

3 August 2015

Mr Robert Wright
General Manager, Water and Wireline Markets Branch
Infrastructure Regulation Division
Australian Competition & Consumer Commission
Level 35, 360 Elizabeth Street
Melbourne VICTORIA 3000

Dear Robert

RESPONSE TO TELSTRA'S NBN CLAIMS

Optus wishes to provide additional comments in response to Telstra's submission that the ACCC errs in its proposed treatment of payments under the NBN Co–Telstra Definitive Agreements (DAs).

Telstra has submitted that:

- payments under the DAs are not sufficient to offset revenue and margin loss due to the roll out of the NBN; and
- it was not reasonable to form the view in 2010-11 that the ACCC would lower access charges in the 2014 FAD Inquiry.

This letter addresses both of these claims.

First, Telstra has made contradictory claims in 2011 and during this FAD Inquiry relating to the impact of payments under the DAs. The ACCC should give little weight to claims made during this Inquiry if they are inconsistent with previous statements made by Telstra.

Second, Telstra may have formed the view in 2011 that the ACCC would not lower access charges, but it was also reasonable to form the view that the ACCC would lower access charges in the 2014 FAD Inquiry. Indeed, Optus and other access seekers held this view. If Telstra had made an incorrect assumption it is not the role of the ACCC to compensate for errors of judgement.

Telstra claims that DAs do not reflect increased fixed line costs

The central theme of Telstra's submissions is that it must be compensated for the loss of value, or increased cost, associated with the loss of fixed line users primarily due to the migration of end-users to NBN.

Telstra has claimed that at the time of the DAs it had not anticipated that "*Telstra would be deprived of an opportunity to recover the cost of supplying legacy fixed line services, and*

therefore this is not factored into the NBN-Telstra deal payments.”¹ Telstra goes further and claims that its “shareholders did not approve the commercial arrangements with NBN Co on the basis that Telstra would be fully compensated for the economic effects of the NBN transition.”²

Telstra has repeated these claims in its response to the further draft decision.³

Optus finds these claims puzzling. On the one hand Telstra claimed in 2011 that the NBN payments offset all losses in Telstra’s fixed line business; and yet in 2015 Telstra is revising this view and claiming it was not compensated.

Both views cannot be correct.

Market share losses are compensated through disconnection payments

The above claims that the DAs did not take into account increased costs due to deployment of NBN would appear to contradict the clear statements made by Telstra to the stock market and investors at the time of the deal in 2011.

David Thodey, CEO of Telstra, made clear that “*the payments to be received are to offset both any market share loss and any **margin erosion in Telstra’s fixed line business***”.⁴ As a result, Mr Thodey did not expect to see any revenue loss as a result of migration to NBN:

*While we may see some margin dilution in an NBN world, we are confident in our ability to continue to grow our revenues in mobiles, media and network applications and services and that **growth plus payments received as part of the deal will offset any NBN-related retail and wholesale revenue losses**.*⁵ [emphasis added]

This view was again emphasised by the CFO, Mr John Stanhope, who described the disconnection payments as being NBN Co’s “*consideration to [Telstra] for anticipated share and margin dilution in our fixed line business*”.⁶ He continued to explain that the payments protect Telstra from the impact of competition:

*So put another way, that \$4 billion is expected to replace any share loss in fixed line and any margin dilution. Why do we think there’ll be some share loss? Of course there is a disruptive event about to occur. Every home in Australia will, over 10 years, get a doorknock that says have I got a deal, come with me, I’m a great retail service provider. **So we’ve protected ourselves from that possibility.***⁷ [emphasis added]

There is clear evidence, at the time the agreement was announced, that the purpose of the disconnection payments was to make Telstra whole and compensate for losses associated with migration to NBN.

Telstra’s current claims should be discounted as they are clearly at odds with the facts previously presented by Telstra’s most senior executives.

¹ Telstra, 2015, Response to ACCC draft decision on primary price terms, May, p.36

² *Ibid.*, p.47

³ Telstra, 2015, Response to the ACCC further draft decision, July, s.1.4.3

⁴ Telstra, Transcript of Conference Call: Telstra signs Definitive Agreements, 23 June 2011, p.8

⁵ Telstra, Transcript of Conference Call: Telstra signs Definitive Agreements, 23 June 2011, p.9

⁶ Telstra, Transcript of Conference Call: Telstra signs Definitive Agreements, 23 June 2011, p.21

⁷ Telstra, Transcript of Conference Call: Telstra signs Definitive Agreements, 23 June 2011, p.21

Reductions in regulated prices were reasonably foreseeable in 2010/11

Telstra claims that it could not have reasonably anticipated that the ACCC would not allow it to recover costs associated with NBN roll-out. Telstra claims it could not have anticipated such an outcome.⁸

As noted above, this claim is inconsistent with the views presented by Telstra's senior executives at the time the deal was announced. In addition, it is also inconsistent with statements made by the ACCC and access seekers during the 2010-11 period. A review of the documents and correspondence between the ACCC and industry during the 2010-11 period shows that it was clear at that time that the ACCC would take into account the impact of the NBN Co–Telstra payments. Further, it was also clear that parties other than Telstra had formed the view that this would lead to lower regulated access prices.

