Submission in response to the Australian Competition and Consumer Commission's consultation on NBN Co's Special Access Undertaking

16 July 2021

Commpete—an industry alliance for greater competition in telecoms markets—welcomes the opportunity to contribute to the Australian Competition and Consumer Commission's (**ACCC**) consultation on the necessary reforms to the NBN Co's special access undertaking (**SAU**) and the long-term regulatory framework it establishes for the national broadband network.

Commpete supports the ACCC proposal for a "first principles" review of the SAU and being open to revisiting the existing arrangements and prior decisions. The present opportunity for major reform to the SAU must be embraced by all stakeholders and used to set up more suitable regulation of NBN Co.

In short, Commpete believes:

- the SAU should be substantially revised to ensure it is fit for purpose for the decades ahead and in light of the experience of the past decade;
- the scope of the SAU should be expanded to cover all products supplied by NBN Co in all markets (including business/enterprise markets) to ensure retail service providers (**RSPs**) are always protected from potentially anti-competitive and exploitative practices, bearing in mind that those protections and the flexibility available to NBN Co may need to vary according to the extent to which NBN Co faces effective competitive constraints in some markets/segments;
- NBN Co's pricing and product constructs are unduly complex, which can be especially problematic for smaller RSPs to navigate;
- reform of the initial cost recovery account (**ICRA**) is crucial to achieve meaningful change and is key to addressing many of the concerns raised by industry and the ACCC.

Scope of a revised SAU

1. NBN Co is a monopoly provider of nationally significant infrastructure that faces only limited competition at the margins. The SAU should reflect this reality and cover all NBN Co's wholesale services in their entirety. To be effective, regulation of NBN Co must take account of all its technologies, all its products, and all its costs and revenues. Such an "all inclusive" approach would have an added benefit of simplifying the monitoring for anti-competitive cross-subsidisation relative to a regime that allows cost allocations between regulated and unregulated services to be debated ad nauseam. However, that regulation should be tailored to the circumstances; greater discretions and flexibility should be afforded to NBN Co in respect of products its offers in markets where it faces—or will face—an effective competitive constraint.

Treatment of the ICRA

2. The ACCC's discussion paper correctly diagnoses the fundamental problems with the ICRA. A substantial write-down of the balance of the ICRA (at least for the purpose of regulatory pricing) is crucial to any meaningful reform of the regulatory regime that is to govern NBN Co for the decades to come. Reform of the ICRA is key to resolving most of the concerns that have been raised about NBN Co's pricing behaviour, including the use of a two-part pricing construct, the affordability of entry level prices, and the over-use of discounting outside of the SAU terms.
3. An additional issue to consider in this context is how NBN Co's provision for depreciation of assets may have contributed to the losses that have accumulated in the ICRA.

4. The ICRA is made up of accumulated losses since the inception of NBN Co. The costs of those accumulated losses being carried forward is reflected in debt financing, which in turn adds to the losses. However, a major contribution to those accounting losses and thus to the ICRA is NBN Co's provision for depreciation, which seems unduly conservative (in the sense that that NBN Co's assets are being written down as quickly as may be reasonably justified).
5. According to NBN Co's 2020 Annual Report, depreciation and amortisation expenses account for some 60% of its loss before interest and tax, up from 54% the year before.[1] Total accumulated depreciation is $9.5 billion in respect of total property, plant and equipment that cost $43.2 billion.[2] Network Assets account for more than 95% of both these figures, which means that NBN Co—having only just completed its build phase—has already written down the value of its network by 22%.
6. NBN Co's auditors no doubt annually review the processes applied by NBN Co to determine asset lives and depreciation provisions. Nonetheless, it is open to the ACCC to adopt a different approach to the depreciation of NBN Co's assets for regulatory pricing purposes and to consider whether, in the light of experience with these and similar assets both in Australia and overseas, whether extended depreciation lives could be sustained.[3] Assuming longer asset lives would mean a lower depreciation provision might have been made in the past and might be made for the future. In other words, the ICRA might be recalculated and reduced materially as a result.
7. NBN Co presumably would have considered the approaches in other organisations to the depreciation of infrastructure assets such as fibre cabling, trenches and ducts, so benchmarking those practices elsewhere is unlikely to lead to a material reduction in NBN Co's provision for depreciation. It is the actual engineering lives of these assets that might now be reviewed, not accounting practices.
8. If the regulatory depreciation for ICRA is revised, it will also need to be revised for the RAB. If the depreciation provision is recalculated and reduced it will increase the value of assets in the regulatory asset base (**RAB**), effectively to the same extent. However, this would not be for nought because, as the ACCC notes in its discussion paper, it is only when the ICRA balance is zero that the total revenue constraint for NBN Co will become effective.

