Final access determinations for fixed line services—primary price terms

Department of Communications submission to the Australian Competition and Consumer Commission

3 October 2014

Introduction

The Australian Competition and Consumer Commission (ACCC) is in the process of making Final Access Determinations (FADs) for the seven declared fixed-line services (FLSs) – the unconditioned local loop service, the line sharing service, fixed originating and terminating access services, the wholesale line rental service, the local carriage service and the wholesale asymmetric digital subscriber line service. As part of this process the ACCC has commenced an inquiry into setting final primary prices for the seven declared services.[1]

Amongst other things, the ACCC is considering how it should treat payments to Telstra by NBN Co under the Definitive Agreements (DAs). This is the focus of the Department's submission. The Department is concerned that an erroneous approach in this area could significantly affect the overall industry reform process.

On 16 July 2014 the Minister for Communications and the Minister for Finance wrote to the ACCC Chair in relation to the ACCC's inquiry.[2] The Ministers commented, *inter alia*, that:

- payments from NBN Co to Telstra are generally not connected with the issues the ACCC must consider in setting prices for declared fixed-line services;
- the payments are part of a wider process to reform the telecommunications sector to promote competition and improve access to broadband;
- for this wider reform agenda to be successful, price stability in the transition to the NBN is an important policy goal.

This submission follows on from these concerns but reflects further analysis of the issues in the light of the ACCC's discussion paper. It makes four main points.

First, the FLS FAD outcome should support the significant reform of the telecommunications industry that is underway. This will be best achieved by adopting a pricing approach that provides Telstra with an opportunity to recover appropriate costs, but gives the highest possible priority to pricing stability and the smooth migration of customers from legacy networks to the National Broadband Network (NBN). The telecommunications industry is in a period of significant transition, with the rollout of a multi-technology mix (MTM) NBN. The NBN will provide wider access to faster broadband. The Vertigan Cost-Benefit Analysis concluded a MTM approach to the NBN should have net benefits of around $18 billion to the Australian economy over the

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[1] ACCC (2014a) **Public Inquiry into final access determinations for fixed line services—primary price terms – Discussion paper**.

[2] The Hon Malcolm Turnbull MP and Senator the Hon Mathias Cormann (2014) **NBN Co Payments to Telstra and ACCC Fixed Line Access Determinations**.

next 25 years. Furthermore, the NBN is designed to foster more effective retail level competition by enabling the structural separation of Telstra. The NBN itself will also foster more effective retail level competition by providing services on an open access, wholesale-only basis.

Second, the submission argues that payments by NBN Co to Telstra are generally irrelevant to the ACCC’s determination of FLS access prices because the costs these payments relate to are not included in the cost of FLSs provided by Telstra. Consequently, the costs of the Telstra assets used by NBN Co should be recovered separately from NBN Co (unregulated sale or lease proceedings), and the costs of the assets used to provide FLSs should be recovered separately from the access seekers that use the FLSs.

Third, while the preceding point means that, considered correctly, NBN Co payments to Telstra will have no effect on prices for FLSs, other factors, such as changes in expenditure incurred in the supply of FLSs or demand by access seekers can still affect pricing. The submission therefore argues that price stability, at least in real terms, in the period to the migration to the NBN is important, particularly in support of wider structural reform of the industry. The most beneficial form of price stability would be a form which also secured stability in the relative prices of the different FLSs.

Fourth, the submission also notes that ongoing renegotiations of the Definitive Agreements and uncertainty as to the timing of the NBN rollout mean that some matters, for example the timing of FLS-related expenditure and changes in demand for FLSs, remain highly uncertain, meaning even more regulator judgement than usual is required in setting future FLS prices. These issues are further complicated by the continuing decline in demand for fixed-line services, which will be exacerbated by the transition of customers from legacy networks to the NBN. Although demand is forecast to decline steeply, a significant proportion of Telstra’s costs of providing FLSs are fixed, creating the potential for a sharp increase in FLS prices. These circumstances warrant a conservative regulatory approach that prioritises pricing stability, to reduce the risk of regulatory error. This has two major implications:

- an early statement of policy from the ACCC on these matters will promote industry certainty. A statement during October 2014 would provide access seekers with timely clarity on how access prices are to be determined, and facilitate NBN Co and Telstra finalise their negotiations expeditiously and allow the NBN rollout proceed forthwith.

