ACCC Industry Roundtable on regulatory arrangements under NBN Co's Special Access Undertaking

Purpose

The ACCC is issuing this discussion paper to facilitate discussion at a roundtable that it is hosting on Friday 18 June 2021. The roundtable is to discuss options for the regulatory arrangements for the NBN that could be established under a special access undertaking (the SAU). The roundtable will mark the start of a collaborative process between the ACCC, NBN Co, industry participants, and other key stakeholders, to develop a revised long-term regulatory framework for the national broadband network. We expect that this process will form the basis of a future variation to the SAU to be proposed by NBN Co.

Under the *Competition and Consumer Act 2010,* the ACCC can accept SAUs submitted to it by NBN Co. The ACCC also has the ability to determine the terms and conditions of access to NBN wholesale services under a range of regulatory instruments. The Minister's recent Statement of Expectations to the ACCC in regard to telecommunications has sought that the ACCC develop a comprehensive regulatory solution on NBN Co's wholesale pricing that delivers certainty to all stakeholders.

The current SAU has been in place since 2013, when it was accepted by the ACCC as the key long-term regulatory framework for NBN Co's wholesale services. The SAU establishes a framework of price and revenue controls, among other things, but only covers a subset of NBN technologies: fibre-to-the-premise, fixed wireless and satellite. NBN Co intends for any variation it proposes for the SAU would extend it to cover all network technologies.

The purpose of this paper is to discuss some of the key issues raised by stakeholders, or arising from our experience in regulating the NBN, to date and to present alternative options for testing with roundtable participants. We intend for this paper to assist participants prepare for the roundtable and allow for more structured and productive discussions on the day. These discussions are to provide an opportunity for stakeholders to raise issues relevant to them. The ACCC hopes that there will be common ground and further understanding of competing perspectives that may remain.

This paper reflects our current understanding of the main issues of concern and does not intend to limit the scope of issues participants can raise at or ahead of the roundtable. We are approaching this process from a first-principles basis and are open to revisiting existing arrangements and prior decisions.

The industry roundtable contains multiple sessions, each focusing on specific stakeholders' perspectives or on specific parts of the SAU. The morning sessions will be presented by NBN Co and industry participants and will provide an opportunity for questions stemming from those presentations. This includes a discussion of NBN Co's SAU proposals as set out in its discussion paper. The afternoon will feature ACCC led workshop style sessions covering materials presented later in this paper. The ACCC workshops will also provide an opportunity for points raised in the morning sessions to be further explored within the context of regulatory controls that could be established with a revised SAU.

We have attached the agenda for the roundtable discussions and housekeeping rules. The roundtable will be conducted under Chatham House Rules. As such, participants are free to discuss any information at the roundtable, but both the identity and the affiliation of any speakers may not be disclosed to the public. These rules are designed to encourage stakeholders to put forward their views and provide for open discussion at the roundtable.

ACCC perspectives on SAU and current market context

The ACCC has been considering the wholesale access arrangements for the NBN for some time. Most recently, in November 2020, the ACCC finalised its NBN access pricing and wholesale service standards inquiries. The inquiries found that the package of pricing and service standard commitments to be implemented through WBA4 would address matters that had been examined in the inquiries and would promote the long term interests of end-users (LTIE). These commitments will apply for the two-year term of WBA4. With WBA4 now in place, we consider that it is an appropriate time to look at the longer term arrangements for NBN regulation.

The current regulatory framework for the NBN is set out in NBN Co's SAU, which has been in place since 2013. When we originally accepted the SAU, we recognised the potential for NBN Co's incentives to change significantly over the long term horizon of the SAU. We considered that it was necessary for the SAU to include revenue constraints, price controls and mechanisms for regulatory oversight to ensure the efficient use of the network, encourage certainty in retail markets and provide protections to consumers and businesses using the NBN.

When accepting the SAU, we considered that it would deliver a framework for the regulation of NBN Co's services which, among other things:

- ensures consumers and businesses would be able to receive services that are of equivalent quality and price to legacy services – and would pay more for higher quality and higher speed services,
- allows for vigorous retail competition,
- provides NBN Co with the opportunity to earn a reasonable return on its investment, subject to efficient investment and adequate demand for its services,
- provides incentives for NBN Co to operate and invest efficiently, but also to innovate and invest in improved services and capacity over time in response to market demand, and
- provide the ACCC with key oversight roles in relation to pricing and product withdrawal to provide protection for access seekers and end-users against NBN Co pricing or withdrawing products in a way that does not promote the LTIE over the longer term.

