



Optus Submission to the ACCC
Supplementary Consultation

NBN Co's Special Access Undertaking

(Public Version)

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Section 1. Executive Summary

- 1.1 The SAU is a significant instrument. If accepted, it will supplant many of the ACCC's existing regulatory powers and will determine the rules of engagement with NBN Co for access to the NBN over the next decade. In particular it will establish; obligations on NBN Co; the rights of access seekers; and the scope and limits to the ACCC's oversight role for access to NBN services.
- 1.2 In striking the balance between the potentially competing interests of NBN Co and access seekers it is important that the SAU puts the interests of end customers first. These interests will be best served if the SAU facilitates the delivery of services that meet end-customer expectations in terms of service capability and quality, which are affordable and which ensure the NBN is viable.
- 1.3 Optus will argue in this submission that the regulatory arrangements set out in NBN Co's proposed SAU, and its related Wholesale Broadband Agreement (WBA) do not put the interests of end-customers first.
- 1.4 Optus has concerns with each component of the proposed SAU. However, a common theme is the lack of appropriate ACCC oversight. Such oversight is either absent or so constrained that it is likely to be ineffective in practice. These concerns extend to;
 - (a) The arrangements for setting prices;
 - (b) The arrangements for ensuring only NBN Co's efficiently incurred costs are recovered in access prices; and
 - (c) The processes for agreeing the non-price terms and conditions of supply.
- 1.5 However, this problem is best demonstrated by the interaction of NBN Co's WBA and other regulatory instruments, including the SAU and ACCC Access Determinations.
- 1.6 In effect NBN Co has given ultimate primacy to commercial negotiations over all other regulatory instruments. Whilst the SAU sets out various commitments these are vague with the substance matter subordinated to the WBA.
- 1.7 Why is this important? It is important because;
 - (a) The WBA is outside the scope of the ACCC's oversight powers; and
 - (b) Within the WBA, NBN Co retains wide discretion to determine all of the key terms of access.
- 1.8 Conceptually NBN Co is seeking to restore the primacy of commercial agreements as the mechanism to set access terms to the NBN.
- 1.9 This is perplexing since little over twelve months ago major policy reforms to the telecommunications access regime finally called time on the negotiate/arbitrate model that had proven so ineffective in an environment with a monopoly provider.

In fact NBN Co's model is worse still because it promotes negotiation without the fall-back of arbitration. This is akin to restoring a twentieth century model of regulation for a twenty first century network.

- 1.10 Whilst it is true that NBN Co will be a structurally separated wholesale-only entity and it will have no incentives to discriminate against its customers, it will be a monopoly provider with unprecedented market power. It should not be assumed that the interests of NBN Co will always align with those of Retail Service Providers and consumers on key matters such as pricing, risk sharing and responsiveness to customer demands. Regulatory oversight is essential to ensure that interests of consumers prevail in setting appropriate terms of access to the NBN. The industry anticipated that NBN Co would be subject to such oversight.
- 1.11 Optus has reservations as to whether an SAU is the best way to regulate access to the NBN, given that NBN Co is being established to operate as a monopoly provider of services and that the NBN is being built to deliver significant social and economic benefits for Australia. As a voluntary document, the SAU necessarily gives the Access Provider a significant advantage in determining the rules of engagement. Whilst the ACCC ultimately has to agree to those rules, there is a clear risk that negotiation of any changes to those rules will take place within boundaries that are set by NBN Co, so from the outset the negotiations will be tilted in its favour.
- 1.12 Optus submits that a threshold test for the SAU is whether NBN Co is prepared to agree to changes that will restore a central oversight role for the ACCC. This oversight should extend to each aspect of the processes for setting and modifying the terms and conditions of access to NBN services, including giving the ACCC final authority over NBN Co's WBA.
- 1.13 This should not be a controversial recommendation, since ACCC oversight of the terms of access to the NBN can only benefit end-consumers. Further, this issue is even more critical given the commitment to ultimately privatising NBN Co. It will be much harder to strengthen the regulatory oversight framework in the lead-up to a privatisation process, when there will be pressure to maximise the sale price. It is not in the public interest to create an overly powerful and inadequately regulated monopoly; providing for rigorous ACCC oversight of NBN Co's behaviour is essential to ensuring that this does not occur.
- 1.14 If NBN Co is unwilling to voluntarily make the changes required to its SAU to lock-in ACCC oversight, then Optus submits that the ACCC should consider an alternate direct means to regulate access to the NBN. However, if such an agreement is forthcoming then there is some prospect that an SAU that meets the long term interests of end-users might be developed. The further issues that will need to be addressed in developing such an SAU are summarised below.

Arrangements for setting access prices

- 1.15 The pricing arrangements put forward in the SAU are out of step with standard practice for the regulation of monopoly providers since they give NBN Co wide discretion to set and change its prices over time with little or no ACCC scrutiny.

- 1.16 Only a limited number of prices are set out in the SAU with prices for the majority of services (including an unlimited number of ancillary charges) at NBN Co's discretion under the WBA. In a clear break from regulatory precedence NBN Co has provided no cost material to support its prices.
- 1.17 Whilst NBN Co has proposed a number of mechanisms to constrain or cap increase in prices these are likely to be ineffective. They will not, for example, prevent significant above CPI increases in the average cost to access the NBN over time (assumptions that are built into its Corporate Plan). These prices control mechanisms certainly provide no effective substitute for rigorous ACCC oversight.
- 1.18 Optus recommends significant changes to the proposed pricing arrangements;
- (a) Prices for all NBN services (including ancillary services) should be approved upfront by the ACCC following detailed scrutiny of all the forecast cost inputs;
 - (b) Prices should be locked-in based on NBN Co's long-term forecast of its efficient costs and revenues; and
 - (c) Prices should only be allowed to change following ACCC scrutiny and in line with justifiable and material changes to its business case.
- 1.19 These arrangements would apply an appropriate discipline on NBN Co to ensure its costs are reasonable, appropriate and proportionate and thereby help to deliver on the Government's objectives for affordable broadband prices.

Arrangements to ensure costs are prudent

- 1.20 Under the SAU NBN Co proposes to be allowed to recover all of its prudently incurred costs under a long-term revenue constraint. However, the arrangements to determine the prudence and efficiency of its incurred costs are deficient and out of step with regulatory practice both in Australia and overseas.
- 1.21 Capital and operating expenditure running into tens of billions of dollars are simply deemed to be "prudent" with no further scrutiny. In respect of the majority of other expenditure, it will be considered prudent if it is in line with rules that are set by NBN Co and policed by NBN Co.
- 1.22 These arrangements provide neither an incentive for NBN Co to incur expenditure in a prudent manner nor do they provide scope for inefficient expenditure to be excluded from access charges. There is a clear risk that the SAU arrangements will enable NBN Co to operate on an inefficient cost-plus basis, and these costs will be passed on to end users, to the ultimate detriment of the Australian economy as a whole. It is therefore critical that ACCC oversight of NBN is at least as rigorous as equivalent regulatory oversight of other forms of monopoly publicly-owned infrastructure
- 1.23 Consistent with arrangements in other utility industries, NBN Co's expenditure should be subject to detailed scrutiny arrangements that have the effect of

replicating the discipline that NBN Co would face if it were subject to competition. This could best be achieved by an ex ante approach to regulation where prices are capped based on approved forecasts of efficient cost and NBN Co has to manage its costs to ensure that those prices deliver an appropriate return.

Non-price terms of access

- 1.24 The SAU provides little by way of non-price terms and conditions of access. To the extent that any commitments are set out in the SAU they are very high level, with the detailed application of those commitments subordinated to the WBA.
- 1.25 Whilst the recommendations made above will address the lack of ACCC oversight, Optus considers that the SAU should set out more comprehensive commitments on non-price terms and conditions of supply. This should include clear and detailed commitments on issues such as:
- (a) Service Levels and planned outages;
 - (b) POI reviews and relocations;
 - (c) Ancillary services including;
 - (i) Facilities access;
 - (ii) NBN Co's platform;
 - (iii) Products that are ancillary to the supply of Product Components and associated Product Features;
 - (d) Product commitments and arrangements to change, introduce and withdraw products;
 - (e) Oversight to changes to the Access Agreement;
 - (f) Confidentiality arrangements;
 - (g) Arrangements for managing risk;
 - (h) Intellectual Property Rights; and
 - (i) Privacy arrangements.

Section 2. The need for tight regulation of the NBN

- 2.1 The SAU is a unique instrument in the history of telecommunications regulation within Australia. Whilst ordinary access undertakings have been an aspect of the regulatory landscape, these have tended to be limited in scope to setting prices or terms of access for a single service over a limited timeframe. In contrast the SAU is broader in scope since it effectively seeks to determine the regulatory framework for access to a potentially broad range of NBN services over a 30 year period. In doing so it seeks to define both the scope and limits to the ACCC's powers to regulate the NBN.
- 2.2 Whilst Optus acknowledges that the legislation has encouraged NBN Co to develop such an undertaking, this approach is optional and in the absence of an SAU the ACCC has extensive powers under the CCA to regulate access to the NBN in the long term interests of end users. In this respect the SAU raises some critical threshold questions about the nature of the regulation of the NBN and the appropriate level of independent oversight of the NBN.
- 2.3 Whilst NBN Co will be a structurally separated wholesale-only entity, it is important not to lose sight of the fact that it will also be a monopoly provider with unprecedented market power. It should not be assumed that the interests of NBN Co will always align with those of Retail Service Providers and Consumers. The regulation of the NBN is therefore of utmost importance. It will have long term ramifications that will impact the industry structure, levels of investment, affordability and take-up of services, consumer welfare and, ultimately, the success or failure of the NBN policy.
- 2.4 The recent reforms to the regulatory framework that were designed to address Telstra's market power demonstrate that structural separation has to go hand in hand with strong ACCC oversight. This is why the reforms to the Competition and Consumer Act (CCA) sought to enhance the powers of the ACCC whilst also introducing measures to achieve the structural separation of Telstra.
- 2.5 To ensure that the NBN is effectively regulated Optus considers that the ACCC will similarly need to have available to it all of its current powers under the CCA, which will give it the flexibility to respond to unforeseen circumstances given the dynamic nature of the industry.
- 2.6 The SAU should have a critical part to play in the effective regulation of the NBN. It provides opportunity to achieve more effective practical regulatory oversight by;
- (a) Setting out upfront comprehensive approved terms of access to the NBN;
 - (b) Ensuring the ACCC's general powers in the CCA are given more practical effect by conferring specific ACCC oversight to access terms;
 - (c) Streamlining the application of the regulation by setting out clear commitments on NBN Co and access seekers and identifying key in processes to be followed;
 - (d) Conferring additional powers on the ACCC that are not specifically set out in the legislation; and
 - (e) Providing greater certainty for NBN Co and access seekers.
- 2.7 The SAU fails to deliver on this opportunity. Rather than enhancing the process of regulation it seeks to exclude and limit the ACCC from the process of setting access terms. In broad

terms, the arrangements, outlined in the SAU, amount to a model of self-regulation whereby NBN Co largely retains discretion to determine the rules of engagement with access seekers and then self-polices compliance with those rules. It is an inadequate model of regulation for an entity that will have such an unprecedented level of market dominance. In reaching this conclusion Optus has had regard to the;

- (a) The interaction between the WBA, the SAU and other regulatory instruments (such as Access Determination and Binding Rules of Conduct) which clearly indicates that the WBA, which is not subject to ACCC oversight, will have primacy in setting terms of access to the NBN. This effectively means that many aspects of the NBN access arrangements will be left to be determined commercially with little or no regulatory recourse;
- (b) That the SAU confers on the ACCC a very limited role in setting access terms;
- (c) The Prudency arrangements which provide little if any role for the ACCC to scrutinise the reasonableness of NBN Co's expenditure so long as that expenditure falls within broad parameters set by NBN Co; and
- (d) Whilst the SAU sets out certain commitments in respect of non-price terms, the detail of these are a matter for the WBA and are therefore set at NBN Co's discretion.

2.8 The remainder of this section focuses on the interaction between instruments regulating NBN Co's access terms and in particular the "gap" in the regulatory oversight between the Part XIC framework and the degree of oversight permissible under the WBA and SAU. Optus has also provided some examples of how those instruments would apply, based upon the WBA and SAU published by NBN Co, at Appendix A.

2.9 Optus' concerns about the specific oversight arrangements relating to price, the prudency of NBN Co's expenditure and the non-price terms in the SAU are set out in the following sections of this submission.

Key features of Part XIC instruments

2.10 There are four key instruments available to set terms and conditions of access to the NBN under Part XIC. These are;

- (a) an access agreement created by NBN Co, such as the WBA;
- (b) a special access undertaking given by NBN Co, but accepted by the ACCC (SAU);
- (c) binding rules of conduct made by the ACCC (BROC); and
- (d) an access determination made by the ACCC (AD).

2.11 The role of each of these and their interaction between each other is examined briefly below.

Access agreement

2.12 An access agreement is a written legally enforceable agreement between NBN Co and an access seeker for a declared service that satisfies the subject-matter test in Part XIC s.

152BE(1)(e). The list in (e) contemplates that matters the access agreement may deal with include:

- (a) dealing with some or all terms of supply for the declared services;
- (b) terms for NBN Co's compliance with its standard access obligations; and
- (c) terms and conditions for compliance with any requirements imposed by an AD.

2.13 Part XIC allows NBN Co substantial freedom in setting access agreement terms. The only substantive regulatory constraints in formulating access agreement terms are that NBN Co must:

- (a) comply with the Category B standard access obligations (SAO) (Part XIC s. 152AXB); and
- (b) supply services on a non-discriminatory basis (Part XIC s. 152AXC).

2.14 If an access agreement is in operation and specifies terms on a matter relating to the SAO, then NBN Co and the access seeker who is a party to the access agreement must comply with those terms.

2.15 Importantly, there is no obligation that the terms of the access agreement must be reasonable nor are there any checks and balances on the power of NBN Co as a monopoly supplier to set terms that may have adverse consequences to access seekers or an adverse impact on services or competition in downstream markets.

ACCC's role in determining access agreements

2.16 The terms of the access agreement are not subject to ACCC approval. However, Part XIC gives the ACCC the potential to have a limited role in access agreement negotiations relating to the SAO in two ways:

- (a) Section 152BBA(2) enables the ACCC to give a procedural direction to NBN Co and/or an access seeker negotiating matters dealt with in s. 152AY(2)(a). The ACCC's power to give a direction is triggered by a request from either party. The directions power is limited to procedural matters about how the parties conduct themselves during negotiations. The directions power does not extend to directions on the content of access terms.
- (b) Section 152BBC(2) provides that, where NBN Co and an access seeker are negotiating matters dealt with in s. 152AY(2)(a), NBN Co and the access seeker may jointly request the ACCC to attend or mediate those negotiations. Involvement of the ACCC is dependent upon:
 - (i) both NBN Co and the access seeker agreeing to request ACCC involvement; and
 - (ii) the ACCC agreeing to the request.

However, again the ACCC's involvement is limited to conduct of negotiations rather than the content of the matters to be negotiated.

- 2.17 It is also important to note that once an agreement is signed there is no regulatory oversight of agreements unless this is specifically provided for in such an agreement (which in the case of NBN Co's WBA it is not). This means that once an agreement is in place regarding how the NBN Co will meet its SOAs, the ACCC's power to make directions and/or to mediate negotiations relating to the agreement is not available.

