecision and margin for error inherent in modelling of this nature.

*Assessment of parties' LSS incremental cost estimates against the section 152CR(1) criteria*

Telstra submits that adopting all of its preferences (and using its proposed model) will result in a measure of LSS incremental cost of between *[c-i-c redaction]* $X and $"Y" per LSS per month. *[end c-i-c redaction]* Different cost estimates within this range result from adopting alternative positions advanced in respect of the WACC.

The contribution of each of Telstra's claims to the higher claimed cost is not able to be calculated without access to Telstra's newly-developed cost model (assuming that it permits such sensitivity testing to be undertaken). However, the Commission expects each of the following factors influence (to varying degrees) the higher cost estimate: the inclusion of indirect capital costs, a higher WACC, the more granular approach to cost allocation, no levelisation, and revised LSS and ULLS demand.

Adopting the access seekers' position would result in a measure of between $2.00 and $2.25. The lesser charges flow from either reducing the allowance for Telstra's internal equivalent capital employed, or by adopting an 'all-lines allocation'.

Adopting a mix of Telstra's contentions and those advanced by access seekers would result in a measure within the range of $2 and *[c-i-c redaction]* $Y.

The cost estimate that is derived from the position that the Commission proposed to the parties is $2.43, which is rounded to give a $2.50 annual charge.

The Commission considers that the overall cost measure that results from its approach is appropriate having regard to the section 152CR(1) criteria.

This is because this measure results from adopting the approach on each of the material issues that it considers appropriate, having regard to those criteria. Further, the overall TSLRIC+ measure, and hence the access charge, which results from the Commission's proposed approach falls within the range of measures that could result from adopting the alternative approaches that have been advanced on those issues.

### *4.1.9 Commencement date, expiry date and interest*

As noted above, the Commission has backdated the LSS annual charge to 1 June 2004. The charges will apply until 31 December 2007. Interest is to be paid on resulting overpayments.

## 4.2 LSS single connection and disconnection charges

These terms were not in dispute between Telstra and Chime, and hence are not addressed in the final determination.

## 4.3 LSS Managed Network Migration ('MNM') terms and conditions

### *4.3.1 Background*

A Managed Network Migration is a transfer or migration of services that is achieved by the project management by Telstra of a coordinated cancellation and connection of services.

MNM terms include charges payable for connections, disconnections, or order cancellations; preconditions to ordering a MNM; and forecasting timeframes and migration plan amendment terms.

There are potentially a number of different types of network migrations that could be requested. In these proceedings, consideration was given to migration from a wholesale DSL platform to the LSS; and migration from a LSS platform to a ULLS platform.

Telstra, Chime and Primus participated in the joint hearing on all the MNM related terms that were disputed. Request participated only on the price-related terms and the pre-requisites to ordering a LSS MNM.

### *4.3.2 Current terms and conditions*

Chime, Primus and Request are each in dispute with Telstra over LSS MNM terms and conditions. These terms and conditions are addressed in agreements between the parties, e.g., Customer Relationship Agreement 192 (which in some cases incorporates terms specified in Customer Relationship Agreement 191), or separate agreements.

The MNM connection, disconnection and cancellation charges, and (in the case of the arbitrations involving Chime and Request) pre-requisites to MNMs, currently applying are specified in interim determinations.

### *4.3.3 Prior consideration*

LSS MNM terms and conditions have been considered by the Commission in each of these arbitrations. ACCC, *Statement of reasons relating to an interim determination*, 12 July 2006 (Primus dispute); *Reasons for interim determination*, 2 November 2006 (Request dispute); *Reasons for interim determination*, 2 November 2006, and *Reasons for interim determination*, 21 December 2006, (Chime dispute).

The Commission has published an extract from each of the decisions to make an interim determination in the Telstra / Request LSS arbitration and Telstra / Chime LSS arbitration concerning LSS MNM charges. (www.accc.gov.au)

### *4.3.4 Principles to apply*

The Commission proposed to the parties that the price-related terms for LSS MNMs should be determined having regard to the LSS pricing principles. The parties' submissions regarding the use of these principles are discussed previously.

The parties are generally supportive of the use of the LSS pricing principles. Some parties questioned whether MNM charges should be averaged, as had been proposed, while others where supportive of averaging. [Primus, 4/5, p.20] [Chime, 18/5, pp.14, 17] [Request, 4/5, p.39] [Telstra, 4/5, Part 4, p.8]

The Commission has had regard to the LSS pricing principles in determining the price-related terms for LSS MNMs. Under those principles, these charges should comprise the forward-looking efficient costs of connecting and disconnecting the LSS as part of a MNM.

Further, in principle, these charges should be geographically de-averaged. However, averaged prices can be justified where the distortionary effect of an averaged charge is not significant. As a result of the approach adopted in these proceedings to the cost of materials, the same costs apply to LSS MNMs across different bands. Hence, using averaged charges does not lead to a different charge.

*4.3.5 Technical advice*

*Introduction*

The Commission has received a number of reports (some of a draft or interim nature) concerning the connection or disconnection of the LSS. The reports that are relevant to an assessment of the efficient costs of LSS MNM costs are:

- Consultel, *Analysis relating to Primus / Telstra LSS Dispute interim report*, February 2006
- Consultel, *Small Scale MNMs between wholesale ADSL, ULLS and LSS – Interim report*, March 2007

The Commission proposed to the parties that these reports should be considered, and further that Dr Brooks' views should be sought on relevant points raised in the parties' submissions. The Commission sought the parties' views on this approach.

*Parties' submissions*

Telstra submits that the Commission should not have regard to the Consultel reports. Telstra's main criticism is that Consultel is not qualified to advise on salary costs. Telstra also questions whether Dr Paul Brooks, the author of the reports, is impartial. [Telstra, 4/5, Part 4, p.2] [Telstra, 14/5, Response to Request, Part 4, p.1]

Request submits that the Consultel reports should be taken into account. Request advises that it considers the conclusions reached in the Consultel reports to be reasonable and in line with its experience. Request also notes that the position put by Consultel falls within the range advocated by Telstra and access seekers. [Request, 4/5, p.36]

Primus bases its submissions on views expressed by Gibson Quai in a report prepared for Primus and other access seekers, and also the Consultel reports. [Primus, 14/5, Part 4, p.1]

*Commission's views*

Dr Brooks and Consultel are qualified to provide advice to the Commission regarding the systems and processes that are used to make LSS MNMs. The Commission considers that Dr Brooks and Consultel are impartial, and does not consider that they could reasonably be perceived to be otherwise.

Accordingly, the Commission has had regard to the Consultel reports in reaching its decision, and referred relevant matters raised in submissions to Dr Brooks for his assessment.

### *4.3.6 Assessment of efficient costs*

*Introduction*

There are a number of distinct cost categories that are relevant to LSS connections and disconnections.

