



Submission in response to ACCC
Discussion Paper

**Public Inquiry into final access
determinations for fixed line services —
primary price terms**

CONFIDENTIAL VERSION

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Section 1. Introduction

- 1.1 This short submission responds to the letter (“the letter”) jointly signed by the Minister for Communications and the Finance Minister titled NBN Co Payments to Telstra & ACCC Fixed Line Access Determination.
- 1.2 That letter responds to a number of views in public consultations about the relevance of NBN Co’s payments to Telstra in the context of the ACCC’s pricing determinations for fixed line access services. Optus is concerned that some of the comments do not convey a full understanding of Optus’ position, currently or historically. Accordingly, we thought it would be useful to put Optus position in context so that there can be no misunderstanding
- 1.3 Optus appreciates the value of the structural reforms being implemented in connection with the roll-out of the NBN. We understand and accept that Telstra is entitled to receive considerable value as result of its participation in the NBN and its commitment to de-commission its copper network. We also recognise the value that policy stability plays in underpinning both commercial and consumer confidence. However, it is also important for the ACCC to consider all relevant matters required under Part XIC in determining access prices for existing legacy services in the transition period to the NBN.
- 1.4 Further, it appears that Telstra may also be arguing that the ACCC consider only the NBN-related inputs that favour its desired outcome (i.e. higher access prices). **[CiC]**¹ Optus submits that it would appear unreasonable for the ACCC to take a position that allows consideration of NBN-related factors that would be favourable to Telstra but exclude from consideration factors that would not be.

¹ **[CiC]**

Section 2. Response to the letter

- 2.1 Optus wishes to respond to five statements made in the letter. These are:
- (a) Inclusion of NBN payments may undermine competition;
 - (b) Inclusion of NBN payments was unforeseen and may undermine Telstra shareholder approval;
 - (c) No justification why payments should be included in the RAB;
 - (d) Inclusion is too complicated for the ACCC; and
 - (e) The need for regulatory predictability.

Inclusion may undermine competition

- 2.2 The letter suggests the ACCC consider the structural reforms already in place within the industry, including the benefits from increased competition as a result of dealing with the vertical integration problem.
- 2.3 Optus agrees with this, and has been a long term advocate and supporter of the need for structural reform in the fixed line communications industry. Indeed the ACCC should take into account the structural reforms already in place, the reasons for such reform, and the benefits likely to accrue as a result. The ACCC should also take into account the extent to which payments received by Telstra — for the long term leasing of network assets for use by NBN Co, and revenue received from the disposal of fixed line assets to NBN Co — have the potential to undermine these competitive benefits.
- 2.4 The NBN payments are forecasted to amount to a significant level during the period of the next Final Access Determination (FAD). Telstra expects to receive around \$3.3 billion from NBN Co in revenue for access to fixed- line assets during the period of the next declaration (2014-2019).² In pre-tax nominal terms, the revenue received by Telstra from NBN Co is reported to be around \$95 billion over 50 years. This is a significant level of funding. It is virtually a risk free form of cash flow to Telstra. However, it comes with a real risk to competition not only in fixed line markets post NBN, but also related horizontal communications markets.
- 2.5 Optus consider that these risks are a relevant consideration for the ACCC.

Inclusion of NBN payments was unforeseen and may undermine shareholder approval

- 2.6 The letter argues that consideration of NBN Co payments and asset disposal within the current fixed line FAD *“would undermine the integrity”* of the October 2011 deal between Telstra and NBN Co *“if Telstra shareholders are deprived of the benefit of arrangement they did not initiate but negotiated in good faith”*
- 2.7 An underlying assumption of this statement is that shareholders, when approving the Definitive Agreements (DAs), could not foresee the operation of Building Block Methodology (BBM) in future fixed line services FADs. This assumption needs to be reconsidered against countervailing evidence.

² Telstra, Telstra’s participation in the roll-out of the National Broadband Network, Explanatory Memorandum for the resolution under item 2 at the annual general meeting on 19 October 2011

- 2.8 First, Telstra shareholders approved the DAs in October 2011. The ACCC issued the fixed line FAD, outlining the BBM in July 2011. The inquiry process leading up to the final decision involved extensive discussion between the ACCC and industry on how to include future NBN payments within the regulated asset based of Telstra. The ACCC made clear on many occasions that it would take into account NBN-related issues during the making of the next (i.e. 2014) FAD. In September 2010, the ACCC stated:

In the process of reviewing prices and determining the revenue requirement for subsequent regulatory periods, the ACCC will take into account any migration payments received by Telstra and any impact that de-commissioning the network may have on the RAB.³

- 2.9 In July 2011, the Final Report for the 2011 FAD Inquiry stated:

*In the next regulatory period, the **ACCC will take into account the impacts of the NBN roll-out in determining the inputs to the FLSM**. If any modifications to the design of the FLSM are required, the ACCC will consult on any such modifications at an appropriate time prior to finalising prices for the next regulatory period.⁴ [emphasis added]*

