



Australian
Competition &
Consumer
Commission

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

Position statement on the treatment of the
Telstra-NBN Co arrangements for
regulated pricing

October 2014



Australian Competition and Consumer Commission

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List of abbreviations and acronyms

ACCC	Australian Competition and Consumer Commission
ADSL	asymmetric digital subscriber line
AER	Australian Energy Regulator
BBM	Building Block Model
BBM RKR	Building Block Model Record Keeping Rule
CCA	<i>Competition and Consumer Act 2010</i>
DSL	digital subscriber line
FAD	final access determination
FLSM	Fixed Line Services Model
FOAS	fixed originating access service
FTAS	fixed terminating access service
FTTN	fibre-to-the-node
FTTP	fibre-to-the-premises
HFC	hybrid fibre coaxial
LCS	local carriage service
LSS	line sharing service
LTIE	long term interests of end-users
MTM	multi-technology-mix
NBN	National Broadband Network
PSTN OA	public switched telephone network originating access service
PSTN TA	public switched telephone network terminating access service
RAB	regulatory asset base
RKR	record keeping rule
ULLS	unconditioned local loop service
WLR	wholesale line rental

Glossary

Access determination	Written determinations made by the ACCC relating to access to a declared service after conducting a public inquiry; specifying any or all of the terms and conditions for compliance with any or all of the standard access obligations.
access seeker	Telecommunications companies that seek access to a declared service (that is, the right to use the declared service).
access provider	Telecommunications companies that provide access to a declared service.
ADSL	Asymmetric Digital Subscriber Line. A technology for transmitting digital information at high data rates on existing copper phone lines. It is called asymmetric because the download and upload speeds are not symmetrical (that is, download is faster than upload).
Building Block Model Record Keeping Rule	The Building Block Model Record Keeping Rule (BBM RKR) requests information on forecast and actual data from Telstra relating to operating expenditure, capital expenditure, depreciation and demand that is required to effectively implement the Fixed Line Services Model (FLSM). The FLSM is used as part of the ACCC's building block model-approach to determine prices for the declared fixed line services and wholesale ADSL.
declared service	A service that the ACCC regulates under Part XIC of the CCA. Once declared, a service provider must supply the service to other parties in accordance with the standard access obligations and the terms and conditions set in the final access determination.
Definitive Agreement	Agreements made between Telstra and NBN Co on 23 June 2011 to migrate customers from Telstra's fixed line network to the NBN and for NBN Co to lease and acquire certain infrastructure from Telstra.
end-user	Retail residential and business consumers of telecommunication services.
exchange	Place where various numbers and types of communication lines are switched so as to establish a connection between two telephones. The exchange also houses DSLAMs, allowing end-users to connect to the internet.
FAD	Final Access Determination. The FAD is made by the ACCC and sets the terms and conditions (including prices) on which a service provider must supply a declared service.
FOAS	Fixed Originating Access Service. The declared service replacing the previously declared PSTN OA service. Enables a telephone call to be connected from the caller to a point of interconnection with another network.
FTAS	Fixed Terminating Access Service. The declared service replacing the previously declared PSTN TA service. Enables a telephone call to be

	carried from the point of interconnection to the party being called on another network.
fixed line services	Telecommunications services provided over fixed networks, such as Telstra's copper network and HFC networks. The 'declared fixed line services' comprise seven services: the six fixed line services declared in 2014—the ULLS, LSS, WLR, LCS, FOAS and FTAS and the wholesale ADSL service declared in 2012.
fixed principles provision	An FAD may contain a fixed principles provision, which allows a provision in an FAD to have an expiry date after the expiry date of the FAD. Such a provision would allow the ACCC to 'lock-in' a term so that it would be consistent across multiple FADs.
FLSM	The Fixed Line Services Model (FLSM) is used as part of the ACCC's building block model-approach to determine prices for the declared fixed line services and wholesale ADSL.
LCS	The declared Local Carriage Service. Enables access seekers to resell local calls to end-users without having to invest in their own network and switching equipment. The LCS is purchased in conjunction with the WLR service.
LSS	The declared Line Sharing Service. Enables access seekers to share the use of the copper line connecting consumers to the telephone exchange, allowing them to provide fixed internet services using their own equipment.
PSTN	Public Switched Telephone Network. The telephone network that allows the public to make and receive telephone calls via switching and transmission facilities and utilising analogue and digital technologies.
PSTN OA	The declared PSTN Originating Access service. The name of this service has been changed to Fixed Originating Access Service (FOAS). PSTN OA is still used to remain consistent with Telstra documentation where applicable.
PSTN TA	The declared PSTN terminating access service. The name of this service has been changed to Fixed Terminating Access Service (FTAS). PSTN TA is still used to remain consistent with Telstra documentation where applicable.
retail service provider	Companies that offer telecommunications services to end-users.
revenue requirement	The revenue requirement refers to the aggregate revenue requirement calculated by the FLSM that allows Telstra to recover its cost of supplying regulated services.
ULLS	The declared Unconditioned Local Loop Service. Allows access seekers to use the copper line connecting end-users to the local telephone exchange, allowing them provide both fixed internet (broadband) and voice services using their own DSLAMs and other exchange equipment.