If we assume that (contrary to its statements) Telstra made the assumption that regulated access charges would remain at the same level then it may be possible that the DAs do not “compensate” Telstra for the full impact of lower access charges. However, in this hypothetical Telstra would have made an error of judgement. But the role of regulation is not to compensate for commercial errors. It is not the role of the ACCC to compensate Telstra due to losses it incurs because it made an assumption about future regulated rates that has proven to be false.

In any event, such a hypothetical seems implausible for a sophisticated commercial entity as Telstra. It was well known prior to the finalisation of the DAs in October 2011 that the ACCC would take into account the impact of future NBN payments when making the next FAD (i.e. the current FAD Inquiry). In September 2010, the ACCC stated:

In the process of reviewing prices and determining the revenue requirement for subsequent regulatory periods, the ACCC will take into account any migration payments received by Telstra and any impact that de-commissioning the network may have on the RAB.⁹

In July 2011, the Final Report for the 2011 FAD Inquiry stated:

In the next regulatory period, the ACCC will take into account the impacts of the NBN roll-out in determining the inputs to the FLSM. If any modifications to the design of the FLSM are required, the ACCC will consult on any such modifications at an appropriate time prior to finalising prices for the next regulatory period.¹⁰

It was clear for at least the year prior to October 2011 that the ACCC would take into account migration payments made by NBN Co, and that de-commissioning of assets would impact on the RAB during the 2014 FAD Inquiry process.

While Telstra may have assumed that access charges would remain stable over the next regulatory period, it is clear that other parties formed the view that access charges are very likely to fall in subsequent regulatory periods. Optus made several public statements over 2010 and 2011 that the impact of any agreement between NBN Co and Telstra will likely result in lower fixed line access charges.

⁸ Telstra, 2015, Response to the ACCC further draft decision, July, p.26

⁹ ACCC, Review of the 1997 telecommunications access pricing principles for fixed line services, Draft report, September 2010, p.29

¹⁰ ACCC, Inquiry to make final access determinations for the declared fixed line services, Final Report, July 2011, p.29

Optus wrote to the ACCC in July 2010 signalling concerns around the pricing of fixed line regulated services as a result of the Heads of Agreement signed on 20 June 2010:

In conclusion, fixed line access prices should be expected to fall as a result of this agreement. Since Telstra will receive additional revenue streams under the agreement, it will require a substantially lower level of revenue from wholesale access prices over the remaining life of its network.¹¹

Optus submitted in June 2011 that both the RAB and regulatory depreciation within the FAD should deal with compensating Telstra for its capital investment in its fixed line network. Given that this is the same investment for which NBN Co will compensate Telstra, there is a very real risk that Telstra will effectively be compensated twice for the same investment. Specifically:

Migration payments should be viewed as a 'return of capital' to Telstra shareholders for capital invested in the CAN. Accordingly, once received Telstra should no longer earn either a return on capital or a return of capital associated with the asset for which the payment was made.

Ducts, trenches and pits form part of the RAB for the CAN. Compensation for the use of RAB assets is a component of total compensation to Telstra, which represents a 'return of capital' to shareholders for capital invested in the network. Accordingly, the ACCC should deduct this RAB-related element of lease payments from Telstra's RAB for fixed line services.¹²

In summary, Telstra is suggesting that based on the same set of facts, it came to different views on the future path of regulated access charged in the period after 2014 than Optus and other access seekers. This seems both implausible and is inconsistent with the views expressed by its senior executives.

In any event even if Telstra had made an incorrect assumption it is not the role of the ACCC to compensate Telstra for errors of judgement. The ACCC's role is to promote the long term interest of end-users and to promote competition.

Please do not hesitate to contact me if you have any questions or comments.

Yours sincerely,

Luke van Hooft
Manager Economic Regulation

¹¹ Letter from Optus to ACCC Re: Review of Access Pricing Principles for Fixed Line services – 13 July 2010

¹² Optus Submission in response to the ACCC's discussion paper Public Inquiry to make Final Access Determinations for the Declared Fixed Line Services, June 2011, p.21