21 December 2018

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Sophie Corea
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Dear Mr Harding and Ms Corea,

Re: Regulatory regime applying to nbn co and Long Term Revenue Constraint Methodology 2017-18 review

nbn co was established in 2009 to design, build and operate Australia's wholesale broadband access network with the key objective of ensuring all Australians have access to fast broadband as soon as possible, at affordable prices, and at least cost. A decade after its establishment, with nbn co close to completing its rollout and significant migration occurring, it is timely to assess the effectiveness of the regulatory regime applying to nbn co and the prices being charged for wholesale and retail access.

It is Telstra's view that the regime has not been effective in generating price outcomes that maximise the benefits from the National Broadband Network (NBN) and Australians are not getting affordable access to broadband services. Prices for wholesale access are too high, RSPs face significant pricing uncertainty under the regime and RSPs are operating on low margins. This is unsustainable, is driving smaller players from the market and leaves little room for ongoing service innovation for the benefit of Australian consumers.

Telstra agrees with the concerns raised by the ACCC regarding the pricing framework applying to nbn co (raised as part of nbn co's SAU variation application). Indeed we believe it is timely to revisit the regulatory framework applicable to NBN pricing. In doing so, Telstra submits that change is required in three areas:

- **First, and most critically, wholesale prices are too high.** This has made Australian consumer broadband prices amongst the highest in the world and increasingly poses a risk to continued investment, innovation and diversity in Australian fixed broadband services.
- **Second, the framework is not delivering stable and predictable wholesale prices.** When introduced, the CPI less 1.5% price caps applicable under nbn co's special access undertaking (**SAU**) were intended to deliver predictable and relatively stable wholesale pricing. Instead, over recent years, the predominant nbn co offers 'in market' are discounted bundles that can be removed or altered without regard to the price caps. The result has been greater wholesale pricing volatility and, at the same time, growing inflexibility in the market (through forced bundling to suit nbn co commercial drivers rather than consumer or RSP demand).
- **Third, as nbn co's products increasingly enter and compete in contestable enterprise markets, a lack of geographic and product level transparency around its costs and revenues is leading to concerns about cross-subsidisation.** nbn co is subject to far less regulatory oversight around its activities in contestable markets than other similar network entities (such as

energy companies) or as applied to Telstra when operating the PSTN. Telstra submits it is time to consider extending to nbn co the applicable regulatory accounting obligations accordingly.

Each of these three areas is briefly outlined below. We acknowledge that not all of these pricing issues are able to be addressed through the LTRCM process. Nonetheless it is important that the ACCC is aware of these broader pricing issues, and Telstra considers that there are some where the LTRCM process can immediately assist — for example, the ACCC could confirm that bundles are to be treated as "nbn offers" under the SAU. This would ensure that they are subject to the CPI less 1.5% price cap.

Telstra welcomes the opportunity to engage more fully with the ACCC over the course of the LTRCM process, and more widely, on potential regulatory responses to these critical NBN pricing issues.

The regulatory regime (and building block revenue model) does not provide any meaningful pricing constraint on nbn co

nbn co's wholesale prices are simply too high. Australians already pay some of the highest next generation broadband prices in the world. A recent study by Ovum commissioned by Telstra found that of 30 leading fixed broadband markets globally, Australia was the fifth most expensive of all markets across each speed tier.[1]

While outside the immediate scope of the LTRCM process, Telstra remains concerned that the operation of the Initial Cost Recovery Account means that the building block-based revenue caps applicable to nbn co are not likely to pose any meaningful constraint on pricing for decades. [2]

Relatedly, Optus has stated *"NBN Co's current pricing structure and its proposed trajectory on ARPU are unlikely to be sustainable. At some point there will need to be a downshift in pricing to preserve a viable market structure."* [3] Telstra CEO Andy Penn also noted "*without doubt the current wholesale price for NBN is absolutely unsustainable, it is leading to operators starting to exit the business and – unless it is addressed – it will ultimately lead to higher prices for consumers.*"[4] Amaysim is one operator that has recently ceased to supply nbn services because of margin pressures.[5]

This is not a sustainable position for industry and has implications for realisation of the benefits expected from the NBN rollout.

The CPI less 1.5% price cap is being circumvented by nbn co's discounted bundles – undermining wholesale price stability and creating product inflexibility

There are no binding constraints on nbn co pricing. It has too much flexibility in the pricing of its services which has created significant price uncertainty.

A key factor leading to this uncertainty has been nbn co's use of its Discount, Credits and Rebates list to introduce new pricing initiatives. Telstra notes that pricing concerns, particularly as they relate to regulatory protections under the SAU, have been raised by the ACCC with nbn co and this has recently led to nbn co withdrawing its SAU variation application. In announcing the withdrawal the ACCC stated:

> *…implementing price changes through the discount mechanism means that the bundled offers or promotions are outside of the SAU framework and the price controls (which apply to the maximum regulated prices) do not apply. This means that NBN Co*

[1] Refer Comms Day, 13 December 2018, *Telstra brandishes Ovum analysis to make case against NBN pricing.*

[2] Telstra also notes that nbn co's regulated price cap can continue to increase by CPI less1.5% until the ICRA is paid off. **[c-i-c begins]** **[c-i-c ends]**

[3] Andrew Sheridan, Optus, https://www.afr.com/technology/web/nbn/telstra-and-its-telco-rivals-head-for-a-pricing-car-crash-with-delusional-nbn-20181124-h18bca.