Access agreement prevails over all other instruments

- 2.18 Part XIC provides that, to the extent that terms in an access agreement applicable to NBN Co and an access seeker are inconsistent with the terms of any other Part XIC instrument listed above that also applies to those parties; then the other instrument is of no effect. This means that, the regime set out in Part XIC places NBN Co in a significantly superior position to access seekers when negotiating an access agreement. For NBN Co, a comprehensive long term access agreement which reserves discretions to NBN Co can substantially limit regulatory oversight. There is no mechanism in Part XIC to prevent NBN Co from requiring access seekers to enter access agreement on terms favourable to NBN Co.
- 2.19 This is not a hypothetical issue. A number of access seekers, including Optus, have expressed concerns at having to sign an interim WBA notwithstanding the fact that a number of provisions of that agreement remain unsatisfactory. This ability for NBN Co to force its hand in respect of access agreements will increase as access seekers dependency on access to the NBN services increases.

Special Access Undertaking

- 2.20 Part XIC allows NBN Co to create an SAU that:
- (a) forms a comprehensive set of terms of supply; or
 - (b) only deals with certain issues.
- 2.21 NBN Co has chosen the latter approach with significant implications for the level and rigour of the regulatory oversight arrangements.
- 2.22 An SAU prevails over an inconsistent BROCC and over an inconsistent AD. However, an SAU has "no effect" to extent that it is inconsistent with an access agreement. This order of hierarchy means that an accepted SAU is not relevant to pre-existing access agreements but any access agreement entered into after an SAU is accepted must be consistent with the terms of the SAU.
- 2.23 Under Part XIC, the ACCC must not accept an SAU unless the ACCC is satisfied that the criteria set in Part XIC has been met (see s. 152CBDA). The fact that an SAU prevails over an inconsistent BROCC or AD necessitates that the ACCC should only accept an SAU only where the terms cannot or are very unlikely to have any adverse impact on access seekers in any circumstances. This creates a high threshold test since it is difficult to predict how changing technologies or changes in market structure might affect the practical application of the terms of an SAU.

Binding rules of conduct and ADs

- 2.24 BROCC and ADs can be used by the ACCC to set the access terms that the ACCC considers appropriate. However, significant constraints to this are:

- (a) Part XIC limits what BROC and ADs may address; and
- (b) these instruments can be overridden by an SAU or access agreement and will be of no effect to the extent of any inconsistency.

2.25 Part XIC also details procedures to be followed by the ACCC and consultation required before the ACCC may make one of these instruments.

Interaction between Part XIC regime and NBN Co proposed WBA and SAU

2.26 Given the hierarchy established for various instruments noted above and the rights each of these confers on the ACCC in respect of NBN Co's proposed access terms a critical factor the ACCC must have regard to in assessing the appropriateness of the SAU is the interaction between Part XIC regime and NBN Co proposed WBA and SAU

2.27 NBN Co proposed a 30 year term for the SAU. NBN Co has also issued an interim WBA that expires on 30 November 2012. However, NBN Co's stated intention is to put in place a WBA that has a term running alongside the SAU.

2.28 Based upon the interim WBA and past communications from NBN Co, it is clear that the approach taken by NBN Co in setting the WBA and SAU reflects that:

- (a) the WBA will form an almost complete set of terms for regulating access to NBN Co services;
- (b) the SAU will have a limited role dealing with select, higher level issues, but its subject-matter overlaps with subject-matter in the WBA. Where the overlap means the WBA and SAU terms are inconsistent, Part XIC provides that the SAU terms are of no effect to the extent of the inconsistency;
- (c) NBN Co will undertake a process to offer to "align" the WBA with the SAU. However it is unclear how this will practically operate and NBN Co retains control of the alignment process; and
- (d) ACCC ADs and BROCs appear to have a very limited role in the regime.

Significant Regulatory Oversight Gap

2.29 In summary, it is clear that the approach taken by NBN Co in setting the terms of the WBA and SAU means that all important elements of access to the NBN will be determined through commercial relationships in the form of the WBA. However, as indicated above this will put NBN Co in a very powerful position to override access seeker requirements. It is difficult to see how circumstances might arise between NBN Co and an access seeker that may be subject to ACCC oversight through recourse to a BROC or AD under NBN Co's arrangements. The issue would have to:

- (a) arise between NBN Co an access seeker who has not signed an access agreement;
- (b) relate to conduct entirely outside the terms of an access Agreement; or
- (c) arise in the very limited circumstance where the access agreement says NBN Co will apply a BROC or an AD.

- 2.30 In this way NBN Co has effectively removed the ability of the ACCC to have regulatory oversight to influence the terms of access to the NBN (absent an issue dealing with the SAO or non-discrimination). While Part XIC gives the ACCC the ability to set parameters for NBN Co's terms of supply, as explained above, to the extent those parameters are inconsistent with the WBA, they will be of no effect.
- 2.31 This leaves the terms of access to the NBN as essentially a private, contract law matter. This is a significant concern for access seekers and is fundamentally at odds with the hard fought policy reforms that were introduced in 2010 to deal with the problems associated with the dominance of fixed line market by a single player. In essence, NBN Co is seeking to sweep away those reforms and restore the "negotiation" part of the "negotiate/arbitrate" model, without the limited checks and balances of arbitration. It is akin to a pre-1997 set of regulatory arrangements for a 21st century network.
- 2.32 Whilst NBN Co will be a wholesale-only entity, it will have strong incentives to set those terms and conditions in a manner that aligns with its interests and not necessarily those of access seekers. In particular, it is likely to favour itself in the following key areas;
- (a) The price it charges to ensure it maximises its return and share of total retail spend;
 - (b) Levels of risk sharing at all levels of the supply chain;
 - (c) The levels of discretion and certainty it reserves for itself to change key terms and processes; and
 - (d) Responsiveness to customer demands for product innovation and quality of service improvements.
- 2.33 This is a significant threshold issue that has to be addressed.

Recommendations

- 2.34 The problem has arisen from NBN Co's reliance on and interpretation of the provisions in the CCA, as outlined above, which give primacy to access agreements to the exclusion of other regulatory instruments. Optus is strongly of the view that this provision of the CCA is not supposed to operate in the way it is being applied by NBN Co. The provisions ought to be designed to allow two parties to strike a commercial agreement in a mutual way and have the confidence that the agreement will stand if there are subsequent regulatory decisions. For example, two parties may mutually agree price for access to a service and this will prevail notwithstanding the fact that the ACCC might issue an AD that sets a different price for access to that service. The critical element here is that such an agreement is "**mutual**".
- 2.35 A number of access seekers, including Optus, have indicated that NBN Co's WBA should provide for a mechanism to enable either party to seek regulatory recourse whether in terms of enforcing elements of an SAU, an AD or a BROCC. NBN Co has resisted such a request and has sought to impose a WBA on the industry which provides for little if any regulatory oversight.
- 2.36 Whilst this is a fundamental issue, it is one that is capable of being addressed by changes to the SAU and WBA. Specifically Optus proposes that NBN Co should include a commitment both its SAU and WBA to guarantee a right of NBN Co and access seekers to seek recourse to

the ACCC notwithstanding other terms in the WBA and for an ACCC decision (whether by means of an AD or a BROC) to be binding on the parties¹.

- 2.37 In addition the SAU to WBA alignment process should be strengthened from the current drafting in the WBA to enable either party to seek an ACCC AD on that alignment in the event of a dispute.
- 2.38 Optus considers this to be a threshold issue for consideration of the SAU. If NBN Co is unwilling to agree to the changes noted above then Optus submits that the ACCC should consider an alternate means to regulate NBN Co, such as issuing an access determination that sets out comprehensive terms and conditions of access to the NBN.

Term of the SAU

- 2.39 NBN Co has proposed a 30 year term for the SAU. The justification for this term is that it will “provide sufficient regulatory stability over both a substantial part of the life of the key network assets, and the expected payback period of the initial investment, as well as ongoing prudently incurred costs”.²
- 2.40 It is clear from this statement that the term of the SAU has been chosen with NBN Co’s interest in mind. Optus submits that such a term is unprecedented and inconsistent with the interests of access seekers and end-users. Whilst Optus recognises the need for some level of certainty over access terms. NBN Co’s proposal risks locking the industry into a set of regulatory arrangements that may become out dated and unresponsive to the market conditions and the needs of end-users.
- 2.41 It is worth noting that since 1997, there have been several quite fundamental changes to the telecommunications regulatory framework to deal with issues or circumstances that were not envisaged at that time.
- 2.42 We note that in respect of the SAU put forward by the G9 consortium, which proposed a period of 15 years, the ACCC expressed some clear concerns with the proposed period of that SAU

*The ACCC does, however, have concerns as to whether it can be satisfied that the specific terms and conditions of access in FANOC’s SAU, if applied over 15 years, will continue to promote competition and remain in the interests of access seekers.*³

- 2.43 Optus submits that these same concerns will also be relevant to NBN Co’s SAU.
- 2.44 It is also questionable whether the usual claims for certainty apply in the case of NBN. Such certainty is normally required to encourage commitment of capital by private sector investors. In the case of the NBN, the investment will be fully funded by Government, so it is

¹ A number of access seekers, including Optus, have sought such a commitment in negotiations on NBN Co’s WBA but NBN Co has rejected this request.

² NBN Co, Introducing NBN Co’s Special Access Undertaking, NBN Co Discussion Paper, July 2011, p.9

³ ACCC, Assessment of FANOC’s Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.102

questionable as to whether the same standard should apply. Further, the SAU cannot eliminate the ultimate uncertainty NBN Co faces from a three year electoral cycle.

- 2.45 Optus submits that whilst it would be appropriate for the SAU to have a term beyond the usual three year duration for ordinary access undertakings, this term should be significantly shorter than that proposed by NBN Co. In terms of the precise length of the SAU, this will be dependent upon the form of the final SAU and the level of oversight it confers on the ACCC, but it should be significantly less than the period proposed by NBN Co.

Section 3. Price Commitments and the Long Term Revenue Constraint

- 3.1 A critical objective of the NBN policy is to deliver enhanced competition in the provision of high speed broadband services and thereby ensure that customers benefit from lower prices. Consistent with this aim NBN Co's business plan and the Government have stated that prices will be affordable and will decline over time.⁴
- 3.2 It is critical, therefore, that the SAU helps to ensure that this objective is met. In assessing the SAU the ACCC will assess it against the criteria contained in the Competition and Consumer Act 2010. Specifically at paragraph 152BCA(1)(a) the ACCC must be satisfied that a SAU it is in the long term interests of end-users (LTIE), of which the ACCC has stated:

In the ACCC's view, particular terms and conditions promote the interests of end-users if they are likely to contribute towards the provision of:

- Goods and services at **lower prices**
- Goods and services of a high quality, and/or
- A greater diversity of goods and services.⁵ [emphasis added]

- 3.3 The Australian Competition Tribunal has expressed a similar view on the legislative criteria, it stated that:

*...the **interests of the end-users lie in obtaining lower prices** (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings...⁶ [emphasis added]*

- 3.4 The SAU will help to deliver on these objectives if the components that deal with the pricing of NBN access services provide for the following;

- (b) That prices are subject to independent oversight by the ACCC, with appropriate opportunities for input by access seekers who will make investments reliant on these prices and end-users who will pay for the services;
- (c) That prices are structured to encourage efficient usage of services whilst maintaining a clear linkage to the costs of supply over time; and
- (d) That prices are only based on efficient and prudently incurred costs.

⁴ NBN Co, Corporate Plan 2011-2013, 17 December 2010, pp.100-104; and Joint Media Release with the Hon Julia Gillard MP Prime Minister and Senator the Hon Penny Wong Minister for Finance and Deregulation and Senator the Hon Stephen Conroy Minister for Broadband, Communications and the Digital Economy, "Government release NBN Co Corporate Plan", 20 December 2010.

⁵ ACCC, Telecommunications services – declaration provisions: a guide to the declaration provisions of Part XIC of the Trade Practices Act, July 1999, p.33

⁶ *Seven Network Limited (No 4)* [2004] ACompT 11 at [120]

- 3.5 Optus submits that the pricing components of the SAU are inconsistent with the above principles. This means that there is significant uncertainty as to whether the SAU will lead to prices that are affordable and in the long term interests of end-users.

Appropriate oversight of prices

- 3.6 The experience of regulating Telstra has demonstrated the problems that arise when an access seeker with market dominance has too much discretion in setting prices. For this reason recent reforms to the Competition and Consumer Act (CCA) have handed full control of price setting for declared services to the ACCC. This has removed the scope for price gaming available under the previous access regime through the negotiate/arbitrate arrangements and the opportunity to submit ordinary access undertakings. The benefits of the reform were clearly articulated in the Explanatory Memorandum to the CCA:

*The Government is persuaded that any reform undertaken must include removal of the negotiate-arbitrate model from the regime, in favour of more direct ex ante price-setting by the regulator. **This will lead to greater certainty, less dispute and more timely and efficient outcomes.***⁷ [Emphasis added]

- 3.7 In the context of setting prices for the NBN, Optus submits that greater certainty over access pricing will similarly be achieved if the ACCC has a very clear and direct role in price setting. This should include oversight of the appropriateness of the:

- (a) Approach and methodology of setting prices;
- (b) Structure of charges;
- (c) Level of charges at the appropriateness of underlying cost assumption;
- (d) Arrangements for updating or varying charges over time;
- (e) Likely annual revenues that will result from the application of the charges; and
- (f) Incentives to incur costs efficiently;

- 3.8 The ACCC has previously recognised the need for such a role when it examined the Special Access Undertaking put forward by FANOC in respect of its roll-out of a high speed broadband network. In its draft decision on the FANOC SAU the ACCC stated that:

*...any methodology for setting access prices would require effective regulatory audit or review of key inputs and parameters in the methodology (such as demand forecasts and forecast or actual capital and operating expenditure) at appropriate intervals if the undertaking period is very long. This would be necessary for the ACCC to be confident that the access provider will exercise its discretion in applying the pricing methodology in an efficient manner.*⁸

- 3.9 Optus supports the position outlined by the ACCC's draft decision on the FANOC SAU.

⁷ House of Representatives, *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, Explanatory Memorandum, 2010, p.55

⁸ ACCC, Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.99

- 3.10 However, as will be demonstrated in the discussion below the pricing components of the SAU provide for very limited ACCC oversight either in respect of setting initial prices or how these might change over time. This lack of oversight includes concerns relating to:
- (a) Initial prices, for which there is little or no supporting cost analysis;
 - (b) That many prices are set under the terms of the WBA and therefore not subject to ACCC scrutiny; and
 - (c) That prices can change in line with loose price control arrangements with no specific review mechanism.
- 3.11 In summary, Optus submits that NBN Co has provided for very restricted ACCC oversight of access prices. Whilst this is of itself a serious deficiency of the SAU these concerns are further heightened by the very loose prudency arrangements provided for in the SAU (refer to Section 4 for Optus' concerns on prudency arrangements). In combination the pricing and prudency arrangements provide scope for the inefficient cost-plus pricing to drive increases in the cost to access the NBN over time.

