Submission to the ACCC NBN SAU industry roundtable framing paper & NBN SAU pricing paper

July 2021

Public submission

Public

TPG Telecom

Summary

The NBN has undeniably improved broadband connectivity and positively impacted productivity and innovation. However, despite delivering substantial public benefits, NBN Co's business case likely suffers from misaligned commercial incentives and unanticipated regulatory risks.

The NBN was established to significantly increase broadband speeds, promote competition in fixed broadband services and provide parity in broadband service delivery for all Australians. TPG Telecom Ltd (**TPG Telecom**) believes that there must be a reset to align NBN Co's conflicting financial goals with these public policy goals. The time to do this is now, preferably with NBN Co's cooperation but with regulation as a backstop if it is needed.

Given the NBN rollout has been declared as completed, and NBN Co's focus has transitioned from construction to operation, NBN Co now stands at a fork in the road. It can choose to continue on its current path, or pivot towards a different direction. What NBN Co does (or chooses not to do) significantly impacts investment, operational and consumption decisions across Australia's telecommunications industry.

There is no better example to demonstrate that things cannot continue as they are than the effects of the COVID lockdowns. During the 2020 lockdowns and the ongoing 2021 lockdowns, RSPs have seen peak capacity requirements increase substantially, and with it, NBN Co's expected overage revenues, which are costs that the RSPs must absorb. For the last two decades, prices of telecommunications products have fallen in real terms and yet for the last five years, RSPs have faced dramatic cost increases.

This financial outcome is inevitable given the current NBN Co pricing trajectory. The COVID lockdowns provide a glimpse into the future of RSPs' costs and the probable transfer of those increased costs to its customers.

NBN Co's pricing philosophy is that as usage of the NBN increases year on year, NBN Co's revenues (and hence RSP costs) should grow in lockstep. However, RSPs are not seeing a commensurate increase in their customers' willingness to pay. This means that inefficiencies occur as NBN Co's price increases are likely to price some customers out of the market.

To combat this, NBN Co relies on short-term promotions, bundle inclusion adjustments, and overage to drive retail market outcomes that it wants to see. However, this only distorts the market further as: (1) short-term promotions add to market confusion as customers find that their monthly charges can increase substantially after the honeymoon period ends, (2) NBN Co's bundled CVC inclusions are never enough to account for growth in customer traffic so RSPs must provision for overage, and (3) overage continues to be a punitive hidden tax,

especially when there is a sudden usage shock (e.g., during COVID related lockdowns). Not buying overage is even more financially punishing as an RSP would have to pay the rack-rate of $17.50 per Mbps if it fails the CVC utilisation breach condition.

The ever-increasing complexity in NBN Co pricing means wholesale charges are non-transparent and incentivise RSPs to consume less bandwidth to drive down costs, directly working against the public policy objectives that underpin the NBN.

While RSPs are in near universal agreement that an AVC-only charging model must be implemented, NBN Co has been steadfast in backing its unique CVC-based charging model. Until recently, an AVC-only pricing construct is not something NBN Co was willing to publicly explore.

It is only with persistent regulatory pressures and after almost a decade of friction between NBN Co and RSPs over NBN Co's pricing structure that NBN Co has finally taken its first step in a discussion about an AVC-only pricing construct.

Compared to international peers like New Zealand and the United Kingdom, Australia is behind in transforming its national broadband experience. This is not due to the broadband infrastructure itself, but rather the unique Australian problem of the CVC construct which embeds rising costs into NBN's economics.

This is not to say that the cost of home broadband should be identical to those elsewhere. Australia is a big continent with one of the lowest population densities anywhere in the world. It costs relatively more to build national infrastructure to meet its mandate to cover the vast majority, if not all, of Australians with affordable high-quality broadband. However, that does not mean the status quo is optimal. It is clear that the CVC pricing model is unsustainable.

NBN Co's privileged position, with a near-monopoly over the supply of wholesale broadband services, is reinforced by a host of legislative, regulatory and policy protections that have been granted to it. The Government's incentive, as its owner, is to preserve (and increase) NBN's value for privatisation. Even with all its unique advantages, NBN Co is still not able to get to a trajectory where it would be financially sustainable unless it aggressively increases its revenue year-on-year.