- 2.10 It is clear that for at least the year prior to October 2011 that the ACCC would take into account migration payments made by NBN Co, and the impact of de-commissioning assets would have on the RAB during the 2014 FAD Inquiry process.
- 2.11 Second, the Explanatory Memorandum for the shareholder vote of October 2011 stated that changes to regulations may adversely affect the value to Telstra of the NBN arrangement. But it was also noted that the regulatory risk faced by Telstra as a result of the future pricing of declared services did not increase as a result of the DAs.⁵ As noted above, the shareholder vote occurred three months after the finalisation of the 2011 fixed line FAD, in which the ACCC made clear that the future operation of NBN payments would be taken into consideration in the next regulatory period (i.e. from 2014). No additional regulatory risk was identified due to the ACCC taking into account the impact of the NBN roll-out in determining the inputs to the FLSM.
- 2.12 Furthermore, Optus' position on the inclusion of asset disposals and revenues related to NBN services has been consistent over many years. Optus argued in February 2010 that:

... it will be important for the ACCC to consider the implications of a potential deal being negotiated by Telstra to migrate its traffic to the NBN and to allow NBN Co to access its duct network. Such a deal, if it eventuates, may involve significant consideration being paid to Telstra (in one form or another) for effectively closing down large parts of its CAN. Whilst it would be premature for the ACCC to speculate on the details of such a deal it would nevertheless be appropriate for it to signal that any consideration Telstra receives will be taken into account to ensure there is no risk of over-recovery. Further,

³ ACCC, Review of the 1997 telecommunications access pricing principles for fixed line services, Draft report, September 2010, p.29

⁴ ACCC, Inquiry to make final access determinations for the declared fixed line services, Final Report, July 2011, p.29

⁵ The Explanatory Memorandum (EM) to the October 2011 Shareholder vote discussed regulatory risks of the DAs in section 3.4.2. It was highlighted that changes to the regulatory regime may impact the value of the NBN transaction to Telstra. Furthermore, the detailed Grant Samuel analysis attached to the EM noted that "the Commonwealth and the ACCC have very broad powers and the ability to amend regulation of the industry overriding previous regulation and contractual arrangements. A wide variety of changes could result. For example ... changes to the price and no price supply terms for declared services and facilities access determined by the ACCC. However, a number of these risks are risks faced by Telstra in any event and are not a direct result of the Proposal." [Grant Samuel p.56].

*the ACCC should signal that access prices will not rise as a result of any deal negotiated and agreed to by Telstra.*⁶

- 2.13 And again, in July 2010, Optus wrote to the ACCC signalling concerns around the pricing of fixed line regulated services as a result of the Heads of Agreement signed on 20 June 2010:

*In conclusion, fixed line access prices should be expected to fall as a result of this agreement. Since Telstra will receive additional revenue streams under the agreement, it will require a substantially lower level of revenue from wholesale access prices over the remaining life of its network.*⁷

- 2.14 In June 2011, Optus submitted that both the Regulated Asset Base (RAB) and regulatory depreciation within the FAD should deal with compensating Telstra for its capital investment in its fixed line network. Given that this is the same investment for which NBN Co will compensate Telstra, there is a very real risk that Telstra will effectively be compensated twice for the same investment. Specifically:

- (a) Migration payments should be viewed as a 'return of capital' to Telstra shareholders for capital invested in the CAN. Accordingly, once received Telstra should no longer earn either a return on capital or a return of capital associated with the asset for which the payment was made.
- (b) Ducts, trenches and pits form part of the RAB for the CAN. Compensation for the use of RAB assets is a component of total compensation to Telstra, which represents a 'return of capital' to shareholders for capital invested in the network. Accordingly, the ACCC should deduct this RAB-related element of lease payments from Telstra's RAB for fixed line services.⁸

- 2.15 It is clear from the above commentary that this is not a new position from Optus. Having the ACCC recognise the impact of these payments was an important component of the structural reform package for Optus.

- 2.16 Further, the statutory role of the ACCC under Part XIC is to promote the long-term interests of end-users through increased competition and efficient use of, and investment in, infrastructure. The ACCC is legislatively required to consider what is best for all 23.5 million Australian end-users and not place undue weight on the interests of 1.4 million Telstra shareholders.

No justification why payments should be included in the RAB

- 2.17 The letter questions, as a matter of principle, how the *"progressive sale of Telstra's customer access network should reduce the cost base of the part of the network which at any given time remains unsold"*.

- 2.18 As noted above, the DAs contain leasing and disposals of assets clearly included within the RAB. For instance:

- (a) Migration payments should be viewed as a 'return of capital' to Telstra shareholders for capital invested in the CAN. Accordingly, once received Telstra should no longer

⁶ Optus Submission to the ACCC in response to discussion paper Telecommunications Access Pricing Principles for Fixed Line Services, February 2010, p.5

⁷ Letter from Optus to ACCC Re: Review of Access Pricing Principles for Fixed Line services – 13 July 2010

⁸ Optus Submission in response to the ACCC's discussion paper Public Inquiry to make Final Access Determinations for the Declared Fixed Line Services, June 2011, p.21

earn either a return on capital or a return of capital associated with the asset for which the payment was made.