- it is also desirable for the ACCC to provide long term certainty in this area, for example, through a fixed principle in relation to the treatment of NBN Co payments to Telstra and a clear signal on the importance of price stability throughout the legacy copper-NBN migration period.

Structural reform in the telecommunications sector

In their letter of 16 July 2014, the Minister for Communications and the Minister for Finance pointed out that the ACCC in its FLS FAD process should have full regard to the structural reforms underway in the supply of fixed-line telecommunications, including the rollout of the NBN, the Definitive Agreements (DAs) between NBN Co and Telstra and the progressive structural separation of Telstra through customer migration to the NBN. These initiatives will transform the telecommunications sector, and underpinned by Telstra's Structural Separation Undertaking and Migration Plan, and NBN Co's Special Access Undertaking.

The Ministers asked the ACCC to be mindful of the valuable role that stability, regulatory consistency and adherence by all parties to jointly agreed commitments can play in assisting the successful conclusion of these reforms.

Early clarity on FLS pricing will provide all parties with certainty, thereby reinforcing the structural reform process. The Department submits that greater clarity can readily be provided by adopting the analysis set out in the following sections of this submission.

NBN Co payments to Telstra

Background

When it conducted its initial FAD inquiry in 2010-11, the ACCC did not make any explicit adjustments to its Fixed Line Services Model (FLSM) to account for the impacts of NBN payments. At that time, the ACCC considered that a relatively small number of premises would be migrated from Telstra's fixed-line networks to the NBN during the initial FAD regulatory period (1 January 2011 – 31 July 2014), and also noted that 'there is insufficient certainty about the timing and quantum of NBN Co's demand for Telstra infrastructure to take that demand into account in the FLSM'.[3] The ACCC concluded that the uncertainties would be resolved before the next regulatory period, and that it would make any required modifications to the design of the FLSM in setting prices for the next regulatory period.[4]

Since 2010 access seekers have argued that the impact of the arrangements between NBN Co and Telstra should be factored into the pricing of declared fixed-line services. For example, in July 2010 Optus claimed that all the payments Telstra will receive represent a 'return of capital' (an economic cost already covered in the ACCC building block model (BBM), generally associated with asset depreciation) and that the value of the initial regulated asset base (RAB) in the FLSM should be reduced.[5] In advance of the current FAD inquiry Optus submitted a paper by NERA. NERA argued that there should be an adjustment to the annual revenue requirement under the FLSM to subtract the value of NBN payments.[6]

Also in July 2014 Herbert Geer submitted a report on behalf of iiNet and TPG and prepared by Frontier Economics arguing that NBN payments to Telstra should be considered in setting prices for declared services. Frontier Economics argued that the disconnection payments are in effect a payment in relation to regulated assets and

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[3] ACCC (2011) **Inquiry to make Final Access Determinations for the declared fixed line services. Final Report**, pp.32-33.
[4] Ibid.
[5] ACCC (2010) **Review of the 1997 telecommunications access pricing principles for fixed line services**, pp.28-29.
[6] NERA Economic Consulting (2014) **Payments to Telstra for Lease/Purchase of Fixed-Line Assets. A report for Optus** pp.ii-iv.

therefore the payments may lead to Telstra over-recovering its costs if prices are not reduced.[7]

On 16 July 2014 the Minister for Communications and the Minister for Finance wrote to the ACCC Chair querying these arguments and expressing concern that they could cause harm to the telecommunications industry reform process, involving the rollout of the NBN to provide faster broadband and a platform for the structural separation of Telstra. In this context, the Ministers suggested that the ACCC provide guidance on its proposed treatment of payments by NBN Co to Telstra.

On 11 August 2014, Optus lodged a further submission with the Commission, arguing that it had held a constant position on the treatment of NBN Co payments to Telstra, which it considered important to ongoing effective competition, which was an endpoint of structural reform. Optus also emphasised the primacy of the fixed principles set out in the ACCC's first FLS FAD – but did not address the inconsistency between deducting the value of NBN Co payments from the RAB and the widely-used building block approach underlying FLS FAD fixed principles.