Even more troubling is that there has been little oversight of whether NBN Co's investment decisions are well made. The existing Special Access Undertaking (**SAU**) framework does not adequately allow the ACCC to check that NBN Co's investment decisions are prudent, leading to an environment where NBN Co can make those decisions with little commercial risk as it knows current and future users of the network are underwriting that investment even though they have no say in the matter. This is an essential part of access regulation of monopoly services.

A prime example is NBN Co's conclusion, based only on a desktop analysis, that it is always preferable for it to overbuild commercial networks than to purchase dark fibre from the market. This is, on its face, an incomprehensible decision because it implies the wholesale market for dark fibre should not exist when plainly it does.

Another example is NBN Co's obsolete and inefficient 4G LTE fixed wireless network design that is camped on prime 5G mid-band spectrum (in the 3.6 GHz band). While other users of this spectrum are racing to deploy 5G technologies, NBN Co has yet to announce any plans to upgrade its network to 5G.

Because of NBN Co's network choices, the unused metropolitan portion of this spectrum is likely to remain underused as any operator that deploys wide area 5G networks in the unused metropolitan parts of the spectrum band next to NBN Co is likely to cause network interference to both networks. To make matters worse, NBN Co's spectrum was effectively gifted to it by the Government at a price point well below what was achieved in the 2018 3.6 GHz auction.

Not only is NBN Co an inefficient user of this spectrum, but it also makes this spectrum near impossible for others to use as well, causing a ripple effect throughout the telecommunications industry.

What these examples suggest is that NBN Co's decisions on how it spends capital is at times inefficient and at worst reckless. A detailed post-mortem of historic capital expenditure decisions is necessary. Where those costs were inefficient, NBN Co should not be allowed to recoup them.

Outcomes sought

TPG Telecom believes that the current ACCC process is the best way to reset the status quo and re-align NBN Co's commercial and public policy objectives so that all stakeholders can contribute to, and share in, growing the economic pie. While there is a lot of work that industry, NBN Co, and the ACCC must do before these outcomes can be finalised, there are goals that we must aim for, such as the ACCC:

- Mandate that NBN Co implement an AVC-only charging model.
- Assessing the Regulated Asset Base (**RAB**) and the Initial Cost Recovery Account (**ICRA**), and what NBN Co investments should be recoverable and what is not recoverable.
- Developing a Building Block Model (**BBM**) to determine NBN Co's long term revenue constraint.
- Facilitating a broader public policy conversation about sustainability, not only for RSPs but also for NBN Co.

Fundamentally, TPG Telecom believes the sooner NBN Co shifts to an AVC-only model the better as any delay only compounds the cost of switching. TPG Telecom's view is that NBN Co should aim to use the period between now and the end of the current Wholesale Broadband Agreement (**WBA4**) as a transition period. It is important that during this transition period, NBN Co commits to the principle that RSPs should not be worse off than they are under the status quo.

Structure

TPG Telecom welcomes the opportunity to make this submission in response to both:

1. The ACCC's framing paper to the industry roundtable on regulatory arrangements under NBN Co's Special Access Undertaking held on 18 June 2021 (**ACCC Framing Paper**); and

2. NBN Co's industry consultation paper, titled '*RMID1064 - nbn Special Access Undertaking Variation 2021 – Discussion Paper*', released on 7 June 2021 (**NBN Pricing Paper**), including the report commissioned by NBN Co from Accenture, titled '*Moving to a fixed price wholesale pricing model: Risks for low data users*', dated 26 May 2021 (**Accenture Report**).

Given the issues discussed in the ACCC Framing Paper and NBN Pricing Paper are related, TPG Telecom has addressed both papers in this single submission in three parts:

- **Part A** comprises TPG Telecom's comments on the ACCC Framing Paper;

- **Part B** comprises TPG Telecom's comments on the NBN Pricing Paper and Accenture Report; and

- **Part C** comprises an independent expert report from the Centre for International Economics (**CIE**).

Part A: Comments on ACCC Framing Paper

Introduction

TPG Telecom welcomes the ACCC's proactive approach and its acknowledgement that there are areas where regulation should be reviewed and could be improved, through amendments to NBN Co's SAU. We support the ACCC leading this regulatory review. The ACCC plays an essential role by keeping monopoly power in check via access regulation and this is particularly important when it comes to the NBN. An ACCC-led review would ensure that regulatory decisions are independent, transparent and promote the long-term interests of end users (**LTIE**).