Pricing arrangements

- 3.12 Optus submits that any regulatory arrangements approved by the ACCC should ensure that the pricing arrangements for the NBN have the following objectives:
- (a) Encourage efficient expenditure to provide the lowest sustainable cost of service;
 - (b) Provide incentives for efficient tariff structures to encourage efficient utilisation of the network; and
 - (c) Fosters end-user take-up and retention to maximise the positive externalities of the public project.
- 3.13 The pricing arrangements included in the SAU fall well short of meeting these objectives.
- 3.14 Optus' concerns are set out below on each of the following elements of the pricing arrangements:
- (a) Pricing structure;
 - (b) Initial prices; and
 - (c) Price controls.

Price structures

- 3.15 NBN has proposed a two part tariff for the NBN Access Service comprised of an access component (the AVC charge) and an usage component (the CVC charge), as will be discussed further below. The SAU does not include any information on the prices for Ancillary Services.
- 3.16 Optus submits that the two-part tariff proposed by NBN Co requires re-examination.
- 3.17 The access prices levied by NBN Co will be a critical factor influencing consumer take-up and demand for services on the NBN. Crucially, the initial price structures are likely to have a

longstanding influence on future prices and price structures. It is therefore imperative that careful consideration is given to initial price structures.

3.18 Optus has previously expressed concern to NBN Co and the ACCC regarding NBN Co's price structure (see Attachment 1). Despite NBN Co acknowledging that it had conducted an 'extensive, two-year consultation process',⁹ it has not addressed industry's concerns. Specifically, Optus has stated that the reliance on usage based charges in the way NBN Co has proposed to recover its costs will act as a barrier to the take-up of higher speed access plans. In fact, NBN Co is relying on the take-up and usage of higher speeds to increase average revenue per user and recover its costs. CVC revenues are expected to account for approximately 30 per cent of NBN Co's wholesale revenue by FY2025, and 36 per cent by FY2040 compared to less than 4% today.¹⁰

3.19 This expectation has been highlighted in press commentary:

*CVC income is therefore the sizzle in the NBN sausage: it begins fairly slowly, but builds up rapidly as usage of the network rises and the complexity of the products being run on the network increases; unlike the AVC revenue, which is tied to end-user numbers, it has much more blue sky – as consumption per head rises, so does CVC revenue.*¹¹

3.20 Optus is not opposed to the use of a two part tariff in principle; however the current proposed ratio of the fixed and variable components needs to be re-balanced. NBN Co should be expressly required to encourage take-up and the efficient use of the NBN in designing the structure of its tariffs.

3.21 The ACCC has acknowledged that different pricing structures can have different impacts on downstream markets.¹² For example, the ACCC notes that a large fixed cost component may advantage larger access seekers since it can be spread over a larger customer base. Optus does not consider this to be a real risk in the context of the NBN. This is because a substantial proportion of access seekers' costs, regardless of their size, will largely be made up of the NBN access fee and therefore scale advantages may only have a limited impact on end-user prices and downstream competition.

3.22 However, a large variable component which has only a tenuous link to costs of supply can have damaging effects in downstream markets by discouraging the adoption of higher speed plans and the take-up of data rich services and applications. This is because customers are unlikely to move up the speed tiers if they know they will be faced with a substantial increase in the cost of the service, which would be an inevitable result given the high variable component implicit within the construct of the access charges. This will be a particularly 'hard sell' for ISPs given existing pricing arrangements. Lower take-up and usage of data will in turn effect innovation for data rich services and applications, which are promoted as major benefits of the NBN.

⁹ NBN Co, *NBN Co's Special Access Undertaking (SAU)*, Letter to the ACCC, 23 March 2012

¹⁰ NBN Co, Corporate Plan 2011-2013, p.110

¹¹ Sydney Morning Herald, "Avoiding a monster: 70 is the magic number," 4 February 2011, <http://www.smh.com.au/business/avoiding-a-monster-70-is-the-magic-number-20110203-1afg6.html>

¹² ACCC, NBN Co Limited Special Access Undertaking, Supplementary Consultation Paper, February 2012, p.40

- 3.23 Currently, broadband customers do not generally pay for data usage and certainly not in the linear manner proposed by NBN Co. In fact, intense competition for broadband customers has resulted in internet service providers (ISPs) increasing the data allowances with little or no change to the average prices paid for such services. Market Clarity has recently highlighted this fact when it noted that *“In general, ISPs have focussed on adjusting their plan allowances rather than their price points.”*¹³
- 3.24 Market Clarity found that in recent years there has been a significant increase in the data allowance included in broadband plans. For example, retail plans offering 50 GB of data usage have grown from 11 per cent of all plans in 2006 to 76 per cent by 2010. However, this significant lift in data usage has not led to a significant change in the price of plans. Since 2007, notwithstanding the increases in data allowances, prices have remained relatively steady, with the distribution of residential customers on broadband plans of less than \$80 remaining relatively stable at 78 per cent and 76 per cent, in 2007 and 2010 respectively.¹⁴
- 3.25 Optus notes that NBN Co has put forward no evidence to suggest that customers will be willing to pay the levels of premium over current broadband access prices implied in NBN Co’s wholesale access pricing plans. The reality is that broadband will have to compete for share of wallet with many other services.
- 3.26 In principle, the price structure should reflect the structure of underlying costs. In this way, prices can promote an efficient allocation of resources.
- 3.27 For example, although there is no cost model to assess the proportion of NBN Co’s variable costs, it would be expected that the additional cost to serve customers on higher speed tiers or for incremental data would be very low. As a result, a low variable charge may encourage customers to use more (and faster) data with little cost impact on NBN Co. However, a very high fixed component associated with a very low variable component may discourage the take-up and retention of customers. It is therefore important to strike an appropriate balance between these factors.
- 3.28 As such, Optus recommends that NBN Co rebalance the fixed and usage components of its proposed access charges to address these concerns.

Initial prices

Prices included in the SAU

- 3.29 NBN Co has included only a limited set of initial prices in the SAU with scant information provided in support of those prices. In fact, it is striking how little information NBN Co has submitted in support of its initial prices given that it will become the *only* provider of fixed broadband services in the country.
- 3.30 It is common regulatory practice in deemed declared service industries (such as electricity transmission and distribution, gas distribution, urban water, etc) that monopoly providers submit extensive justification for regulatory approval of their proposed revenues (and

¹³ Market Clarity, Broadband download behaviour in Australia: The disconnect between allowance and usage, January 2011

¹⁴ Market Clarity, Broadband download behaviour in Australia: The disconnect between allowance and usage, January 2011

prices, depending on the form of regulation). Information that is essential to justify prices invariably includes:

- (a) Forecast costs such as operating and capital expenditure (including associated parameters such as asset lives);
- (b) Forecast demand; and
- (c) A full suite of prices and/or pricing principles.

3.31 Indeed the ACCC has stated that:

[NBN Co's approach] differs substantially from other common regulatory frameworks where the regulated businesses make periodic pricing submissions to the regulator that contain proposed annual revenue requirements (together with the revenue components and in some cases, prices) for regulatory approval...

The ACCC notes that NBN Co has not provided the ACCC with any modelling of its long-term revenue methodology in support of its SAU.¹⁵

3.32 Given that NBN Co has not submitted any such modelling or information it is therefore impossible for both the ACCC and Access Seekers to determine:

- (a) Whether the given initial prices are reasonable and based on the efficient costs of supply;
- (b) Whether the total costs facing an Access Seeker are likely to be reasonable; and
- (c) How prices for new and other services will be determined.

3.33 NBN Co has simply stated that initial prices have been set to “allow Access Seekers to serve their existing base of End Users at wholesale cost of supply that compares favourably to that which they currently face (including voice-only End Users)”.¹⁶ That is, the ACCC is asked to accept that the initial prices are reasonable on the sole basis that they are consistent with the price of existing legacy access services. Optus submits that the initial prices *might* be in a reasonable range, but there is insufficient information for the ACCC to test this claim and to be satisfied that those prices are consistent with the long term interested of end-users. For the ACCC to be satisfied that prices are reasonable, then consistent with its draft decision on the FANOC SAU, the ACCC will:

need to have before it rigorous estimates of the expected penetration of the network, projected demand for different services, expected future efficient costs associated with the development of the network and the proposed depreciation profile, including constraints on the minimum capital asset value at the end of the SAU.¹⁷

¹⁵ ACCC, NBN Co Limited Special Access Undertaking, Supplementary Consultation Paper, February 2012, p.46

¹⁶ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, page 52

¹⁷ ACCC, *Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service*, Draft Decision, December 2007, p.88

3.34 Optus submits that since initial prices will act as a considerable anchor for future prices it is imperative that they be subject to significant scrutiny given their importance. NBN Co has acknowledged that the prudence of its costs is likely to be a significant concern for Access Seekers.¹⁸ However, this is not only important in the context of an efficient asset base and future prices, but for Access Seekers to have confidence that initial prices are appropriate as well.

Principles to determine other prices

3.35 The SAU states that initial prices other than the price controlled offers (other prices) be set subject to the following:

- (a) The long term revenue constraint methodology; and
- (b) The maximum regulated prices on the price controlled offers.¹⁹

3.36 Optus submits that these are an inadequate substitute for independent ACCC scrutiny. Further, these constraints are likely to be too loose to be of any real value and are in any case?

3.37 Firstly, the long term revenue constraint (LTRC) methodology provides limited if any insight into the appropriateness of initial prices. Rather, the methodology simply limits the total revenues that NBN Co can earn. As such it will only have a limited bearing on the level of prices at any time which will be just as impacted by demand and the structure of prices. Moreover, while the constraint does not influence the make-up of NBN Co's revenue (such as the balance of charges between certain services or the structure of prices), it just simply limits the total revenues across all regulated services (the role of the LTRC is discussed later in this section). Further, since NBN Co is expected to earn insufficient revenues to cover its costs for a significant period of time, the constraint will not be binding.

3.38 Secondly, it is unclear how NBN Co intends to utilise the price controlled offers as an anchor on other products or product components. That is, there is no further information given as to what rule or principle will be used to apply the price controlled offer prices to new products or product components.

3.39 Finally, NBN Co has included a significant degree of discretion for the pricing of products that arise out of the Product Development Forum (PDF). Under Clause 3.6 of Schedule 6 simply states that it will consult with customers. There is little certainty accorded to Access Seekers on the pricing that will apply to new products nor are these prices subject to access seeker agreement.

Exclusion of Ancillary Services

3.40 While NBN Co notes that it will supply and charge for a range of other services, including the Ancillary Services, the SAU fails to set out the pricing for such services.

3.41 Optus submits that the SAU should set out the framework NBN Co intends to apply to such services. Given the significance of the Ancillary Services (eg. the Facilities Access and

¹⁸ NBN Co, Introducing NBN Co's Special Access Undertaking, NBN Co Discussion Paper, July 2011, p.38

¹⁹ NBN Co, NBN Co Special Access Undertaking, 5 December 2011, clause 3.4.

Systems Interfacing services), which will need to be acquired concurrently with the NBN Access Service, NBN Co should provide the same degree of transparency and certainty that will apply to Access Services. Charges for all Ancillary Services should be made transparent in the SAU, and not subject to NBN Co's discretion.

- 3.42 The importance of this issue is illustrated by emerging evidence that NBN Co is seeking to structure Ancillary Services prices in a way that may disguise its true manner of recovering costs despite industry objections. As an example, NBN Co has proposed to charge fees for missed appointments ranging from \$300 to \$450 depending on the time of day. These are significant fees that are likely to bear no relation to the costs of supply.
- 3.43 NBN Co claims that it has “undertaken additional consultation in developing our initial business-focused products and the facilities access arrangements, and see this as being part of our normal mode of operation.”²⁰ However, Optus' experience is that these processes are not consultations whereby stakeholders' views are given appropriate consideration and so should not be supplant ACCC oversight as a 'normal mode of operation'.
- 3.44 In Singapore, similar concerns have arisen about the ability of open net (NBN Co's equivalent) to charge exorbitant fees:

*One example of how prices might be influenced beyond those laid down in the regulatory terms is the way that OpenNet [the company building and operating the network] has proposed a 'patching charge' of S\$160 per cable for patching in the main distribution frame for consumer connections. It's also proposing extra charges for deactivating patching services or removing patch cables at the central office. And this despite OpenNet already getting paid an installation charge. As many submissions [in the review] noted, the exorbitant charges would simply make their way into higher end user charges.*²¹

- 3.45 This illustrates the importance of upfront regulatory oversight of all prices given the scope and level of NBN Co's ancillary charges.
- 3.46 Overall, Optus submits that NBN Co has not submitted sufficient evidence for the industry to have confidence in its initial prices. In addition, there is insufficient information to ensure that other prices will be set in an appropriate manner. This is compounded by the price control arrangements which lack the strict discipline expected for a monopoly business such as NBN Co.

Price controls

- 3.47 NBN Co has proposed a set of price controls to apply to individual products, product components and services, being:
- (a) Fixed maximum prices for the price controlled offers during the initial period; and
 - (b) An individual price increase limit of CPI/2 to apply to all products and services and the price controlled offers following the initial period.

²⁰ NBN Co, *NBN Co's Special Access Undertaking (SAU)*, Letter to the ACCC, 23 March 2012

²¹ Communications Day, "Singapore's NBN woes shouldn't go unheeded in Oz", 19 March 2012

3.48 However, Optus notes that these price controls are not linked to any submitted changes in the underlying costs of supply. Further, the ability for the price controls to provide certainty on price increases is also limited given:

- (a) any increase in cost that can't be recovered through these mechanisms can be recovered in later periods through the ICRA subject to the LTRC or through the non-transparent arrangements for new prices; and
- (b) the proposed mechanism which allows for NBN Co to separately seek price increases outside of these arrangements.

3.49 Firstly, the proposed price control arrangements do not impose strict pricing discipline on NBN Co because it is accorded a significant degree of discretion for setting new prices in the SAU. Therefore any pricing certainty that may be achieved with the arrangements on existing prices can be circumvented by the introduction of higher prices on new products and product components.

3.50 Further, in the initial period, any unrecovered costs are accumulated in the ICRA to be recovered in later periods. In turn, since the price controls are not designed to work as a strict control on pricing they do not provide the appropriate incentive and discipline for NBN Co to minimise costs. This is a substantial problem. In order for the public benefit of the NBN to be maximised Optus suggests that NBN Co must have very strong incentives to minimise costs.

3.51 This has been a recognised benefit with the adoption of price caps in regulated industries. In Canada, the Canadian Radio-Telecommunications Commission (CRTC) offered the following motivation for moving to a price cap regulation framework from a revenue approach:

Price caps allow for more efficient and effective regulation in a number of ways. First, price caps reduce incentives and opportunities for companies to over-invest or misallocate costs. Once caps are established, prices cannot exceed them (apart from the operation of a limited number of exogenous variable), even if the investment base is increased. Second, price caps reduce opportunities to cross-subsidize or engage in anti-competitive pricing, because price changes in one basket cannot be offset by price changes in other baskets. Third, price caps provide incentives for telephone companies to be more efficient and innovative, since shareholders assume more of the risks and rewards of business decisions and retain the benefits of higher levels of productivity. Fourth, price caps can eliminate the need for regulatory assessment of investment, expenses and earning between price cap performance reviews.²²

3.52 It should be a primary objective of NBN Co's to deliver a certain quality of service at the lowest sustainable cost to encourage take-up and utilisation of the network. This will only be achieved if NBN Co is subject to strict, long term price controls that lock-in low, constant prices. There should neither be a presumption nor the ability for prices to increase as take-up and use of the network is expected to expand.

