

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

Draft Decision - March 2015

Submission by iiNet Limited

Public Version

1. INTRODUCTION

The Australian Competition and Consumer Commission (**ACCC**) is currently undertaking public inquiries into making new final access determinations (**FADs**) for seven fixed line services¹ (**the Declared Services**).

In July 2014 the ACCC released a discussion paper about the primary price terms for the FADs for the Declared Services (**the Discussion Paper**). In October 2014 the ACCC released a position statement on the treatment of the arrangements between Telstra and NBN Co (**the NBN Position Statement**). In March 2015 the ACCC issued a draft decision entitled: *Public inquiry into final access determinations for fixed line service – primary price terms* (**the Draft Decision**). The Draft Decision relates to:

- the primary price terms for the Declared Services;
- one supplementary price term;
- the scope of the standard access obligations (**SAOs**) for the Declared Services.

The non-price terms and other supplementary prices to be included in the Declared Services FADs are subject to a separate consultation and draft decision.

The ACCC is seeking submissions in response to the Draft Decision. iiNet Limited (**iiNet**) welcomes the opportunity to respond to the Draft Decision.

Please note this submission contains confidential information which has been marked as [c-i-c] and highlighted in yellow.

2. KEY MESSAGE

iiNet maintains the view that any outcome other than a fall in prices would be irrational.² The ACCC's independent consultant, WIK Consult (**WIK**) has formed the view that increasing prices for legacy infrastructure is not in line with economic value of the infrastructure which is not increasing but decreasing.³ WIK has raised many concerns about the reliability of information provided by Telstra on which the ACCC has based its inputs for updating and rolling forward its fixed line services costs model. According to analysis and modelling done by Frontier Economics, addressing some of those concerns will lead to a fall in prices of 9.7%.⁴ On the basis of Frontier Economics' analysis, iiNet submits that a fall in prices of 9.7% would be an appropriate outcome, albeit something of a reasonable compromise, given that a larger price increase may, in fact, be justified.

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**) and the Wholesale ADSL service (**WDSL**).

² This view was expressed by iiNet in response to the Discussion Paper, see - iiNet submission 5 November 2014, at p.25.

³ Wik Consult - Assessment on the efficiency and prudence of Telstra's expenditure forecasts 5 March 2015 (**WIK Report**), at paragraph 127.

⁴ Frontier Economics, Submission on the ACCC's draft decision on the fixed line prices – A Report prepared for the Competitive Carriers Coalition, iiNet and Optus, May 2015 (**Frontier Report**), at p.5.

3. STRUCTURE OF THIS SUBMISSION

The Draft Decision is in three parts:

- Part A – pricing approach for the primary price terms for the Declared Services. iiNet's views on the overall pricing outcome for primary prices are set out in section 4 below.
- Part B – pricing approach for the supplementary price terms. iiNet's views in response to Part B of the Draft Decision are set out in section 5 below.
- Part C – scope of the application of the SAOs. iiNet's views in response to Part C of the Draft Decision are set out in section 6 below.

4. PRIMARY PRICES OUTCOME

In its response to the Discussion Paper, iiNet submitted that under the current circumstances the central question to be determined as regards primary prices for the Declared Services is:⁵

By how much should access prices for the Declared Services be reduced?

iiNet maintains that this remains the central question and that an outcome other than a price decrease would be irrational under the current circumstances. The ACCC has commissioned WIK to provide advice on the assessment of the prudence and efficiency of Telstra's expenditure forecasts. As regards the overall pricing outcome, WIK comments as follows:⁶

increasing prices for a legacy infrastructure is not in line with the economic value of the infrastructure which is not increasing but decreasing due to technological change.

And further:⁷

The combined effect of the quantitative implications of our proposed changes to the expenditure forecast and the allocation of costs to the declared fixed line services would lead to a price decrease of the declared fixed line services and not a price increase.

These comments support iiNet's view that the overall pricing outcome should be a decrease in prices.

The Draft Decision, if applied, would deliver a decrease in prices of 0.7%. iiNet agrees with and supports the following aspects of the Draft Decision which iiNet believes should be

⁵ iiNet submission 5 November 2014, at p.25.

⁶ Wik Report, at paragraph 127.

⁷ *ibid* at paragraph 356.

carried through to the final decision because the ACCC's analysis of the issues as set out in the Draft Decision is complete and robust:

- The rejection of Telstra's submissions on the cost of capital (discussed in Chapter 5 of the Draft Decision).
- The removal of the half WACC (discussed in Chapter 8 of the Draft Decision).

