

Annexure 1 to nbn letter to ACCC – March 2023

Changes to November SAU Variation: investment grade credit rating provisions

This document sets out particular changes to nbn's SAU variation of November 2022 being contemplated by nbn.

These changes are in addition to the changes identified in the separate draft riders related to:

- the replacement module process and pricing regulation provisions – Annexure 2;
- service performance and improvements – Annexure 3;
- other contemplated changes – Annexure 4; and
- WAPC simplifications and clarifications – Annexure 5.

Changes are shown in track / mark-up, against extracts of the November Variation.

Changes:

Module 2 Subsequent Regulatory Period

[...]

2G.4.2 Nominal Annual Drawdown of ICRA

The Nominal Annual Drawdown of ICRA will be:

- (a) for each Financial Year prior to the WAPC Factor Change Year, zero; and
- (b) for each Financial Year (t) that is, or occurs after, the WAPC Factor Change Year, an amount calculated in accordance with the formula below:

$$\begin{aligned} & \text{Nominal Annual Drawdown of ICRA}_t \\ & = \text{Annual Module 2 ICRA Drawdown Percentage}_t \times \text{Real Module 2 Core Services ICRA} \times \text{CIF}_t \end{aligned}$$

where:

- (i) the **Annual Module 2 ICRA Drawdown Percentage** is a percentage which:

(A) subject to clause 2G.4.2(b)(i)(B), when applied in the formula above (and taking into account the other terms of Module 2 of this Special Access Undertaking and the ACCC Replacement Module Determination for the relevant Regulatory Cycle), will set a Nominal Annual Drawdown of ICRA for that Financial Year which will allow NBN Co a reasonable opportunity:

(I) to transition, in the shortest timeframe practicable while avoiding price shocks, to a position where NBN Co satisfies quantitative financial metrics consistent with achieving and maintaining, ~~for the duration of that Financial Year and the remaining Financial Years in the Subsequent Regulatory Period,~~ a stand-alone investment grade credit rating with a stable outlook from one or more ~~of the following~~ established and reputable rating agencies, such as Moody's, Fitch Ratings and Standard and Poor's; or

(II) subject to avoiding price shocks, to satisfy quantitative financial metrics consistent with maintaining a stand-alone investment grade credit rating with a stable outlook from one or more established and reputable rating agencies, such as Moody's, Fitch Ratings and Standard and Poor's;

(as applicable); and:

~~(I) — Moody's;~~

~~(II) — Fitch Ratings; and~~

~~(III) — Standard and Poor's; and~~

(B) cannot be more than the following: 100% minus the sum of the Annual Module 2 ICRA Drawdown Percentages for the preceding Financial Years;

Note: Clause 5.8(b) provides that in making an ACCC ~~Regulatory~~Replacement Module Determination, the ACCC must take into account the matters set out in section 152BCA(1) of the CCA and may take into account any other matters it thinks are relevant.

(ii) **Real Module 2 Core Services ICRA** is measured in Financial Year 2013/14 dollar terms and is determined in accordance with clause 2G.3.1(c); and

(iii) **CIF_t** is to be calculated in accordance with clause 2G.1.4.

[...]

Module 3 Post-2032 Regulatory Period

[...]

3B.3.1 General principle in respect of an Annual Regulated Revenue Allowance

(a) The terms of, and matters set out in, any Replacement Module Application or ACCC Replacement Module Determination for a Regulatory Cycle within the Post-2032 Regulatory Period must allow NBN Co a reasonable opportunity to earn Revenues in that Regulatory Cycle equal to the sum of the Annual Regulated Revenue Allowance for each Financial Year in that Regulatory Cycle (in terms of net present value).

(b) The **Annual Regulated Revenue Allowance** for a given Financial Year within a Regulatory Cycle is equal to:

$$\text{Forecast Nominal ABBRR} + \text{Nominal Annual Drawdown of ICRA}$$

where:

(i) *Forecast Nominal ABBRR* is calculated in accordance with clause 3B.3.2; and

(ii) *Nominal Annual Drawdown of ICRA* is calculated in accordance with clause 3B.3.6.

~~(c) The Annual Regulated Revenue Allowance for a Financial Year within a Regulatory Cycle must be set to allow NBN Co a reasonable opportunity to achieve and maintain, for the duration of that Regulatory Cycle, a stand-alone investment grade credit rating with a stable outlook from one or more of the following established and reputable rating agencies:~~

~~(i) — Moody's;~~

~~(ii) — Fitch Ratings; and~~

~~(iii) — Standard and Poor's.~~

Note: Clause 5.8(b) provides that in making an ACCC Replacement Module Determination, the ACCC must take into account the matters set out in section 152BCA(1) of the CCA and may take into account any other matters it thinks are relevant.