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[1] NBN Co, Annual Report 2020, p126

[2] Ibid, p138.

[3] NBN Co's 2020 Annual Report (at p141) describes the useful lives of its network assets as is being the 'lower of lease term and/or 5-40 years', which is not very helpful to understanding which network assets have which useful lives (eg active vs passive, FTTC, FTTN, HFC etc.

Question 1: We have outlined three high level principles to use in assessing whether particular NBN Co access product and pricing arrangements would promote the long-term interests of end-users. What additions, deletions or refinements would you recommend?

9. Commpete considers all three principles to be appropriate and supports them. However, the implications of the principles may need to be spelled out in some detail to avoid misinterpretation.

10. Principle 1 is that 'Access arrangements should support a range of retail service offerings that represent value to different categories of end-users'. We infer this to mean that NBN Co's access arrangements should not try to engineer or determine or unduly influence and shape retail service offerings. After all, that is not the role of NBN Co. RSPs should have the flexibility and freedom to distinguish themselves as retailers. They should not be encouraged to be, or confined to being, mere resellers of offers that have been designed by NBN Co.

11. Wholesale access conditions should be structured as simply as possible and not rely on discretions that are developed separately by the wholesaler. The notion that the RSP should be able to control quality and other dimensions of the access service is agreed but should not be the basis on which NBN Co generates complexity in its offerings. Some of the suggestions in the ACCC's discussion paper (such as speed bolt-ons) should not be the basis for a new era of creative complexity by NBN Co.

12. Principle 2 is that 'Access seekers should have reasonable certainty over access costs over time for a given level of quality'. Reasonable certainty means that access seekers should be able to rely on the prices that constitute their access costs being based on NBN Co's efficiently incurred costs. Further, RSPs should be able to rely on those efficiently incurred costs being set out definitively for each regulatory period in a binding instrument (not necessarily the SAU).

13. Principle 3 is that 'The access provider should have a reasonable opportunity, but not the guarantee, to earn an appropriate return on its efficient investment and recover its efficient operating costs'. All entities that invest in infrastructure need such an opportunity, but they are often in markets that are far more competitive than the wholesale broadband market and do not have the protections already afforded to NBN Co (such as the limitations on the ability of network operators to compete via their own fixed or wireless broadband networks).

14. There has been no independent ACCC review of the efficiency or reasonableness of NBN Co's investments to date. The costs that sit in the RAB and ICRA are unfiltered by any such assessment and therefore may well have some element of inefficiency already baked into them. The ICRA is a clear case in point. In 2013, NBN Co assumed that the ICRA would have a zero balance by now. Instead, the balance is some $32 billion and continuously growing, fed by NBN Co's losses and the costs of financing those losses. This does not seem in any way efficient. In a competitive, commercial setting (such as that which RSPs operate in) it would be necessary to recognise that the ICRA is unlikely ever to be recovered and thus write it off.

Question 3: What suggestions do you have to preserve the breadth of retail products that are in market in the event that volumetric CVC charges were to be withdrawn or scaled back? Please consider how support for unique maximum speed products, diverse busy hour speeds, voice only and low data quota products could best be provided in such a wholesale pricing model.

15. Effective competition would be the best means of ensuring there is reasonable breath of retail products available to end-users. Variety is not dependent on CVC and will endure after CVC is withdrawn. CVC is not necessary to enable RSPs to differentiate, throttle or optimise theirs services, for example; RSPs can do so without CVC should they wish to do so. CVC does not encourage or allow service or product differentiation—indeed the experience to date proves the opposite as RSPs have tended to revert to re-selling NBN Co’s bundles. Other retail broadband markets in other countries seem to manage to have a breadth of retail products in the absence of a volumetric charge, and we expect Australia would be no different.
16. This question seems to be looking for reasons to retain CVC when the appropriate framing is what justification could there be today for retaining CVC charges. NBN Co’s revenues must be a function of its efficiently incurred costs and not indexed to matters – such as capacity – that are not drivers of those costs.

Question 4: Should we consider regulatory controls to safeguard against discounts again becoming the principal means by which NBN CO access products and pricing are implemented? What form could these take?