Although iiNet agrees with and supports these aspects of the Draft Decision, it is clear that the Draft Decision is a work in progress and more work needs to be done on matters that have a significant impact on the final pricing outcome. In the Draft Decision the ACCC has foreshadowed further consideration being given to:

- Telstra's expenditure forecasts; and
- the loss of economies of scale caused by the NBN.

iiNet notes that WIK has raised significant concerns about these matters and made a number of recommendations. iiNet⁸ has engaged Frontier Economics to consider the Draft Decision and WIK's concerns and recommendations. Frontier Economics has suggested four things arising from WIK's concerns:⁹

- The ACCC should implement WIK's proposed changes that are capable of being implemented now.
- The ACCC should consider the feasibility of setting cost allowances independently of Telstra's forecasts, similar to the process of the AER, at the least to provide Telstra with better incentives to produce more transparent information.
- In the meantime, the ACCC should seek further information from Telstra on the base year costs for opex and capex, and satisfy itself that costs have been appropriately allocated to RAB asset categories (and not double counted).
- Once the base year costs have been established, the ACCC should forecast the aggregate opex and capex forward in proportion to the changes in SIOs due to the NBN rollout. This would represent a 'top-down' approach to forecasting that would obviate the need to make a detailed, bottom-up assessment of changes in Telstra's costs, which would be very information-intensive. Aligning the forecasts with the change in SIOs will reflect that the primary driver of cost changes will be the NBN rollout and will also ensure that access seekers are no worse off from the rollout, in line with WIK's recommendations.

In addition, Frontier Economics has recommended that:

⁸ Along with the other members of the Competitive Carrier's Coalition and Optus.

⁹ Frontier Report, at pp iii, iv.

- The ACCC reverse its decision to shorten asset lives to align with the expected completion date of the NBN rollout.¹⁰
- The ACCC reverse its decision to use CPI inflation to deflate costs.¹¹

Implementing Frontier Economics' recommendations would lead to a decrease in prices of 9.7%. iiNet believes that this is an appropriate outcome which represents something of a reasonable compromise given the significant information asymmetries that exist. The full reasoning for Frontier Economics' recommendations is set out in the Frontier Report. iiNet does not intend to repeat that reasoning here. iiNet simply provides some comments on the following issues:

- the context in which the ACCC should assess Telstra's expenditure forecasts; and
- the need to provide access seekers with procedural fairness.

4.1 The context in which the ACCC should assess Telstra's expenditure forecasts

iiNet believes that consideration of Telstra's expenditure forecasts used for the Draft Decision needs to take place in the context of the following facts:

- The fixed principles require Telstra's expenditure forecasts to reflect prudent and efficient costs.¹²
- As noted by WIK, Telstra has an incentive, and it is rational for Telstra, to seek to distort inputs to the fixed line services model (**FLSM**) (i.e. to overstate expenditure or to allocate expenditure to the Declared Services that should not be allocated to the Declared Services) compared to values which are prudent and efficient.¹³
- For the purposes of making the Draft Decision, the ACCC has entered inputs into the FLSM that are based on expenditure forecasts that lack transparency and are subject to significant concerns.¹⁴ Accordingly, at the time of making the Draft Decision the ACCC was unable to conclude that the inputs used reflect prudent and efficient costs.

iiNet submits that this context requires the ACCC to do more than simply provide Telstra with an opportunity to 'shore up' its forecasts. More drastic action, of the kind recommended by Frontier Economics, is required.

4.2 Providing procedural fairness to access seekers

iiNet respectfully submits that the ACCC needs to be careful to balance its understandable desire to make a final decision by 30 June 2015 against the need to give access seekers

¹⁰ Frontier Report, at section 4.5.

¹¹ Frontier Report at section 5.

¹² Fixed Principles 6.9 and 6.10.

¹³ WIK Report at paragraph 10.

¹⁴ See for example, the Draft Decision at p.29.

procedural fairness. In this regard iiNet notes that the opportunities that access seekers have had to comment on Telstra's expenditure forecasts have been limited to:

- responding to a discussion paper which focused consideration on Telstra's response to the Building Block Model Record Keeping and Reporting Rules, which Telstra subsequently abandoned; and
- responding to a draft decision which concludes that the expenditure forecasts used for the Draft Decision lack transparency and the ACCC cannot be satisfied that they reflect prudent and efficient costs.