<i>wholesale ADSL</i>	The declared Wholesale ADSL service. Allows access seekers to purchase a Wholesale ADSL product from Telstra and resell internet services to end-users.
<i>WLR</i>	The declared Wholesale Line Rental service. For a monthly 'per-user' charge, it allows access seekers to purchase a line rental service from Telstra, which includes access to the copper line and associated services (including a dial tone and telephone number) supplied using Telstra's equipment.

Executive summary

The ACCC is currently undertaking an inquiry into final access determinations for Telstra's seven declared fixed line services. This inquiry forms part of the ongoing review of regulated fixed line services (the Fixed Services Review).

A key focus of the inquiry is the transition to the National Broadband Network (NBN) and the fundamental change in the way Telstra's assets will be used as the NBN is rolled out. The ACCC and a number of stakeholders have identified accounting for the impacts of the arrangements between Telstra and NBN Co regarding the migration of customers to the NBN and use Telstra's assets by NBN Co as a key issue in setting prices for declared services.

The ACCC has decided to release a statement on how it proposes to account for the arrangements between Telstra and NBN Co in advance of a more comprehensive draft decision. The ACCC considers that a position on this matter will provide a degree of regulatory certainty at a time of industry transition. Accounting for these arrangements is a straightforward regulatory decision in the context of the pricing framework for the declared fixed line services. The ACCC considers that this, combined with the level of interest in the matter by stakeholders, makes it appropriate to make its views known in advance of a draft decision.

The key element of the ACCC's position is that a regulatory values approach should be adopted to account for the impacts of the Telstra-NBN Co arrangements on prices for the declared fixed line services. A regulatory values approach would involve specific adjustments to account for the various transactions under the arrangements between Telstra and NBN Co and basing these adjustments on the values assigned to affected assets in the regulatory asset base (the RAB), as reflected in the fixed line services model (the FLSM) used to determine primary prices. The ACCC does not propose to take the value of payments made by NBN Co to Telstra into account in setting prices for declared services.

Use of regulatory values maintains the current cost based approach to setting prices for Telstra's declared fixed line services, and is consistent with the common practice in regulated sectors of relying on regulatory asset valuations for price setting purposes.

The ACCC has also reached positions on how to implement a regulatory values approach for each of the transaction types under the arrangements between Telstra and NBN Co.

For assets that are sold to NBN Co, the ACCC proposes to treat these as asset disposals and to remove the regulatory values of those assets from the RAB. The ACCC considers that treating assets sold to NBN Co in this way will ensure that assets no longer used in the provision of declared services are not reflected in regulated prices, and maintain cost reflective prices.

For assets that are leased to NBN Co, the ACCC proposes to account for this in the cost allocation framework of the FLSM. Treating leased assets in this way will ensure that the costs allocated to, and recovered from, declared services reflect the costs of supplying the declared services. It will also ensure that Telstra does not continue to receive revenue from users of declared services for the share of assets no longer used to provide declared services.

The ACCC considers that as a consequence of the migration of customers to the NBN, certain fixed line assets will be decommissioned or utilised to a lesser extent. The ACCC proposes to remove the regulatory values of decommissioned assets and an appropriate share of assets utilised to a lesser extent from the cost base. The ACCC considers this will ensure assets no longer used in the provision of declared services are not reflected in regulated prices and maintain cost reflective prices.

The ACCC notes that demand for Telstra's fixed line services is declining for reasons other than the migration of customers to the NBN—principally because of loss of market share to competitors and displacement of fixed line services by mobile telecommunications services.

This position statement deals only with loss of fixed line services to the NBN pursuant to the arrangements in the Definitive Agreements which provide compensation to Telstra for the migration. Declining demand for reasons other than NBN migration will be dealt with in the draft decision on the FAD primary price terms.

The ACCC expects to release its draft decision on the FAD primary price terms for consultation in early 2015, before making a final decision in mid-2015.

1 Introduction

The fixed services review and FAD inquiry

On 11 July 2013, the ACCC commenced a public inquiry under Part 25 of the *Telecommunications Act 1997* into making final access determinations (FADs) under section 152BC of the *Competition and Consumer Act 2010* (CCA) for the seven declared fixed line services (FAD inquiry).¹ This inquiry is part of the overall review of the regulated fixed line services — the Fixed Services Review.

The current FADs for the seven declared fixed line services specify certain price and non-price terms and conditions that apply in the absence of agreement between the access provider and the access seeker. These FADs were due to expire on 30 June 2014. Due to a number of factors the ACCC was not in a position to complete the current FAD inquiry prior to that time. On 16 April 2014 the ACCC extended the current FADs until the day before new FADs come into force.²

Primary price terms discussion paper

On 24 July 2014, the ACCC released for consultation a discussion paper which provided access seekers with the opportunity to make submissions on issues relevant to the primary price terms included in the FADs for the declared fixed line services. One of the issues raised in the discussion paper was the arrangements between Telstra and NBN Co under the Definitive Agreements³ and their potential implications for determining prices for the declared services. The ACCC proposed to account for the arrangements in setting prices for the forthcoming FADs, and identified some potential approaches for doing this.