In 2016 and 2017, NBN Co attempted on two separate occasions to vary the SAU to incorporate additional technologies under the multi-technology mix (**MTM**) model into the SAU, however these attempts were unsuccessful. The prevailing concern raised by the ACCC and industry at the time of those past variations was NBN Co's pricing, particularly the level of CVC prices and NBN Co's use of short-term pricing initiatives which fell outside the regulated scope of the SAU. NBN Co's conduct was (and remains) inconsistent with the intent of the SAU to ensure stability and certainty in downstream markets. We note that NBN Co's fundamental approach to pricing has not changed since 2016/2017, and NBN Co continues to rely on promotions and overage charges as key parts of its monetisation strategy.

NBN Co's pricing remains a significant issue and we have made preliminary comments regard the NBN Pricing Paper in **Part B**. Notwithstanding, our view is that pricing should be considered an *output* of the regulatory review process, rather than an *input* that determines or drives regulatory decisions the ACCC should make, such as revenue controls. For this reason, the merits of prices proposed in the NBN Pricing Paper cannot be assessed until after the ACCC regulatory review process.

As the SAU variation process may take 12 months or more to complete, TPG Telecom supports the ACCC taking temporary measures to limit RSPs' exposure to overage charges. At the conclusion of the SAU variation process, TPG Telecom expects a swift and permanent transition to AVC-only charging by NBN Co.

Competing objectives of NBN Co

NBN Co is tasked to reconcile a number of objectives, which are often incongruent or competing. For example, NBN Co states that one of the objectives of the SAU is '*providing nbn with the opportunity to recover efficiently incurred costs*', but this is clearly not NBN Co's pricing philosophy today as its pricing proposals are seemingly arbitrarily set without reference to *any* costs incurred to supply NBN services. That NBN Co is trying to achieve so many objectives creates confusion about its own operations.

The conflicting objectives cause NBN Co to optimise prices for achieving undisclosed commercial/financial outcomes rather than being based on sound economic principles. As noted in the CIE Report in **Part C**, the NBN Pricing Paper/Accenture Report fails to express key anchoring points for a discussion of price structure for a regulated business, such as (a) costs and what part of costs would be expected to be recovered from users over time, (b) long run marginal costs of peak data use and speed and (c) minimal distorting price discrimination to achieve a specified level of cost recovery, including minimising impacts on consumption and minimising transactions costs.

Another seemingly arbitrary objective is NBN Co's insistence on overbuilding private networks rather than prioritising to provide the best access technologies in underserved residential areas. There is no real alternative explanation to this behaviour other than NBN Co is dedicated to the monopolisation of supply of broadband services. This has come at the expense of the underserved parts of the market. In the counterfactual – the more commercially sensible outcome – instead of overbuilding private networks already served by high-speed broadband, NBN Co ought to have invested that capital in more greenfield areas or an accelerated upgrade of suboptimal access technologies.

In addition, it is unclear at what point in time NBN Co's mandate expanded from providing residential broadband into business/enterprise markets. The matter of overbuilding existing commercial networks where there are multiple existing suppliers, rather than to focus on underserved residential buildings is again counterproductive. NBN Co's objectives in this context are completely opaque.

It is increasingly clear that NBN Co's decision to do so has produced inefficient outcomes, and no economically rational operator would have sunk those costs in the first place hence their recoverability is questionable.

The ACCC has pointed out that there must be incentives for NBN Co to make investments in the future. However, the incentive must be to force NBN Co to make *economically efficient investments* and this can only be done by examining what historic behaviours has led to suboptimal outcomes, so those types of behaviours are discouraged. The best incentive is for the ACCC to not permit NBN Co to recover on costs that have resulted in inefficient outcomes.

Fundamentally, NBN Co has made, or was directed to make, inefficient investments which it now finds difficult to recover so it obfuscates by delinking its WBA pricing proposals from any reference to input costs. And because Government has mandated the NBN to be 'user pays', current and future users of the NBN have to inevitably wear the cost of inefficient investment decisions that they have not had any say in.