- ‘Back-of-house’ costs
- Jumpering, travel and vehicle and tool costs
- Indirect costs
- Materials (coper pairs)

Telstra uses third party contractors to perform the exchange-based work necessary to connect and disconnect the LSS as part of a MNM. Telstra staff and systems perform back-of-house tasks.

*‘Back of house’ costs*

*Introduction*

Costs associated with the following Telstra workgroups and processes are considered within this category:

- Wholesale customer service group (WCSG)
- Wholesale Product Delivery (WPD), which includes the data activation centre (DAC)
- Integrated deployment solution centre (IDS)

However, costs associated with Telstra’s wholesale customer front of house activities (WCSG and WPD) are recovered through LSS annual charges.

These work groups have periodically been reorganised. Now, some of these functions are performed by the Wholesale Broadband Infrastructure and Operations (WBI&O) group and the Product Delivery Co-ordination (PDC) team.

The Commission proposed to include an allowance for IDS group costs within LSS MNM connection charges, and to base this allowance on advice previously provided by Consultel concerning the efficient cost associated with IDS group tasks. The relevant costs are those incurred by Telstra in coordinating LSS MNMs and scheduling contractors to perform them.

*Parties’ submissions*

Telstra considers that the *[c-i-c redaction]* proposed hourly labour rate *[end c-i-c redaction]* for IDS group staff is quite low, although it was not in a position to provide an estimate of what it considers the efficient forward-looking labour cost for the IDS group would be. In Telstra’s view, this would vary from team to team within the IDS group, depending upon tasks performed.

Telstra would not object to the proposed allowance for IDS group costs, provided that an allowance was made for costs associated with the WCSG and WPD work groups. Telstra submits that if this is done, then the total allowance for these work groups would align with efficient cost measures for all ‘back-and-front-of-house’ functions that are derived from Telstra’s accounts. [Telstra, 4/5, Part 4, p.7]

Telstra disputes that it would be appropriate to base efficient labour cost of its IDS group on salaries paid by access seekers to their administrative staff. [Telstra, 14/5, Response to Chime, Part 3, p.1]

Telstra submits that WCSG and WPD group costs should be recovered in LSS MNM charges, and to this end has excluded costs associated with these groups from the cost claim it has made in these proceedings in respect of LSS annual charges. Telstra provides estimates of the costs associated with these work groups, including how these costs have changed over time as manual tasks have been automated. [Telstra, 4/5, Part 4, pp.3-7, Annexure A, Annexure B]

Chime submits that *[c-i-c redaction]* the proposed hourly rate *[end c-i-c redaction]* for IDS group staff is too high, and that a rate derived from the salaries of Chime's administrative staff would provide a more reasonable measure. [Chime, 4/5, p.17] Chime and Primus are concerned by the potential for double recovery of WCSG and WPD group costs, and consider that the better approach is to leave these costs in the LSS annual charges cost pool. They also submit that only efficient, automated, processes should be costed. [Chime, 18/5, p.14] [Primus, 14/5, Part 4, pp.1-2]

Primus also questions whether the costs of IDS functions are already recovered through the mark-up for indirect costs allowed in the LSS annual charges cost pool. [Primus, 14/5, Part 4, p.2]

*Commission's views*

The Commission has determined to maintain its estimates of efficient back-of-house costs that were proposed to the parties.

The Commission's view is to include in LSS MNM connection charges an allowance for efficiently incurred IDS group costs. The measure of efficient IDS related costs are derived by multiplying (i) an hourly labour cost, by (ii) the amount of time it would take an efficient operator to perform IDS functions in relation to a LSS MNM (as claimed by Telstra).

The efficient hourly labour cost used for the period up to 30 June 2006 is $[c-i-c], with an annual indexing used to derived a *[c-i-c redaction]* per hour rate for 2006-07 and 2007-08. *[end c-i-c redaction]* This is considered to result in a reasonable measure of the cost that will be incurred by the IDS group on an efficient and forward-looking basis, and falls between the rates advocated by the parties in these proceedings.

The Commission does not consider that the costs associated with the tasks performed by the IDS group would already be recovered within LSS annual charges. The mark-up for indirect costs there is to cover additional cost categories, such as costs of managing contracts and billing.

Adopting the position advocated by Chime would have reduced the allowance for back of house costs below these levels. The Commission has assessed its proposed approach and that advocated by Chime against the section 152CR(1) criteria.

In terms of the promotion of competition, Chime's position would be preferable if this better reflects the forward-looking, efficient cost of performing the IDS group tasks.

However, the Commission is not satisfied that using the access seeker's salary costs would be a suitable benchmark for efficient forward-looking costs of the IDS group, given the potential for the work performed by each workforce to differ.

For similar reasons, the Commission considers that adopting Chime's position would not better encourage more efficient use of and investment in infrastructure, or the efficient supply of the LSS and downstream services, or is necessary to satisfy access seeker's interests in competing on their merits. On the other hand, adopting this approach would tend to compromise Telstra's legitimate interests, including its ability to recover direct costs, to the extent that Telstra could not attain salary and on costs, at the levels advocated by Chime.

The Commission has not included in LSS MNM connection charges an allowance for WCSC and WPD costs. The costs of these work groups are fully reflected in the cost pool that the Commission has recognised for the purposes of setting LSS annual charges.

This approach results in an allowance for back-of-house costs of between $126.00, for the period ending 30 June 2006, and $134.50, for the period commencing 1 July 2007 (per LSS MNM).

*Jumpering, travel, vehicle and tool costs; Materials costs; Mark-up for indirect costs*

The Commission proposed to base the efficient costs for jumpering, travel, vehicle and tool cost categories for MNMs involving 50 or more services on third party contractor rates Telstra obtained in 2005 for substantial network migrations in Adelaide and Perth. Details of these contractor charges were provided by Telstra in August 2005. (Telstra, *Primus LSS access dispute – Telstra's submission*, August 2005, Annexure A) The Commission modelled the efficient cost estimate on the scenario where MNMs were performed in two stages: a pre-jumpering stage, and a cutover stage.

For smaller scale MNMs (involving between 20 to 49 services), the Commission proposed to base the efficient costs for these categories on third party contractor rates that Telstra obtained in 2005 for 'single' connections at the one exchange or at exchanges in close proximity. Details of these contractor charges were provided by Telstra in August 2005. (Telstra, *Primus LSS access dispute – Telstra's submission*, August 2005, Annexure B)

The Commission proposed to adopt the materials cost (i.e., the cost of copper pairs used to connect points on the MDF) that Telstra modelled in previous proceedings. No allowance was made for materials in disconnection costs, as no cable is required. The costs proposed were, for CBD areas, [c-i-c], and for other areas [c-i-c]. This was on the understanding that these costs weren't already included in third party contractor charges.