Prior to the release of the July 2014 discussion paper, the ACCC received three early submissions on the issue of accounting for the impact of the Telstra-NBN Co arrangements from Optus, Herbert Geer (on behalf of TPG and iiNet) and the Ministers for Communications and Finance. These submissions provided views on alternative methods for accounting for the arrangements in determining prices for the declared services.⁴

As indicated in the July 2014 discussion paper, the ACCC expects to release a draft decision on the FAD primary price terms in the coming months. The draft decision will respond to submissions to the discussion paper and provide the ACCC's views on pricing issues raised by stakeholders.

Position on the treatment of the Telstra-NBN Co arrangements

The ACCC considers that the issue of an appropriate method of treating the Telstra-NBN Co arrangements is straightforward in the context of the pricing framework for the declared fixed line services, and is now in a position to state its position prior to the release of its draft report. The ACCC acknowledges the current uncertainty facing the industry in relation to the renegotiation of the Definitive Agreements and the rollout of the multi-technology NBN, and has therefore decided to provide its position on this matter in order to increase regulatory certainty at a time of industry transition.

¹ The declared fixed line services are the unconditioned local loop service (ULLS), line sharing service (LSS), wholesale line rental service (WLR), local carriage service (LCS), fixed originating access service (FOAS), fixed terminating access service (FTAS) and wholesale ADSL.

² <http://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fixed-line-services-fad-inquiry-2013/extension-of-existing-fads>

³ The current Definitive Agreements, which formalise the arrangements between Telstra and NBN Co, were executed in June 2011.

⁴ Submissions made before the discussion paper are available on the ACCC website: <http://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fixed-line-services-fad-inquiry-2013/receipt-of-preliminary-submissions>. These submissions were summarised and discussed in the discussion paper.

The ACCC notes that there are a range of other outstanding pricing issues which were also raised in the July 2014 discussion paper. The ACCC is considering these issues in light of submissions to the discussion paper, and will provide its views in the forthcoming draft decision.

1.1 Assessment framework

Legislative framework

The legislative framework that applies to the making of FADs is set out in Division 4 of Part XIC of the CCA. Section 152BCA of the CCA specifies the matters the ACCC must take into account in making an access determination. The ACCC considers the following matters to be relevant to its assessment of how to account for the Telstra-NBN Co arrangements in prices for declared services:

- whether the determination will promote the long-term interests of end-users of carriage services or of services supplied by means of carriage services (in particular in relation to the efficient use of and investment in infrastructure and competition)
- the legitimate business interests of Telstra
- the interests of all persons who have rights to use the declared service (access seekers) and
- the direct costs of providing access to the declared service.

Pricing methodology

As noted in the discussion paper, the ACCC uses the fixed line services model (FLSM) to determine prices for the declared fixed line services.⁵ The FLSM separates Telstra's fixed line network assets into 'asset classes' and uses a building block model (BBM) approach to calculate revenue requirements for each asset class.⁶

A key component of the FLSM is the methodology used to allocate a share of Telstra's total fixed line costs to the declared services. Given that most of the network assets whose costs are reflected in the FLSM are shared assets—that is, they are used to provide both declared and non-declared services—it is necessary to determine the share of each asset class' revenue requirement that should be recovered by a particular declared service. The FLSM uses 'cost allocation factors' for each service to determine these shares.

In September 2013, the ACCC issued Telstra with a request to provide information under the BBM RKR for the purposes of this FAD inquiry. Telstra's response to this request, and related confidentiality arrangements, were discussed in the July 2014 discussion paper.⁷ Telstra provided updated information with its submission to the discussion paper in October 2014. The updated information includes a rebasing of forecasts using actual demand and expenditure data for 2013-14 and changes to incorporate the change in the NBN architecture and expected timeframes.⁸

⁵ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms: Discussion paper*, July 2014, pp. 2-3.

⁶ ACCC, *Inquiry to make final access determinations for the declared fixed line services: Final report*, July 2011, p. 37.

⁷ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms: Discussion paper*, July 2014, p. 7.

⁸ This information can be obtained by persons who execute confidentiality undertakings with Telstra.

Fixed principles provisions

As noted in the discussion paper, an access determination may contain fixed principles provisions that lock in certain matters until a nominal termination date.⁹ In making the 2011 and 2013 FADs, the ACCC made fixed principles for the seven declared fixed line services that will apply until 30 June 2021. The fixed principles provisions lock in key elements of the pricing framework and provide the industry with certainty over time about how the ACCC will estimate prices for the declared fixed line services.

⁹ ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms: Discussion paper*, July 2014, p. 3.

2 Background

2.1 Arrangements between Telstra and NBN Co

The National Broadband Network (the NBN) will replace Telstra's fixed line network as the infrastructure used to provide fixed line telecommunications services in Australia. The transition from Telstra's fixed line network to the NBN will occur under arrangements between Telstra and NBN Co to migrate customers to the NBN and for NBN Co to lease and acquire certain infrastructure from Telstra. These arrangements will have significant impacts on the way Telstra's fixed line assets are used.