3.53 Secondly, NBN Co has proposed to have the right to request price increases outside of the individual price increase limit. This arrangement undermines any potential effectiveness of the price control because there are effectively no limits on the changes that can be

²² CRTC, Review of regulatory framework, Telecom Decision CRTC 94-19, 16 September 1994

requested in terms of the amount of any price increase, the duration of the increase and subsequent effects of the increase on other products or product components. Moreover, NBN Co has not defined the information that it will provide in support of any such request.

3.54 Optus submits that any exception to price control arrangements should be designed such that it is clear that it will only be triggered in very specific and limited circumstances and that NBN Co, should be required to submit specific evidence in support of its application. The presumption of the regulator should not be that any request should be accepted ‘unless inconsistent with the LTIE’; rather, the presumption should be that price controls remain in force unless exceptional circumstances arise outside of NBN Co’s control (such as a change of government policy or new technology becomes available). This is an integral component of a price control regime to provide access seekers with certainty and confidence in pricing and associated arrangements.

3.55 By contrast, it appears that part of the motivation for NBN Co to include such a mechanism is to facilitate price re-balancing in the event that its forecasts provide to be inaccurate:

NBN Co anticipates that one possible reason for making a request for an above CPI/2 price increase at some point in the future would be as part of a price rebalancing, which may involve some prices increasing and some prices decreasing to respond to changing usage patterns.²³

3.56 Optus submits that is inappropriate for price control arrangements to have such an objective. Any price re-balancing to account for variations in outturn demand should be addressed with specific mechanisms or reviews subject to caps on the amount that can be adjusted in any single period.

3.57 Furthermore, any rebalancing mechanism should be clearly designed not to alter the total amount that can be recovered from prices for variations in outturn demand. That is, prices should not change as a result of total outturn demand varying from the forecast. A key feature of price control arrangements is that the demand risk should be carried by the Access Provider in order to incentivise network utilisation. NBN Co should have strong incentives to encourage take-up and utilisation of the network. If it is able to simply recover all of its costs and re-adjust prices depending on outturn demand it will not face the risk of losing money if it does not structure its prices appropriately, carry out robust demand modelling and encourage network utilisation. Further, such an approach provides no incentive for NBN Co to minimise its costs.

3.58 Thirdly, given the structure of Access Services prices, the proposed limits on price increases will not provide a cap on the effective prices facing end-users. This is illustrated in NBN Co’s Corporate Plan which shows a significant increase in Average Revenue Per User (ARPU) over the life of the project as the growth in data usage by customers is monetised in its wholesale access fees, as the table below illustrates.

Table: NBN Co’s Forecast ARPU’s

	FY12	FY15	FY20	FY25	FY40
ARPU (Option 1)	\$38	\$40	\$56	\$68	\$103

²³ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011, p.54

3.59 Essentially, NBN Co has proposed a regulatory arrangement that affords it too much flexibility to set its own prices without consultation or approval. This is exactly what independent regulation following the Hilmer competition reforms was designed to avoid. The risks of this approach were recently recognised by the ACCC Chairman, Rob Sims who said:

...[during] pre-Hilmer reforms...Ministers and government departments were in effect the price regulators of government-owned utilities. We had plenty of experience with the pre-Hilmer model and it was not a success.

- *There was a lack of transparency, rigour and consultation in price setting.*
- *The track record was of inefficient service provision by utilities with low labour productivity; worse outcomes than what we see now.*
- *There were conflicts of interest for the government in pursuing shareholder interests, policy objectives and political concerns with often a confused result and cross subsidies.²⁴*

3.60 It is imperative that we learn the lessons identified above and ensure that a rigorous regulatory regime be put in place to achieve the objectives of delivering low and affordable prices.

Revenue requirement

3.61 NBN Co has proposed to set prices for the NBN Access Service based on a structure which allows it to recover costs subject to a long-term revenue constraint. That is,

Over the long term, the maximum revenues that NBN Co will be able to earn are those consistent with recovering its costs, including a regulated return on capital (regulatory WACC). Such revenues would result in a zero expected net present value of all relevant cash flows, which is typical for a regulated monopoly.²⁵

3.62 This proposed approach is therefore largely predicated on the establishment of the relevant Regulatory Asset Base (RAB) and the inclusion of an additional Initial Cost Recovery Account (ICRA) mechanism. NBN Co considers its RAB approach is consistent with the 'Building Block' revenue methodologies used by the ACCC and other regulators in a range of industries.²⁶

3.63 However, there are several key departures in NBN Co's proposed approach from the BBM approaches adopted by regulators (such as the ACCC's Fixed Line Service Model (FLSM)), including:

²⁴ Sims, Rod (ACCC Chairman), "Infrastructure: why, when and how to regulate", Speech given at the SMART Facility, University of Wollongong, 23 February 2012.

²⁵ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011, p.57

²⁶ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011, p.55

- (a) NBN Co's RAB has not been subject to any external review, including both the ACCC and industry stakeholders. For example, *"The ACCC notes that NBN Co has not provided the ACCC with any modelling of its long-term revenue methodology in support of its SAU."*²⁷ Irrespective, the RAB approach is deficient in a number of areas including:
 - (i) Full cost recovery might not be appropriate; and
 - (ii) There needs to be a clearer linkage between the price of services and underlying cost of supply of those services.
- (b) The regulatory WACC is based on an unprecedented government bond rate plus an arbitrary 350 basis points. Given that the NBN is a large-scale Government-funded infrastructure project, the WACC rate should be restricted to the bond rate for cost recovery purposes.

3.64 As a result of these issues it is unlikely that the long term revenue constraint will act as an effective constraint since it may never be triggered. Furthermore, it also provides no guarantee that initial prices will be consistent with cost principles.

3.65 These issues are discussed below.

The Long Term Revenue Constraint

3.66 Optus has long been a strong advocate for regulated prices to facilitate the recovery of the access provider's efficiently incurred costs.

3.67 The principles of a locked-in regulated asset base (RAB), ex ante approval of expenditure and providing incentives to incur costs efficiently are good initiatives that Optus would generally support. However, as discussed above a key concern with NBN Co's proposal is the lack of initial scrutiny of the costs that will be locked into the RAB. Further, there are concerns as with the prudency arrangements (which we discuss in more detail in the following chapter). However, it is first important to recognise that a presumption of full cost recovery may not be as appropriate as it would be for a private enterprise undertaking an investment. There are several reasons for this:

- (a) The NBN is a large public project undertaken because ubiquitous high speed broadband was not capable of being delivered by the market; and so
- (b) It may indicate that broadband has characteristics of a public good and due to large positive externalities is more efficiently provided by the government.

3.68 Moreover, the presumption of full cost recovery could also lead to the problems that were inherent in early utilities regulation such as 'gold plating' and 'managerial slack'. That is, explicit 'guarantees' that all costs that are incurred will be recovered can be a dangerous principle as it can lead to:

- (a) Higher than necessary costs to meet a certain quality of service requirement which can lead to the underutilisation of the network;

²⁷ ACCC, NBN Co Limited Special Access Undertaking, Supplementary Consultation paper, February 2012, p.46

- (b) Underutilisation of the network will lead to a failure to capture the expected public benefit arising from high penetration rates; and
 - (c) Low productivity and innovation in service delivery and product development by fostering a work culture that simply builds and maintains a network rather than delivering an exciting service as part of dynamic industry.
- 3.69 Clearly these would be undesirable outcomes. It is therefore imperative that NBN Co has appropriate incentives to minimise costs and maximise value to Australian consumers. To achieve this NBN Co will need to face a real risk that if it does not incur costs efficiently, it will make losses, which will be unacceptable to its shareholder, the Government.
- 3.70 In order to achieve this, it is imperative that the revenue requirement acts as a binding constraint on prices. As it is currently designed, the LTRC has no effect in the first periods of the SAU's operation. This is unacceptable as it raises significant concerns regarding the costs that are to be recovered in later periods – there should be a direct link between the 'lowest total cost of supply' provision and the prices that are charged throughout the NBN's lifetime.
- 3.71 This can be achieved by linking the price controls with the revenue requirement to deliver an expected net present value of zero. This in turn will be achieved by locking in the prices and controls which are consistent with the underlying efficient costs of supply.

Weighted Average Cost of Capital (WACC)

- 3.72 Optus considers the WACC proposed by NBN Co is inappropriate. NBN Co should receive compensation for the efficient capital costs it has incurred, and no more. In this regard the key relevant fact is that the NBN is a public project funded by taxpayer funds. At the very most, the WACC should represent the Government's actual borrowing costs, that is, the Government bond rate, not the WACC that would be required for a commercial project.
- 3.73 The Government has recognised that it does not require a commercial rate of return for the project as it stated that:

... we have never taken the approach that we need to make the rate of return that the telco sector is used to.²⁸

- 3.74 Notwithstanding this, the Government has also indicated that it expects to receive more than its actual costs of borrowing as the Minister has stated that:

NBN Co's expected rate of return is 7.04 per cent, which compares favourably with the average 10 year bond rate (July 2009 to November 2010) of 5.39 per cent. The NBN Corporate Plan shows the Government can expect to recover all its funding costs with interest.²⁹

- 3.75 Optus questions the appropriateness of this approach since the expected rate of return represents a cost to consumers above the actual costs of building the network. Setting a

²⁸ Computerworld, "Conroy: NBN Co doesn't need regular telco commercial returns", 10 May 2010

²⁹ Joint Media Release with the Hon Julia Gillard MP Prime Minister and Senator the Hon Penny Wong Minister for Finance and Deregulation and Senator the Hon Stephen Conroy Minister for Broadband, Communications and the Digital Economy, "Government release NBN Co Corporate Plan", 20 December 2010.

lower return is likely to better deliver the Government objectives of providing affordable broadband to all Australians.

3.76 Should prices be higher than necessary (for example by including a premium return or inefficient expenditure), the Government's objectives of capitalising on the positive externalities of ubiquitous high speed broadband are likely to be jeopardised. The success of the project ultimately depends on consumers' take-up and use of the network. This will be determined primarily by the prices that are charged, the higher the price the lower will be the level of take-up.

3.77 The combination of a higher than necessary return and a regulated cost base can create the opposite effects the Government is aiming to achieve with the NBN - higher than necessary prices. Recently, the Australian Energy Regulator (AER) made the following observation:

The AER considers that the current RAB roll forward mechanism creates incentives for NSPs [network service providers] to incur more than the efficient levels of capex, particularly in the latter years of the regulatory control period. It suggests that this is particularly an issue where the regulated cost of capital for a NSP is higher than its true cost of capital, or where the NSP is responding to a broader range of incentives, rather than just financial incentives.³⁰

3.78 Optus submits that NBN Co should only include a return commensurate with the long-term Government bond rate. Such an approach will reflect the actual borrowing costs faced by Government in funding the NBN. It will also help to ensure access prices remain low and affordable.

Recommendations

3.79 As highlighted throughout this section, Optus has significant concerns with numerous aspects of the price commitments set out in the SAU. Below Optus describes a recommended approach to address these concerns.

3.80 Firstly, Access Seekers require price transparency. All prices need to be published, their determination understood, and subject to regulatory oversight. This needs to be addressed through an upfront process whereby:

- (a) NBN Co submits all its underlying costs, forecast demand and prices to the ACCC;
- (b) The ACCC undertakes a significant review and public consultation process to determine the reasonableness of the costs, with regard to 'lowest sustainable cost' and efficient pricing principles; and
- (c) The ACCC approves (determines) a full set of prices based on the approved (determined) efficient costs of supply.

3.81 This process is entirely consistent with existing arrangements in place in other network industries, such as electricity and gas. Furthermore, such an upfront, price determination process is consistent with the recent reforms to the telecommunications regulatory framework. It is imperative that the industry not lose this hard won reform.

³⁰ AEMC, Economic regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Directions Paper, 2 March 2012, p.35

- 3.82 Secondly, NBN Co and Access Seekers require price certainty. The NBN is intended to be a long term project for which NBN Co as well as Access Seekers will be undertaking significant investment. Price certainty will be achieved by an extension of the above process, being:
- (a) NBN Co submits the entire set of forecasts which underpin its Business Plan (30 year term to return an expected net present value of zero);
 - (b) The prices approved (determined) by the ACCC are set ‘in principle’ for the duration of the proposed initial period; and
 - (c) There is a presumption that prices will remain in force in subsequent periods unless there is an unforeseen event or circumstance that is outside of NBN Co’s control (such as a technological upgrade or change in Government policy).
- 3.83 It will be important to have appropriate quality of service standards in conjunction with these pricing arrangements to ensure that NBN Co does not seek to cut costs through a degradation of quality. There should be scope for the ACCC to review the quality of service standards and to allow changes in prices to reflect declining or improving quality of service. This should act as an incentive mechanism for NBN Co to provide a high quality of service.
- 3.84 Furthermore, the presumption that prices remain in force will be important to promote certainty as well as encourage cost discipline and network utilisation.
- 3.85 Thirdly, Access Seekers require price stability. Fluctuating prices are not in the LTIE nor will they encourage the efficient utilisation of the NBN. NBN Co should therefore be subject to price controls that drive stable and/or declining prices by:
- (a) Capping all prices (rather than revenues) consistent with recovering the forecast efficient long term costs.
 - (b) Specific limits on price re-balancing for changes in the pattern of demand; and
 - (c) Price review every 3 to 5 years to approve any re-balances or changes to reflect prices for new products, product components or services.
- 3.86 A crucial element of the price review process is the presumption that prices remain constant. Locked in long term prices will facilitate the long term investments necessary for Access Seekers to deliver long term services to end users. This will enforce strict cost discipline on the part of NBN Co to meet its forecasts as well as to encourage network utilisation to increase revenues. Any changes in prices should be linked to clear and measurable changes to the forecast that were outside of NBN Co’s control. For example, a change in Government policy to roll out FTTN instead of FTTP or a change in the available technology to meet the Government’s objectives.
- 3.87 Optus submits that these arrangements will encourage far better outcomes for end-users compared to those proposed by NBN Co. It should be of utmost importance for the regulatory regime to minimise the prices facing end-users in order to maximise the public benefits expected from such a monumental investment. There is a serious risk that if NBN Co is not encouraged to ‘think like a competitor’ and face a real risk of losing money it will remain in an ‘engineering’ mindset of ‘build and operate’. This would not be an acceptable outcome for a twenty first century technology project.

Section 4. Prudency Arrangements

- 4.1 NBN Co has recognised that the efficiency of its costs is likely to be a 'key issue' for access seekers and the ACCC. The significance of this issue reflects the fact that NBN Co has proposed a cost recovery model which essentially enables it to recoup all the costs it incurs and that those costs will be incurred in the absence of any competitive constraints. As indicated in Section 3, one of the central controls NBN Co has proposed over the reasonableness of its prices is the long term revenue constraint. In essence, this will provide for a straight pass-through in time of all of NBN Co's expenditure into access prices.
- 4.2 In the absence of competition, it is important that rules are in place to provide appropriate oversight of NBN Co's expenditure to ensure that its expenditure is necessary, reasonable, proportionate, and that access prices are not inflated by inefficiencies in its operations or decision making processes.
- 4.3 In this respect, the SAU puts forward a set of rules that are essentially self-policing in the sense that expenditure is considered to be efficient if it complies with certain pre-determined rules. To the extent that expenditure meets these pre-determined rules then it is deemed to be prudent and is subject to no ACCC oversight.
- 4.4 Optus submits that this approach is unacceptable and that a new approach must be developed that applies a genuine discipline on NBN Co to incur its costs efficiently. This should include full ACCC oversight of NBN Co's anticipated and actual expenditure together with an unambiguous right for the ACCC to exclude expenditure it considers to be inappropriate or inefficient.