The Commission proposed a mark-up of 10 percent on third party contractor rates to cover indirect costs such as contract management costs, in preference to Telstra's previously claimed mark-up of [c-i-c] percent. This reflected the view that when using third party contractors, Telstra will avoid the indirect cost categories that comprise its claimed mark-up. Further, efficiently incurred contract management costs would not represent a significant component of per LSS connection costs.

The Commission sought the parties' views.

*Parties' submissions*

Telstra confirms that the contractor charges for MNMs used in preparing the draft determination are correct, and these charges have applied from April 2005 to now. Telstra advises that the charges to apply in future are being negotiated, and as a result they may increase. [Telstra 4/5, Part 4, p.5] Telstra subsequently provided revised rates agreed with contractors to apply from I June 2007. These rates are for LSS MNM connections made, by way of pre-jumpering and cut-over, either in the one visit or in two visits to the exchange. [Telstra, 10/7] Telstra does not object to a 10 per cent mark-up for indirect costs. [Telstra 4/5, Part 4, p.5]

Telstra considers that efficient costs should be modelled upon the scenario where pre-jumpering and cutover activities are done on separate days. In Telstra's view, this maximises the number of services that can be cutover on the day. [Telstra 14/5, Response to Primus, Part 3, p.3]

Telstra confirms that the contractor charges include the cost of materials. [Telstra, 14/5, Response to Chime, Part 3, p.1]

Primus submits that the efficient cost for larger scale MNMs should be modelled on the scenario where the service is cutover in a single step. In its view, pre-jumpering is unnecessary, and only serves to increase associated costs, especially where the service order is cancelled after pre-jumpering. [Primus, 4/5, pp.20-21]

Primus and Chime also question whether contractors charge Telstra on the basis of a two-stage process, even where such a process is adopted. [Primus 14/5, Part 4, pp.4-5] [Chime 18/5, pp.15-16]

Primus submits that the cost allowances for MNMs should be revised down, in line with revised contractor charges that apply to LSS 'single' connections at the one exchange or at exchanges in close proximity. [Primus, 14/5, Part 4, p.3]

*Commission's views*

The Commission had proposed different per connection costs for these categories to apply to larger-scale and smaller-scale MNMs, on the understanding that contractor charges would differ materially in each case.

The Commission has revised this approach following Telstra's further advice in its submission to the joint hearing of 4 May 2007 concerning contractor charges that apply to 'single' connections at the one exchange. The average of these charges is now below the charges that apply to MNM connections.

In these circumstances, it is unlikely that a contractor would require a premium above the agreed per connection charge in order to conduct a smaller scale MNM. And so, the agreed MNM rate has been applied as an efficient benchmark for the jumpering costs for all MNMs.

Contractor rates for LSS 'single' connections are pegged to rates for 'ADSL simplex' connections; but LSS MNMs are performed for access seekers alone. Telstra may not have as compelling an incentive to seek the most efficient connection costs for LSS MNMs, given these flow through to LSS access seekers only.

As contractors have agreed to perform LSS 'single' (ADSL simplex) connections on average more cheaply than the agreed rate for LSS MNM connections, there could be scope to reduce the allowance for jumpering costs for MNM connections. At this time, the Commission has not done so. However, further consideration could be given to this option should LSS MNM connection rates remain above LSS 'single' connection rates.

As contractors incur the cost of materials, they are already reflected in contractors' charges and the Commission has not included a further and discrete allowance for materials costs.

The Commission notes that a 10% mark-up for indirect costs is not controversial.

The remaining issue is whether efficient cost should be modelled on a single process or two-stage process. Further, if a two-stage process is used, whether the associated costs have been correctly estimated.

Adopting the position put by Primus would reduce the allowance for these cost categories by around $3. The Commission is satisfied that the contractor charges that Telstra has reported for MNM connections done in two stages or single stage have been correctly reported, given Telstra's express confirmation of them. It considers it is reasonable that the 'two-stage charge' would be higher than the charge for 'cancellation following pre-jumpering', as more work would be involved in connecting the jumpers than in simply removing the pre-jumper on a cancelled order.

Here, the approaches that the Commission could adopt would be (i) to model jumpering and related costs on a single process; or (ii) to model efficient jumpering and related costs on a two-stage process. The Commission has assessed these options against the section 152CR(1) criteria.

On the first criterion and the promotion of competition, a single process would be preferable if this better reflects the forward-looking, efficient cost of performing MNM connections. If so, this would better facilitate efficient entry and exit by suppliers in the supply of downstream DSL services. The effect on competition would be most pronounced in marginal exchanges, where higher MNM charges may preclude entry by LSS-based suppliers.

The information before the Commission does not clearly establish whether, looking forward, one or other approach would be more efficient in a particular instance. The fact that Telstra has negotiated rates for each eventuality suggests that a single stage process could be more efficient for some MNMs at least. The Commission anticipates that the least cost approach could vary between MNMs, depending upon whether, e.g., pre-jumpering would increase or decrease the number of technician days required for that MNM. It will also be influenced by access seeker preference. However, it could be that, at least in the longer term, contractors may be unwilling to perform 'single stage' MNMs at the lesser charge unless this represented the least cost option to them.

Next, efficient use and investment will be encouraged where Telstra is able to recover efficiently-incurred costs of MNMs, including a normal commercial return on capital employed. MNM charges above this level for LSS-based competitors would have the effect of discouraging efficient investment in and use of infrastructure used to supply the LSS. Use and investment in downstream services would likely be below efficient levels as a result.

Following on from the discussion regarding the promotion of competition, the Commission considers that the efficient, forward-looking level of these cost categories would likely fall somewhere in between the contractor charges that apply to the single stage and two-stage process. This is on the basis that some MNMs will use a single process, and others follow a two-stage process. At this time, the Commission does not have information to allow it to estimate where in this range the efficient cost measure would most likely fall.

Telstra's legitimate and commercial interests, including its interest in recovering its direct costs would be satisfied by modelling these costs on the basis that a two-stage process is always required. The alternative approach would prevent full cost recovery except for those MNMs where a single stage process is adopted.

For MNMs performed to date, Telstra consulted at least some access seekers and it was their preference for a two-stage process to be adopted. This approach represents a higher quality service, in that it minimises necessary disruptions to end-user service provision. It would be contrary to Telstra's legitimate interests to now model costs on the lesser-quality single-stage approach.

The next criterion concerns the legitimate business interests of the access provider, and the carrier's or provider's investment in facilities used to supply the declared service. The Commission's views on the effect of this decision on these matters are discussed as part of the first criterion. These would be better met by basing MNM charges on a two-stage process, especially for MNMs previously performed.

Looking ahead, access seekers' interests could tend to be compromised by basing MNM charges on only the charges associated with a two-stage process when they do not require the increased quality associated with the two-stage process. This could impede their ability to compete on their merits to the extent that it allowed costs to exceed the actual charges paid to contractors, or the increased costs could not be justified in terms of the associated increase in quality.