The Definitive Agreements, in their current form, reflect a predominantly fibre-to-the-premises (FTTP) network design for the NBN and provide for the following key elements:

- customers will be migrated from Telstra's fixed line network as the NBN is rolled out
- NBN Co will lease certain infrastructure from Telstra
- certain assets will be transferred from Telstra to NBN Co.

The Definitive Agreements also provide for migration payments and infrastructure payments to be made by NBN Co to Telstra:

- NBN Co will pay Telstra a one-off migration payment for each end-user disconnected from its copper network when they are migrated to the NBN in areas covered by NBN Co's fibre network.
- NBN Co will pay Telstra ongoing infrastructure payments for the lease of certain infrastructure. NBN Co will lease ducts, rack space in exchange buildings, and dark fibre (optical fibre with no active electronics attached) from Telstra. NBN Co will also pay Telstra a one-off payment for each lead-in conduit (that is, the pipe leading into a customer premise that houses the lead-in copper cable) that is transferred to NBN Co as customers are migrated to the NBN.

Telstra and NBN Co are currently renegotiating the Definitive Agreements to reflect the current government's NBN policy. A central element of this is a change to a 'multi-technology mix' design for the NBN. The multi-technology model provides for a combination of FTTP, fibre to the node (FTTN), and hybrid fibre coaxial (HFC) in the NBN fixed line footprint and depends on the use of some of Telstra's existing copper and HFC assets. These elements of the multi-technology mix were not contemplated by Definitive Agreements made in 2011.

The ACCC did not make any specific adjustments to prices for declared services to account for the impacts of the NBN in the 2011 FADs.¹⁰ This was due to insufficient certainty at that time about the timing of the NBN rollout and a number of other commercial and regulatory matters, and the expected minor impact the NBN would have for Telstra over the three-year regulatory period. However, the ACCC indicated that it would develop and consult on the design of the FLSM to take into account the impact of the NBN rollout for the next regulatory period.

2.2 July 2014 discussion paper

In the July 2014 discussion paper, the ACCC discussed the issue of accounting for the impacts of the Telstra-NBN Co arrangements on prices for the declared fixed line services. The ACCC noted that these arrangements will fundamentally change the way Telstra's fixed line assets

¹⁰ ACCC, *Public inquiry to make final access determinations for the declared fixed line services – final report*, July 2011, pp.32–33.

are used, and that as the NBN rollout progresses, the share of the network used to supply declared services will fall.

The ACCC considered that as a result of this change in the use of Telstra's assets, the Telstra-NBN Co arrangements should be accounted for in determining prices for the declared services. This is for two main reasons: first, it would ensure that only assets that are used in the supply of declared services are reflected in prices for those services; and second, it would ensure that any assets that are used for the NBN and do not create any benefits for users of declared services are not reflected in prices for declared services.

The ACCC considered that the key issue in accounting for the arrangements is quantifying their impact. The two distinct potential approaches identified by the ACCC were:

- to base any adjustments on the values assigned within the FLSM to the underlying assets affected by the arrangements, or
- to base any adjustments on the value of the payments made to Telstra by NBN Co.

The ACCC noted that, given the different ways that these approaches could be implemented, the limited publically available information on the value of the payments to Telstra, and uncertainty about the timing of the NBN rollout, it is difficult to compare the relative impact of these approaches on prices. Nonetheless, the ACCC considered that explicitly reflecting the payments from NBN Co in prices for declared services is likely to have a more material impact on prices compared to using values within the FLSM to reflect the arrangements.

In considering the two methods for quantifying the impacts of the Telstra-NBN Co arrangements, the ACCC identified the following two issues as relevant considerations:

- the relationship between the payments from NBN Co and the impact on underlying assets, and in particular the relationship between migration payments and the decommissioning of fixed line assets, and
- whether payments from NBN Co could be conceptualised as regulated revenue or non-regulated revenue.

Finally, the discussion paper outlined some potential options for implementing the two approaches identified for accounting for the Telstra-NBN Co arrangements in the FLSM.

2.2.1 Submissions

Submissions to the July 2014 discussion paper on the issue of the Telstra-NBN Co arrangements were received from Optus, the Department of Communications (the Department), Telstra, the Competitive Carriers' Coalition (the CCC), and Frontier Economics (Frontier) on behalf of the CCC. Key points are summarised below.¹¹

Approach to quantifying the impact of the Telstra-NBN Co arrangements

Optus submitted that the NBN payments should be taken into account when setting access prices, as otherwise there is a risk that Telstra will be over-compensated for the provision of fixed line services.¹² Optus submitted that it is in the interests of competition and end-users that NBN payments be factored into wholesale pricing arrangements.¹³

¹¹ Optus provided the ACCC with two submissions to the discussion paper — the first in August 2014 in response to the July 2014 letter to the ACCC from the Ministers for Communications and Finance, and the second in October 2014 in response to the questions raised by the ACCC in the discussion paper. The summaries below reflect both of these submissions.

¹² Optus, *Submission in response to ACCC Discussion Paper: Fixed Line Services Final Access Determination – Primary Prices*, October 2014, p. 4.

¹³ Optus submission, October 2014, p. 9.