In its July 2014 discussion paper on setting final primary prices for the new regulatory period, the ACCC returned to the issue of the impacts of the NBN arrangements. The ACCC identified two key issues it needs to resolve:

- the treatment of the arrangements between Telstra and NBN Co for the migration of customers and the use of Telstra's assets; and
- how the migration of customers to the NBN is to be reflected in FLSM demand and expenditure forecasts that the ACCC uses to estimate prices for the declared services.[8]

The ACCC has noted that there continues to be uncertainty about the nature and timing of migration to the NBN, given ongoing negotiations between Telstra, NBN Co and the Government on the adoption of the MTM model. However, it considers that the impact of the NBN arrangements (as distinct from payments from NBN Co to Telstra) should be taken into account in setting prices for FLS. This should ensure that assets that are not used to supply declared services, but may be used for the NBN, are not considered in setting the prices for declared services and, conversely, only assets that are used in supplying declared services will be considered in finalising the prices for those declared services.[9]

In relation to the treatment of arrangements between Telstra and NBN Co generally (as opposed to payments from NBN Co to Telstra), the ACCC argued that a key issue is how to determine the value of those arrangements. The ACCC identified two approaches:

- adjusting the values assigned within the FLSM to the underlying assets (the RAB) affected by the arrangements and appropriately attributing costs to regulated FLS; or

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[7] Frontier Economics (2014) **Payments between NBN Co and Telstra and prices for the declared fixed line services. A report prepared for Herbert Geer**, pp.19-22.
[8] ACCC (2014a) p.ix.
[9] ACCC (2014a) p.68.

- basing any adjustments on the value of NBN Co's payments to Telstra.[10]

As the Department understands it, it is inherent in the FLSM and the fixed principles that the arrangements between NBN Co and Telstra can be dealt with through adjustment to the values assigned within the FLSM. Currently, although the FLSM determines annual costs for each asset class, the total annual revenue requirement for the RAB is only calculated for, and allocated to, the FLSs. As such only a proportion of revenue that Telstra earns in any year is allocated to FLSs. Telstra has proposed instead that costs should be fully allocated to different services, and an annual revenue requirement calculated across all services, both regulated and unregulated.

The Department submits that this approach is appropriate in the context of this inquiry, for the reasons outlined below. As the Department understands it, this approach would be consistent with the operation of the building block model (BBM) used in the FLSM and the fixed principles set out in the ACCC's final access determinations on the seven FLSs.

Where an asset class is used in providing a declared service, the costs associated with the declared service should, as happens today, be allocated to the actual users of that declared service. Telstra's approach ensures that an appropriate amount of the cost of common assets is allocated between regulated (FLS) and unregulated (NBN Co) services. This helps ensure that the regulated prices reflect the costs of the assets that are being used by users of regulated services. The approach prevents any over-recovery or under-recovery of costs. It therefore means that (unregulated) payments from NBN Co to Telstra are irrelevant to the setting of (regulated) prices for FLSs. If the ACCC were to subtract the revenue from unregulated services from the cost of regulated services, as proposed by NERA, there is a risk that users of the regulated services face prices that do not reflect efficient costs of providing the service, which would not promote economic efficiency and is therefore unlikely to promote the long-term interests of end-users.

The Fixed Line Services Model and Telstra costs for NBN products
Since 2011, in determining the prices of FLSs in a FAD, the ACCC has used a BBM. This is a common approach in regulatory pricing and provides industry with a considerable degree of predictability and regulatory certainty. Under a BBM approach the ACCC first determines the assets that comprise the RAB, and the initial value of the RAB. The ACCC then determines revenue requirements for each asset class based on asset-specific forecasts of operating and capital expenditure and the value of the asset class within the RAB. Allocation factors are then applied to asset class revenue requirements and the resulting asset class costs allocated to each service are summed to produce a service revenue requirement for each declared service. Based on this process, the ACCC determines an annual revenue requirement for the FLSs (and prices for those services). At the end of each year the value of the RAB is adjusted to include forecast capital expenditure for the next year and to remove depreciation and the value of any assets in the RAB that have been disposed.