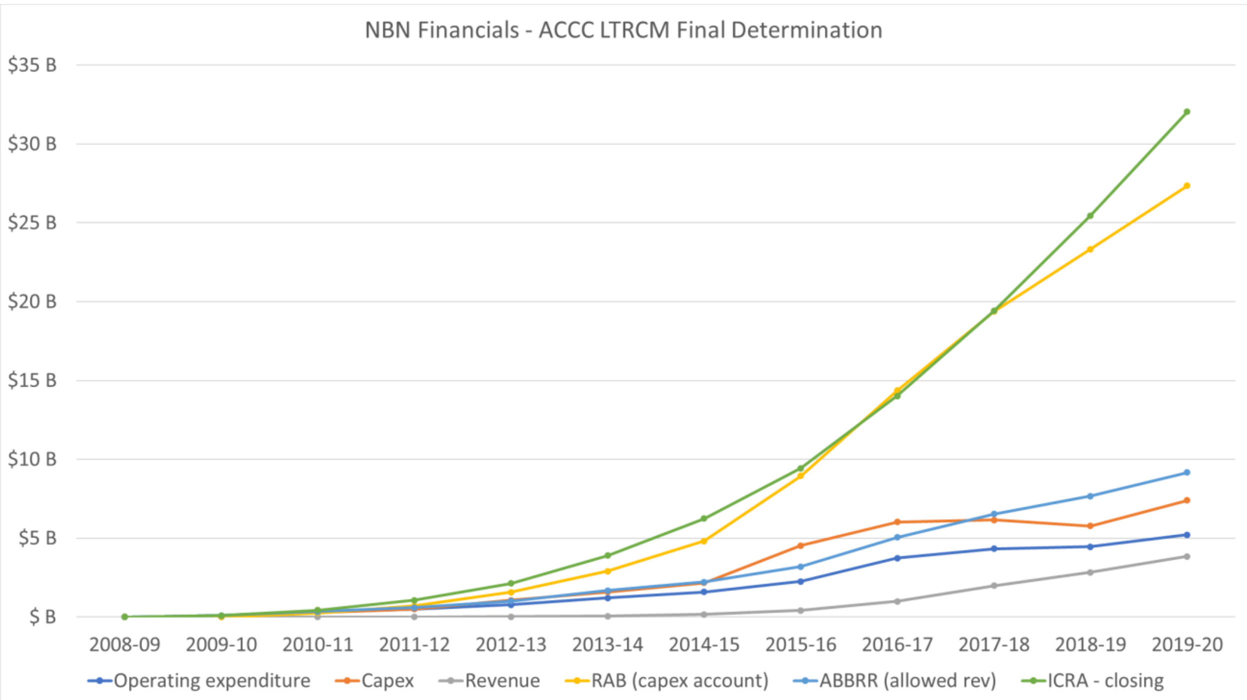
The ACCC can readily observe for itself that for NBN Co to be wholly 'user pays' without a thorough examination of past investment decisions, the cost of home broadband in Australia will have to rise by multiples without any improvement in the quality of that service. There is no doubt this reduces the LTIE.

Both the ACCC and NBN Co have stated principles for how to regulate NBN Co (and developing a BBM). There are obvious differences in view when the ACCC's design principles are contrasted with what NBN Co considers to be the objectives of the SAU. Indeed, NBN Co's pricing proposals are constructed based on its need to meet internal revenue targets and financing commitments that support its 2024 corporate plan, while the ACCC's are broader in scope.

While having principles are positive, the application of it is more critical. Furthermore, clarification of priority of competing objectives is needed, for example, if the price of broadband will have to increase substantially for NBN Co to meet its financial obligations, how would the ACCC weigh up that consideration with the need to maintain affordability and uptake. It is within the ACCC's remit to weigh up the various considerations and how these should be applied in the regulation of monopoly access services, such as NBN.

NBN's regulatory accounts tell a story of unsustainability

TPG Telecom has graphed below the year-on-year changes of NBN Co's regulatory accounts using data taken from the ACCC's long term revenue constraint methodology (**LTRCM**) Final Determination assessments.



While TPG Telecom does not put too much weight on the actual figures, because of the relatively weak mechanisms for ensuring NBN Co's capital expenditure decisions were made prudently and efficiently during the 'Initial Regulatory Period', we can call out certain trends that we believe need to be closely examined.