Since the SAU was originally accepted, there have been several developments that have resulted in most current NBN services operating outside of the SAU framework.

First, the design of the NBN network has changed. The current SAU only applies to fibre-to-the-premises, fixed wireless and satellite services and does not cover the additional technologies incorporated as part of the multi-technology mix model.

Further, there have been significant market developments, including changes to consumer behaviour and product availability that have resulted in an increased demand for data. NBN Co has responded to these developments by introducing several pricing initiatives through a discount mechanism. The discounted offers are set out in the ‘Discounts, Credits and Rebates List’ published by NBN Co, but they do not form part of the SAU. This means the price controls (which apply to the maximum regulated prices) and other protections around product withdrawal do not apply to the discounted offers.

The introduction of various discount and bundled offers also appears to have led to increasingly complex pricing and product constructs for NBN services, with the potential for access costs to vary considerably where the discount conditions are not satisfied. While the discount mechanism has allowed NBN Co the flexibility to respond to market developments, the current situation does not support the original intentions of the SAU which was to provide access seekers with reasonable certainty around pricing and reduce the risk of price shocks for consumers and businesses using the NBN.

The current SAU also includes a revenue constraint. The annual ‘building block’ revenue is determined through the long term revenue constraint methodology (LTRCM), which currently includes an annual assessment of actual expenditure incurred in the previous financial year. Under the current SAU, the approach to considering NBN Co’s expenditure is scheduled to change with the commencement of module 2 in 2023. Under this approach, expenditure would be assessed on an ex ante basis for regulatory periods of three to five years.

A feature of the revenue constraint provisions contained in the current SAU is the initial cost recovery account (ICRA). This account allows unrecovered costs in early years to be recorded in the account for recovery in later years. As a result, there are no direct links between NBN Co’s annual building block revenue and its prices. This means that while there is a positive ICRA balance, the revenue constraint in the SAU will not act to limit NBN Co in the amount of revenue it can recover in any given year. As a result, the revenue constraints in the current SAU only become binding once the ICRA balance is reduced to zero. The ICRA balance is currently around $32 billion and is continuing to grow. It is higher than the regulatory asset base (RAB), of around $27 billion. Under the current arrangements, we do not expect the ICRA balance to be extinguished within the SAU period.

Consequently, setting an opening value for the accumulated losses, and their relationship to price and revenue controls, will be important when considering a revised SAU. In particular, the lack of a binding revenue constraint as a result of the presence of large accumulated losses would put greater focus on price controls for delivering increased pricing certainty.

Nature and purpose of engagement over a revised special access undertaking

We are looking for the new regulatory arrangements to give a high level of assurance that they will continue over time to deliver outcomes that promote the LTIE. Promoting the LTIE in this context encompasses two key objectives:

- promote competition
- encourage the efficient use of and investment in infrastructure

Promoting competition encompasses whether the regulatory arrangements will help improve the price, quality and availability of the services to end-users and not inhibit the ability of competing providers to supply services.

Encouraging the efficient use of, and investment in, infrastructure tends to be achieved by access prices that recover the efficient costs of the supply of access services and allow for the opportunity to recover the costs of efficient new investments, including an appropriate return.

Some higher level considerations in contemplating the new regulatory arrangement are outlined below. We ask that stakeholders think about these as either stand-alone issues or in responding to or suggesting particular matters to be covered in a revised SAU.

Focus on regulatory arrangements: At the roundtable and throughout this upcoming engagement, we are principally seeking input on the regulatory arrangements that should be established within a revised SAU that would cover the NBN access networks (subject to scope considerations below). Consequently, this framing paper is directed at eliciting feedback on regulatory controls that should be considered for inclusion in that undertaking.

We acknowledge, however, that this exercise will inevitably raise issues concerning the price related terms that are being offered in the market. For instance, we expect that participants would wish to point to the effect of the current price related terms to illustrate particular improvements that they consider the revised regulatory measures should be capable of delivering. Further, we acknowledge that over the course of this engagement access seekers will wish to understand the price-related terms that are likely to emerge from the different forms of regulation that could be established, such as the level of prices on commencement of the regulatory period and their likely trajectory.