Telstra's ability to recover the direct costs of MNMs (including a contribution to overheads) will be better ensured by basing MNM charges on a two-stage process. However, this approach may exceed to a small extent what is required to recover direct costs going forward, in those cases where an access seeker requests a single-stage process.

The Commission does not consider that the next two criteria are particularly relevant here. There is no information to suggest that the adopting one or other approach would lead to unsafe practices being used, for instance.

The last criterion concerns the economically efficient operation of a carriage service, a telecommunications network or a facility. As noted above, the Commission considers that should an approach result in MNM charges that are above efficient forward-looking levels, then this would impede competition. If so, Telstra would be able to set above-cost prices for its services, leading to a reduction in the consumption of these services below efficient levels, and consequential allocative inefficiencies.

Weighing these considerations is a matter of judgment. In these proceedings, the Commission accepts a two-stage MNM process as the approach more consistent with the statutory criteria, especially for MNMs that have already occurred. Accordingly, it has modelled MNM connection charges on this basis. That said, should an access seeker prefer that a single-stage process be adopted for future MNMs, it can negotiate on this basis.

*Costs for 2006-07 and 2007-08*

The Commission indexed the back-of-house costs for 2006-07 and 2007-08. The Commission used *ABS 6345 Labour Price Index 'Ordinary time hourly rates of pay excluding bonuses; Australia; Communication services; Private; All occupations'.*

The Commission has not indexed contractor charges, but has used the rates as negotiated for each period.

In specifying a charge for the period from 1 June 2007, the Commission has adopted the agreed rate with the first contractor for a two-visit LSS MNM (as per Telstra's advice on 10 July 2007). The Commission considers that specifying the LSS MNM charge on this basis is reasonable, as it will reasonably align with the costs Telstra is likely to incur.

The actual LSS MNM connection cost Telstra faces may, in some instances, be *[c-i-c redaction]* a little higher or lower depending upon, e.g., whether the MNM requires one or two visits. *[end c-i-c redaction]* And so, the actual cost faced by Telstra will depend upon the distribution of LSS MNM connections between the four price points that Telstra has supplied. However, it is not possible to estimate on the available information the precise cost, as the likely distribution of LSS MNM connections is not known.

*Cost model*

A simple cost model that adopts the Commission's views is attached to these reasons. This model is further simplified from the model distributed at the draft determination stage. The contents of this cost model are to be treated as [c-i-c] and subject to the confidentiality undertakings given and directions made, as it reproduces information that is confidential to the parties.

*Averaged or de-averaged charges*

As noted previously, the Commission decided to base MNM charges on a geographically averaged estimate of the efficient costs of providing these MNMs. As a result of the approach taken to materials costs, the costs of MNMs do not differ significantly between geographic bands.

*Bands 1, 2, 3*

The Commission did not specify charges to apply to LSS MNMs in Band 4, due to there being little if any demand for these connections.

*4.3.7 MNM connection charges*

*Introduction*

The Commission proposed different schedules of charges to apply to larger-scale and smaller-scale MNMs.

*Parties' submissions*

Telstra objected to this approach, as it considered that the resulting rate table was too complicated and too difficult to implement within an automated billing system. [Telstra, 4/5, Part 4, p.4] Access seekers considered the difficulties of implementation were overstated. [Chime, 18/5, p.14] [Primus, 14/5, Part 4, p.2]

*Commission's views*

As discussed above, as a result of revised information provided in respect of jumpering and related costs, the fixed and variable costs associated with smaller and larger scale MNMs are, in fact, similar. In these circumstances, a simple two part tariff for MNM connections can align with costs. Accordingly, the Commission has been able to simplify the MNM connection charges, with a single schedule of charges to apply to all MNMs.

*MNM disconnection charges*

The Commission proposed not to allow LSS disconnection charges where the LSS is disconnected as part of a MNM. This reflected the view that any associated costs would be taken into account in setting connection charges for that MNM type. The migration type to which this is potentially of more relevance is a migration from the LSS to ULLS. The parties did not object to this approach being adopted. [Telstra, 4/5, Part 4, p.8]

*4.3.8 Forecasting timeframes and MNM plan amendment terms*

*Introduction*

Chime and Primus (but not Request) each seek final determinations that address MNM forecasting timeframes and MNM plan amendment terms. *[c-i-c redaction]* Late efforts by Chime and Telstra to reach agreement on these terms did not resolve the dispute. *[end c-i-c redaction]*

These terms have required that, for each MNM, the access seeker is to advise Telstra of the exchange and the number of services to be migrated, and the week in which the cutover is to occur. This 'forecast' must be made at least 84 calendar days before the requested cutover date. The forecast is confirmed, or updated, 56 calendar days before the cutover date. The access seeker confirms, and provides details of the full national number of the services to be cutover, 20 business days before the cutover date. There are limits on an access seeker's ability to alter the number of services to be cutover as part of a MNM within 56 calendar days of the cutover. Limits also apply to the number of MNMs an access seeker can request for a given day.

The Commission has not considered these terms previously. For the purposes of the draft determination the Commission adopted the terms specified in the current customer relationship agreements, and sought the parties' views.

*Parties' submissions*

Telstra provides details of tasks performed during the MNM forecast period. These tasks are performed by the wholesale front of house (WCSG) and IDS/PDC workgroups. Some of these are done soon after the MNM request is initially submitted; others are performed when the MNM request is confirmed; and some are performed when the full national numbers of the services to be cutover have been provided.

Telstra considers that these forecasting timeframes are appropriate to ensure the smooth operation of MNMs, and permit contractors to be arranged to perform exchange-based work. The notice periods are also designed to protect Telstra from incurring unnecessary costs arising from cancellations. Telstra notes that when forecast demand is not reached at a particular exchange, the *per-connection* cost to Telstra increases. [Telstra, 4/5, Part 4, pp.8-9; Annexure A & B] [Telstra, Reply to Primus, 14/5, Part 3, p.4]

Telstra submits that variations to MNMs arise primarily from inaccurate forecasting by access seekers, which are circumstances beyond Telstra's control. Telstra also advises that the limitation of one MNM per state per day allows Telstra to meet its obligations to all access seekers. First, there is a limit to the number of technicians that can work at an exchange at once. Second, a limit of one MNM per state per day per access seeker ensures a level of equivalence for all access seekers. [Telstra, Reply to Primus, 14/5, Part 3, p.10]

Telstra submits that the Commission's proposal of only permitting cancellation charges in respect of cancellations that occur within 20 business days of the scheduled date of a LSS MNM would prevent Telstra from recovering costs that are reasonably incurred earlier in the process. Telstra claims a significant proportion of the work and cost associated with the effective execution of a MNM occurs between 84 days and 56 days prior to the scheduled week of a MNM. [Telstra, 4/5, Part 4, p.10]

Chime objects to an 84-day forecast period, and considers that a 56-day forecast timeframe is more than sufficient to allow Telstra to allocate staff or arrange contractors for a MNM. Chime states that this is supported by the Commission’s approach to date in regards to MNM cancellation charges, in that an efficient operator would not incur costs for MNM cancellations before 20 days prior to the proposed cutover date.