Firstly, the increase in ICRA (green line) is growing faster than the increases in the RAB (yellow line) and actual revenue (grey line). This suggests that the ICRA needs to be overhauled as it is increasing at a rate that is outstripping its constituent components which implies there is a breakdown in relationships between the ICRA, RAB, and revenues. We believe this is partly due to the ICRA earning interest at the WACC rate turning the ICRA into an appreciating asset.

This introduces poor incentives as cost recovery shortfalls are put into an attractive 'high interest savings' account. The incentives for NBN Co to pay down the ICRA is low because every dollar spent and not recovered is theoretically worth more in the future on an inflation adjusted basis due to the accrued interest. While this needs to be tested further, the WACC rate is likely also above NBN Co's actual cost of capital over the regulated periods given its Government ownership and the ongoing low interest rate environment. Furthermore, as long as the ICRA is above $0, certain regulatory constraints do not apply to NBN Co. This lessens the incentives to pay down the ICRA even more.

Secondly, the annual building block revenue requirement (**ABBRR**) is consistently rising due to the feedback loop between it, the ICRA, and potentially undisciplined spending of NBN Co. There ought to be some forward guidance on when the ABBRR is expected to plateau and potentially reduce to a steady state, and guidance on when the ICRA will be extinguished.

Lastly, the increasing gap between NBN Co's revenues and the ABBRR suggests that NBN Co's business model is not sustainable. If the RAB and ICRA are assumed to be efficient (which we do not believe they are), then NBN Co will have to materially increase its take of industry revenues by at least 100 per cent to get to sustainability. Everything being equal, end-users should expect to pay double or more of what they pay today for broadband.

NBN Co's conduct distorts contestable markets

NBN Co's cost account does not distinguish between regulated services (i.e. residential customers) and contestable services (i.e. business/enterprise customers). This is problematic given NBN Co is Government owned with very different incentives compared to commercial operators.

As we understand it, both NBN Co's costs associated with residential and business end-users are included in the RAB, and it is unclear how difficult it would be to separate common costs. A revised regulatory framework must recognise the distinction between NBN Co's monopoly business, and its business in contestable parts of the market. NBN Co must not be able to obtain advantages in contestable markets by virtue of the benefits it obtains by being a monopoly provider for residential services. Not only would it be inappropriate for end-users to underwrite NBN Co's investments in adjacent markets, such an outcome distorts incentives for commercial operators to invest in those markets.

We are also concerned that the current structure of the SAU places no discipline on NBN Co to prevent it from extracting unreasonable value through other services that a third party may need to acquire from NBN Co in order to effectively compete. For example, **[c-i-c]**

Revised SAU must contain direct and meaningful constraint on revenue controls

TPG Telecom welcomes the ACCC's acknowledgement that under the current SAU, '*as long as the ICRA balance is positive there will not be any direct constraint under the SAU on the amount of revenue NBN Co can generate in a single year. Further, the recovery of ICRA (in addition to the recovery of the building block model revenue) could also potentially result in inefficiently high prices.*' To ensure that NBN Co does not have the incentive or ability to raise wholesale prices to inefficient levels, TPG Telecom believes that significant changes are needed to ensure that the revenue controls in a revised SAU provide a real, direct and meaningful constraint on NBN Co.

If no changes to the revenue controls are made, then when combined with the proposed new constructs in the NBN Pricing Paper (discussed below), the end result would be very minimal, if any, regulation of a monopoly provider in NBN Co's position. That result would run entirely contrary to the underlying role of the ACCC in access regulation.

We note that the ACCC has proposed two high level objectives, which will guide the ACCC's thinking in relation to revenue controls. These objectives are discussed in turn below.

<u>ACCC objective: NBN Co should be able to recover efficiently incurred costs</u>

TPG Telecom agrees that NBN Co should have the opportunity to recover its efficiently incurred costs. While we recognise that this is a standard tenet of regulating monopoly infrastructure, it is yet unclear how it will be applied and executed in practice, particularly:

(1) What test or framework will the ACCC apply to determine whether NBN Co's costs have been incurred efficiently?

    While we support the ACCC testing whether NBN Co's past spend has been 'efficient', it is unclear to us the specific test or framework that would be applied to determine efficiency and in what context would the ACCC consider spend by NBN Co is efficient or not efficient. For example, does the ACCC consider that the subscriber payments made to Telstra and Optus by NBN Co to have been 'efficiently' incurred?