Scope: Should we be looking for the revised SAU to cover the NBN wholesale services in their entirety or should some services be excluded from its scope (for example because they are subject to competition)? If all services are included, should some services, such as those supplied in the mass market, be treated differently to any value added or specialist services that are directed towards market segments that are more conducive to effective competition emerging within the market (for example, should the residential market be treated differently to the enterprise market)? Inclusion of value added or specialist services might help to reduce the cost burden born by mass market services, but alternatively it may raise concerns about cross-subsidisation of competitive services by less competitive services.

Ongoing engagement: The roundtable commences engagement with stakeholders that will inform NBN Co's decisions on the form of the SAU to submit to the ACCC for formal consideration. We are also keen to receive ideas on the nature of this ongoing engagement and how this can be integrated with other consultation that is occurring, such as over the commercial offers that NBN Co will be looking to develop within the term of WBA4.

Issues for discussion at the roundtable: price controls

Our overarching objective for the price control measures is to promote the LTIE, which in turn calls for consideration of competition, and efficient investment in, and efficient use of, the NBN.

Broadly the ACCC considers that to meet this objective NBN Co's SAU should include a range of measures that provide incentives for NBN Co, and indirectly access seekers, to efficiently invest in the networks and systems used to supply NBN services. Further, we consider that it is important for the SAU to provide mechanisms that encourage the supply of NBN access products with certainty over cost and technical quality so as to promote downstream competition and efficient use of the NBN.

Accordingly, we are proposing for discussion, three design principles that would guide the development of these SAU measures:

- Access arrangements should support a range of retail service offerings that represent value to different categories of end-users.

- Access seekers should have reasonable certainty over access costs over time for a given level of quality.
- 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.

These design principles are discussed further below together with particular measures or features that the SAU could potentially include to implement each design principle. We are presenting this further detail to elicit informed discussion at the roundtable and feedback from stakeholders. Hence, none should be considered to represent firm positions that the ACCC currently holds and that we would be unreceptive to considering alternatives.

Principle 1: Access arrangements should support a range of retail service offerings that represent value to different categories of end-users.

This principle can promote the LTIE most directly by facilitating competition between access seekers that can better differentiate their products. This in turn can drive dynamic efficiencies in the supply of NBN services.

In addition, allowing product differentiation over busy hour speeds can lead to more efficient outcomes. By rewarding consumers that are willing to tolerate some performance reductions in the very busiest hours of the week, these arrangements can better militate against the potential for over-investment in the network to meet unexpected demand peaks.

Potential measures include:

(i) Commitments to offer a range of specified wholesale products, and to not effectively withdraw them from the market. One way a product offer can effectively be withdrawn is for its price to be increased relative to alternatives so that it no longer represents value to the purchaser.

(ii) Measures that allow access seekers to control various quality dimensions though selectable product features. The inclusion of access virtual circuit (AVC) speed tiers in formal product specifications is an example of a measure that has allowed the access seeker to control the maximum speeds that their various retail product offers can achieve. Similarly, optional product features have allowed access seekers to select the level of operational quality and traffic class priority that they can offer to individual customers.

Other aspects of technical quality have been controlled by access seekers via connectivity virtual circuit (CVC) and network to network interface (NNI) purchase decisions. This includes the busy hour speed and other performance characteristics that access seekers can provide to their customers. In particular, should CVC be removed as a product or pricing component then other measures may be required to allow access seekers to control busy hour performance, or to continue to support niche product offers such as the 30 Mbps or 75 Mbps AVC offers that have emerged in the retail market.

One way this could be achieved is to make additional product features such as busy hour speed selectable within the access product description, and potentially to introduce additional AVC 'speed bolt-ons' to allow further differentiation of off–peak speeds. Unlike the situation under volumetric CVC pricing, these product features could be offered for a fixed monthly fee.

(iii) Price control measures – these are measures that keep access prices oriented towards efficient and competitive levels. There are a range of alternatives here. The price controls can potentially set maximum prices for individual product offers or even individual tariff items such as AVC or CVC. Alternatively, controls can be established over average prices applying either to individual access products or to a basket of different access products or tariff components.