[4] Refer Comms Day, 13 December 2018, *Telstra brandishes Ovum analysis to make case against NBN pricing.* CEO address to Illawarra Chamber of Commerce Lunch.

[5] See Amaysim CEO Peter O'Connell, https://www.2gb.com/amaysim-ditches-broadband-offering-blames-nbn-for-exorbitant-prices/.

> *is able to increase the discounted prices (up to the price caps) at any time, subject to the notice period listed in the relevant discount notice. We are concerned that this undermines a central objective of the SAU which is to ensure certainty for access seekers and to minimise price shocks for consumers and businesses using the NBN.*[6]

In addition to the concern articulated by the ACCC, key issues relating to nbn pricing include:

- Regulated maximum price caps under the SAU are able to increase by CPI less 1.5% annually and are significantly higher than current discount offers (e.g. the nbn50 bundle is priced at $45 whereas the regulated price cap for equivalent AVC and CVC is almost $70). This provides scope for nbn co to increase prices significantly.
- The current Dimension Based Discounting offer is intended to expire in April 2019. For non bundled services, removal of this discount will result in higher CVC prices. Legacy offers (i.e. those involving purchase of unbundled AVC and CVC) will no longer be a suitable substitute for the relevant bundle, making it harder for RSPs to dimension services and differentiate themselves from each other.

It is yet to be seen how nbn co will respond to the concerns raised by the ACCC, and therefore the extent to which the above issues will be addressed through nbn co's pending SAU variation application.

Greater transparency on nbn co's costs and revenues to prevent cross subsidisation

As part of the ACCC's LTRCM 2016-17 determination Telstra raised concerns in regard to the treatment of the costs that could be regarded as being outside nbn co's core business. These concerns were also reiterated by Optus.[7] In response, the ACCC stated that "*an appropriate level of scrutiny over NBN Co's costs in relation to the roll out of infrastructure through the LTRCM process is essential, particularly as NBN Co enters competitive markets. It is important that NBN Co is not able to use its position as a provider of regulated services to obtain an advantage in the supply of services in competitive markets."*[8]

Telstra endorses the concern identified by the ACCC. nbn co is increasingly moving into contestable markets, such as enterprise markets for special services, transmission and backhaul. Telstra notes that the level of regulatory accountability applicable to nbn co in this regard is substantially weaker than for other regulated entities in a similar position (such as energy companies that operate in contestable markets) or that applying to Telstra.

Telstra submits that the ACCC should consider establishing a more rigorous and transparent regulatory accounting framework (**RAF**) to apply to nbn co that requires separate and public accounting for costs and revenues by product, technology and geography — and which provides transparency over cost allocation in relation to common costs between contestable and non-contestable activities. The information currently required from nbn co as part of the LTRCM process each financial year is wholly inadequate to enable any assessment of whether cross subsidisation occurs between contestable and non-contestable products. Improving financial transparency in this regard is also consistent with good regulatory practice and, Telstra submits, is overdue in relation to nbn co.

The attachment to this letter provides examples of the kind of additional information that could be included by the ACCC in any RAF for nbn co. Telstra expects that the ACCC would wish to separately consult on the approach which might be adopted to develop this framework, such as under its record keeping rules.

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[6] See https://www.accc.gov.au/system/files/NPC%20-%20final%20-%20SAU%20variation%20%20Public%20statement%20on%20withdrawal%20-%202%20November%202018.pdf, p. 2-3.

[7] Optus, submission to ACCC, *2016-17 LTRCM Determination Consultation*, 07 June 2018.

[8] ACCC, *NBN Co Special Access Undertaking Long Term Revenue Constraint Methodology 2016-2017: Final Determination and Price compliance reporting 2016-2017*, June 2018.

We would be happy to meet with the ACCC to discuss further these important issues. If you have any queries on this submission, please contact Kim Longin on (03) 8649 2030 or kim.longin@team.telstra.com.

Yours sincerely

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nbn co to prepare and publish regulatory accounts that provide transparency over:

Capital expenditure, operating expenditure, revenues and appropriate profitability measures (operating margin/EBIT, EBITDA), by:

1. residential and enterprise;
2. product – unbundled (e.g. this would include AVC and CVC so we can understand the efficiency of nbn's bundling activities);
3. technology type; and
4. geographic areas (e.g. those profitable vs non-profitable geographic areas to identify whether and to what extent, there is a cross subsidy).

Any cost allocation should be in accordance with a published cost allocation methodology approved by the ACCC.

Separately, the ACCC should receive:

1. 'building block' cost components for each category (e.g. residential and enterprise); and
2. details of direct and indirect (shared) costs for each category (e.g. residential and enterprise).