The CCC submitted that the NBN payments are, at least in part, payments for disposal of assets and must be taken into account in determining regulated revenues, and these assets should no longer form part of the RAB.¹⁴ The CCC also submitted that if lease payments are not accounted for, this could result in over-recovery of costs.¹⁵

Frontier submitted that, at a minimum, the ACCC must account for NBN Co's usage of Telstra's network when allocating costs to declared services to ensure that access seekers and end-users pay no more than a reasonable share of common network costs.¹⁶ Frontier further submitted that the RAB value associated with network assets stranded as a result of NBN migration should be removed from the RAB, and that migration payments provide the necessary return of capital for these assets.¹⁷

The Department submitted that it is inherent in the FLSM and the fixed principles that the Telstra-NBN Co arrangements be accounted for by making adjustments to asset values in the FLSM. Costs associated with declared services should be allocated to the actual users of those services, thereby ensuring that regulated prices reflect the cost of providing services. The Department submitted that the unregulated NBN payments are therefore irrelevant to the setting of regulated prices.¹⁸

The Department submitted that the uncertainties associated with the renegotiation of the Definitive Agreements and the multi-technology NBN create the risk of regulatory error, and lend themselves to a conservative regulatory approach which emphasises price stability.¹⁹ The Department submitted that long term certainty could be provided in this context if the ACCC made a fixed principle in relation to the treatment of the NBN payments.²⁰

Telstra submitted that the NBN payments are irrelevant to determining prices for the fixed line services, as they do not relate to the cost of supplying fixed line services. Accounting for the payments would be inconsistent with the fixed principles, which establish a cost-based pricing framework.²¹ However, Telstra submitted that the Telstra-NBN Co arrangements should be taken into account to the extent that they impact on the cost of supplying the declared services.²² Further, Telstra considered that the option identified by the ACCC in the discussion paper to base any adjustments on RAB values of assets affected by the arrangements is consistent with the fixed principles.²³

Implications of the treatment of the Telstra-NBN Co arrangements for the long-term interests of end-users

Optus submitted that the NBN payments will significantly enhance Telstra's capital position relative to its competitors, have the potential to distort competition in post-NBN fixed line and related horizontal communications markets, and undermine the benefits of NBN structural reforms. Optus submitted that this distortion could be mitigated through appropriate consideration of the NBN payments.²⁴

¹⁴ CCC, *Supplementary Submission in Response to Ministers' Letter*, October 2014, p. 2.

¹⁵ CCC supplementary submission, p. 1.

¹⁶ Frontier Economics, *Submission on the final access determinations for fixed line services: A report prepared for the Competitive Carriers' Coalition*, October 2014, p. 43.

¹⁷ Frontier submission, p. 43.

¹⁸ Department of Communications, *Final access determinations for fixed line services—primary price terms: Submission to the ACCC*, October 2014, p. 5.

¹⁹ Department of Communications submission, p. 11.

²⁰ Department of Communications submission, p. 2.

²¹ Telstra, *Public inquiry into final access determinations for fixed line services—primary prices: Response to Discussion Paper*, October 2014, p. 41.

²² Telstra submission, p. 32.

²³ Telstra submission, p. 42.

²⁴ Optus submission, October 2014, p. 5.

Optus submitted that the ACCC is required under Part XIC to consider what is best for all end-users and not place undue weight on the interests of Telstra shareholders.²⁵ Optus submitted further that the ACCC should not place undue weight on the objective of price stability, as it is only relevant to the extent that it promotes competition, and ignoring NBN payments in the interest of price stability will not promote competition.²⁶

The CCC submitted that the impact of the NBN payments should not be ignored in the FAD as this would risk harming the long-term interests of end-users by giving rise to distortions in the market.²⁷ The CCC submitted that a failure to account for the payments would be detrimental to competition and contrary to the interests of end-users.²⁸

Frontier submitted that accounting for the NBN payments would minimise access prices while allowing Telstra to recover its costs; this would promote efficient use of infrastructure (without compromising efficient investment) and protect Telstra's legitimate business interests.²⁹ Frontier further submitted that accounting for the NBN payments would minimise potential distortions to competition.³⁰

The Department submitted that it would be in the long-term interests of end-users for the ACCC to consider setting access prices so as to promote price stability in the transition to the NBN.³¹ The Department submitted that, in considering the treatment of the Telstra-NBN Co arrangements and other factors that may affect prices (for example, expenditure and demand forecasts), the ACCC should consider the forthcoming FAD in the context of the transition to the NBN, and should consider promoting real price stability to facilitate this transition.³²

Telstra submitted that it disagrees with the early submissions to the FAD inquiry (discussed in section 7.3 of the discussion paper) which suggest that a treatment of the Telstra-NBN Co arrangements that would be in the long-term interests of end-users would be the one that results in the lowest access prices. Telstra submitted that an approach that minimises prices cannot be in the long-term interests of end-users if it does not allow Telstra a reasonable opportunity to recover its costs, nor if it leads to significant price volatility during the transition to the NBN.³³

Telstra submitted that its proposal for accounting for NBN impacts is the most appropriate approach, as it considers all the impacts of the NBN on the basis of its impact on the cost and usage of the underlying assets, thus ensuring prices are set in the long-term interests of end-users.³⁴

Treatment of transfer payments / transferred assets

Optus did not submit to the discussion paper specifically in relation to the treatment of transferred assets or transfer payments. Optus did, however, refer to its earlier submission to the FAD inquiry (discussed in section 7.3 of the discussion paper) which argued that payments for the sale of assets should be deducted from Telstra's fixed line cost base.³⁵

The Department submitted that transferred assets should be removed from the RAB at their regulatory value, and that they should be removed at the time of transfer. This would ensure

²⁵ Optus submission, October 2014, p. 10.