The measures need not be one size fits all – some access products or product items could be placed under tighter controls than others in order to achieve specific outcomes. For instance, the access products used to supply consumers with basic speed requirements could be the subject of more direct controls so that those consumers are protected from higher prices in return for unwanted product features. At the same time, more flexibility could be provided over very high speed and value added access products where efficient pricing levels are less certain and are more likely to change over time.

Choosing between these various options is important to providing certainty over the level of prices and access costs on the one hand and allowing some flexibility for prices to rebalance as demand shifts over time (such as within a regulatory period). The duration of the regulatory period, which dictates the frequency of resets of the price control measures, can also be important to the overall success of the arrangements.

(iv) Product and pricing measures that respond to entrenched market failure, such as the ongoing potential for overselling of fibre to the node speeds to occur, and the lack of a commercial pathway for improving fibre to the node speeds to meet customer demand. For example, the adoption of suitability priced AVC 'speed bolt-ons' could allow access seekers and their customers to more closely match access product speed and price to the attainable speed of the line. This in turn would provide a stronger incentive to fix poor fibre to the node connections where efficient to do so.

Principle 2: Access seekers should have reasonable certainty over access costs over time for a given level of quality.

This principle focuses on measures that mitigate access seeker uncertainty over its access cost. We have already heard that growth in the network capacity required to deliver a constant level of quality, e.g. busy hour speed, is a significant source of this uncertainty.

In this regard, access seekers consider that they, and through them end-users, have tended to bear the risk of significant cost increases as capacity requirements have grown while NBN Co has retained and periodically exercised the option to address this risk via just-in-time increases to its bundled CVC inclusions or other concessions made within its various discounting constructs.

Consequently, we wish to explore whether the revised regulatory measures could provide more certainty over access costs. Implicit in this view is that NBN Co is well placed to monitor overall network capacity and utilisation trends, and invest to meet aggregate demand at an efficient cost. Further, NBN Co could potentially share this risk by pricing in the cost of necessary investments into its revenue requirements that are to be recouped through future access prices. That said, as discussed in the next principle, other changes to the regulatory arrangements may be required so that they provide incentives for the efficient investment in network capacity.

Potential measures include the following:

(i) Flat (or flatter) price constructs whereby volumetric charges are removed (or significantly reduced to represent no more than a nominated proportion of total revenues). CVC and NNI are the two product elements that have volumetric charging. Possible options include:

Option A: Access is offered to AVC products without volumetric (CVC or NNI) charges, i.e., at a fixed monthly price. NBN Co has put forward an option for this in its discussion paper that involves an increase in AVC charges as an offset to the removal of the CVC volumetric charge.

Option B: Access is offered to product bundles where CVC inclusions increase, and/or CVC overage charges reduce on a regular cycle. NBN Co's proposal for this in its discussion paper provides for a reduction in the CVC overage charge, a boost to bundle CVC inclusions and some increases in AVC charges.

Option C: Some access products are offered under Option A and others under Option B. We note that NBN Co has proposed an option whereby 100 Mbps AVC and above are offered without volumetric CVC pricing (along with a rise in the AVC charge and an extra bundle CVC inclusion for the currently popular 50 Mbps speed tier).

Importantly, we consider that in order for Options B or C to be effective in meeting the design principle for giving certainty, the rate of increase to the CVC allowances and/or reduction in the volumetric unit charges that remained in place would need to keep pace with forecast demand. Otherwise CVC overage volumes and revenues, and hence RSP access costs, would continue to grow on a per AVC basis.

(ii) The specification of a minimum technical quality of service including for attributes that are no longer able to be controlled by the access seeker via volumetric product or pricing elements such as CVC and NNI. That is, access products could have a specified maximum tolerance for speed reductions during busy hours and/or for higher latency or packet loss during times of heavy network utilisation. As discussed above, access seekers could also be offered the choice of quality over these product elements for an additional fixed monthly fee to preserve downstream product differentiation. Measures that specify when NBN Co would augment network capacity as utilisation triggers are met could also be considered, similar to those that are presently specified only in operations manuals.