In making the first FAD for the declared FLSs the ACCC set out fixed principles relating to the FLSM.[11] The fixed principles apply until 30 June 2021. Subsequent FLS

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[10] ACCC (2014a) p.69.
[11] Fixed principles are permitted under section 152BCD of the *Competition and Consumer Act 2010*.

FADs to that date must not be varied so as to alter or remove any of the fixed principles (except in certain minor cases). The fixed principles include the opening value of the RAB and the roll-forward mechanism, which sets out that the RAB is to be rolled forward each year according to a formula in which the value of the RAB for the next year equals the opening value of the RAB for the current year, plus forecast capital expenditure for the current year and minus depreciation and asset disposals. The fixed principles list components the revenue requirement must contain and principles to be applied in determining cost allocation factors.[12]

Currently, the RAB is largely composed of Telstra's core fixed-line network and customer access networks, with some exceptions – for example, it does not include Telstra's HFC network. The RAB includes assets which will be transferred to NBN Co under the Definitive Agreements (e.g. lead-in conduits) as well as assets which may be transferred to NBN Co depending on the outcome of the current negotiations (copper lines and lead-ins). Currently separate components of the costs of these asset classes are allocated to FLSs and to other unregulated services. The RAB also includes assets which Telstra will use to provide products to NBN Co on an unregulated basis and to supply FLSs to access seekers generally. (This would include NBN Co if it required such access, although this is separate from the question of the payments NBN Co is making to Telstra, which are the focus of this discussion.) This includes assets such as ducts and exchange space. Those assets are still owned and used by Telstra for its own use and to provide regulated FLSs at the same time as they are used by NBN Co.

From the NBN perspective, there are therefore two categories of assets in Telstra's RAB which could generate costs that could need to be recovered from NBN Co:

- assets that will be transferred (i.e. sold) by Telstra to NBN Co; and
- assets that are used to supply services at the same time to Telstra's retail customers and to other service providers (e.g. other access seekers, NBN Co).

The two categories may be considered to overlap, to the extent that they may be used to provide services to both Telstra customers and NBN Co until they are transferred to NBN Co.

The FLSM and the fixed principles together provide a consistent and predictable framework for handling these NBN transactions.

Telstra assets transferred to NBN Co

In relation to the first category above, as assets are transferred to NBN Co they should be removed from the RAB at the value given them in the RAB from the original RAB valuation and the roll-forward mechanism, in accordance with the fixed principle relating to the roll-forward mechanism. Once removed from the RAB, by definition any costs associated with that asset will no longer be relevant to the setting of regulated FLSs prices, and therefore those costs do not need to be included in the annual revenue requirement. The prices also cannot reflect assets that have been disposed of, because these are no longer part of the RAB and no longer used by Telstra to supply FLSs.

[12] ACCC (2014b) **Final Access Determinations of 2011** (as varied 18 June 2014), pp.5-7.

This method of reducing the value of the RAB to account for the disposal of assets also clearly indicates that disconnection payments from NBN Co to Telstra cannot validly be considered in determining prices for declared services. As assets are transferred to NBN Co they will no longer play a role in delivering the regulated service and, therefore, in establishing Telstra's cost base and revenue requirements in relation to that RAB. Consequently, the payments are simply irrelevant to any consideration of the pricing of declared services.

In this context the more important issue in setting FLS prices is the timing of the transfer of ownership of such assets. Until the ownership transfers, Telstra should be able to count the cost of those assets in setting relevant FLS prices; after the ownership of the assets transfers to NBN Co the assets are disposed of from the RAB. Their cost cannot be recovered from FLS prices, but equally, the payments from NBN Co to Telstra are irrelevant to the other costs of FLS services.