(2) How much of NBN Co's past costs have been incurred efficiently?

TPG Telcom notes that under Module 1 of the SAU, NBN Co's expenditure has not been independently tested for efficiency. If NBN Co is only able to recover efficiently incurred costs, then it would follow that a retrospective assessment of NBN Co's costs will need to be made by the ACCC.

(3) How will the ACCC treat those costs that are inefficiently incurred?

If the ACCC finds historic inefficient costs, it is unclear whether the ACCC would retrospectively remove them from the RAB and ICRA (including any accrued interest).

(4) How will the ACCC determine whether NBN Co's future costs have been incurred efficiently and investment decisions are reasonable and appropriate?

There appears to be limited scrutiny around the high-level strategic decisions that NBN Co makes, such as decisions to upgrade technology, when or how this would be done, and the amount of oversight that the ACCC will have. This is a different assessment to ensuring NBN Co's procurement process is competitive.

The ACCC acknowledges that it is unclear if the ICRA balance will likely be extinguished during the term of the SAU and this means there will effectively be no regulatory control over NBN Co's revenues under Module 2 of the SAU. We believe RSPs, current end-users and future end-users are entitled to better understand the composition of the ICRA and the rationale for NBN Co's past overbuilding and investment decisions. There is a lack of information to explain why the ICRA is currently sitting at $32 billion as at June 2020. There is also no information regarding NBN Co's own forecasts to take the balance to $0.

TPG Telecom has strong concerns that the inefficient past (and future) costs incurred by NBN Co means that RSPs will be unfairly tasked with convincing current and future customers to pay higher prices to underwrite those costs, particularly if higher charges are being driven solely by NBN Co's need to meet financial targets.

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

NBN Co's future expenditure and investments (along with its past expenditure) should be subject to an 'efficiency' test. If inefficient investment and spend decisions have been made, or will be made, then the ACCC and industry should not accept that NBN Co should be able to generate cash flow for those poor decisions.

We do not necessarily agree with the ACCC's statement that '*given the current level of the ICRA balance, NBN Co may be disincentivised to make new investments as it may be less risky for NBN Co to seek to recover what is already in the ICRA first, even if new investments may make good commercial sense on a stand-alone basis and would promote the LTIE*.'

First, the ICRA needs proper assessment to ensure no inefficient costs have got into it, and second there is no evidence to suggest that the ICRA has or will constrain NBN Co's expenditure. For example, NBN Co announced in September 2020 that it would spend $4.5 billion in network investments to give up to 75 per cent of homes and businesses in regional and metropolitan areas access to ultra-fast broadband on demand by 2023 (i.e. the highest peak wholesale download speed tiers of 500 Mbps to close to 1 Gbps).[1] At best, NBN Co is indifferent to the ICRA and at worst, NBN Co is encouraged to spend inefficiently.

The ICRA should be a liability, rather than an asset. The ability of the ICRA to earn interest at the WACC is unreasonable. It sends NBN Co the wrong signal as the risk of getting the investment case wrong on any project is underwritten by current and future customers. At worst, the costs simply go into the ICRA to be paid back at some future period (with interest).

TPG Telecom believes that the ICRA should not have been allowed to accrue to the current levels. NBN Co should not be allowed to 'double dip' on its revenue cap and ICRA both compounding at the WACC.

NBN Co's incentives should be to make efficient investment decisions and the ICRA as it is does not do so. This is demonstrated in NBN Co's approach to the dark fibre procurement process – see the **Case Study** below.

Case study: Industry consultation regarding NBN Co dark fibre procurement

On 28 January 2020, NBN Co released an industry consultation paper to '*explore possible approaches for the procurement of additional dark fibre services from network carriers in customer locations already served by existing fibre*'. NBN Co stated that it wanted to achieve more efficient investment outcomes for the benefit of enterprise and government customers requiring fibre, by drawing greater utility from the spare capacity in Australia's existing stock of dark fibre infrastructure. NBN Co sought written submissions in response to its industry consultation.

On 18 May 2020, NBN Co provided an update to industry and noted that it would proceed to conduct a proof of concept involving a selection of commercial sites to allow interested

[1] See https://www.nbnco.com.au/corporate-information/media-centre/media-statements/Initial-build-complete-NBNCo-announces-next-phase.

parties to provide indicative quotes detailing relevant service costs and connection timeframes.