(iii) Measures that ensure that cost certainty is not displaced by widespread discounting practices that do not come with suitable protections regarding removal or replacement. At its simplest, these measures could require NBN Co to cease its practice of offering a bundle of AVC and CVC inclusions under a discount strategy and instead offer these access products via product offers. Additional measures could take a variety of forms, ranging from more direct regulatory oversight via a notification regime, to standing rules that deal with how discounts can be withdrawn, e.g. the withdrawal of discounts could be staggered over a specified period. Rules could also be considered around how the revenues foregone by discounting are treated when assessing compliance with the relevant price or revenue controls, which could indirectly place limits over the extent of discounting that is used. An important consideration would be whether such additional measures are required for all market segments or whether they could be restricted to mass market product offers.

Principle 3: 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.

This principle for pricing principally interacts with the revenue requirement that is allowed via a building block model, as well as the demand forecasts that are adopted for the various access products from which the revenue allowance could potentially be recovered. Hence this principle is discussed more fully under the revenue controls section of this framing paper.

That said, a mismatch between current price levels and those required to generate an appropriate revenue on the forecast demand profile will have implications for setting the price control measures. An important consideration in this circumstance is whether to permit a disconnect between existing prices and those established on commencement of the new arrangements, or to put in place transitional arrangements such as a glide path to avoid such a price shock. This could take the form of a CPI +/– X adjustment to the prices caps established on commencement.

Similarly, even if there is no initial mismatch in current and required prices initially, a suitable price path would need to apply over the duration of a regulatory period due to ordinary fluctuations in costs and revenues. In this regard, NBN Co may face increasing costs over time to meet increasing labour or other input costs, or as financing costs fluctuate. This will become increasingly relevant in circumstances where the potential for revenue growth via volumetric charges or adding more services to the network is significantly reduced.

Other pricing matters for consideration

We are aware that there are a range of other price-related matters that could be relevant to the nature and the form that the price control measures should take. The additional matters we are currently aware of include:

(i) Whether to develop a voice-only product and pricing. We have been reluctant to date to require this via regulation on the basis that this product could often be more efficiently delivered using existing wireless products.

(ii) What form a low income broadband product could take and how this should be funded.

We would welcome views from stakeholders on these matters.

Questions

To inform the discussion around options for the price control framework, we are interested in stakeholder views on the following questions on the price control framework:

1. **We have outlined three high level principles to use in assessing whether particular NBN access product and pricing arrangements would promote the long term interests of end-users. What additions, deletions or refinements would you recommend?**
2. **What ideas do you have so that NBN Co and access seekers can have reasonable certainty over their wholesale average revenues per user and access costs respectively?**
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.**
4. **Should we consider regulatory controls to safeguard against discounts again becoming the principal means by which NBN access products and pricing are implemented? What form could these take?**
5. **Do you support a cheaper broadband product for low income earners? What form should it take and how should it be funded?**

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 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?**
7. **How often should the price related regulatory controls be reset?**

Issues for discussion at the roundtable: revenue controls

The SAU provides for revenue controls under the long term revenue constraint mechanism. In particular, all of NBN Co's prudently incurred expenditure and revenues are recorded each year and any losses incurred initially are capitalised and accumulated in the ICRA.

Under the current SAU, it is intended that NBN Co will be subject to a standard revenue cap once the ICRA balance has been reduced to zero. Under the revenue cap, NBN Co's allowable revenue is set by direct reference to the building block revenue period, and any under recovery or over recovery must be accounted for in the subsequent regulatory period. The ICRA balance is around $32 billion as at 2019-20. Because the ICRA balance attracts a rate of return, it may continue to grow for a long period even after NBN Co annual revenue is sufficient to cover its BBM costs. It is unclear if or when the ICRA balance will likely be fully extinguished during the term of the SAU.

As a consequence, as long as the ICRA balance is positive there will not be any direct constraint under the SAU on the amount of revenue NBN Co can generate in a single year. Further, the recovery of ICRA (in addition to the recovery of the building block model revenue) could also potentially result in inefficiently high prices. In that case, price controls will be the only other remaining option for regulatory oversight on the price level of NBN Co's wholesale services. We would also be concerned if a revised SAU would enable NBN Co to prioritise revenue targets at the expense of other policy objectives, such as providing affordable high speed broadband to all Australians and maximising benefits of the NBN.