17. Discounts should not be the principal, default or permanent means by which NBN Co implements its products and pricing as has been the case to date. Discounts and inclusions have only been necessary to date because the SAU has been ineffectual and has failed to address RSPs’ concerns about NBN Co’s access pricing and other terms. If the present review process reforms NBN Co’s cost base and pricing constructs, and leads to an effective long-term revenue constraint, then there should be less need for, or value in, discounting. A reduced cost base combined with an effective revenue constraint and cost-based pricing would enable substantially lower wholesale prices and provide greater pricing certainty.
18. NBN Co’s discounting practices are also unduly complex and difficult to access. RSPs have to “self-assess” whether they are entitled to those discounts and actively request that they are applied; NBN Co does not automatically apply them. The needless complexity of those eligibility requirements and their specification can act as an additional barrier to developing a viable retail product construct around that discount and getting an offer to market within the period that the discount is available.
19. Givens NBN Co’s position as a de facto monopolist wholesaler, its pricing discretions must be restricted. All amendments to NBN Co’s price settings within and between regulatory periods should be implemented under regulatory supervision. This would still allow for some use of discounts, but under some form of regulatory supervision and with regulated protections for RSPs.

Question 5: Do you support a cheaper broadband product for low-income earners? What form should it take and how should it be funded?

20. In principle, yes, but subject to two caveats: (1) the word 'cheaper' is used here in the sense of a product that is objectively affordable for low-income end-users; and (2) the pursuit of a social policy objective in respect of a particular segment of society should not dictate the structure of wholesale broadband pricing for the economy as a whole.

21. There would seem to be four general implementation options for such a policy (in order of preference):

    (a) It could be left to the retail market. This obviously lacks the certainty of ex ante regulation, but the retail market has to date not been allowed to either fail or succeed in respect of this issue. In other competitive markets overseas, participants have made a virtue and built brand recognition based on community spirit and "looking after all customers". It would be reasonable for the Australian retail market to be given a similar chance to respond.

    (b) It could be addressed directly by government through budgetary mechanisms, like other social policies are.

    (c) It could be addressed directly through regulation of RSPs or a subset thereof (assuming an actual market failure is identified).

    (d) It could be addressed indirectly via wholesale pricing. However, such an approach would be much more problematic that any of the other alternatives because NBN Co supplies services to premises, not end-users. NBN Co therefore would not have the means to define and administer some potential aspects of a low-income schemes, such as means testing end-users or assessing the eligibility of end-users. Given that the end-users that occupy a particular premises may change over time, NBN Co would face a major challenge in preventing the low-income offer being taken up inappropriately and thus may be forced to consider highly restrictive conditions (such as limiting eligibility to premises without connections), which would undermine the original policy objective.

22. Commpete believes that NBN Co's commitment to some form of low-income offer is primarily driven by its desire to justify the preservation of CVCs in whole or in part. This scepticism can be tested when the CVC construct is withdrawn. We note that there is an entry level 30 Mbps basic wholesale fibre service in New Zealand that Chorus and the local fibre companies must offer and like all NBN-equivalent products elsewhere in the world, it is not subject to a volumetric CVC-equivalent charge.

23. As service quality also poses a barrier to the take-up of NBN services, NBN Co should putting forward regulatory controls that will ensure it is accountable for reducing its reliance on copper in its network and for investing in network upgrades to address those quality issues. NBN Co should also be completely transparent about the relationship between quality and price across all the different access technologies.

Question 6: Regulatory controls can conceivably take the form of direct controls over certain price related access terms, along with more flexible arrangements for other prices. For instance, some individual tariff items could be specified in a regulatory instrument while other tariff items could be included within a broad basket for which there is an overall regulatory control. In what circumstances (if any) should we consider providing greater flexibility for NBN CO access product and pricing commitments within a regulatory period? For which price related terms is certainty so important that we should not consider providing such flexibility?

24. It is not clear what flexibility NBN Co requires or why. NBN Co should need only the certainty of a price formula with a review mechanism that will give it a reasonable opportunity to recover its efficiently incurred costs (inclusive of a risk adjusted return on capital). It is RSPs—not NBN Co——that require flexibility to react innovatively to retail market dynamics.

25. Overall revenue constraints have not worked since 2013 because they do not have traction while the ICRA is positive. However, that is not reason to abandon overall revenue constraints for the future, but they must be augmented with direct controls on actual prices. Experience overseas suggests that overall revenue return constraints alone are inadequate and that more detailed service category controls are needed to ensure consistent adherence to cost-based pricing at all levels of the wholesale operation.

How often should the price related regulatory controls be reset?

26. If there is no CVC component, price controls should be reset every 3–5 years. However, if there continues to be a CVC component to pricing, then price controls should be reset annually to ensure that a usage-driven windfall does not occur.

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