Chime also considers that it is unreasonable that Telstra should be able to amend a migration plan without Chime’s consent and without the same right being given to Chime. Chime considers that it should be allowed to vary forecast figures 20 percent in both directions prior to 42 days from the cutover date, and 10 percent in both directions up to 14 days before the cutover date. [Chime, 4/5, p.18]

Primus states that the existing MNM forecasting timeframes are unnecessarily slow, cumbersome and inflexible. In its view, a 56 day forecast timeframe is sufficient to allow Telstra to allocate staff or arrange contractors for a MNM. Furthermore, Primus considers that a single confirmation date at 20 days prior to the cut over sufficiently protects Telstra’s interests in efficiently allocating staff and contractors.

Primus considers that there is no reasonable explanation that it is restricted to a daily limit of one MNM in each State. In Primus’s opinion, a lead-time of 56 days provides Telstra with sufficient time to allocate staff or arrange contractors without this restriction. [Primus, 4/5, pp.22-23]

Primus also notes that it is unreasonable that Telstra should be able to amend a migration plan without Primus’s consent without the same right being given to Primus. [Primus, 4/5, p.24]

*Commission’s views*

In considering these terms, the Commission has sought to remove unnecessary delays to MNMs being completed, while not compromising Telstra’s ability to efficiently manage MNM processes. This calls for a weighing of potential benefits from additional flexibility in the MNM process, against possible detriments to MNMs generally if forecast accuracy and lead times are insufficient to properly manage MNM processes.

The Commission has considered against the section 152CR(1) criteria three possible approaches to these terms: (1) Maintaining the current arrangements as advocated by Telstra; (2) Providing the additional flexibility as sought by access seekers; and, (3) Providing some additional flexibility, but not all changes that access seeker's sought, and providing measures that seek to promote accuracy in the forecasts and some flexibility in the actual cutover date.

More particularly, the third approach that the Commission considered was to reduce the forecast period to 56 calendar days, and allowing modest fluctuations in forecast volumes. This option does not remove the daily limits on MNMs per state. This option also provides for cancellation charges to apply in all cases where MNMs are forecast for an exchange, and then completely withdrawn.

On the information before the Commission, an 84 day forecast period is unnecessary to perform the project management tasks associated with a particular MNM. The work done within the 84 to 56 day range would not take a substantial amount of time and can be easily accommodated within the 56-day period.

The longer forecast period could potentially be supported if it is reasonably necessary to the efficient conduct of all MNMs; where, e.g., it was necessary to efficiently manage contractors. However, the information before the Commission indicates that the 84-day forecasts would contribute little to this goal. The 84-day forecasts were not passed on to contractors, and Telstra's submissions suggest the volumes forecast at this time were not in any event reliable.

On the information before the Commission, unlimited variations to the forecasts once submitted would tend to compromise Telstra's ability to effectively manage its contractors. This is because large fluctuations in individual forecasts will mean that either too many or too few contractor resources will have been allocated to that MNM. However, the same could not be said for small variations in volumes, where the same level of resourcing would remain appropriate.

Further, it is likely that the number of wholesale ADSL services supplied to the access seeker in the relevant exchange will vary within the eight week forecasts period. This will be due to, e.g., end-user churn, rather than a lack of care when submitting the initial forecast.

To this end, the Commission considers that Telstra should not unreasonably refuse variations that are submitted by the access seeker. This reflects an approach that has been adopted in practice between the parties.

What is unreasonable would depend upon the particular circumstances. However, as general guidance, the Commission would consider that it is likely to be unreasonable to refuse a variation of up to 10 per cent (either above or below the original forecast volume). Further, there could be scope to reasonably accommodate higher order variations the earlier that the request for variation is notified.

Departures from forecast data will not impede cost recovery, as MNM connection charges (including minimum charges) will fully recover project management costs for MNMs that proceed; and cancellation charges will apply for all MNMs that are cancelled following inclusion in a 56 day forecast. This will promote reliability in 56-day forecasts.

Where Telstra cannot reasonably commence a MNM cutover on the agreed cutover date, then Telstra is to commence the cutover as soon as reasonably practicable following the agreed cutover date. This provides leeway where a particular agreed cutover date cannot be met within the 56-day forecast period.

The Commission considers that arguments in favour of ongoing limits to the number of MNMs an access seeker can forecast per day per state are relatively weak. However, at this time, the Commission considers it is generally unlikely that the current arrangements would materially delay finalisation of a network migration program.

This conclusion would hold unless the access seeker has forecast migrations in a significant number of exchanges in a particular state. At present, access seekers have typically restricted forecasts to metropolitan exchanges within each state. Should this change, so that a larger number of exchanges could be involved in MNMs, then further consideration could be given to the reasonableness of the restriction remaining.

For general guidance, the Commission notes that if rationing mechanisms are necessary, these should be applied only until relevant capacity can be increased. Further, they should respond to the constraint. Where, e.g., available space restricts the number of MNMs that can be performed at the exchange at the one time, the rationing measure should deny access to that exchange to the additional MNMs until the following day. On their face Telstra's restrictions act to deny access to exchanges on the basis of possible constraints, regardless of whether capacity is actually constrained.

In applying the section 152CR(1) criteria, the Commission first considered the long term interests of end-users, and within this criterion, the promotion of competition. The Commission considers that current arrangements impede competition, as they prevent or delay the migration of services at least cost. Additional time and uncertainty associated with migrating services present obstacles to competition, as they tend to discourage access seekers from entering and competing by use of own DSLAMS. This will ultimately be to the detriment of the long term interests of end users.

Reducing delays between forecasts and cutover, and providing a reasonable degree of flexibility to vary forecasts, will tend to alleviate these competition concerns. The access seeker's proposals for further flexibility may further promote competition in the short term, but risks reducing competition in the longer term if it were to compromise the efficacy of MNM processes.

Economic efficiency in use of and investment in infrastructure used to provide listed services requires consideration of Telstra's infrastructure as well as the infrastructure of LSS access seekers. MNM restrictions would tend to discourage otherwise efficient use of and investment in infrastructure used to provide the LSS and downstream DSL services. This is because those restrictions would delay MNMs completing or prevent existing services being migrated to the LSS at least cost. Uncertainty or delay will discourage take up of the LSS, and use of Telstra's LSS ordering systems, as well as discourage efficient investment in access seeker's DSLAMs.

Telstra's legitimate business and commercial interests, including the recovery of direct costs, are satisfied under the third proposed approach. Telstra's interest in recovering project management costs is satisfied, as well as Telstra's interest in the efficient management of resources used to deliver the MNM program more generally. The Commission notes that a 56-day forecast timeframe has been used for LSS MNMs, and on occasions MNM forecast volumes have been able to be amended within limits without adverse consequence. Measures to encourage greater reliability in forecasts will further support Telstra in efficiently managing contractors.