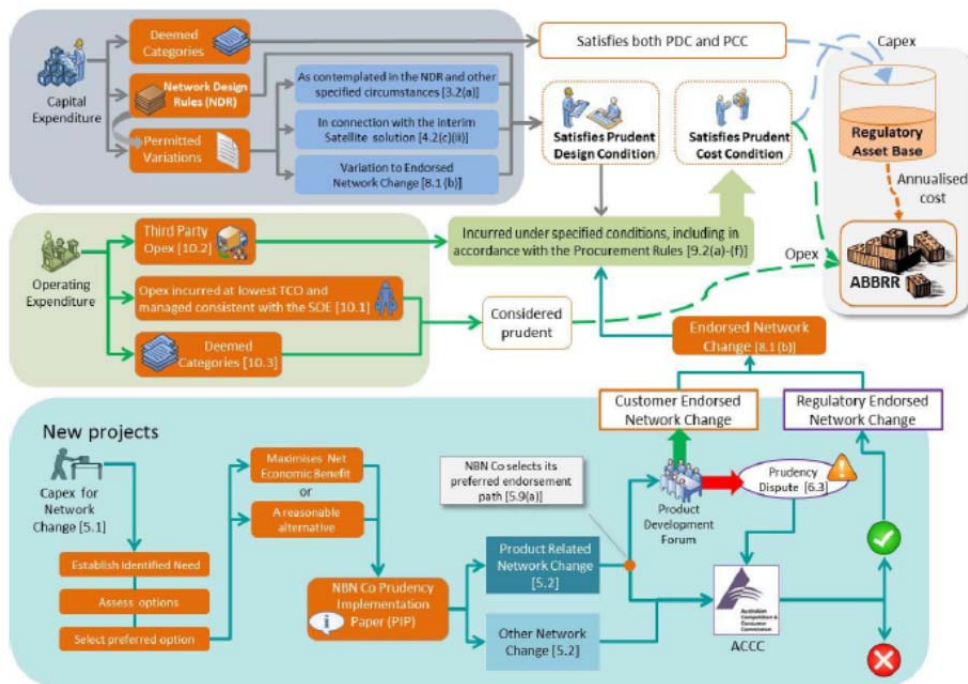
Prudency commitments

- 4.5 NBN Co has acknowledged that its prudency commitments provided in the SAU are intended to *"ensure that the cost it incurs, and the processes it uses to incur those costs are prudent – that is, the costs and processes are necessary, effective, efficient and aligned with NBN Co's and its Customers' interests. [In doing so] NBN Co has drawn on established approaches to prudency in other regulated industries to develop these commitments and adapted them to reflect the objectives set for NBN Co."*³¹
- 4.6 NBN Co has also provided a Prudency Model to further illustrate the key interactions of its prudency commitment processes. This is set out below.³²

³¹ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011, p.112

³² NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011, p.113

Figure A.1: Overview of the prudency model



- 4.7 What this schematic shows is that the vast bulk of NBN Co's expenditure will be subject to no ACCC oversight;
- Firstly, spend that is simply "deemed" to be prudent can be rolled straight into NBN Co's RAB with no further scrutiny, even though these costs are likely to run into tens of billion dollars;
 - Secondly, NBN Co's capital expenditure will be deemed to be prudent and subject to no further scrutiny if NBN Co's determines that the expenditure satisfies NBN Co's Network Design Rules and its Prudent Cost conditions; and
 - Thirdly, operating expenditure which will run into billions of dollars a year is considered to be prudent if in NBN Co's opinion such expenditure offers "value for money" and "the lowest total cost of ownership" and is otherwise in line with the "Statement of Expectations" and "any other regulatory requirements applicable to NBN Co."
- 4.8 As will be seen below these rules, which are self-policed, set a very low bar in terms of meeting the proposed prudency test. In fact, it would be unlikely that any capital or operating expenditure would be deemed impermissible under these rules.

Network Design Rules

- 4.9 The Network Design Rules serve as the basis for establishing the baseline for the operation of the prudency provisions in the SAU. This is notwithstanding the fact that NBN Co itself sets those rules. Notably, it forms the framework from which to assess any changes against the efficiency and prudency of NBN Co initial network design (however this is also based on the presumption that the NBN Co Initial Network Design is, by NBN Co's own admission, prudent and efficient).

- 4.10 As set out in Clause 3.1(b) in Schedule 8 (Prudency), “NBN Co will ensure that the Network Design Rules for the Relevant Assets satisfy the Initial Design Scope.” This represents as extremely low bar given that the Initial Design Scope only sets out high-level principles for the Design of the network in line with, as set out in the Statement of Expectations with applicable laws. Optus also sets out a number of its high level concerns in Appendix B.
- 4.11 Further, whilst the Network Design Rules are intended to provide the baseline design for the NBN Co Network, there is considerable scope in the Initial Network Design for NBN Co to make changes through the variation and enhancement processes (deemed a Permitted Variation) without the appropriate level of scrutiny or ACCC oversight. Further, the rules are vague in respect of a number of significant network design arrangements such as in relation to how NBN Co intends to allow “for the required level of availability and resiliency in an efficient manner.”³³
- 4.12 The involvement of the ACCC in the points of interconnect (POI) decision demonstrates the important oversight role that the ACCC can play in ensuring design prudency and efficiency. Without ACCC oversight of the POI decision, NBN Co would have made a very different design decision – one that was driven by a desire to build an elegant network, rather than a cost-efficient, pro-competitive network in the LTIE. There is a clear risk that an ‘engineering mindset’ takes hold for an infrastructure project of this size – it is an exciting and rare opportunity to build a network from scratch. However, it illustrates the importance of commercial business budgeting practices and capital management, as well as strict oversight to impose cost discipline to ensure the network is not over-capitalised purely for ‘elegance’.
- 4.13 Optus notes that NBN Co’s initial Network Design Rules have been supported by an Analysys Mason report which essentially concludes that it finds “... NBN Co’s design of its fibre and wireless networks reflects an efficient and prudent network design.”³⁴ However, there are caveats to its conclusions.
- 4.14 In conducting its review of the Network Design Rules, Analysys Mason indicates that it has applied the following framework for analysis:
- (a) *In reviewing the ‘prudency’ of network design decisions made by NBN Co, we have had regard to whether those decisions have been made with care and thought for the future based on various factors, such as scalability, resilience and flexibility of the relevant element of the network design.*
 - (b) *In reviewing the ‘efficiency’ of network design decisions made by NBN Co, we have had regard to whether those decisions are likely to achieve the maximum result with minimum wasted effort or expense in the circumstances.*³⁵
- 4.15 However in accepting these conclusions, one must also take into account the key caveats in the technical review that has been undertaken. In particular, while the literal definitions set out above have been applied, Analysys Mason also notes that their “their analysis of some of

³³ NBN Co, Network Design Rules, 19 December 2011, p.4

³⁴ Analysys Mason, Review of the efficiency and prudency of NBN Co’s fibre and wireless network design, Report for Webb Henderson, 2 March 2012, p.2

³⁵ Analysys Mason, Review of the efficiency and prudency of NBN Co’s fibre and wireless network design, Report for Webb Henderson, 2 March 2012, p.12

the design decisions has, depending on the subject matter, focused on the prudence or efficiency of the particular choice, but not both.”³⁶

- 4.16 As such, in concluding that some design decisions are prudent, Analysys Mason has also neglected to address any inherent inefficiency in the acceptance of one design alternative over another. For example, almost all the assessment for prudence has been conducted against the constraint set out in the Statement of Expectations, despite the acknowledgement from the NBN Implementation Study noting that aspects such as the appropriate mix of network topologies should retain some level of flexibility. These estimates have currently been *“estimated today based on pre roll-out and limited field trials, but it is prudent to retain some flexibility until actual roll-out cost data are available.”³⁷* Similarly, Analysys Mason notes that *“NBN Co’s decision to re-use Telstra’s infrastructure is prudent from an operational perspective.”³⁸*
- 4.17 Optus submits that the limitations and constraints to the Analysys Mason report are significant. As a result the ACCC should treat its conclusions with caution. The fact that the Network Design Rules are consistent with the Statement of Expectations should not be determinative of whether the proposed network design is efficient and prudent in all respects. There may well be different ways of delivering the Government’s objectives as set out in the Statement of Expectations. It should be incumbent on NBN Co to prove that its chosen option is the most efficient from the various options available. This is the approach NBN Co itself proposes for changes to the Network Design Rules (clause 5.6 of schedule 8). The same principle should apply to the broader network design.
- 4.18 Further, whilst a particular technology might be appropriate from a social or welfare perspective, it does not automatically follow that it is appropriate in all circumstances to recover the costs of such a choice in access prices.

Deemed prudent expenditure

- 4.19 NBN Co has specified a number of Deemed Categories for the purposes of meeting the prudence requirement of capital expenditure and operating expenditure. Optus is somewhat conflicted in commenting on this approach given that it includes expenditure in relation to the Optus/NBN Co HFC transaction. However, we note that this is a novel approach that excludes considerable costs from the ACCC’s oversight.
- 4.20 Further, it does not appear reasonable to allow for categories such as ‘Third Party Funded Changes’, ‘Minor Variations’ and ‘Urgent and unforeseen variations, changes and enhancements’ to be included under the same terms as the interim, trial and Telstra/Optus arrangements (given the latter categories have generally been subject to extensive scrutiny prior to NBN Co entering into those arrangements). As such, this reclassification of Deemed Categories may be warranted for several reasons.

³⁶ Analysys Mason, Review of the efficiency and prudence of NBN Co’s fibre and wireless network design, Report for Webb Henderson, 2 March 2012, p.12

³⁷ KPMG-McKinsey, NBN Implementation Study, March 2010, p.472

³⁸ Analysys Mason, Review of the efficiency and prudence of NBN Co’s fibre and wireless network design, Report for Webb Henderson, 2 March 2012, p.103

- (a) ‘Third Party Funded Changes’ refer to the wholly third-party funding arrangement in relation to “*extensions to the NBN beyond the footprint originally designed by NBN Co.*”³⁹ While NBN Co cites a similar arrangement in relation to the ARTC Hunter Valley Access Undertaking⁴⁰ is in place, Clause 10 (User Funded Options) in that Undertaking in fact does not treat this class of expenditure to be automatically deemed prudent.⁴¹
- (b) ‘Minor Variations’ refer to expenditure that is incurred as part of network changes, in addition to Permitted Variations, and which falls under a Minor Expenditure Limit (MEL) threshold of \$100 million (annually indexed to CPI). This threshold is too high and should be reduced substantially. Further, it is not reasonable for the MEL threshold to be automatically increased by CPI (or any other factor) on an annual basis, but should (at a minimum) be subject to a review that is open to industry and in line with the SAU review periods.
- (c) ‘Urgent and unforeseen variations, changes and enhancements’ refer to expenditure that is incurred as part of network changes and which satisfies the following three conditions set out in Clause 4.10(b);

“(i) it is necessary that the variation, change or enhancement be operational within 6 months; (ii) the event or circumstances causing the variation, change or enhancement was not reasonably foreseeable by, and was beyond the reasonable control of, NBN Co; and (iii) a failure to address the variation, change or enhancement is likely to materially adversely affect the safe and reliable operation of the NBN Co Network or the supply of Product Components, associated Product Features or Ancillary Features.”

This raises several concerns for cost overruns to occur. Firstly, the proposed 6 month threshold is too long given that the change must address an issue that would adversely affect the safety or reliability of the network. It would be unacceptable for it to take 6 months to rectify (and make operational) a network issue that would put at risk the safety and operation of the network. Secondly the 6 month timeframe within which NBN Co is required to notify the ACCC of its intention is too lax. This notification of intent should be provided at the onset, or prior to the commencement, of any work to be conducted in relation to the proposed variation. Its inclusion into the RAB should also be pursuant to the ACCC’s approval of NBN Co’s notification (with an onus on proof) that the change was necessary and prudently incurred. Thirdly, the scope of affected supply aspects is also insufficiently broad and may include ‘Product Components, associated Protect Features or Ancillary Features’ that have not been approved by

³⁹ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011, p.116

⁴⁰ ARTC, Hunter Valley Coal Network Access Undertaking, 23 June 2011 [Commenced on 1 July 2011]

⁴¹ In this example onus is on the ‘Contributor’ to elect whether the ‘Project’ should undergo the process to be deemed prudent. For example, Clause 10.1(d) the Undertaking states that “*In negotiating a user funding agreement, a Contributor may elect: (i) to seek to have some or all of the Project costs deemed as Prudent through the Project proceeding through the RCG or seeking ACCC endorsement of the Project costs as Prudent (in which case ARTC will provide reasonable cooperation to the Contributor at the Contributor’s cost); and/or (ii) fund the Project without seeking to have some or all of the Project costs included into the RAB.*”

the ACCC. This raises the risk for the inclusion of capital expenditure that may have a tenuous link to the supply aspects.

The Prudent Cost Condition (and Prudent Design Condition)

- 4.21 Under the SAU, NBN Co will be allowed to recover all capital expenditure that satisfies both the Prudent Design and Prudent Cost conditions. Furthermore, in meeting these conditions, the capital expenditure incurred must be ‘materially consistent’ with the Network Design Rules (i.e. the Prudent Design Condition) and compliant with the NBN Co Procurement Rules (i.e. the Prudent Cost Condition).⁴² It follows that in assessing the reasonableness of the SAU, the ACCC *must* have regard to both the NBN Co documents setting out its network design and procurement rules.⁴³
- 4.22 As indicated above, both these Conditions set a very low hurdle in respect of the conditions to be satisfied for expenditure to be considered prudent and therefore off-limits to the ACCC. For example, expenditure can be considered prudent simply because it is incurred on an “*arm’s length basis*”, which presupposes that unlike any other regulated monopoly NBN Co has an innate ability to only pay the efficient rate for a good or service. Similarly, the CEO of NBN Co has the ability to determine whether expenditure is prudent, subject to only very loose rules, including the CEO’s sole opinion that “*it is in the best interests of the company to incur*” such expenditure. Neither of these examples provide a rigorous test of prudence.

