

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

Further Draft Decision – Outstanding Issues – June 2015

Submission by Macquarie Telecom

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## 1. Introduction

Macquarie Telecom (**Macquarie**) welcomes the opportunity to make this submission to the Australian Competition and Consumer Commission (**ACCC**) in response to the ACCC's *Public inquiry into final access determinations for fixed line services – Primary price terms – Further Draft Decision – Outstanding Issues – June 2015 (June Draft Decision)*.

### 1.1 Summary

Macquarie's overall view is that:

- (a) The June Draft Decision supports the long term interests of end users and represents a reasonable reflection of the direct costs of providing access;
- (b) The exclusion of NBN-specific costs and price stability have been adequately considered by the ACCC.

On balance and for the reasons noted below, Macquarie generally supports the ACCC's findings which result in a uniform price reduction of 9.6%.

Macquarie retains concerns regarding whether Telstra's forecast operating expenditure is accurate and consistent in the long term interests of end users. Asymmetrical access to information and lack of visibility with respect to Telstra's forecasts potentially lead to an imprudent and inefficient level of expenditure. On this basis, Macquarie considers that a uniform price reduction of 9.6% for the proposed period is a conservative reduction and it is likely that a greater reduction in access prices is justifiable.

The ACCC's proposed 4 year term for the FADs is acceptable given the circumstances of the currently delayed processes and need to move forward and should be commenced as a priority to provide price certainty. The ACCC should consider backdating the decision to 1 July 2014.

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## 2. Uniform price reduction supports long term interests of end users

The ACCC must be satisfied that Telstra's forecast operating expenditure and capital expenditure reflects prudent and efficient costs.<sup>1</sup>

In March 2015 the ACCC issued a draft decision entitled: *Public inquiry into final access determinations for fixed line service – primary price terms (the March Draft Decision)*. At the time of the March Draft Decision, the ACCC did not have sufficient information to make a determination regarding the overall prudence and efficiency of operating expenditure and capital expenditure forecasts<sup>2</sup>. To address the ACCC's major concerns regarding visibility of the cost allocation basis which Telstra applied to the fixed line services, the ACCC sought further information from Telstra regarding these matters and engaged Analysis Mason to independently verify Telstra's revised forecasts.

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<sup>1</sup> Fixed Principle 6.9 and 6.10.

<sup>2</sup> June Draft Decision, p. 9.

In response, Telstra provided a number of iterations and revisions to its operating expenditure forecasts. In doing so, Telstra has shown that it has 'considerable discretion' to allocate its expenditures such that ACCC could only review its accounts on a limited basis.<sup>3</sup> It is also clear that Telstra has a powerful commercial incentive to structure these forecasts to maximise the ultimate price to access seekers.

Macquarie remains concerned about the continuing information asymmetry, lack of visibility and variation in Telstra's forecast expenditure and that those limitations could result in an imprudent and inefficient outcome. Telstra is seeking to increase prices based on its own costs assessment in which Telstra may exercise discretion regarding its cost allocation model. Macquarie therefore submits that the ACCC has given Telstra enormous latitude to submit and re-submit its expenditure forecasts with the result being little return by way of transparency.

Further, the ACCC's independent consultant, WIK Consult, has identified that Telstra has a range of incentives to structure its expenditure forecasts such that they result in high revenue requirements.<sup>4</sup>

Macquarie notes Wik Consult's observations that:

*"The ACCC does not make adjustments for 'unders or overs' in actual expenditure compared to forecast expenditure during the regulatory period. This creates incentives on Telstra's side to overstate expenditure. Given these incentives the ACCC cannot simply accept the forecast expenditure claimed by Telstra. The ACCC has to check Telstra's expenditure forecast on their prudence and efficiency and whether they have to be corrected before they can generate a revenue requirement."<sup>5</sup>*

Macquarie is of the view that the ACCC should not accept any forecast expenditure figures above those already provided by Telstra, and should accept the forecasts provided for purposes of the January 2015 forecast operating expenditure with appropriate adjustments to remove NBN propex and any other inappropriate inclusions or inflations for the fixed line services. Further, the ACCC should take steps to ensure that the uniform price reduction is not biased in favour of Telstra due to lack of visibility.

The ACCC in its June Draft Decision revised the interim 0.7% price reduction in the March Draft Decision to a 9.6% uniform price reduction. While Macquarie supports the ACCC's findings and decisions which lead to a 9.6% uniform price reduction, Macquarie submits that it would be open to the ACCC to impose an overall price reduction greater than 9.6%. The ACCC has at its discretion the ability to accept the January 2015 forecast operating expenditure provided it is adjusted to remove NBN propex and other excluded inflations.

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### **3. Exclusion of NBN-specific costs and price stability adequately considered by the ACCC**

Macquarie agrees with the ACCC's view, and reasoning for its view, that:

- (a) costs associated with NBN-induced loss of scale economies should not be reflected in regulated revenues and;
- (b) it would be inappropriate to recover from fixed line access seekers, or other users of the fixed line network, costs of the network investments which would not be required in the absence of the NBN rollout.<sup>6</sup>

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<sup>3</sup> June Draft Decision, pp. 35 and 41.

<sup>4</sup> Wik Consulting, pp 31-33.

<sup>5</sup> Wik Consulting, p. 23.