In contrast, maintaining the current approach would not be necessary to ensure these interests are met; while moving to the position advocated by access seekers could compromise these interests, should they prevent Telstra from effectively managing resources used to make MNMs.

The Commission considers that LSS access seekers' interests lie in being able to compete on their relative merits without being unnecessarily delayed, or being denied access to more efficient (least cost) MNM connection processes. These interests are promoted by arrangements that provide more timely access to MNMs, and avoid additional costs that would be incurred if MNMs were not able to be used. The Commission considers that the third proposed approach would meet these interests. The arrangements that access seekers would prefer may go further than what is necessary to achieve these interests, or may not be sustainable if they were to compromise the efficacy of MNMs more generally. However, maintaining the current approach would be contrary to these interests.

The Commission's approach to MNM minimum charges, MNM connection charges, and cancellation charges, means that in all eventualities, the efficient cost associated with a MNM will be borne by the LSS access seeker.

The Commission considers the third proposed approach will provide Telstra with reasonably reliable forecast data that may be necessary to ensure the safe and reliable operation of the facilities it uses in providing MNMs. For instance, sufficient time will be available to ensure safe access to facilities.

Similarly, the Commission considers that the third proposed approach will encourage the efficient operation of carriage services and associated networks and facilities by both Telstra and LSS access seekers. Were the current arrangements to remain, competition in downstream services will suffer as LSS access seekers will be delayed in accessing efficient MNMs, and thereby discouraged from making additional investment in DSLAM infrastructure. A lessening of competition would have significant adverse consequences for the efficient supply of downstream services.

In comparison, the access seekers' proposed approach could compromise the efficient operation of facilities used to provide the LSS, should it compromise Telstra's ability to effectively manage contractors' access to those facilities.

The Commission considers the third option it has proposed balances the interests of Telstra and LSS access seekers, and better ensures that the economically efficient operation of both Telstra's and access seekers' carriage services and facilities will be encouraged.

After applying these criteria to the three identified approaches, the Commission considers that the third option should be preferred, as it is more consistent with each of the criteria than the other approaches.

*Cancellation charges*

*Introduction*

The Commission proposed that cancellation charges are to be paid where a MNM is cancelled, or the number of services to be connected as part of a MNM is reduced, 20 business days or less from the cutover date. This reflected the view that cancellation charges would be necessary in each of these instances to enable efficiently incurred costs to be recovered.

The proposed charges were a charge of 50 cents per service, plus an additional charge of $18 where the cancellation follows pre-jumpering.

*Parties' submissions*

Telstra considers the proposed charges are too low to enable it to recover costs associated with cancellations. It considers that the 50 cent per service allowance is too low to recover back-of-house costs, and should reflect the total back-of-house costs associated with a MNM. Further, the contractor charge for cancelled orders after pre-jumpering is *[c-i-c redaction]* more than the proposed allowance of $18. *[end c-i-c redaction]* [Telstra, 4/5, Part 4, pp.10-11] Telstra considers that significant project management tasks are performed between ordering and 20 days from the cutover date, and these costs should be able to be recovered in all cases. [Telstra, 14/5, Response to Chime, Part 3, p.4]

Primus objects to paying for pre-jumpering. In its view, pre-jumpering is done at the election of Telstra. [Primus, 4/5, pp.21-24] Primus considers cancellation charges are unnecessary where the cancellation occurs more than 20 business days from the cutover date, as no significant costs would be incurred by an efficient operator before this time. [Primus, 14/5, Part 4, p.2] Chime and Request support the proposed approach to cancellation charges. [Chime, 4/5, p.18] [Request, 4/5, p.40]

*Commission's views*

The Commission has varied its approach to cancellation charges following the parties' submissions. The changes are to better ensure that back-of-house costs will be recovered in the case of cancelled MNMs, and that contractor-related costs will be recovered in the case of cancelled services following pre-jumpering. They are also intended to promote more reliable MNM forecasting, to compliment the other initiatives discussed above.

To achieve this, the Commission has removed the '20 business days or less' condition for 'standard' cancellation charges to apply, and increased the allowance for back-of-house costs for 'MNM cancellations' within the 'standard' cancellation charge. A 'MNM cancellation' is where an access seeker cancels the entire MNM, as opposed to simply reducing the number of services to connect.

The Commission has also increased the allowance for cancellations following pre-jumpering to reflect the charges contractors impose in this instance. The Commission's views on whether 'two-stage' (pre-jumpering followed by cutover) or 'single-stage' MNM processes should be adopted as the efficient MNM process are provided previously. However, these charges are only able to be imposed where the cancellation occurs not less than 20 business days from the cutover date as it would not be necessary for an access provider to pre-jumper earlier than this.

This approach leads to a (entire) MNM cancellation charge of $126 in 2005-06 (indexed for later years), and a 'cancel following pre-jumpering charge' of $23.60 per relevant service for 2005-06 and following years. Telstra's letter of 10 July 2007 did not expressly update the cost data concerning 'pre-jumpering' for the period from 1 June 2007; or provide contractor charges for a combined LSS MNM process, which appear to have operated as a basis for setting the contractor's charge. The information provided in this letter for LSS pre-jumpering and cutover on the same visit suggests that it is reasonable to retain the $23.60 charge for 2007-08. This is because these cost data suggest that, at least in some instances, Telstra will face a lesser cost, should the relevant contractor charge continue to be aligned with 'LSS combined' rates.

On the other hand, the Commission has not specified a 'standard' cancellation charge to recover back-of-house costs for MNMs that proceed with a reduced number of services. This is because the back-of-house costs will still be fully recovered in the MNM charge, including the minimum MNM charge, under the two part tariff that has been specified for those charges.

Further, the possibility of a MNM being deferred as a result of too great a variance between original forecasts and actual cutovers provides an appropriate degree of encouragement for accurate forecasts. And so, an additional ‘penalty’ type charge is not needed for this purpose.

*4.3.10 Pre-requisites to ordering a MNM and minimum MNM connection charges*

*Introduction*

The Commission proposed to the parties that there should be a minimum charge payable for all MNMs, and that this should be based upon the cost of a MNM involving 20 services. However, the Commission proposed that there should be no minimum number of services to be connected before a MNM process could be requested. This reflected the view that access seekers are best placed to determine on the basis of the time and cost associated with a MNM process whether it would be preferable to request a MNM.