3B.3.2 Forecast Nominal ABBRR Requirements

- (a) For a Financial Year within a Regulatory Cycle, the Forecast Nominal ABBRR must include, at the minimum, the following elements:
 - (i) forecast prudent and efficient Operating Expenditure for that Financial Year that an operator in NBN Co's position would incur, including to meet any benchmark service standards included in the ACCC Replacement Module Determination for that Regulatory Cycle;
 - (ii) forecast nominal regulatory depreciation for that Financial Year;
 - (iii) a return on capital for that Financial Year, calculated by reference to a rate of return and the forecast Nominal RAB at the start of that Financial Year; and
 - (iv) a forecast tax allowance for that Financial Year.
- (b) The Forecast Nominal ABBRR must be calculated in such a way as to satisfy the NPV=0 expectation as set out in clause 2G.2.4(f).
- (c) For the purposes of clause 3B.3.2(a):
 - (i) the rate of return will be determined by estimating a nominal vanilla WACC for the Financial Year, commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to NBN Co in providing the NBN Access Service, Ancillary Services and Facilities Access Service, having regard to:
 - (A) the objective of producing reliable estimates of the market cost of capital in a wide range of plausible market conditions; and
 - (B) the objective of promoting stability in the rate of return over time; and
 - (ii) the forecast Nominal RAB must be determined in accordance with clauses 3B.3.3 and 3B.3.4.

(d) In calculating the Forecast Nominal ABBRR, regard must be had to the objective of allowing a prudent and efficient operator in NBN Co's position (and with benchmark efficient capital structure) a reasonable opportunity to maintain a stand-alone investment grade credit rating with a stable outlook from one or more established and reputable rating agencies, such as Moody's, Fitch Ratings and Standard and Poor's.

Note: Clause 5.8(b) provides that in making an ACCC Replacement Module Determination, the ACCC must take into account the matters set out in section 152BCA(1) of the CCA and may take into account any other matters it thinks are relevant.

[...]

[...]

3B.3.6 Nominal Annual Drawdown of ICRA

- (a) The Nominal Annual Drawdown of ICRA for each Financial Year within a Regulatory Cycle in the Post-2032 Regulatory Period will be determined in accordance with the following formula:

$$\text{Nominal Annual Drawdown of ICRA} = \text{Annual Module 3 ICRA Drawdown Percentage} \times \text{Real Module 3 ICRA} \times \text{Cumulative Inflation Factor}$$

where:

- (i) the **Annual Module 3 ICRA Drawdown Percentage** is a percentage which:
- (A) for each Financial Year (for the purposes of this clause 3B.3.6(a)(i)(A), a **Given Financial Year**) from Financial Year 2032/33 to Financial Year 2038/39 (inclusive), cannot be more than the following: 100% minus the sum of the Annual Module 3 ICRA Drawdown Percentages for the Financial Years preceding the Given Financial Year; and
 - (B) for Financial Year 2039/40, is 100% minus the sum of the Annual Module 3 ICRA Drawdown Percentages for the Financial Years 2032/33 to 2038/39;

Note: The effect of this clause 3B.3.6(a)(i) is that the sum of the Annual Module 3 ICRA Drawdown Percentages for the Financial Years in the Post-2032 Regulatory Period will be 100%.

- (ii) the Real Module 3 ICRA is determined in accordance with clause 3B.3.5(b); and
- (iii) the **Cumulative Inflation Factor** is a factor which is the cumulative product of inflation for each Financial Year from Financial Year 2013/14 to the relevant Financial Year to which the Nominal Annual Drawdown of ICRA relates, where the Cumulative Inflation Factor for Financial Years up to 2031/32 will be the same values as determined for those Financial Years (respectively) pursuant to clauses 1E.8.4(b) and 2G.1.4, and where the Cumulative Inflation Factor for Financial Years in the Post-2032 Regulatory Period will use estimates of inflation expectations.

(b) Subject to clause 3B.3.6(a)(i), the Annual Module 3 ICRA Drawdown Percentage is a percentage which, when applied in the formula in clause 3B.3.6(a) (and taking into account the other terms of the ACCC Replacement Module Determination for the relevant Regulatory Cycle), will set a Nominal Annual Drawdown of ICRA for each Financial Year within the Relevant Regulatory Cycle that allows NBN Co a reasonable opportunity:

- (i) to transition, in the shortest timeframe practicable while avoiding price shocks, to a position where NBN Co satisfies quantitative financial metrics consistent with achieving and maintaining a stand-alone investment grade credit rating with a stable outlook from one or more established and reputable rating agencies, such as Moody's, Fitch Ratings and Standard and Poor's; or
- (ii) subject to avoiding price shocks, to satisfy quantitative financial metrics consistent with maintaining a stand-alone investment grade credit rating with a stable outlook from one or more established and reputable rating agencies, such as Moody's, Fitch Ratings and Standard and Poor's;

(as applicable).

Note: Clause 5.8(b) provides that in making an ACCC ~~Regulatory~~Replacement Module Determination, the ACCC must take into account the matters set out in section 152BCA(1) of the CCA and may take into account any other matters it thinks are relevant.