We therefore consider that it would be useful to have in place a meaningful revenue constraint under a sustainable long-term regulatory framework for the NBN. Our current thinking is guided by the following high level objectives, which we consider will support the LTIE:

- NBN Co should be able to recover efficiently incurred costs
- NBN Co should face incentives for making efficient investments and have the ability to generate sufficient cash flows to support its ongoing operations and fund new investments

We discuss these high-level objectives in more details below and seek stakeholder's views on those as well as any other objectives that should be considered when reforming the arrangements in the current SAU.

NBN Co should be able to recover efficiently incurred costs

We consider that NBN Co should be provided with opportunities to recover its efficiently incurred costs, including an appropriate rate of return on its capital. This approach is consistent with our overarching legislative objective of promoting the LTIE. It is also consistent with the ACCC's standard approach for regulating monopoly infrastructure.

We note that NBN Co's current capital structure consists of both equity injections by the commonwealth government ($29.5 billion[1]) and debt financing from both the government (to be fully paid back by June 2024) and Australian and overseas private capital markets. NBN Co is expected to raise a total of $27.5 billion external debt by June 2024 plus additional working capital facilities.[2] Given the likely ongoing need for NBN Co to refinance its debt or raise capital to fund future investment, it is important that NBN Co should have the ability to service an efficient level of external debt on an ongoing basis.

NBN Co may also seek a certain level of return on the equity investment made by the government. Currently the SAU provides for a commercial rate of return (or WACC) to be accrued on both NBN Co's capital expenditure and capitalised losses. To date, the rate of return is determined as the risk free rate plus 350 basis points (4.9 per cent in 2019-20[3]). The current SAU provides a mechanism for this rate of return to be determined by the ACCC in future.

NBN Co's 2021-24 corporate plan estimates the internal rate of return for NBN Co as 3.7 per cent,[4] which is significantly below the rate of return values adopted in the SAU so far. This suggests that NBN Co, based on its own forecast, is likely to generate lower return on its equity than that would be indicated by the rate of return adopted in the SAU.

To inform our thinking on the implication of the objective of ensuring NBN Co has the opportunity to recover its efficient investment, it would be useful to undertake an assessment of NBN Co's future cash flow.

NBN Co should face incentives for making efficient investments and have the ability to generate sufficient cash flows to support its ongoing operations and fund new investments

We consider that there should be incentives for NBN Co to undertake new efficient investments. NBN Co should be encouraged to progressively upgrade the network in an efficient way to cater for increased traffic volumes and growing demand for higher speeds. To that end, NBN Co should be provided with an opportunity to recover those investments as long as they are incurred efficiently.

Under the current SAU, any losses from investments by NBN Co, subject to meeting the relevant requirements in the SAU, will be accumulated in the ICRA regardless of timing and their relative level of efficiency. Given the current level of the ICRA balance, NBN Co may be dis-incentivised to make new investments as it may be less risky for NBN Co to seek to recover what is already in the ICRA first, even if new investments may make good commercial sense on a stand-alone basis and would promote the LTIE.

It may be appropriate to incorporate into the SAU rules about how new investment should be assessed with priorities of cost recovery given to those investments that make the most commercial sense. This may also require changes to rules around how losses are capitalised into the ICRA.

Ensuring NBN Co has efficient incentives to invest will also require that NBN Co can generate sufficient cash flow to support its ongoing operation and fund new investment. NBN Co was projecting to become cash flow positive by 2022-23,[5] which will be an important

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[1] NBN Co annual report 2020, p. 56.

[2] NBN Co corporate plan 2021-24, p. 52.

[3] This is based on NBN Co submission to the ACCC under the SAU long-term revenue constraint methodology for 2019-20.

[4] NBN Co corporate plan 2021-24, p.54

[5] NBN Co corporate plan 2020-23, p 47.

milestone. Any reform to the current arrangement needs to take into account the objective of ensuring an efficient level of cash flow.

Establishing a binding revenue constraint and treatment of accumulated losses

As discussed above, it is unclear whether NBN Co will be able to reduce its current ICRA balance to zero during the term of the SAU. This creates a risk of RSPs facing potential price shocks because as long as the ICRA is positive, NBN Co has the ability, if it wishes, to lift its prices to the level of its maximum prices permitted under the current SAU. Such risks can potentially be fully mitigated by an effective price control regime.