*Parties’ submissions*

Telstra submits that it would be unreasonable not to specify a minimum number of services as a pre-requisite to requesting a MNM. Telstra submits that it incurs significant fixed costs in relation to a MNM, and not imposing a minimum number of services would be inconsistent with this. [Telstra, 4/5, Part 4, p.4,11]

Telstra submits that it could accept a 30 service MNM, but would need time to change its systems and processes. [Telstra, 4/5, Part 4, pp.4-5]

Chime, Request and Primus support basing the minimum charge on a 20 service MNM. Primus considers that basing the minimum charge on a higher number of services could make an exchange service area unviable for LSS-based supply. [Primus, 14/5, Part 4, p.2] Chime also supports the approach of not specifying a minimum number of services as a pre-requisite for a MNM. [Chime, 4/5, p.18] Request notes that it typically uses a MNM process when connecting between 20 and 49 services at an exchange to the LSS. [Request, 4/5, pp.38, 40]

*Commission’s views*

The Commission has determined to maintain the position proposed to the parties.

The Commission considers that 20 services is an appropriate scale for MNMs to be requested, as the connection of this number of services can be performed at less cost when done as part of a MNM. This is demonstrated by comparing the cost of 20 connections (as per the cost model for LSS MNMs) ($752.50) to the costs associated with making 20 LSS ‘single’ connections.

This is not to say that access seekers will always request a MNM for this number of connections at an exchange. They may prefer the shorter connection timeframes offered by ‘single’ connection processes.

The Commission has not specified a minimum number of connections to qualify for a MNM. The Commission considers that access seekers should have flexibility to request a MNM even if there are fewer then 20 services to connect if this is the approach that they consider preferable. However, Access seekers will still pay for the MNM as though they were connecting 20 services given the specification of the minimum charge.

The approach taken to setting MNM connection charges means that Telstra’s ‘largely-fixed’ back-of-house costs will be recovered in all instances. This is because of the inclusion of a fixed amount within MNM connection charges, including the minimum MNM charge, to recover this fixed cost component.

The final determination will take effect 21 days after the date it is made. As Telstra has previously supplied MNMs comprising 20 services, the Commission does not consider that there is a need to provide additional time for systems changes in order for these arrangements to be implemented.

In terms of the section 152CR(1) criteria, the Commission considers that this approach promotes competition, by removing obstacles to service providers migrating services to the LSS, and migrating services at the efficient, forward-looking cost. LSS-based supply will allow service providers greater ability to differentiate the price and quality of downstream DSL services they offer to end-users.

Economic efficiency in use of and investment in infrastructure used to provide listed services requires consideration of Telstra's infrastructure as well as the infrastructure of LSS access seekers. Restricting MNM processes to larger scale migrations, when MNM processes can result in more efficient outcomes for smaller scale migrations, would tend to discourage otherwise efficient use of and investment in infrastructure used to provide the LSS and downstream DSL services.

This is because those restrictions would delay MNMs completing (until sufficient demand is accumulated within the exchange) or prevent existing services being migrated to the LSS at least cost. Uncertainty or delay will discourage take up of the LSS, and use of Telstra's LSS ordering systems, as well as discourage efficient investment in access seeker's DSLAMs.

This approach satisfies Telstra's legitimate business and commercial interests, including its interest in recovering direct costs, as the minimum MNM charges, and MNM connection charges, permit Telstra to recoup the costs associated with MNMs. It also is consistent with access seekers' interests in being able to compete in downstream markets on the basis of the price and quality of the services they can offer.

The Commission does not consider that higher minimum MNM charges, or a minimum number of services as a MNM pre-requisite, are necessary to promote safe and reliable operation of the network or facilities, or to ensure the recovery of costs Telstra has incurred in making any enhancements that MNM processes may represent.

The Commission considers that the economically efficient operation of carriage services and associated networks and facilities of the access provider and access seekers will be encouraged by smaller-scale migrations utilising MNM processes. This is because it will promote competition in downstream services by removing obstacles to connecting the LSS, while ensuring that efficient costs of connecting the LSS is able to be recovered. Greater competition in the supply of downstream DSL services will encourage efficiency in the supply of those services.

#### *4.3.11 Commencement date, expiry date and interest*

The Commission has backdated the LSS MNM connection charges. The balance of the terms that the Commission has specified in relation to LSS MNMs will commence when the final determination comes into effect. These terms are to apply until 31 December 2007. Interest is payable on any over-payment that has occurred. The term of backdating, and reasons for this approach, are discussed previously.

#### *4.3.12 Changes to draft final determination*

A number of the terms specified in the final determination differ to some extent to those proposed at the draft determination stage. These changes reflect revised cost data, or approach to cancellation charges, forecasting timeframes and migration plan amendments and backdating for the MNM connection charges. Reasons for these changes are discussed previously.

Further, the decision not to backdate certain of the charges has meant that it is not necessary to specify charges to apply for 2004-05, 2005-06 and 2006-07 for all charges. Any 'obsolete' charges have been deleted.

Minor drafting changes were made to make clear that parties can override the operation of the final determination terms by subsequent agreement, and that, like the MNM connection charges, the MNM minimum charge is not to apply to Band 4 MNMs.

## 5. TERMS AND CONDITIONS ADDRESSED IN SEPARATE HEARING

### 5.1 Network modernisation terms and notice periods relating to the LSS.

'Network modernisation' and 'network upgrades' describe a broad range of actions that could affect the network over which the LSS (and other services) are supplied. These range from the relocation of exchanges/nodes; matters that affect access to existing exchanges, or require altering deployment class of equipment; to matters that will have little consequence for the availability or quality of the LSS. These actions could be taken in remedying damage to the network as a result of an emergency, or in implementing long-planned network changes.

*5.1.1 Current terms*

Chime and Telstra are in dispute regarding the network modernisation terms that apply to the LSS, including the period of notice Telstra should give Chime. The network modernisation terms, and network modernisation notice periods, currently applying between the parties in respect of the LSS are specified in Part B of CRA 191, at clauses 6.2 and clauses 6.6 to 6.11 respectively.

*5.1.2 Prior consideration*

The Commission previously considered network modernisation terms, and associated notice periods, in making model terms and conditions for the ULLS. ACCC, *Final determination – Model Non-price Terms and Conditions*, October 2003). The relevant model terms are those numbered G.1 to G.13. These terms are discussed at pages 34 to 36 of the Commission's final report.

More recently, the Commission considered terms and conditions that Telstra proposed in respect of the ULLS for network modernisation. [ACCC, *Assessment of Telstra's ULLS monthly charges undertaking, final decision,* August 2006] The Commission considered that these terms and conditions were not reasonable. These terms are similar to those currently applying between the parties.

*5.1.3 Terms and conditions to apply*

*Introduction*

The Commission proposed to the parties to have regard under section 152CR(2) of the TPA to the model terms and conditions report, and for these model terms to take precedence to the extent that they were inconsistent with the existing provisions applying between the parties.

This reflected the view that technically the ULLS is the service closest to that of a LSS since it is effectively a "spectral proportion" of the full ULLS. Further, the model terms would be an appropriate basis to set terms for the LSS.