Telstra assets used to provide services to NBN Co as well as FLSs

In relation to the second category above, the cost of NBN Co's usage of Telstra's assets is currently excluded from the annual revenue requirement. The costs allocated to different asset classes, for example, for use of Telstra's duct network, include a component allocated to the FLSs. The remaining cost pool associated with these shared assets is directed to other services provided to the different users of that network, including Telstra's fixed-line retail services and services provided to NBN Co. This is in accordance with the fixed principle on cost allocation factors, which states that the allocation of the costs of operating the PSTN (which is used to provide FLSs) should reflect the relative usage of the network by various services.

On this basis, the Department considers that, if the ACCC were to adopt a fully allocated approach, the costs associated with NBN Co's use of assets in the RAB should be allocated directly to NBN Co. Those costs should not be allocated to FLSs, because they have nothing to do with Telstra's costs of supplying the FLSs. This means that FLS access seekers would not be asked to pay for NBN Co's use of the assets. Equally, Telstra would separately be recovering the costs of providing services to NBN Co using those assets, through the payments it is receiving separately from NBN Co.

As a result, where NBN Co uses an asset category in the RAB (for example, access to exchange buildings or ducts), the costs of supplying the service to NBN Co should be allocated within the cost allocation framework to NBN Co and recovered from it directly and excluded from Telstra's regulated FLS annual revenue requirement.

Comparison of use by NBN Co of declared FLSs

To better illustrate this point, it is worth considering the situation that would prevail if NBN Co was to acquire regulated FLSs. In this situation NBN Co would need to contribute to the cost base for those services in the same way as other access seekers using that service. That is, the cost of producing those services would be allocated to the product lines, the costs would be divided by usage, and NBN Co, like other access seekers, would pay the relevant price.[13]

However, this is the case with regulated FLSs; it is quite different from the situation where other assets are transferred to NBN Co or other services are provided to NBN Co, the costs of which are treated separately and recovered separately, and to which NBN payments relate. Again, for this reason, such payments are not relevant to the setting of FLS prices.

Costs that arise in providing FLSs are quite appropriately reflected in FLS prices, because those prices have to recover the costs of supplying the declared services to those carriers that actually use them. Conversely, it would not be appropriate to recover costs that arise from providing other services to NBN Co through these charges. Accordingly they are not; they are recovered separately. But equally, they cannot be taken into account in seeking to recover FLS costs.

Telstra's full cost allocation proposal

The Department notes that Telstra is proposing a new approach to the allocation of costs. This would involve the assets and costs associated with the provision of services to NBN Co (and other third party users) being explicitly allocated to them, leaving other costs to be allocated to FLSs. For example, under Telstra's proposed approach, a share of network buildings/support is first allocated to third party use (such as other access seekers that install their own equipment or NBN Co installing equipment for use in the NBN). This allocation is based on internal Telstra information on third party use of exchange buildings and values of exchange buildings and related facilities. This approach is consistent with that outlined above, but would be clearer and more robust because it is based on a bottom-up model of Telstra's own networks. In all instances, assets transferred to NBN Co, and the costs of providing services to NBN Co, would be excluded from the cost base for determining the prices of FLSs. This would continue to mean that it would be irrelevant to make other adjustments for payments by NBN Co to Telstra.

Summary

The Department therefore submits that the ACCC should implement full cost allocation in the FLSM and consider the NBN arrangements in accordance with the FLSM and the fixed principles. Costs should be allocated to specific users, and revenue to cover those specific costs should be linked to the specific uses. When assets are transferred to NBN Co the ACCC should write off the assets using the values recorded in the RAB. While assets are being used by both Telstra and NBN Co to supply services, and the assets are also part of the RAB, then the costs apportioned to those asset categories within the FLSM should reflect the relative usage of the asset, in accordance with the FAD fixed principles, with the result that usage by NBN Co is not included in the FLS costs to be recovered, meaning access seekers are not paying for usage by NBN Co and, equally, payments by NBN Co to Telstra for such usage need not be deducted from the annual revenue requirement for the FLSs.

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[13] The Department makes this point for illustration only. It is not aware that NBN Co is currently accessing, or intends to access, any of the declared services that are the subject of this inquiry.