²⁶ Optus submission, October 2014, p. 10.

²⁷ CCC submission, p. 1.

²⁸ CCC submission, p. 2.

²⁹ Frontier Economics submission, p. 43.

³⁰ Frontier Economics submission, p. 44.

³¹ Department of Communications submission, p. 10.

³² Department of Communications submission, pp. 9-10.

³³ Telstra submission, p. 46.

³⁴ Telstra submission, p. 33.

³⁵ Optus submission, October 2014, p. 9.

that prices would not reflect the costs associated with assets no longer used to provide declared services.³⁶

Telstra submitted that any asset in the RAB that is transferred to NBN Co under the Telstra-NBN Co arrangements should be treated as an asset disposal in the roll-forward of the RAB. This would be consistent with the fixed principles and ensure that adjustments in relation to transferred assets would reflect the change in the cost base at the time of transfer.³⁷

Treatment of lease payments / leased assets

Optus submitted that payments for NBN Co's use of assets contained in Telstra's RAB represents a return of capital to Telstra shareholders, and accordingly, the ACCC should deduct this RAB-related element of lease payments from the RAB.³⁸ Optus submitted that if NBN Co's usage of Telstra's assets were ignored, this would be inconsistent with the fixed principle which specifies that cost allocation should reflect the relative usage of the network by various services.³⁹

Frontier submitted that the ACCC must, at a minimum, account for network usage by NBN Co in allocating costs to the declared services. This would be consistent with the fixed principle which specifies that cost allocation should reflect the relative usage of the network by various services.⁴⁰

The Department submitted that, where NBN Co uses an asset that is also used to provide declared services, this should be accounted for in the cost allocation framework and excluded from the regulated revenue requirement.⁴¹ This would mean that prices would not reflect the share of assets no longer used to provide declared services, and would be consistent with the fixed principles provision which states that cost allocation factors should reflect the relative usage of the network by various services.⁴²

Telstra submitted that, in the context of its proposed fully allocated cost framework,⁴³ it is necessary to incorporate NBN Co's expected increased usage of Telstra's ducts and exchange space over time. This is to ensure that the costs of these assets can be fully allocated across the services that use them, thereby ensuring a fair sharing of these costs among users.⁴⁴

Treatment of migration payments / assets affected by migration

Optus submitted that migration payments should be viewed as return of capital to Telstra shareholders, and accordingly, Telstra should no longer earn a return on or of capital with respect to assets for which payments are made.⁴⁵ Optus submitted that its position is consistent with the fixed principles provision which specifies that asset disposals will be removed from the RAB.⁴⁶

³⁶ Department of Communications submission, pp. 6-7.

³⁷ Telstra submission, p. 76-77.

³⁸ Optus submission, October 2014, p. 10.

³⁹ Optus, *Submission in response to ACCC Discussion Paper: Public Inquiry into final access determinations for fixed line services – primary price terms*, August 2014, p. 7.

⁴⁰ Frontier Economics submission, pp. 42-43.

⁴¹ Department of Communications submission, p. 7.

⁴² Department of Communications submission, p. 7.

⁴³ As discussed in section 3.2 of the discussion paper, Telstra has proposed a fully allocated cost framework for the purposes of allocating its total fixed line costs to the declared services.

⁴⁴ Telstra submission, p. 108.

⁴⁵ Optus submission, August 2014, p. 7.

⁴⁶ Optus submission, August 2014, p. 7.

Frontier submitted that the RAB value of network assets stranded as a consequence of NBN migration should be removed from the RAB as an asset disposal.⁴⁷ Frontier also submitted that the migration payments provide at least the necessary return of capital for these assets. This would be consistent with the fixed principle which specifies the RAB roll-forward mechanism.⁴⁸

Telstra submitted that assets expected to be decommissioned should be treated as asset disposals, with their remaining RAB value removed from the RAB at the time of decommissioning.⁴⁹

⁴⁷ Frontier Economics submission, p. 43.

⁴⁸ Frontier Economics submission, p. 43.

⁴⁹ Telstra submission, p. 34.

3 ACCC position

The ACCC's position on how the impacts of the Telstra-NBN Co arrangements should be quantified for the purpose of setting prices for declared services, and how its proposed approach should be implemented for each transaction type, is set out below.

3.1 Quantifying the impacts of the Telstra-NBN Co arrangements using regulatory values

The ACCC's position on quantifying the impacts of the Telstra-NBN Co arrangements is that they should be accounted for using a regulatory values approach for each transaction type. That is, any adjustments to account for the arrangements between Telstra and NBN Co should be based on the values assigned to affected assets in the RAB (as reflected in the FLSM) and not based on the value of payments received from NBN Co.