Oversight of Network Changes

- 4.23 It is only when NBN Co proposes to make changes to its network that are outside the scope of the Network Design, or other permitted exclusions that the ACCC is given a more formal oversight role. However, under this process NBN Co affords itself maximum discretion such that the role of the ACCC is highly circumscribed.
- 4.24 For example, as set out in Clause 5 in Schedule 8 (Prudency), it is stipulated that NBN Co will be responsible for the assessment and selection of the appropriate Network Change Option to undertake subject to a number of high-level principles. Upon completion of its initial assessment, NBN Co will prepare a written report (the NBN Prudency Implementation Paper) that sets out only a summary of its key findings and recommendations.
- 4.25 Optus submits that this lack of transparency is not acceptable. This is further highlighted by Clause 5.9 in Schedule 8 (Prudency) which essentially grants NBN Co the discretion to select its own path for the approval of its preferred Network Change Option whereby “*in the case of a Product-related Network Change, NBN Co will either, at its option, seek the endorsement of: (i) Customers in accordance with the customer engagement and endorsement process under clause 6; or (ii) the ACCC in accordance with the regulatory endorsement process under clause 7.*”
- 4.26 However these proposed endorsement processes ultimately remain at NBN Co’s discretion. For example, whilst NBN Co acknowledges that a central aspect of its prudency model is customer engagement⁴⁴ this process is undermined by the fact that NBN Co in Clause 6.3 in

⁴² ACCC, NBN Co Limited Special Access Undertaking, Consultation Paper, December 2011, p.43

⁴³ The ACCC notes that NBN Co has not yet submitted its Procurement Rules to the ACCC

⁴⁴ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011, p.140

Schedule 8 (Prudency) has limited the ability of customers to endorse or object to NBN Co's preferred Network Change Option to NBN Co's own timeframe. For example, customers must make its decision within a stated time period upon publication of the NBN Prudency Implementation Paper. Furthermore, pursuant to Clause 6.3(b), the customer must also satisfy a number of stringent conditions set out in Clause 6.4 in order to object to the proposed Product-related Network Change Option. The efficacy of this process is clearly compromised given that NBN Co is responsible for both the preparation of the NBN Prudency Implementation Paper (in accordance with the loose requirements set out in Clause 5.8) and in the event of a Prudency Dispute, NBN Co has also set out the decision making criteria for a Prudency Dispute (in Clause 6.5) that states the ACCC must accept NBN Co's preferred Network Change Option unless the ACCC can effectively reasonably prove otherwise.

- 4.27 The SAU also provides NBN Co with considerable discretion to abruptly end the Network Change processes identified in Clauses 5 to 8 in Schedule 8 (Prudency), including where the product development process is terminated under Schedule 6 (Product development and withdrawal), in the event NBN Co decides not to proceed with the Network Change.
- 4.28 Finally, if the ACCC fails to reach a decision on an NBN Co network change proposal within a specified timeframe the network change is approved. This subverts the natural order which should stipulate that ACCC endorsement is a requisite for any expenditure to be approved since such expenditure will ultimately roll into access prices.

Operating expenditure

- 4.29 Under the SAU, NBN Co will be allowed to recover all operating expenditure that meets a number of principles. This includes if it meets the 'lowest Total Cost of Ownership' and a 'value for money' approach; or is incurred in a manner that is consistent with the 'Statement of Expectations' and any other regulatory requirement relating to procurement by NBN Co.⁴⁵
- 4.30 NBN Co has also set out a loose definition of operating expenditure in Schedule 1 (Dictionary and Interpretation) to include "*labour, marketing, general administration and overheads, materials, licence fees, government charges, universal service obligation levies, insurance premiums and applicable taxes.*" In addition, Clause 10.3 in Schedule 8 (Prudency) also sets out a number of Deemed Prudency of categories for operating expenditure.
- 4.31 Once again the approach sets a very low threshold for expenditure to be considered prudent. Given the quantum of operating expenditure that is likely to be incurred once NBN Co is fully operational, it is imperative that in line with common regulatory practice, operating expenditure should be subject to regulatory oversight in order to be deemed prudent.

Compliance arrangements

- 4.32 Not only does the SAU allow NBN Co wide discretion to set the rules on what is deemed to be prudent expenditure, it also allows NBN Co to police its own compliance with those rules.
- 4.33 The only recurring involvement of the ACCC in the prudency of NBN Co's expenditure is through the annual compliance reporting requirement set out in Clause 3 in Schedule 10 (Reporting). However this arrangement remains deficient in terms of providing any

⁴⁵ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011, pp.125-126

mechanism for recourse, since “the ACCC is not given a formal approval role to determine NBN Co’s expenditure has been incurred prudently.”⁴⁶ The ACCC is simply the recipient of a compliance report prepared and verified by NBN Co. There is no onus on NBN Co to provide any evidence, or even report, on what basis the expenditure has complied with the prudency arrangements. There is no role for the ACCC to independently check or seek verification of expenditure.

Summary

- 4.34 It is clear from the analysis above that the SAU provides for limited, if any, ACCC oversight of NBN Co’s expenditures. This is not acceptable and a new prudency model should be established that provides for actual oversight and scrutiny of NBN Co’s costs with the objective of applying a genuine discipline on NBN Co to incur its costs in a prudent and efficient manner.
- 4.35 Without such regulatory oversight, NBN Co will be able to incur costs that it itself declares to be prudently incurred, particular given the low thresholds (and commitments) for prudency compliance it has set out in the SAU. This raises the real prospect that self-interest will prevail, with the result that access charges and ultimately end-users charges are higher than they ought to be because there is no discipline on NBN Co to actually reduce its costs. Such an outcome will not be in the long term interest of end-users nor would it meet the standards of control expected for a regulated entity.

Regulatory oversight of expenditures in other network industries

- 4.36 Whilst NBN Co has cited precedent from other regulated industries in support of its proposed approach, it has departed substantially from those established approaches. The ACCC acknowledged that the prudency framework set out in the SAU “differs from other common regulatory frameworks which generally provide periodic regulatory oversight of the quantum of expenditures that can be recovered through regulated access prices.”⁴⁷
- 4.37 It is common practice across different regulated network industries for the regulator to have strict oversight of expenditures, some of which are summarised in Appendix C. Importantly, there is recognition that regulatory review must occur both before and after the investment has been incurred.
- 4.38 For example, during the transition from state-based regulation to national regulation of electricity networks there were less stringent requirements for ex-post review which lead to incentives to incur potentially inefficient costs. Under the transitional rules for the AER’s 2009 determination a cost overrun in the last regulatory period was allowed to be rolled-in to the RAB without the same level of regulatory scrutiny in the new determination. This was a significant departure from the approach under the previous state-based regulatory regime. As a result, there was a significant capital overspend among the NSW electricity network businesses in the final year of the previous five-year pricing period. This was recently highlighted by Industry and Investment NSW:

⁴⁶ ACCC, NBN Co Limited Special Access Undertaking, Supplementary Consultation Paper, February 2011, p.55

⁴⁷ ACCC, NBN Co Limited Special Access Undertaking, Supplementary Consultation Paper, February 2012, p.54

Energy Australia exceeded its approved capital allowance over the full period by 32% including by 72% in the final year. Its RAB increased from \$4.6b to \$8.5b from the start of the previous pricing period to the start of the new pricing period in 2009/10. Country Energy overspent by 41% in the final year of the period. In comparison Integral Energy underspent by about 3.5% for the period. TransGrid deferred its capital expenditure which resulted in an underspend over the first 4 years and increased expenditure in 2008/09. Its expenditure exceeded the allowance for the period by about 7%.

... However, there is no doubt that this massive increase in capital expenditure is a major driver of the large costs and electricity bill increases paid by customers in NSW.⁴⁸

4.39 This emphasises the importance of *ex-ante* as well as *ex-post* assessments of expenditures.

Recommendations

4.40 As indicated above, NBN Co is expected to incur substantial capital and operating expenditures in an environment where it faces no market discipline. It is important, therefore, that the regulatory arrangements that apply to NBN Co create an incentive for it to only incur costs that are necessary and at levels that are reasonable for it to meet its objectives. In essence the regulatory arrangements should seek to replicate the disciplines that an entity would face in a competitive environment.

4.41 Optus submits that this will be achieved by ensuring that all of NBN Co's expenditure is subject to detailed ACCC scrutiny and oversight. How this should be applied in practice will to some degree depend upon the nature of the arrangements for setting and approving NBN Co's prices. Nevertheless, as set out in Section 3, the arrangements should help to ensure that each of the following Access Seeker requirements for pricing arrangements are met:

- (a) Price transparency;
- (b) Price certainty; and
- (c) Price stability.

4.42 Ultimately there should be no presumption by NBN Co that it can recover costs unless they have been endorsed by the ACCC.

4.43 Optus therefore submits that, as a minimum the ACCC should have clear powers to:

- (a) Review and approve upfront NBN Co's forecast capital and operating expenditure;
- (b) Review and approve NBN Co's actual capital and operating expenditure; and
- (c) To exclude expenditure that the ACCC considers to be inefficient.

⁴⁸ Industry and Investment NSW, NSW Electricity Network and Prices Inquiry, Final Report, December 2010, p.34

- 4.44 The significance of this regulatory oversight should not be underestimated since it will deliver clear benefits. Firstly, it will apply strong behavioural incentives on NBN Co to incur costs in an efficient and prudent manner, since it will create a real threat that the ACCC can disallow expenditure. Second, it will apply an appropriate check and balance on NBN Co through the ex post approval of actual expenditure.

Section 5. Non-Price Commitments

- 5.1 Recent experience in the telecommunications sector has demonstrated that where there is a monopoly supplier of wholesale services the non-price terms and conditions are as likely to raise competition concerns as price related terms of access. The non-price terms of access can raise barrier to competition by impose unnecessary costs on access seekers and/or processes that are unaligned with customer expectations making it harder for access seekers to develop the services that end users demand.
- 5.2 The fact that NBN Co will operate as a wholesale-only entity will address a number of problems this sector has historically faced. Since NBN Co will not operate in retail markets it has no incentive to discriminate in setting access terms for its wholesale services. Moreover, there are legislative obligations to prevent NBN Co from discriminating in the provision of services between access seekers.
- 5.3 However, whilst NBN Co will have no incentive or ability to set non-price terms of access that are discriminatory, it does not follow that its interests in setting non-price terms of access will fully align with those of access seekers or end customers. There are some key risks related to the non-price terms and conditions of supply, this includes;
- (a) That NBN Co will seek to push risks (and consequently costs) in the provision of services onto access seekers even when NBN Co is in the best position to control those risks;
 - (b) That NBN Co will seek to set access terms that meet the lowest threshold in terms of the quality of services offered; and
 - (c) That NBN Co is unresponsive to customer requirements.
- 5.4 Optus anticipates that many of these risks can be mitigated if there is an appropriate degree of balance in the way access terms and conditions are agreed. As discussed in Section 2 of this submission this will be achieved by ensuring that access seekers' have recourse to appropriate regulatory oversight in negotiating any access agreement with NBN Co. It is also important to ensure that there are adequate controls over NBN Co's ability to unilaterally vary access terms and conditions (which it currently has to a substantial degree under the WBA).
- 5.5 These issues have recently been highlighted by the roll-out of Singapore's NBN. The equivalent of NBN Co in Singapore, OpenNet, is subject to regulatory oversight. Since OpenNet has commenced its commercial operation for more than a year, the Info-communications Development Authority (IDA) has undertaken a review on the OpenNet's

Interconnection Offer. This has unearthed a number of significant complaints from access seekers about OptusNet's operational performance. This includes excessive wait times for activating customer fibre services, delays in installations, slow responses in relation to faults, and exorbitant and hidden charges from OpenNet.⁴⁹

- 5.6 The IDA has subsequently directed OpenNet to amend particular provisions of its Interconnection Offer.⁵⁰
- 5.7 Optus submits that the ACCC should have a similar oversight role. In addition, the SAU should also set out clear commitments in respect of the non-price terms and conditions of supply.
- 5.8 In the remainder of this section Optus has set out some specific comments and recommendations on the non-price commitments that are provided in the SAU.

Relationship between the SAU and the WBA

- 5.9 Under clause 2.6 of the SAU, it states that to the extent that the SAU does not specify an aspect of the supply of a Product Component, associated Product Features and/or Ancillary Services, those aspects will be set out in the WBA.
- 5.10 In addition, NBN Co has deferred most of the non-price terms in the SAU to the WBA.
- 5.11 The ACCC has stated in the discussion paper that the WBA does not form part of the SAU and that it does not have a legislative role in assessing the reasonableness of the WBA. As a result, it will not be assessing the specific terms and conditions that are contained in the WBA as part of the SAU assessment process (unless they are incorporated into the SAU).
- 5.12 Optus is concerned that if the SAU becomes accepted by the ACCC, access seekers will be bound by the terms outlined in the SAU as well as terms that have been deferred to in the WBA.
- 5.13 By having most of the supply of a Product Component, associated Product Features and/or Ancillary Services in the WBA, NBN Co reserves significant discretion for itself to unilaterally vary the provisions (without requiring access seekers' agreement or providing for the ACCC's oversight).
- 5.14 Further as discussed in Section 2, the SAU has lower priority than the WBA in the statutory hierarchy. This effectively locks in NBN Co's broad discretion over those terms and thereby creates a lack of certainty for access seekers in relation to the non-price terms of supply and a lack of adequate protections and controls over NBN Co (including ensuring those terms remain fair and reasonable over time).
- 5.15 *Recommendation*

⁴⁹ Communications Day, "Singapore's NBN woes shouldn't go unheeded in Oz", 19 March 2012

⁵⁰ IDA, letter to OpenNet Pte Ltd –Direction of the IDA of Singapore made pursuant to section 27 of the Telecommunications Act in respect of the review of OpenNet Pte Ltd's Interconnection Offer for the Provision of Services over the Next Generation Nationwide Broadband Network, 27 February 2012

- (a) The SAU should be a self-contained document. NBN Co should not be allowed to simply deter its terms in the SAU to a commercial agreement. The SAU should set out comprehensive commitments on its non-price terms and conditions of supply.
- (b) In the absence of a SAU that could be accepted by the ACCC, the ACCC should consider alternate means to regulate NBN Co.

Service Levels, POI Relocations, NBN Upgrades and Network Availability

- 5.16 Optus submits that the “commitments” NBN Co has made on service levels do not promote the LTIE and are not reasonable.
- 5.17 NBN Co made a number of “commitments” regarding service levels.
- 5.18 In Schedule 11 Clause 14.2(a) NBN Co commits to introduce service levels no later than 30 June 2012 *“dealing with matters including network performance, service delivery, communication with Customers and planned and unplanned event management”*.
- 5.19 Additionally through the Product Development Forum (Schedule 6 Clause 3.7) and Schedule 11 Clause 14.2(b) , *“NBN Co will consult with Customers”* in relation to service levels and will *“maintain and periodically update a service level regime in respect of those Product Components and associated Product Features for which a service level is introduced”*.
- 5.20 Optus submits that these commitments *cannot* be taken to mean that NBN Co will provide service levels that meet the market requirements or reflect the capability of a world class network. The SAU does not specify any service levels. It is also unclear if the service level regime is expected to apply only to NBN Co’s existing fibre product or if it includes products that form part of the Initial Roadmap. These commitments simply show NBN Co’s intention to introduce service levels in the near future. These commitments do not ensure that there is a proper consultation in place to specify the service levels or that any resultant service levels will meet customer requirements.
- 5.21 Further NBN Co has omitted to make any service level commitments for the Wireless or Satellite services. Optus submits that service levels for all services, whatever the delivery method, should be specified. NBN Co has already started the consultation process regarding service levels as part of the consultation on the WBA and the subsequent Contract Development Process. This consultation process has been occurring for more than 12 months. The consultation process however lacks any formal process, transparency or resolution processes when Customers genuinely consider that the service levels (and associated pricing) do not meet current market expectations. This is particularly the case for the Business Services where there is a clear lack of tangible service levels that will meet the requirements of its Customers and end users.
- 5.22 Additionally NBN Co fails to acknowledge any nexus between service levels, network availability and any activity undertaken by NBN Co that may affect network availability or access to the NBN Co Platform. Activities such as POI Upgrades, NBN Upgrades, NBN Co Platform changes and NBN Maintenance⁵¹ have the potential to make services unavailable for extended periods of time.