<sup>6</sup> June Draft Decision, p. 49.

In Macquarie's view, the ACCC's decision and reasoning on these matters is consistent with the Fixed Principles<sup>7</sup> and the long term interests of end users<sup>8</sup>. The Fixed Principles require that the prudent and efficient level of capital expenditure is included in the charges for regulated services.<sup>9</sup>

Further, Macquarie also agrees that users of fixed line services should not pay higher prices due to declining demand for Telstra's fixed line network. It would not be in the long term interests of end users to require users of existing fixed line services to pay higher prices to recover investment costs attributable to the NBN rollout. As the ACCC has stated in the June Draft Decision, the remaining users of the fixed line network during the transition to the NBN should not bear costs they do not cause and which are associated with assets they will not use.<sup>10</sup> Telstra is already receiving payments (and had the opportunity to negotiate those payments) under the Definitive Agreements which cover the costs which Telstra proposes should be borne by access seekers.

In the June Draft Decision, the ACCC has confirmed that loss of economies of scale are predominantly incremental to the NBN and access seekers should not incur higher charges for fixed line services as a consequence of the decision by Telstra regarding the future of the copper network and has provided its approach to the loss of economies of scale attributable to the NBN rollout.<sup>11</sup> Macquarie strongly supports this approach.

Macquarie notes the comments regarding 'price stability' made by the Hon Mr Malcolm Turnbull MP and Senator the Hon Mathias Cormann in a letter to Mr Rod Sims on or about 16 July 2014 regarding NBN Co payments to Telstra & ACCC fixed line access determinations.

In the letter, Mr Turnbull and Mr Cormann state that price stability is vital during the transition to the NBN and that 'price shock' could occur where fixed line asset prices are reduced because DA payments are subject to regulatory treatment. The Ministers note:

*"Reductions in access charges passed to consumers as lower retail prices will open a gap between entry-level broadband prices on the Telstra network and equivalent offerings on the NBN. While most consumers would prefer lower broadband prices while they wait for the NBN, price differentials that favour legacy networks will delay migration, and mislead consumers about prices they should expect in the future."<sup>12</sup>*

Macquarie does not consider that maintaining higher prices in the fixed line services model would promote the long term interests of end users<sup>13</sup> or a competitive outcome. Neither does Macquarie accept that access seekers have the ability or incentive to delay migration onto the NBN. The deployment of the NBN and subsequent decommissioning of legacy networks is a matter within the control of NBN Co and Telstra and is a process over which access seekers have no control. In addition, access seekers have strongly embraced transition to the NBN and will continue to do so.

In making an access determination, the ACCC must take into account certain matters including the long term interests of end users. It also must act in accordance with the fixed principles framework. Macquarie considers that the ACCC has considered the appropriate level of price stability during the NBN roll out and migration.<sup>14</sup> The ACCC in the March Draft Decision said that it considered

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<sup>7</sup> See specifically Fixed Principle 6.10.

<sup>8</sup> See specifically section 152BCA(1)(a) of the CCA

<sup>9</sup> Fixed Principle 6.10.

<sup>10</sup> June Draft Decision, p. 71.

<sup>11</sup> June Draft Decision, p. 73 - 76.

<sup>12</sup> Letter from The Hon Malcolm Turnbull MP and Senator The Hon Mathian Cormann to Mr Rod Sims regarding NBN Co Payments to Telstra & ACCC Fixed Line Access Determinations on 16 July 2014, p. 3.

<sup>13</sup> Section 152BCA(1)(a) of the CCA

<sup>14</sup> ACCC, Inquiry to make final access determination for the declared fixed line services, Final Report July 2011, p. 8.

*“that applying a uniform price change to all declared services will provide a degree of stability to the industry in the lead up to and during the transition to the NBN.*

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*The ACCC considers that applying a uniform price change to all declared services and maintaining price relativities will minimise any undesirable consequences of setting prices for individual services using the current approach. The ACCC considers that the uniform price change will provide stability to the industry in the transition to the NBN. This will minimise incentives for access seekers to change the way they provide services to end users and allow for continued efficient use of infrastructure already in use, which will in turn promote efficient use of declared services. It will also avoid any adverse impacts on competition from changing price relativities.”<sup>15</sup>*

Macquarie agrees with the ACCC’s approach and reasoning.

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#### **4. Term of the FAD**

It has been argued in the context of the review that there is inherent uncertainty around the pace and consequence of NBN deployment such that a shorter term FAD of around 2 years would be in the LTIE. Macquarie continues to be concerned that this uncertainty may best be dealt with via a shorter term period and/or a review on the occurrence of materially different facts than those on which the present decision is based. This is especially the case if the forecast expenditures of Telstra do not eventuate. Again, given the information asymmetry underlying this review that favours Telstra’s position, Macquarie is in a difficult position in which to make an unequivocal submission in relation to timing.

Accordingly, and in the circumstances, Macquarie does not disagree with the FADs expiring after a 4 year term and urges the ACCC to finalise the inquiry as soon as possible to secure price certainty in respect of the fixed line services model. Macquarie also considers that it would be appropriate to back date the FAD to 1 July 2014.

**Macquarie Telecom Group Ltd**  
**[xx] July 2015**

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<sup>15</sup> March Draft Decision, p. 167.