Use of regulatory values as a basis for valuing transactions impacting regulated assets is standard practice by economic regulators. The regulator establishes the value of the assets used to provide regulated services—the regulatory asset base (RAB)—and then uses that asset valuation to set prices.

Further, when a regulated business—or regulated assets as a going concern—change hands the regulator does not allow a revaluation of the assets for regulatory purposes. To do so would result in regulated charges changing for no reason other than the change in ownership of the regulated assets. Moreover, if such a revaluation were allowed—and, for example, amounts in excess of regulatory asset values were deducted from the asset base—it could potentially result in a scenario where the regulatory value of an asset becomes negative.

In the energy sector there are frequent examples of changes in ownership of regulated businesses.⁵⁰ When these businesses are sold, regulated prices continue to be based on the regulatory asset value for the relevant business, which is maintained despite the change of ownership. The payment made for the regulated business is not a consideration in the setting of regulated prices.

Further, regulators consider only the costs attributable to regulated services and do not factor in revenue a regulated business receives from other sources, as such revenue does not affect the underlying cost of providing those regulated services. In line with this standard practice, when assessing price notifications from Australia Post and Sydney Airports Corporation, the ACCC does not consider revenue received by these businesses from other sources.

The ACCC considers that its decision as to how to account for the arrangements between Telstra and NBN Co is an analogous regulatory decision. To use for regulatory purposes the values established in the Definitive Agreements through commercial negotiations, rather than regulatory values determined in the FLSM, would result in prices of declared fixed line services changing for reasons other than changes in the cost of supplying those services.⁵¹ In taking the position to use regulatory values when accounting for the impacts of the Telstra-NBN Co arrangements, the ACCC is adopting common regulatory practice.

The ACCC considers that quantifying the impacts of the Telstra-NBN Co arrangements using regulatory values is in the long-term interests of end-users. The ACCC will provide reasons for why it considers this approach to be in the long-term interests of end users (taking into account the matters set out in section 152BCA of the CCA) in the forthcoming draft decision.

⁵⁰ For example, between 2006 and 2007 a number of transactions resulted in the transfer of AGL's Victorian electricity distribution networks to Jemena Energy Networks, and in 2006, TXU's Victorian gas and electricity distribution assets were acquired by SP AusNet.

⁵¹ Payments from NBN Co would be treated as non-regulated revenue under a regulatory values approach and prices for declared services would be set based on the underlying cost of providing declared services, independent of revenue from non-regulated sources.

3.2 Implementing a regulatory values approach

The ACCC's position on accounting for each transaction type is set out in this section. The precise implementation of these approaches will depend on further information regarding the final network design under the multi-technology NBN and revised timeframes for the NBN rollout.

Assets sold to NBN Co

The ACCC's position on assets that are sold to NBN Co is as follows:

- assets sold to NBN Co should be treated as asset disposals and removed from the RAB, and
- the amounts to be removed from the RAB to reflect the sale of assets to NBN Co should be based on the regulatory value of those assets (that is, the values assigned to those assets in the FLSM) and not based on the value of payments received from NBN Co for the sale of assets.⁵²

Assets leased to NBN Co

The ACCC's position on leased assets is that, to the extent that NBN Co uses assets that are also used to provide declared services, this should be accounted for in the cost allocation framework of the FLSM. Treating leased assets in this way will ensure that the costs allocated to, and recovered from, declared services reflect the costs of supplying the declared services. It will also ensure that Telstra does not continue to receive revenue from users of declared services for the share of assets no longer used to provide declared services.

This approach, like that described above in relation to sold assets, constitutes a regulatory values treatment of leased assets, as the allocation of asset costs to declared services in the FLSM is based on the values assigned to those assets in the RAB. Therefore, this approach would not take into account the value of payments received from NBN Co for the leasing of assets in prices for declared services.

Assets affected by the migration of customers to the NBN

Under the Telstra-NBN Co arrangements, customers will be migrated from Telstra's fixed line network to the NBN as it is rolled out. NBN Co will pay Telstra a one-off migration payment for each customer that is migrated to the NBN and disconnected from Telstra's fixed line network.

In the ACCC's view, it is important to consider the impact that NBN migration will have on the assets that are used to supply declared services. The ACCC considers that a consequence of migration is that certain assets will be either decommissioned or utilised to a lesser extent. This will ultimately mean that some assets that are currently used to provide declared services will no longer be used for this purpose, either fully or in part.

The ACCC considers that this should be accounted for in determining prices for the declared services. The ACCC's position on these assets is as follows:

- assets decommissioned, and an appropriate share of assets utilised to a lesser extent, as a result of NBN migration should be removed from the regulated cost base, and
- the amounts to be removed from the regulated cost base should be based on the regulatory value of those assets (that is, the values assigned to those assets in the

⁵² Payments from NBN Co would essentially be treated as non-regulated revenue under a regulatory values approach, in that prices for declared services would be set based on the underlying cost of providing declared services, independent of revenue from non-regulated sources.

FLSM) and not based on the value of payments received from NBN Co for the migration of customers.