Price stability

Low prices (consistent with recovering costs) for telecommunications services are an important goal of public policy. Reductions in pricing through the growth of competition since 1997 have led to clear benefits for all Australians. In 2012-13, according to the ACCC, Australians are paying 47 per cent less in real terms for fixed voice services and 52 per cent less in real terms for mobile services than in 1997-98.[14] In this context, however, it is important for the ACCC to consider the interplay of access pricing with the structural reforms that are under way.

The letter of the Minister for Communications and the Minister for Finance of 16 July 2014 also noted concerns that significant reductions in FLS prices could impact on pricing stability and thus wider industry reform. The letter was particularly concerned that this could result from the erroneous treatment of payments from NBN Co to Telstra for non-FLS products. Based on its further analysis of the treatment of the arrangements between NBN Co and Telstra as set out above, however, the Department is satisfied that if treated properly the payments from NBN Co to Telstra are irrelevant and need not be a concern.

However, there are also a wide range of other factors that could affect the stability of FLS prices in the normal course of events and there are additional factors in this period of significant industry transition. Leaving aside irrelevant payments by NBN Co to Telstra, the NBN will clearly have impacts on Telstra's expenditure forecasts which it submits to the ACCC as part of the process of working out the annual revenue requirement. Those forecasts will remain subject to two opposed trends. As assets are transferred to NBN Co the demand for Telstra's FLSs will decline. This partly reflects the recent trend towards a slight decline in the number of people using the fixed-line network, but also reflects the migration of customers to the NBN. At the same time as demand declines, however, many of the costs of supplying services remain relatively stable because they are fixed regardless of the number of users, with the result there is pressure on unit costs of the assets to go up.

Moreover, the problem of setting the appropriate prices has two particular dimensions that are uncertain. First forecasts need to be accurate, and then the forecasts need to align with what happens on the ground. The ACCC needs to be mindful of the risks in attempting to set prices for services that are being phased out during the same period that the customer base is being transferred to a new network operated by a different carrier.

The ACCC has repeatedly and correctly emphasised the importance of price stability for access seekers and end-users during the transition from services delivered over the Telstra network to services over the NBN. If prices fluctuate too widely from current levels – whether up or down – there could be unintended consequences. Price differentials that favour legacy networks could delay migration, and mislead consumers about the prices they should expect to pay for broadband going forward, noting the significant investment that is being made to increase broadband performance across

[14] ACCC (2014c). *Telecommunications competitive safeguards for 2012-13. Changes in the prices paid for telecommunications services in Australia 2012-13*, p.1.

Australia. Retail providers may also be encouraged to attempt to delay the transition with a view to seeking higher margins by using the legacy network.

These delays will mean that NBN Co revenues will be deferred, as will the attainment of the customer scale necessary for NBN Co to cover its fixed direct and indirect costs. This will make it more difficult to operate its network efficiently and reduce real prices. If NBN Co needs to respond by lowering wholesale prices to match those on the Telstra network and induce migration, this will reduce its resources for proceeding with the rollout. It will also further reduce its ability to achieve a rate of return on the rollout.

While enforced migration to the NBN will address these problems to some extent, this may become difficult in practice if consumers have to pay materially higher prices in moving to the NBN. Indeed, while NBN Co is subject to a number of price control mechanisms, there are risks that migration delays themselves could put pressure on prices in the short term or long term as costs not recovered as a result of delayed migration are carried forward into the future. These twin risks of higher NBN pricing could lead to public pressure to delay or abandon disconnection of legacy networks – threatening the commercial viability of NBN Co and the policy objective of Telstra’s structural separation.

While not an exact analogy, this conclusion is supported by recent experience in New Zealand over pricing of the copper network. Here a lack of co-ordination between the setting of prices for copper network services relative to charges for access on the Ultrafast Broadband (UFB) network has raised questions about incentives to migrate to the UFB network.

As noted at the outset of this paper, the pricing framework for access should, however, also give Telstra the opportunity to recover appropriate costs incurred in providing access and the FLSM is intended to achieve this. This would only be achieved, however, if price stability was achieved in real terms; that is, having regard to inflation, nominal price stability would prevent Telstra recovering its real costs. For it to recover its real costs, there therefore, some increase in nominal prices may be required, all other things being equal.