Given this, in the absence of changes to the current arrangement which can put in place an effective revenue constraint, it would be essential to have binding price controls on NBN Co to ensure RSPs will not face any undue price shocks.

However if the current arrangement can be reformed with an aim of providing a binding revenue control for NBN Co, similar to how a typical BBM would work, then price controls could take a complementary rather than primary role in price setting. This would likely provide NBN Co with more flexibility on its pricing.

In order to progress our thinking on revenue control issues, it may be useful to begin to consider some broad parameters around timing and level of recovery of the ICRA balance. This could potentially lead to a clear plan being devised about when NBN Co can realistically begin to reduce its ICRA, what an efficient ICRA amount should look like, and how long a period NBN Co should be given to aim to extinguish its ICRA. This would provide much needed certainty for both NBN Co and RSPs.

On the question of an efficient amount of ICRA, there may be a number of factors that we need to consider. The current ICRA balance reflects losses associated with all of NBN Co's expenditure undertaken so far. While these costs have been accepted under the LTRCM process, the assessment approach is primarily based on a prudency test, rather than an efficiency test, which could entail a more rigorous assessment. In addition, the original arrangement was put in place with a view of a fibre to the premise rather than a multi-technology mix rollout. The switch to the multi-technology mix rollout may have implications for the design of the appropriate prudency/efficiency test.

In addition, some of NBN Co's activities and services are a direct result of government policies or pre-existing contractual arrangements and may not reflect competitive outcomes or the behaviour of an efficient commercial operator. For example, NBN Co pays subscriber payments to Telstra and Optus under its agreements with those parties for migration of their customers onto NBN Co's network. These subscriber payments totalled around $9 billion as at 2019-20 on a cumulative basis[6] and have contributed significantly to the ICRA balance. These payments while accepted under the LTRCM as part of NBN Co's opex, may not represent part of the efficient cost base for building the NBN.

Furthermore, some of NBN Co's activities relate to market segments where NBN Co may face competition, e.g. enterprises services. There is a question of whether these services should be captured in the same pool in the BBM and reflected in the ICRA as NBN Co's other services that have a natural monopoly characteristics.

We recognise the issues relating to NBN Co's ICRA are very complex and unique and require careful consideration. We are interested in stakeholders' views about these issues and their implications for devising an appropriate revenue control arrangement.

[6] This is calculated based on data in NBN Co's annual reports.

Arrangements for new investments and expenditures

Under the current SAU, the way expenditure is considered and treated in the LTRCM is due to change from 2023. Under this change NBN Co would provide operating and capital expenditure forecasts to the ACCC as part of a periodic review process. The ACCC would assess these forecasts and the approved forecasts would be used to determine revenue requirements for a 3 to 5 year regulatory period (i.e., an ex ante approach to regulation). This compares to the current approach where the ACCC undertakes this assessment annually on an ex-post basis.

Further, the detailed prudency rules currently in operation would cease to apply. This means there would be greater flexibility in how the ACCC assesses expenditure, which would allow the ACCC to take into account a wider range of factors.

We consider that the above elements could be incorporated into the revised SAU for assessing expenditures, as they reflect arrangements from other established network industries such as energy networks where expenditure is assessed on an ex-ante basis for each regulatory period. We consider this type of assessment approach could be sufficient in terms of giving the ACCC the ability to take into account factors it considers most important at the time.

We also note that there has been concern raised about lack of transparency currently afforded by the SAU reporting arrangements including the LTRCM, particularly as NBN Co continues to expand into areas where it may face competition (e.g. enterprise services). We would be interested to understand what reporting/transparency arrangements should be put in place to support a revised SAU.

Questions

To inform the discussion around options for the revenue control framework, we are interested in stakeholder views on the following questions on revenue control:

1. **Do you have any views on the ACCC's objectives for the SAU revenue control mechanism? Are there any other objectives that should be considered?**
2. **What do you think would be an appropriate approach for incorporating ICRA in a BBM for the SAU?**
3. **What would be an appropriate approach to ensure NBN Co has appropriate incentives to upgrade its network in a timely and efficient manner?**
4. **Could elements of the arrangements that are currently intended to apply from 2023 under the current SAU provide a good blueprint for considering arrangements for new investment and expenditure proposals in a revised SAU?**
5. **What reporting or transparency requirements should be established to support arrangements under a revised SAU?**