*Parties' submissions*

Telstra submits that it is imperative that any determination by the Commission encourages the efficient upgrading of, and investment in, network infrastructure and ensures that Telstra is able to manage and repair its network in a way that is efficient, timely and not detrimental to public health and safety. [Telstra, 4/5, Part 5 p.2]

Telstra considers that it is essential that it have the capacity to undertake emergency network upgrades without prior notice being given to an access seeker. [Telstra, 4/5, Part 5 p.3]

For non-emergency work, Telstra considers giving access seekers 15 weeks' notice of changes that may affect their LSS service is appropriate. This balances the needs of access seekers for certainty of supply with Telstra's rights to modernise its own network and the needs of end-users to have improved service.

A longer period would have an unreasonably detrimental impact on Telstra's legitimate business interests, and on the LTIE.

In Telstra's view, a period of 24 weeks' notice for a relocation of a facility would be overly burdensome, and more time than access seekers require. Telstra points to access seekers not currently deploying LSS at the node in support of this position.

Furthermore, Telstra considers any roll-out of an FTTN network should not be addressed through CRA 191 or the Model Terms but rather through a separate process. [Telstra, 4/5, Part 5, p.2]

Telstra submits that any variations to the existing terms should not be implemented by simple reference to the model terms. Telstra considers these terms to be outdated, and inconsistency with the CRA would lead to uncertainty between the parties.

Further, time should be allowed for Telstra to make necessary arrangements to implement a change in the provisions. Telstra anticipates that implementing the draft final determination arrangements would require four to six months. [Telstra, 4/5, Part 5, p.5]

Chime considers that the minimum notice period should be 15 weeks, but where Telstra 'provides itself' a longer period than 15 weeks in a given instance, an equivalent period should be made available to Chime.

In the alternative, if an equivalent notice period is not feasible to implement, Chime requests a minimum 24 week notice period in respect of Network Upgrades which result in an exchange being rendered commercially unviable for LSS or the service no longer being supplied to Chime. Further, Chime submits that Telstra must offer an equivalent wholesale service for any affected or new customers. [Chime, Submission on network modernisation, 4/5, pp.4-5]

Chime does not want to impede Telstra's ability to undertake emergency maintenance with only minimal, or no, prior notice. Procedures for maintenance are adequately provided for within CRA 191, and it is unlikely that remedying the effects of natural disasters or sudden unforseen damage would cause Chime concern. That is, such works would not permanently truncate or decommission the supply of the LSS. [Chime, Response to Telstra on network modernisation, 18/5, p6]

Chime submits that FTTN upgrades should be contemplated within CRA 191 and the Model Terms. However, if the Commission accepts Telstra's contention that the notification provisions in relation to any roll-out of a FTTN should be addressed through a separate process other than the CRA, Chime requests the Commission delete section 6 of Part B of CRA 191 in its entirety. [Chime, Response to Telstra on network modernisation, 18/5, pp.2-3]

In the event that the Commission does not agree with Chime's preferred solution of removing all possible FTTN references in CRA 191, Chime request that in the event of an FTTN roll-out Telstra must:

- Provide equivalent notice period and in any event not less than 24 weeks; and
- Offer an equivalent service through a wholesale offering. [Chime, Response to Telstra on network modernisation, 18/5, pp.3-4]

Chime also considers that adopting the model terms would not be an appropriate means to implement its preferred approach. In its view, these terms do not set appropriate notice periods in all circumstances, and the inconsistencies with the current Customer Relationship Agreement would make application difficult. [Chime, Response to Telstra on network modernisation, 18/5, p.6]

*Commission's views*

A 'network upgrade' can increase the capacity, quality and/or reliability of the network to better meet the needs of all users. On the other hand, it could represent inefficient over-investment in a network.

The Commission considers that Telstra's arrangements with LSS access seekers should not unduly discourage or delay 'network upgrades', given the potential for this work to improve the quality and reliability of services supplied to end-users (by Telstra or other service providers). However, there are many ways in which 'network upgrades' can be implemented.

Current access arrangements specify a minimum period of notice that will be provided for all network modernisations (except those occasioned by emergencies where no notice is provided). Given the range of works that will fall within the ambit of 'network upgrade', applying a common notice period in all cases will, at best, provide appropriate notice on some occasions. In some instances it will be too long, and Telstra will be unnecessarily delayed in modernising the network. In others, it will not be long enough, and competition will be adversely affected.

Further, the current access arrangements do not generally address consultation and negotiation with access seekers that will be necessary for business continuity following more significant network upgrades. The current arrangements are limited in this regard to consultation on possible location of plant and facilities.

The parties agree that the current arrangements are not suitable for all network upgrades. For instance, the parties appear agreed that they would not be suitable for any FTTN modernisation, should one occur.

The parties have each objected to the approach that the Commission had proposed. The parties have suggested various alternatives, but do not agree on the suitability of these, and each appears in some respects problematic to adopt in the final determination.

In these circumstances, given the limited time for which this determination would operate, and the time that would be reasonably required to make necessary changes to Telstra's planning and notification systems in any event, the Commission has not specified network modernisation terms in the final determination.

However, the Commission considers it is important that progress be made in implementing more appropriate network modernisation terms, and accordingly, the Commission has provided views to assist for future negotiations on the matter.

The Commission considers that network upgrades should occur so that access seekers have an *equivalent opportunity* to Telstra to manage the potential consequences of the 'upgrade', including any associated disruption to current business models. This approach will likely best meet the section 152CR(1) criteria for any given network upgrade.

This 'equivalence' requires LSS access seekers to be notified as soon as practicable of planning for the works being approved, or in the case of emergency remediation, of the works themselves being approved or actioned. It would also require that LSS access seekers have the ability to negotiate commercial arrangements that are reasonably necessary for business continuity. That is, that any interruption of access will be avoided, or minimised where unavoidable, and access will be available to the 'modernised' network.

Arrangements that only provide for LSS access seekers to receive the same notice as Telstra's retail business units would not be sufficient in all cases to provide an equivalent opportunity. Such a period of notice would put LSS access seekers and Telstra Retail on an equal footing on which to notify end-users. However, unlike Telstra Retail business units, LSS access seekers may also need to plan their own complimentary works, e.g., modifications to facilities access or changing the deployment class of their own facilities; and may need to negotiate arrangements with Telstra, or other suppliers, regarding facilities access or substitute services.

That said, an ‘equivalence standard’ alone, in the absence of minimum notice periods, may not provide sufficient certainty to Telstra and access seekers of likely notice periods that should apply. This could impact business planning and investment by both Telstra and LSS access seekers. And so, there would remain a role for minimum notice periods.

However, minimum notice periods should be directed to the categories of ‘network upgrades’ that could occur, with each category attracting an appropriate period of notice. It would be preferable if these categories were specified in an objective way so that each party can readily ascertain where a particular network ‘upgrade’ fits, and hence the minimum period of notice it should attract.