The long-term interests of end-users test enables the ACCC to consider the implications of its decisions for users of different platforms and in light of other regulatory decisions. It encourages co-ordination of regulatory decisions to maximise consistency and minimise the risk of perverse outcomes. In this context, the ACCC should therefore conceive the FLS FAD as being part of a transition to a higher quality network, which has been supported by Government funding and policy. The Department submits that the ACCC should consider setting access prices to promote pricing stability in the transition to the NBN. While ultimately price setting is a matter for the ACCC, if Telstra is to be able to recover its appropriate costs, while maintaining price stability, it would appear that prices should not rise over the regulatory period in real terms, but equally they should not decrease, preventing Telstra from recovering its appropriate costs.

Difficulties calculating regulated FLS prices

While the ACCC has considerable experience in setting access prices, there are inherent complexities and challenges in setting prices in a dynamic environment as the ACCC has noted in its discussion paper.

NBN Co, Telstra and the Government are engaged in ongoing negotiations to amend the DAs to implement the MTM model. Commercial Term Sheets have been agreed to transfer a substantial portion of Telstra's copper lines to NBN Co, but the precise terms and conditions of this agreement have not been finalised. As the ACCC noted in its July 2014 paper, until these processes are finalised Telstra will not have the up-to-date information on the NBN which the ACCC needs to develop revised demand and expenditure forecasts for the FLSM. 'This may create some difficulties for the ACCC in making price terms for the FADs'.

The challenge of achieving the required forecasting precision will be exacerbated by NBN Co's transition to the MTM. A key reason the ACCC did not consider the impact of the NBN in its 2011 fixed line services FAD was the uncertainty of the timing of any migration and payments and to the NBN, and the uncertainty associated with the MTM and the associated amendments to the Definitive Agreements provides the ACCC with good reason to repeat this approach in 2014. The intractable complexity of determining the impact on access prices of a process that is not yet complete, and of which the final terms are not yet known, creates a large and irreducible risk of regulatory error.

Again, these complexities, in the view of the Department, lend themselves to an approach which emphasises pricing stability.

Conclusion

In conclusion, payments by NBN Co to Telstra are effectively irrelevant to the process of setting prices for the seven declared FLSs. When assets are transferred to NBN Co, those assets will be treated as disposals in accordance with the FLSM and the fixed principles. They will therefore have no further impact on Telstra's costs or annual revenue requirement for FLSs. When Telstra is using assets to supply services at the same time to NBN Co and other customers, the costs of supplying to NBN Co will be separated out and recovered separately. Access seekers will not be contributing to NBN Co costs through FLS prices. (If NBN Co uses regulated FLS services it will contribute to their costs just like other access seekers; however this is quite separate to the question of the relevance of NBN Co payments to these prices.) As the costs involved in supplying services to NBN Co for unregulated services are not counted in determining the prices for regulated FLSs, the payments NBN Co makes to Telstra for such unregulated services are irrelevant to setting access prices for FLSs.

Given the considerable uncertainty that currently exists about the final terms of any agreement between NBN Co and Telstra and the timing of its implementation and the other pressures for upward movements in prices, it would be appropriate for the ACCC to adopt a conservative approach to setting access prices, which focusses on price stability in real terms. An approach that maintains real price stability would better the structural reforms under way in the telecommunications sector.

Given the past debate on the issues covered in this submission (particularly the issue of NBN Co payment to Telstra) and the benefits of maximising certainty going forward, the Department considers it desirable for the ACCC to provide early and firm guidance on these matters, as suggested in the Ministers' letter or 16 July. It may be appropriate for the ACCC to set out a fixed principle under the FLS FAD indicating that payments from NBN Co to Telstra for unregulated services are not relevant to, and will not be reflected in, the prices of FLSs. Failing this, a broader statement of principle may be sufficient, albeit second best. The Department submits that such a statement should be made clearly, and quickly. This will provide NBN Co and Telstra with important clarity in the context of finalising negotiations over the DAs. It will also provide other access seekers with clarity and certainty on the irrelevance of these payments in setting prices for FLSs, thereby allowing parties to focus on matters of real substance.