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8 January 2015

Jane Goldwater
Australian Competition and Consumer Commission

By email to: Jane.Golderwater@accc.gov.au

Dear Ms Goldwater

As you are aware, iiNet is an active participant in the ACCC's public inquiry into making new final access determinations (**FADs**) for:

- the six fixed line services[1]; and
- the Wholesale ADSL service (**WDSL**),

(**the Declared Services**).

In October 2014 the ACCC released a position statement entitled: *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* (**the Position Statement**).

The Position Statement sets out the ACCC's view on how the impacts of the arrangements between Telstra and NBN Co should be quantified for the purpose of setting prices for declared services. The ACCC's view is that the impacts of the arrangements between Telstra and NBN Co should be quantified using a 'regulatory values' approach.

It appears to iiNet that the approach adopted in the Position Statement is based on the following assumptions:

- The use of regulatory values as a basis for valuing transactions impacting regulated assets is standard practice by economic regulators.[2]
- 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.[3]

[1] These are: the Local Call Service (**LCS**), Line Sharing Service (**LSS**), the Fixed Originating Access Service (**FOAS**), the Fixed Terminating Access Service (**FTAS**), the Unconditioned Local Loop Service (**ULLS**) and the Wholesale Line Rental Service (**WLR**).
[2] Position Statement, at p.10.
[3] ibid.

iiNet notes that the ACCC does not say in the Position Paper whether the ACCC intends to implement its regulatory values approach as part of its current partially allocated approach to cost allocation or as part of a fully allocated cost allocation approach.[4]

Given the clear importance of the ACCC's approach in the Position Statement to the overall outcome in respect of primary prices for the Declared Services, iiNet wishes to explore the assumptions referred to above. Also, given that the ACCC has previously determined that its partially allocated cost allocation approach satisfies the relevant statutory criteria,[5] iiNet wishes to explore whether it is necessary, in order to implement the regulatory values approach, to adopt a fully allocated cost allocation approach, or whether it is possible to reconcile a regulatory values approach with the ACCC's current partially allocated approach and whether there are any advantages of doing so. To this end, iiNet has engaged Frontier Economics to respond to the following questions:

1. Is it correct to say, as the ACCC does in the Position Statement, that the use of regulatory values as a basis for valuing transactions impacting regulated assets is standard practice by economic regulators?

2. Is it correct to say, as the ACCC does in the Position Statement, that regulators consider only the costs attributable to regulated services and do not factor in the revenue a regulated business receives from other sources?

3. Can the ACCC's current partially allocated cost allocation approach be reconciled with a regulatory values approach to dealing with the NBN Co payments to Telstra, and if so, what are the advantages of doing so?

Frontier Economics' report in response to these questions is attached to this letter. In iiNet's view, the takeout messages from Frontier Economics' report are that:

- There are numerous examples where economic regulators in Australia and overseas have preferred the disposal proceeds or sale values to value transactions rather than the regulatory values.

- Regulators, including the ACCC and AER, have taken account of revenues earned from other sources in setting the price for services that use shared assets.

- The ACCC's current partially allocated cost allocation approach can be reconciled with an approach to dealing with the arrangements between NBN Co and Telstra on the basis of regulatory values.

- Using the partial allocation approach has several advantages, including that it contributes to regulatory predictability, maintains the existing allocation of demand risk, and avoids

[4] Position Paper at p 13.
[5] See iiNet's submission of 5 November 2014, at pp 11-13.

complex issues around the setting of the initial RAB in 2011 which will inevitably arise from changing cost allocation methodologies.

Given these conclusions, iiNet submits that the ACCC should:

- consider whether it is appropriate to maintain an approach based on regulatory values; and if it decides that it is,

- consider, and give appropriate weight to, the fact that it is possible to reconcile a regulatory values approach with the ACCC's current partially allocated approach to cost allocation (which has already been determined to satisfy the applicable statutory criteria and which avoids a number of difficulties that would be encountered if a fully allocated approach is adopted).[6]

Yours sincerely

Stephen Dalby
Chief Regulatory Officer

[6] iiNet notes that Telstra has argued that the ACCC's current approach is inconsistent with the fixed principles. This issue was considered in iiNet's submission of 5 November 2014 (at pp13-14). For the reasons stated in that submission, iiNet believes that Telstra's arguments are without merit and should be rejected.