The precise implementation of this approach, including the timing of adjustments to the cost base, will need to be considered further as the current uncertainties about the mix of technologies to be used in the NBN and the timing of the rollout are resolved. For example, copper lines in FTTP areas will be completely decommissioned broadly in line with the rollout of the NBN. On the other hand, some switching equipment will remain in service while the NBN is rolled out, but will be utilised progressively less and will not be completely decommissioned until it is no longer required to provide services.

3.3 Other issues

Fixed principles

Regarding the Department's suggestion of making a fixed principle⁵³ about how the Telstra-NBN Co arrangements should be treated in setting prices for declared services, the ACCC does not intend to make such a fixed principle.

This is a straightforward matter aimed at providing regulatory certainty in the particular circumstances of discussions on the Definitive Agreements. This is achieved by stating a position on the issue, and a fixed principle is neither appropriate nor required.

⁵³ Department of Communications submission, p. 12.

4 Next steps

As noted in section 1, there are several pricing issues other than the Telstra-NBN Co arrangements which were raised in the July 2014 discussion paper. The ACCC is currently considering these issues in light of submissions received, and will provide its views in the forthcoming draft decision which will provide stakeholders with the opportunity to make further submissions. Below is a summary of these other pricing issues.⁵⁴

- **Telstra's forecasts** — in November 2013, Telstra provided the ACCC with capital and operating expenditure and demand forecasts for 2014-15 to 2018-19 under the BBM RKR. Telstra also provided information regarding its forecasting methodology. In the July 2014 discussion paper, the ACCC considered that given these forecasts were made on the basis of a rollout schedule of the previous government's FTTP NBN, they will need to be revised. The ACCC sought stakeholder views on Telstra's forecasts and options for addressing uncertainty in relation to the government's revised NBN policy.⁵⁵
- **Cost allocation** — in making the 2011 FADs, the ACCC used a 'partially allocated' approach to allocating fixed line costs to the declared services, whereby cost allocation factors changed over time in response to changing demand for declared services. For the current FAD inquiry, Telstra has proposed a fully allocated cost approach. Under this approach, allocation factors for declared services would respond to changes in demand for all services that use the same fixed line assets (declared and non-declared). Telstra's proposal would result in an increase in the total revenue to be recovered from the declared services, all else being equal. The ACCC sought submissions on the 2011 FAD approach and Telstra's proposed approach to cost allocation.
- **Declining demand** — demand for the declared services is falling for three main reasons: migration of customers to the NBN; loss of market share due to increased competition by access seekers; and some displacement by mobile technologies. The ACCC's 2011 FAD approach to cost allocation resulted in prices that did not vary with declining demand, resulting in Telstra bearing the impact of declining demand. Under Telstra's cost allocation proposal, the impacts of declining demand would be borne by access seekers through higher prices. The ACCC sought submissions on how the impacts of declining demand should be shared between Telstra and access seekers.
- **Determining prices** — in the 2011 and 2013 FADs, prices were generally determined using unit cost outputs of the FLSM. As part of its cost allocation proposal, Telstra has proposed that prices for individual services could be set so that revenue earned from a service is between the avoidable and stand alone cost of supplying that service, and so that Telstra can expect to recover the total regulated revenue requirement across all declared services. This would allow greater flexibility in the setting of individual prices, but introduces an element of regulatory discretion. The ACCC sought stakeholder views on the appropriateness of such an approach.
- **Price structures** — the ACCC has previously specified or considered price structures for ULLS, wholesale ADSL and FTAS/FOAS. The ACCC has previously de-averaged ULLS prices using cost relativities in the different geographic Bands; for wholesale ADSL, the ACCC has adopted both a geographic and two-part price structure (based on port and usage charges); for FTAS/FOAS, the ACCC has set a nationally averaged price but considered other price structures. The ACCC sought stakeholder views on the current price structures and whether these or other structures should be adopted.

⁵⁴ For a more detailed description of each issue, see ACCC, *Public inquiry into final access determinations for fixed line services – primary price terms: Discussion paper*, July 2014.

⁵⁵ The ACCC notes that Telstra has provided updated forecasts to reflect the multi-technology NBN. The ACCC will discuss the revised forecasts in the forthcoming draft decision and seek stakeholder views. This information can be obtained by persons who execute confidentiality undertakings with Telstra.

The ACCC also discussed more technical pricing issues in the July 2014 discussion paper. These included FLSM assumptions about the timing of cash flows, determining the cost of capital and taxation allowance, and the indexing of FLSM cost inputs and price outputs. The ACCC sought stakeholder views on each of these technical issues.

The ACCC considers that providing a position on accounting for the Telstra-NBN Co arrangements at this time should assist ACCC and industry consideration of these outstanding issues by providing certainty with respect to an important aspect of the ACCC's pricing framework. As noted above, the ACCC will provide its views on these issues in the forthcoming draft decision, and will provide stakeholders with the opportunity to make further submissions.

The ACCC acknowledges that the current renegotiation of the Definitive Agreements will result in changes to which fixed line assets fall under the different transaction types that the ACCC has identified in this position statement.

At this stage, the ACCC expects to release its draft decision on the FAD primary price terms in early 2015. The positions on accounting for the Telstra-NBN Co arrangements in this position statement will be reflected in the draft decision.