- (b) Ducts, trenches and pits form part of the RAB for the CAN. Compensation for the use of RAB assets is a component of total compensation to Telstra, which represents a 'return of capital' to shareholders for capital invested in the network. Accordingly, the ACCC should deduct this RAB-related element of lease payments from Telstra's RAB for fixed line services.⁹

2.19 Optus' position is consistent with how the Fixed Line Services Model (FLSM) and the RAB is supposed to be rolled over between periods. It is clear that disposal of assets is included within the RAB and reduces the cost base. This mechanism is made clear in clause 6 of the fixed line services FAD, which states that the RAB rolls forward each year by the additional capex incurred minus regulatory depreciation and minus asset disposals in that year.

2.20 Clause 6.14 of the FAD also makes clear that the "*allocation of costs of operating the PSTN should reflect the relative usage of the network by the various services*". Where the PSTN is used by NBN Co (e.g. under long term lease) the cost of operating the relevant assets must be allocated to the services provided to NBN Co and not from other regulated services. It would be inconsistent with the ACCC's approach to the FLSM to simply ignore NBN Co's usage of Telstra's PSTN assets.

2.21 Moreover, these provisions are fixed principles under the Act valid until 30 June 2021. No Access Determination can be made during this period that is inconsistent with the fixed principles. If the position put forward in the letter was accepted — i.e. sale of Telstra's CAN to NBN Co should not reduce the RAB — the ACCC would be required to breach the fixed principles set out in the 2011 FAD.

Inclusion is too complicated for the ACCC

2.22 The letter further argues that issues surrounding the inclusion of NBN Co matters within the RAB would be complicated, and as such magnify the issues of principle. This seems to imply that consideration of the NBN Co issues involve an '*elevated risk of regulatory error*'.

2.23 . Issues surrounding how to take into account cost allocation to services supplied over regulated infrastructure are a standard part of ACCC pricing decisions. First and foremost, issues around how asset purchases and disposals should be included within the RAB are core to the ACCC functions across almost all regulated industries

2.24 As outlined above, the consideration of how the terms of the DAs should be included within the roll-over of the RAB and allocated across services in the FLSM can, and should be, done in a manner consistent with the fixed principles in the 2011 FAD. Optus welcomes the public inquiry conducted by the ACCC and the open and transparent manner in which views put forward by interested parties can be assessed and properly considered. Optus does not agree that issues surrounding the implementation of the RAB roll-over or cost allocation are factors that are not capable of being properly assessed by the ACCC.

The need for regulatory predictability

2.25 The letter argues that the ACCC should give increased weight to '*price stability*' given the negative impact on consumers of lower broadband prices until full migration to NBN post 2020.

⁹ Optus Submission in response to the ACCC's discussion paper Public Inquiry to make Final Access Determinations for the Declared Fixed Line Services, June 2011, p.21

- 2.26 The ACCC has to consider a range of factors when setting the price and non-price terms of a FAD.¹⁰ First and foremost, the Act requires that the terms of a FAD promote the long-term interest of end-users. This is achieved through promoting competition and encouraging the efficient use of, and investment in, infrastructure.
- 2.27 The ACCC has already taken into account the need to provide an *'appropriate level of price stability during the NBN roll-out and subsequent migration of services'* in its setting of the 2011 fixed line services FAD and the adoption of a BBM.¹¹ The ACCC stated that the adoption of the BBM (and RAB) was in response to demands for greater certainty.¹² Optus reiterates that its position simply requires the ACCC to consider NBN Co payments within the RAB, consistent with the 2011 fixed principles.
- 2.28 Further, the objective of price stability is not an absolute objective that over-rules other statutory objectives. The ACCC made clear in 2011 that price stability is an important consideration *"to the extent that it supports past investments and **promotes competitive outcomes**"*.¹³ [emphasis added]
- 2.29 It must further be noted that Telstra has already benefitted from, and end-users have suffered loss, as a result of the objective of price stability in the 2011 FAD. To this end, Optus must again highlight that the Telstra RAB includes an arbitrary uplift of \$911 million for the purpose of price stability and maintaining a \$16 price point.¹⁴ There is little justification for forcing higher prices on end-users once again. Price stability is only relevant to the extent that it promotes competitive outcomes. Ignoring the legitimate assessment of NBN payments in the context of Telstra's fixed line RAB for the purpose of price stability does not promote competitive outcomes.

¹⁰ Section 152BCA

¹¹ ACCC, Inquiry to make final access determinations for the declared fixed line services, Final Report, July 2011, p.8

¹² ACCC, Inquiry to make final access determinations for the declared fixed line services, Final Report, July 2011, p.9

¹³ ACCC, Inquiry to make final access determinations for the declared fixed line services, Final Report, July 2011, p.9

¹⁴ ACCC, Inquiry to make final access determinations for the declared fixed line services, Final Report, July 2011, p.44