⁵¹ NBN Maintenance is defined in the WBA as “...any maintenance, repair, rationalisation or remediation of: (a) Any NBN-Related Network; (b) any other matter or thing for which NBN Co is responsible and which affects, or can affect, the supply of products by NBN Co to Customers or any Other NBN Co Customers; or (c) any

- 5.23 As currently drafted under the SAU, NBN Co may perform POI Upgrades, NBN Upgrades and NBN Platform changes simply by providing “notice” to its Customers. There is no onus on NBN Co to contain, or minimise, the impact of these activities. These activities may therefore impact services affecting for extended periods of time and Customers and its end users will have no recourse. This is unacceptable for end users who will expect services to be reliable, robust and available.
- 5.24 To date NBN Co has demonstrated a distinct reluctance to make any changes on issues such as network availability, product components and service levels (particularly for Business and Enterprise Fibre Access Services) despite numerous consultations and written submissions. NBN Co will be a monopoly supplier, it will have no incentive to innovate and adopt best practices for service levels. This is not in the LTIE. As the ACCC stated in the Discussion paper, service levels are necessary for access seekers to undertake network planning and product design for the downstream markets.⁵² It ensures access seekers are able to design a network that fulfils their contractual obligations to end-users around service quality. In the absence of specific identifiable service levels in the SAU, NBN Co will have the ability to lower costs by decreasing expenditure on investment and maintenance, in turn degrading the quality for services.⁵³
- 5.25 OpenNet provides a good example. The OpenNet’s Interconnection Offer fails to specify the relevant service levels.⁵⁴ The IDA has recently received complaints from access seekers that OpenNet had failed to deliver 70% of its non-residential orders in the scheduled timeframes and that in many cases the eventual delay lasted many months. The penalties applied to OpenNet were clearly not enough to discourage poor performance or service.⁵⁵
- 5.26 Further, it is important to note that the proposed term for the SAU is 30 years. It is unreasonable that NBN Co fails to commit to provide any relevant service levels for the next 30 years. Optus therefore submits that the SAU should specify service levels for all components of the NBN Access Service and the underlying network. In addition, there should be a regular review process (with the relevant stakeholders including the ACCC and access seekers) in ensuring the specified service levels are appropriate and reflect best industry standards.
- 5.27 At a minimum, NBN Co should offer services levels that are comparable to domestic and international benchmarks. The service delivery metrics should be based on best market practice for both residential and business grade services. At a minimum, residential service delivery should enable RSPs to meet the CSG standard regardless of whether they are new connections to the NBN Co network or whether the end users are migrating from an existing legacy network. For business grade services, connections should be based on the best in the market and also provide flexibility for expedited fast-tracked connections.

facilities, at, on or under which the NBN Co Network is attached, located or installed, including any maintenance, repair, rationalisation or remediation that is necessary or desirable to repair any NBN Faults.

⁵² ACCC, NBN Co Limited Special Access Undertaking, Consultation Paper, December 2011, p.32

⁵³ ACCC, NBN Co Limited Special Access Undertaking, Consultation Paper, December 2011, p.32

⁵⁴ OpenNet, Interconnection Offer, clause 10 quality of mandated service, submitted to the IDA on 20 January 2009 and approved by the IDA on 30 October 2009, psp.15-16

⁵⁵ Communications Day, “Singapore’s NBN woes shouldn’t go unheeded in Oz”, 19 March 2012

- 5.28 NBN Co should also be obliged to define its service levels which include predefined “maintenance windows”. These maintenance windows should be pre- defined in time periods, frequency and geographical area and should be used for all planned works such as POI Upgrades, NBN Upgrades, NBN Maintenance and NBN CO Platform changes (eg. 2am-6am Monday –Sunday for up to 8 hours per month per CSA). Network availability metrics should then be defined outside of these maintenance windows, ie. all other times outside of the pre-defined maintenance windows. Therefore ,any outages to the NBN Co Network or Platform that fall outside of the maintenance windows timeframes will be deemed a fault.
- 5.29 Additionally, network availability should be more stringent as the network element aggregates more services. For example, network availability of a Network-Network-Interface (**NNI**, 99.99%) should be higher than an Access Virtual Circuit (**AVC**, 99.95%) as the outage on an NNI has the capacity to affect many more end users than an outage on an AVC which may only affect a singular customer.
- 5.30 Network availability will subsequently assist in defining service levels per product. Other metrics such as jitter, latency and packet loss must form part of these service levels as they are inherent to delivering services business grade services in particular. Refer to Appendix D for more details on Optus’ concerns with the current proposals by NBN Co.
- 5.31 As service levels are relevant to the assessment of the price-related terms, Optus considers that NBN Co’s failure to meet the service levels and network availability should result in appropriate service level rebates or service credits, particularly where non-compliance is repeated. This is particularly the case when Customers may have to compensate end users for failing to meet the relevant service levels.
- 5.32 *Recommendations*
- (a) The SAU should specify service levels for all components of the NBN Access Service and the underlying network;
 - (b) At a minimum, the service levels NBN Co offers should be comparable to domestic and international benchmarks;
 - (c) The service levels should be defined to include “maintenance windows” and “network availability” metrics. “Maintenance windows” should be used for all planned works such as POI upgrades, NBN upgrades, NBN Maintenance and NBN Co Platform changes. “Maintenance windows” should be pre-defined in time periods, frequency and geographical area. “Network availability” metrics should be defined outside of these maintenance windows;
 - (d) The service levels should also include other metrics including jitter, latency and packet loss;
 - (e) There should be a regular review process with the ACCC and access seekers in ensuring the specified service levels are appropriate and reflect best industry standards; and
 - (f) If NBN Co fails to meet its service levels, it should compensate Customers with appropriate service level rebates or service credits.

POI

- 5.33 Under Clause 6.1(b) of Schedule 11 of the SAU, NBN Co may initiate a POI review at any time and will consult the ACCC and/or with Access Seeker in respect of the criteria that will apply to the review.
- 5.34 It appears that under the SAU, only NBN Co is able to initiate a POI review. This is not reasonable as both the Access Seekers and the ACCC should be given the same opportunity to initiate a POI review.
- 5.35 Whilst NBN Co will need to consult with the ACCC and Access Seekers in relation to the criteria to be applied in conducting a POI review, Optus considers that these criteria should be set up-front in the SAU as it promotes greater certainty to the industry, particularly as significant capital expenditure will have been incurred by all Customers in establishing POI sites. Optus also considers that any changes to the criteria should be subject to the ACCC's approval.
- 5.36 In addition, whilst any closures or relocations to an Established POI will be provided with a minimum 12-month notice, this notice period does not apply to Temporary POI. A Temporary POI will only be provided with 6-month notice under Schedule 11 Clause 6.4(b).
- 5.37 Optus submits that the notice period provided for Temporary POI is unreasonable. Optus considers that the same notice period should apply to both Established POIs and Temporary POIs. The amount of work Access Seekers are required to undertake to relocate an Established POI is no different to a Temporary POI. Generally a Customer will need to gain access to facilities that may not be owned and operated by NBN Co and this will require significant lead times to access these facilities.
- 5.38 Under Schedule 11 Clause 6.6, the ACCC is required to approve or reject NBN Co's request to relocate, close or open a new POI. This approval process should not be constrained to a maximum of 80 business days, as the ACCC may wish to consult with industry to determine the competitive infrastructure to existing and new POIs. At a minimum, Optus submits that clause 6.6(c) of Schedule 11 should be deleted as an absence of a decision does not constitute acceptance.
- 5.39 *Recommendations*
- (a) The SAU should allow both NBN Co and the ACCC to initiate a POI review;
 - (b) All criteria that will apply in a POI review should be set up-front, with consultation with the ACCC and access seekers;
 - (c) Any closures or relocation to a Temporary POI should be provided with a minimum 12 months; and
 - (d) Clause 6.6(c) of Schedule 11 of the SAU should be deleted.

Ancillary Services (including Facilities Access, NBN Co Platform)

- 5.40 Optus considers that there is a complete lack of regulatory oversight on all Ancillary Services despite the statement that "NBN Co will offer to supply the Ancillary Services to Customers subject to the terms of this Special Access Undertaking" (SAU Clause 2.4).

- 5.41 NBN Co states that Ancillary Services do not form part of the NBN Access Service (Clause 2.4(b)), and defers to the Wholesale Broadband Agreement for the terms and conditions that apply to the Ancillary Services. Ancillary Services are defined in the SAU to include;
- (a) the Facilities Access Service;
 - (b) the Systems Interfacing Service; and
 - (c) any other product or service developed by NBN Co from time to time that is ancillary to the supply of the Product Components and associated Product Features.
- 5.42 Optus submits that Ancillary Services are essential to the interconnection and supply of the declared services. For example, access seekers will not be able to obtain NBN services without first obtaining the Facilities Access products. Ancillary Services therefore should be an integral part of the NBN Access Service.
- 5.43 By stating in the SAU that Ancillary Services do not form part of the NBN Access Service, it appears that NBN Co is intending that Ancillary Services will not become declared services if the SAU is accepted. NBN Co effectively gives itself complete discretion for the terms of supply of Ancillary Services. By providing 40 business days notice, NBN Co incorporates Facilities Access as part of the Access Agreement by sending Optus an updated Product Catalogue which includes the Facilities Access module. The inclusion of Facilities Access, other products on the Initial Roadmap and Ancillaries into the WBA can be done with no prior consultation or opportunity to negotiate. Since it appears NBN Co is entitled to follow that course of action under the WBA, it demonstrates that the WBA does not provide a legal and regulatory framework in which the interests of Customers are appropriately protected.
- 5.44 Similarly, NBN Co has stated in the WBA (Facilities Access Service –Product Description) that Facilities Access Service will not become declared service after the SFAA is published on its website:
- “The Facilities Access Service is not a listed carriage service or a service that facilitates the supply of listed carriage service for the purposes of section 152AL of the CCA. The inclusion or supply of the Facilities Access Service under the Wholesale Broadband Agreement published on NBN Co’s Website does not have the effect of making the Facilities Access Service a declared service for the purposes of Part XIC of that Act.”*
- 5.45 This is not in the LTIE as NBN Co is denying access seekers the right to seek regulatory intervention on facilities services. By excluding facilities services from the SAU, Optus is concerned that access seekers will have no recourse in the event that Telstra gains a competitive advantage in its own exchange building.
- 5.46 Whilst under the WBA, it states that the Facilities Access Service *“supports interconnection between the Customer Network and the NBN Co Network at the Network-Network Interface at a POI located within an Aggregation Node Site”*, in most cases however, NBN Co will be leasing the POI space from a third party such as Telstra (ie. leasing Telstra’s exchange building space).
- 5.47 In these circumstances, the Customer must gain the rights to deploy lead-in or backhaul transmission cables to a relevant Aggregation Node site (**“Building Entry Rights”**) from the third party such as Telstra prior to obtaining the Facilities Access Service from NBN Co.

- 5.48 Obtaining Building Entry Rights effectively means that the building owner, ie. Telstra, who is not required to gain such rights, has the advantage of establishing and gaining continued access to the Facilities Access Service in advance of all other Customers.
- 5.49 Optus considers this is positive discrimination to building owners such as Telstra and must be addressed as part of the SAU. This can be addressed by either queuing all Customers after they have gained Building Entry Rights; or, by NBN Co ensuring that sufficient Building Entry Rights are secured from the building owner for the forecasted demand from all Customers. Regardless of the solution, NBN Co must ensure that access to the interconnection from the Customer Network to NBN Co Network is gained via fair and non-discriminatory terms.
- 5.50 Similarly, Optus submits that access to the NBN Co Systems Interface Service is essential to the supply of the NBN Co Access Service and should form part of the NBN Access Service. This is because all services cannot be service qualified, ordered, repaired, cancelled or billed without reliable access to the Systems Interface Service. Optus considers that the SAU should contain defined availability metrics, functionality, response times, transaction volumes, and maintenance/updates windows in relation to the NBN Systems Interface Service. This is currently absent from the existing SAU as it simply defers to the WBA. Deferring to the WBA for the terms of access to the Systems Interface Service provides no certainty for Customers and maximum flexibility to NBN Co.
- 5.51 Finally, for other services that are an Ancillary Service i.e. “any other product or service developed by *NBN Co from time to time that is ancillary to the supply of the Product Components and associated Product Features*”, regulatory oversight for the pricing and non-price terms of this service is essential and must be included as part of NBN Co SAU obligations. For example, enhanced service assurance for Business Grade Services may be considered by NBN Co to be an Ancillary Service. The price and non-price terms of these services are integral to what an end customer will receive and therefore must be effectively regulated.
- 5.52 *Recommendations:*
- (a) All Ancillary Services should form part of the NBN Access Service with regulatory oversight for price and non-price terms;
 - (b) All Ancillary Services should be subject to a service level regime as access to these services are instrumental to the fibre/wireless or satellite service; and
 - (c) Potential discrimination such as Building Entry Rights should be remedied through commitments by NBN Co to queue Customers equally or by NBN providing Building Entry Rights.

Lifecycle Management – Changes to the Agreement

- 5.53 Under Clause 14.3 Schedule 11 of the SAU, NBN Co may make changes to Access Agreements in accordance with the terms of the Access Agreement. Where there are specific processes defined within the Access Agreement, the specific process will be followed. All other changes will be subject to the consultation process set out in clause 14.3(d) Schedule 11 of the SAU.

- 5.54 Essentially this means that by complying with the notice period determined in the Access Agreement, NBN Co has the unilateral right to:
- (a) define all aspects of the products within Initial Product Roadmap;
 - (b) define all aspects of the Ancillary Services;
 - (c) introduce enhancements to existing products or implement minor changes;
 - (d) increase the price of any service (except for the Basic Access Offer during the First Term);
 - (e) relocate/change or close POI sites;
 - (f) amend the Insurance Terms;
 - (g) implement what NBN Co reasonably believes to be a Minor Change;
 - (h) amend the Credit Policy;
 - (i) amend the Product Technical Specifications and other documents;
 - (j) amend the PDF Process; and
 - (k) amend the NBN Co Operations Manual.
- 5.55 Essentially, NBN Co is afforded wide discretion to change critical parts of the Access Agreement by simply giving notice to its Customers. There is no obligation on NBN Co to consider access seekers' requirements on the long term interests of end users in these matters.
- 5.56 Additionally whilst Schedule 11 clause 14.3(d) imposes an obligation on NBN Co to "consider feedback" from Customers, this will only apply to limited circumstances where the specific processes do not apply. As the specific processes defined above encompass most aspects of the Access Agreement, the opportunity to consult is extremely limited.
- 5.57 Where the consultation process set out in Schedule 11 clause 14.3(d) is undertaken, Optus submits that it is not reasonable or adequate since it does not impose an onus on NBN Co to conduct a transparent process whereby Customers provide concerns/written submission regarding the proposed changes and NBN Co makes genuine effort to resolve these concerns through multilateral negotiations. NBN Co only has to "reasonably consider" any feedback given by a Customer and/or the ACCC. There is no criteria or principles that NBN Co needs to take into account and the ultimate decision will be made by NBN Co.
- 5.58 *Recommendations:*
- (a) The SAU should contain a provision which ensures all changes to the Access Agreement are subject to a transparent process whereby *all* Customers' feedback is brought into a multilateral forum for discussion and resolution. The proposed Contracts Development Process may be an appropriate forum on the assumption that appropriate changes are made to the process such that effective industry engagement is undertaken. Where that fails, Customers must have the opportunity to seek an ACCC AD or BROCC.