Ideally the ACCC would not make a draft decision for the primary prices for the Declared Services FADs until it is able to form a preliminary view that the inputs to the FLSM that it uses for the draft decision are fit for purpose. The ACCC would then be able to express its reasons for its preliminary view in the Draft Decision and stakeholders would have an opportunity to comment on those reasons. All stakeholders would have the same opportunity to comment on the Draft Decision. However, given the conclusions reached in the Draft Decision about Telstra's expenditure forecasts, there is clearly a need for further dialogue between Telstra and the ACCC before the ACCC is able to make a final decision. iiNet is concerned that this further dialogue will go beyond the ACCC simply giving Telstra an opportunity to respond to the Draft Decision, and the need for this further dialogue will give Telstra additional opportunities to influence the ACCC's reasoning process as the ACCC progresses its thinking from the Draft Decision to a final decision. Therefore, iiNet submits that the ACCC needs to consider providing access seekers with an opportunity, where appropriate, to consider and comment on:

- any additional information provided by Telstra as part of the further dialogue between Telstra and the ACCC; and
- any views that the ACCC forms based on this additional information.

iiNet notes that the issue of procedural fairness does not just relate to the ACCC's assessment of Telstra's expenditure forecasts, it also relates to the ACCC's assessment of Telstra's cost allocation framework (which the ACCC has decided to adopt), given that the ACCC has encountered problems with the transparency of some aspects of Telstra's cost allocation framework and further dialogue between Telstra and the ACCC that goes beyond merely providing Telstra with an opportunity to respond to the Draft Decision is likely to occur.¹⁵

¹⁵ Draft Decision at p.155.

5. PART B – PRICING APPROACH FOR THE SUPPLEMENTARY PRICE TERMS

In deciding to include a charge for the IIC in the FLSM the ACCC has had regard to the following:¹⁶

- The ACCC considers that the IIC service is necessary in order for access seekers to access the ULLS and LSS, and the IIC is therefore used in connection with the supply of a declare services. As the IIC is used in order to provide a carriage services, it relates to an aspect of access.
- Even though the IIC is not part of the ULLS or LSS, access seekers are unable to provide ULLS or LSS based services to end users without the IIC service. Therefore, when determining prices for ULLS and LSS, IIC prices must also be determined.
- Telstra has not provided sufficient evidence or justification that the IIC service is not essential to the supply of ULLS/LSS services and the supply of ULLS/LSS based services to end users.

iiNet agrees with each of the above points and iiNet agrees that these considerations justify an IIC charge being included in the FADs for ULLS and LSS. However, iiNet notes that Telstra treats the IIC as [c-i-c starts] [c-i-c ends]. In light of this, iiNet believes that the justifications for including a price for the IIC in the ULLS and LSS FADs apply with equal force to TEBA rack and power charges.

iiNet respectfully submits that there is an urgent need for the ACCC to make regulated prices for TEBA rack and power because [c-i-c starts] [c-i-c ends]. Allowing this to continue clearly does not promote the LTIE, accordingly, iiNet urges the ACCC to set regulated prices for TEBA rack and power services as soon as possible.

¹⁶ Draft Decision, at p.174.

6. PART C – SCOPE OF THE APPLICATION OF THE SAOS

iiNet agrees with and supports:¹⁷

- the ACCC's draft decision to continue to apply the SAOs and FADs for WLR and LCS to all geographic areas; and
- the ACCC's draft decision to limit the application of the WDSL SAOs and FADs to Telstra only.

As regards WLR and LCS, iiNet notes that this issue was considered in April 2014. As previously submitted by iiNet, it would be appropriate for the ACCC to simply apply the conclusions on this issue the ACCC reached in April 2014.¹⁸ Nevertheless, the ACCC has undertaken a full LTIE analysis of the issue. iiNet submits that the ACCC's LTIE analysis is robust and should be applied in the final decision.

As regards WDSL, iiNet notes that this issue was fully considered when the WDSL FAD was made in 2013. iiNet agrees with the ACCC's view that there is no reason to conclude that the reasoning that was applied in 2013 to this issue is no longer valid. Accordingly, iiNet supports the ACCC's decision to continue to limit the application of the WDSL SAOs and FADs to Telstra only.

iiNet Limited

1 May 2015

¹⁷ *ibid*, Chapter 15.

¹⁸ iiNet letter to ACCC 25 November 2014.