Initial Product Roadmap and Product Development Forum

- 5.59 Schedule 6 of the SAU addresses Product Development and Withdrawal.
- 5.60 However under clause 1(b) of Schedule 6, all products which form part of the Initial Roadmap and any ancillary services that support the supply of all products, are excluded from the processes defined in the Product Development Forum.
- 5.61 Further, a minor variation or enhancement to a product component is also excluded from the processes defined in the Product Development Forum.
- 5.62 Optus submits that the exclusions are not reasonable. Effectively, NBN Co has broad discretion to develop products, modify products and withdraw products (except for the Basic Access Offer) which are part of the Initial Roadmap up to the year 2015. NBN Co also has broad discretion in determining whether a variation or enhancement to a product is minor.
- 5.63 All ancillary services that are necessary to acquire products are similarly excluded from any regulatory oversight. An absence of regulatory oversight on all aspects of the products to be released up to 2015 is unacceptable. At a minimum, these products must be subject to the processes of the Product Development Forum. See paragraph 5.67 regarding Optus' proposals for the Product Development Forum to be modified.
- 5.64 As the Initial Roadmap Products will form the core product set, it is essential that the products and their features meet, or exceed, any domestic or international benchmarking. However, NBN Co has failed to develop product components which meet the current industry standard. For example, the service levels are below what is currently in the market, particularly for business services.
- 5.65 NBN Co has developed, or is developing these products, without any obligation to take into consideration feedback from its Customers. Additionally the ACCC will have no oversight of the pricing, services levels or features of any of the products which fall within the Initial Product Roadmap. Optus therefore submits these services must be subject to the same level of scrutiny which includes the initial price, price changes, ancillary pricing to the product components or features and other non-price terms such as service levels.
- 5.66 The Product Development Forum is proposed for all Products, Product Features and Product Components that are not on the Initial Roadmap. NBN Co stated its intention for the Product Development Forum is to provide a forum that facilitates an open and consultative dialogue with Customers in respect of Product Ideas.⁵⁶ However, Optus has a number of concerns with the forum as there are many opportunities for the process to be frustrated. The SAU provides NBN Co with absolute discretion in the Product Development process and is not subject to any regulatory oversight:
- (a) NBN Co may prioritise ideas based on factors such as *“the level of engagement of the Submitting Customer in the assessment and development of the Product Idea”*;
 - (b) NBN Co may assess a product idea based on *“any other factor that NBN Co reasonably considers should be taken into”*;

⁵⁶ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 20 December 2011

- (c) Customers must grant to NBN Co any necessary IP even though any submitted Product Idea may be rejected by NBN Co in its absolute discretion;
- (d) NBN Co has absolute discretion to change or delete any component of the Product Idea;
- (e) NBN Co has ultimate discretion in the pricing and service levels and features of the developed product;
- (f) Where NBN Co is required to seek endorsement of its Product Solution from either the ACCC or its Customers, NBN Co may choose which path offers the lowest impediment for its endorsement process (Schedule 8 Prudency Clause 5.9(a)). The Product Development Process is not subject to any dispute process. Customers have no rights to dispute NBN Co's decision; and
- (g) The ACCC is not able to propose a variation to the PDF process or customer engagement process unless NBN Co submits a variation proposal.

5.67 Optus submits that unambiguous, objective criteria by which NBN Co may suspend, deprioritise and change a Product Idea should be part of all assessments during the PDF. The process should be able to be subject to a dispute resolution process and, finally, the ACCC should have final approval of any new Products that are to be developed and this should include all price and non-price aspects of the new Product.

5.68 *Recommendations*

- (a) There should be no exclusion of any products which form part of the Initial Roadmap and any ancillary services that support the supply of all NBN Co products from the processes defined in the Product Development Forum;
- (b) There should be no exclusion of any minor variation or enhancement to a product component from the processes defined in the Product Development Forum;
- (c) There needs to be appropriate regulatory oversight on the pricing, service levels and/or products features of any of the products which fall within the Initial Product Roadmap;
- (d) NBN Co should be bound by objective criteria in assessing whether a Product Idea should be suspended, deprioritised or amended;
- (e) The Product Development Forum should be subject to a dispute resolution process and if it fails, the ACCC should have the final approval of any new Products that are to be developed and this should include all price and non-price aspects of the new Product.

Product Withdrawal

5.69 Under the SAU, NBN Co will not withdraw any of the four basic Product Components (UNI, AVC, CVC, and NNI) during the term of the SAU or withdraw the Basic Access Offer during the First Period. Also under the SAU, NBN Co undertakes not to introduce a new product substantially similar to the product to be withdrawn for the purpose of avoiding the Individual Price Increase Limit.

- 5.70 These terms are inconsistent with the terms of the WBA. Under the WBA, NBN Co may, with 24 months' notice (or 6 months' notice for a Tasmania Tri-Area Service, "TTAS"), withdraw a Product, or a Product Component/Feature whose withdrawal will have a material adverse change to the Product.
- 5.71 With 12 months' notice, NBN Co may withdraw a Product Component or Product Features. Therefore by providing sufficient notice period, NBN Co may withdraw a Product or Product Component or Product Feature.
- 5.72 However under the SAU, NBN Co needs to have regard to a number of factors, which are detailed in the SAU Schedule 6 Clause 5.3(b), before withdrawing Products or Product Components or Product Features. These factors include the existing demand for the Product Component/Feature and the functionality offered by a replacement or comparable alternative to the Product Component/Feature being withdrawn.
- 5.73 While the WBA Clause A4.2 states that NBN Co "*will not stop supplying or offering to supply a Product, Product Component or Product Feature if to do so would breach any law applying to NBN Co or SAU*", a breach of this clause may simply be a breach of the Access Agreement rather than any absolute obligation under the SAU.
- 5.74 Optus submits that the terms of the SAU for product withdrawal should override those in the WBA. Further, as discussed earlier disputes should be subject to a broader ACCC oversight.
- 5.75 Further, Optus submits that NBN Co should have an obligation to offer a replacement or alternate product if the product withdrawal will have a material impact on one or more Customers. From an end user's perspective, a Product withdrawal will be a detrimental outcome and therefore a product replacement is required.
- 5.76 *Recommendations:*
- (a) NBN Co can only withdraw a Product, Product Component or Product Feature after consultation with the industry and on approval of the ACCC and in the event of such approval with a 24 month notice period; and
 - (b) The SAU should also contain a commitment by NBN Co to offer a replacement or alternate product in the event NBN Co withdraws a product that will have a material impact on one or more Customers.

Confidential Information

- 5.77 Optus submits that the proposed confidentiality regime under clause 11 Schedule 11 is not appropriate. The proposed confidentiality regime does not;
- (a) give Customers sufficient comfort that their confidentiality information will be adequately protected; or
 - (b) describe clearly NBN Co's and its customers rights and obligations in respect of the disclosure and use of Customer confidential information.
- 5.78 Under clause 11.1(b) Schedule 11, the proposed confidentiality regime simply references to, and therefore enshrines, NBN Co's broad rights under the WBA to use and disclose Customers' confidential information.

- 5.79 Optus is concerned by the breadth of NBN Co's rights to disclose Customer Confidential Information to third parties under the WBA, which are unnecessarily broad.
- 5.80 Under the WBA, NBN Co may disclose Confidential Information to a third party to the extent necessary to (among other grounds) plan, develop, test and trial Products and to exercise its rights and performs its obligations under the Product Development Forum; to review the Customer's credit risk; for the purposes of pull through activities; for purposes connected with disconnection of premises from a third party network and the provision by that third party to NBN Co of access to or ownership of parts of that third party's network; to any Commonwealth government minister, their respective government departments and/or their delegates (as authorised by law).
- 5.81 NBN Co is not required to obtain prior consent from the Customer. It has absolute discretion in determining whether the disclosure is necessary.
- 5.82 Further, the approach of simply referencing what NBN Co is permitted to do under the WBA locks in NBN Co's broad rights to unilaterally amend the WBA (in many cases without any consultation with Customers). NBN Co could therefore potentially derogate from Customers' existing rights and NBN Co's existing obligations under the WBA, and therefore under the SAU also, with no ACCC scrutiny or right of recourse.
- 5.83 Optus therefore believes that NBN Co should only be entitled to use or disclose confidential information of a Customer:
- (a) to the extent necessary to exercise its rights or perform its obligations under the SAU (such as to enable NBN Co to provide the NBN Access Service to the Customer); or
 - (b) where NBN Co is required to do so by law.
- 5.84 Further in relation to confidentiality obligations in the PDF process, Optus notes that Schedule 6 Annexure 1 clause 5.6(a) effectively enables NBN Co to override any confidentiality protections in the PDF (by requiring Customers to grant NBN Co additional rights to use and disclose, and waive any restrictions, in respect of Customer's confidential information).
- 5.85 Optus therefore proposes that Schedule 6 Annexure 1 clause 5.6(a) and 5.6(b) to be deleted from the SAU. If NBN Co requires any additional rights to a Customer's confidential information then any such additional rights should be specifically agreed with the Customer.
- 5.86 *Recommendations*
- (a) NBN Co should only be entitled to disclose confidential information of a Customer:
 - (i) To the extent necessary to exercise its rights or perform its obligations under the SAU; or
 - (ii) Where NBN Co is required to do so by law.
 - (b) Schedule 6 Annexure 1 clause 5.6(a) and 5.6(b) to be deleted from the SAU.

- (c) If NBN Co requires any additional rights to a Customer's confidential information then any such additional rights should be specifically agreed with the Customer.

Default Management

- 5.87 Whilst it appears that the default management provision outlined in clause 12 of Schedule 11 places limits on NBN Co's exercise of contractual rights, Optus submits that these statements provide very little comfort or protection to Customers.
- 5.88 The statements in effect simply defer the substantive issues to the WBA, which can be unilaterally varied by NBN Co. For example, this section does not definitively spell out what the contractual remedies are which NBN Co may impose. Under the WBA, NBN Co has the ability to apply any remedy including ordering freeze, service reduction, suspension, disconnection or termination without providing customers appropriate notice. It can also apply all of these remedies simultaneously.
- 5.89 Further, clause 12 of Schedule 11 does not require NBN Co to provide the Customer with a reasonable opportunity to rectify or remedy an issue prior to NBN Co imposing a contractual remedy or require that the notice timeframe is reasonable in light of the potential gravity of the remedy.
- 5.90 *Recommendation:*
 - (a) The default management provision needs to be strengthened in ensuring appropriate limits are placed on NBN Co's exercise of its contractual rights. This includes spelling out the contractual remedies which NBN Co may impose;
 - (b) The default management provision should also include a clause which provides Customer with a reasonable opportunity to rectify or remedy an issue prior to NBN Co imposing a contractual remedy.

Risk Management and liability

- 5.91 Optus submits that the risk management and liability provisions in Schedule 11 clause 13 are in effect a 'skeletal' or high level summary of some of the key elements of the liability regime in the WBA.
- 5.92 The generality of these provisions means that:
 - (a) there remains substantial scope for NBN Co to prepare and amend liability provisions in the WBA that adversely affect (and do not adequately protect) Customers, while remaining consistent with the broad parameters of this section (such as by requiring additional indemnities from Customers); and
 - (b) in its current form, this section could not operate as a 'standalone' liability regime, but rather is dependent upon the WBA.
- 5.93 The drafting of this section also creates the impression that the liability provisions in the WBA are mutual and balanced as between the parties, when that is not in fact the case. For example, under the WBA, NBN Co has the benefit of a number of exclusions of liability and indemnities which apply only to NBN Co and, while NBN Co is not liable for indirect and

consequential losses under any circumstances under the WBA, there are situations in which (on the current drafting of the WBA) the Customer may be liable to NBN Co for such losses.

- 5.94 It is also pertinent to note the final words in section 11 which qualify and potentially undermine the commitments given in the preceding provisions, that is, “*subject to and in accordance with the terms of the Wholesale Broadband Agreement*” – noting that the WBA is a document which NBN Co is able to unilaterally vary, in many cases, without any consultation (or regulatory scrutiny).
- 5.95 This again has the effect of incorporating by reference the liability regime in the WBA, which includes the exclusions on NBN Co’s liability, a Customer’s liability for end user and downstream customer issues and a minimum monetary threshold limit on liability claims (among other issues).
- 5.96 As the ACCC stated, this could have the effect of diluting or rendering ambiguous the commitments made by NBN Co in the SAU.⁵⁷ It is therefore not reasonable to simply defer the liability and indemnity commitments by reference to the WBA.
- 5.97 In addition, ensuring (through the SAU) that NBN Co is subject to a robust and meaningful service level regime (including the payment of rebates for failure to achieve service levels) is an important component of the overall risk management framework. NBN Co needs to be properly incentivised to deliver timely and quality services and Customers need to be appropriately recompensed if NBN Co’s services do not meet the required standards. This will be critical to ensuring that the LTIE are met.
- 5.98 *Recommendation*
- (a) NBN Co to adopt in the SAU the proposed changes Optus made to the Risk Management provisions as set out in Appendix E.

Intellectual Property

- 5.99 Optus submits that the SAU should contain provisions on intellectual property (IP). Optus considers that at a minimum, there needs to be a licence of IP from NBN Co to access seekers to the extent required for access seekers to use NBN Access Service and to provide their own services to their customers which use or incorporate the NBN Access Service.
- 5.100 In addition, unlike the IP terms in the WBA, in the SAU:
- (a) NBN Co should be required to fully warrant and ‘stand behind’ its IP; and
- (b) It should be made clear that Customers own all IP which they create (whereas under the current WBA, NBN Co owns (and the Customer is required to assign to NBN Co) all new IP developed by a Customer ‘pursuant to the Agreement’. The current position under the WBA may act as a disincentive for Customers to invest and innovate in connection with their provision of NBN services.

Privacy/Data Protection

- 5.101 Optus submits that the SAU should contain provisions on privacy/data.

⁵⁷ ACCC, NBN Co Limited Special Access Undertaking, Consultation Paper, December 2011, p.66

5.102 As access seekers will under certain circumstances need to disclose details relating to their customers to NBN Co, it is important that NBN Co:

- (a) is only able to use such details for the sole purpose of providing the NBN Access Services;
- (b) commits to complying with applicable privacy laws; and
- (c) reasonably assists access seekers in complying with their privacy obligations in relation to such information.

Section 6. Supporting documents

6.1 Optus has set out a number of additional appendices in support of this submission. These are listed below and attached separate to this submission.

- **Appendix A** – Examples of applying instruments
- **Appendix B** –Network Design Rules
- **Appendix C** – Regulatory oversight of expenditure in other network industries
- **Appendix D** – Service levels
- **Appendix E** – Risk and liability management
- **Appendix F** – Optus’ response to ACCC questions
- **Attachment 1** – CiC