In April 2021, almost a year after NBN Co announced it would conduct a proof of concept, NBN Co released its decision paper. The decision paper concluded that there was no commercial case to purchase wholesale dark fibre capacity in all instances, including where there is existing fibre and latent capacity for a third-party provider to supply to NBN Co. Surprisingly, the decision paper concluded based on a simple desktop study, it was always financially better for NBN Co to build its own fibre connections to commercial buildings.

The difficulty with the conclusions reached by NBN Co is that it suggests a wholesale market for dark fibre does not - or should not - exist, given it is more commercially sensible for a provider to incur the significant costs involved in overbuilding dark fibre infrastructure, rather than renting spare capacity from a third-party provider. NBN Co's conclusions also call into question whether the right incentives are placed on NBN Co to make efficient investment decisions, or otherwise to act in the LTIE, having regard to the need to encourage the economically efficient use of, and the economically efficient investment in infrastructure.

Furthermore, we understand NBN Co acquires dark fibre access from Telstra in some cases under the terms of the Definitive Agreements, so there appears to be an inconsistency in NBN Co's decision making, as the acquisition of dark fibre from Telstra runs contrary to the conclusions reached by NBN Co. Indeed, the conclusion reached by NBN Co is inconsistent with the commonly accepted principle in telecommunications that infrastructure sharing creates win-win outcomes for access providers, access seekers and end-users.

Premature to form concluded views on appropriate price controls

While it is important to engage with the issues raised in the NBN Pricing Paper, we believe it is sensible to understand the revenue controls that would be included in a revised SAU first. It is premature to form concluded opinions about specific price controls and pricing until RSPs have a better understanding of the changes to revenue controls that would occur. As the ACCC acknowledges, the degree of price control required depends on whether robust revenue controls are in place.

TPG Telecom believes that revenue controls are more desirable than price caps. This is because the ACCC is not well placed to manage NBN Co's actual prices and the risk of getting this wrong may be very high. However, if the structural incentives within the revised SAU are not done right, then direct price control appears to be the least bad outcome.

Non-price terms

We note that the ACCC Framing Paper and NBN Pricing Paper do not discuss operational matters and issues related to non-price terms, such as service levels. We note that these issues have not been raised in the ACCC Framing Paper and NBN Pricing Paper, but we assume they will be addressed as part of the regulatory review process in due course.

RSPs recently had to deal with significant difficulties with appointments as a result of NBN Co's move to a new service operating model called the 'Unify' system. The problems with implementing this system led to widespread delays with customer appointments being cancelled or delayed for long periods of time, all while RSPs were forced to manage customer complaints for problems that were outside of their control. It is clear that improvements are need to NBN Co's non-price terms, particularly to ensure that RSPs and end-users are not made worse off by incidents such as the 'Unify' faults.

Part B: Comments on NBN Pricing Paper

Introduction

We note that RSPs have been calling for the removal of the CVC for many years, including since NBN Co last proposed variations to the SAU in 2016 and 2017. TPG Telecom believes that a flat fee pricing construct is in the LTIE as this is the least distortive manner in which NBN Co can charge for access to the NBN. An AVC-only pricing model can promote the accessibility and use of the NBN.

The distortions caused by CVC pricing are well known to the ACCC, NBN and RSPs and it is essential for the ACCC to step-in and take action now. The most important and essential role an access regulator has is to ensure an efficient access pricing regime is in place and yet the SAU put the ACCC in a position where it virtually plays no role. The usual outcome in declaration processes, such as for MTAS or DCTS, is that the ACCC directly determines the prices of monopoly service. But, in the case of the NBN, the ACCC has not formally asserted pricing principles or pricing levels.

Although the release of a flat fee charging model in the NBN Pricing Paper is a step in the right direction, we believe discussions about specific price points can only occur *after* the development of a BBM.

Today, there is evidence that the NBN is underused suggesting NBN Co needs to not only change its pricing philosophy but also re-examine its business plans.

As of 8 July 2021, only 8.2 million premises out of approximately 12 million Ready-to-Connect premises are connected to the NBN (this is about a 68.5 per cent take up rate). [**c-i-c**] It is therefore unclear whether NBN Co's forecast that by FY24, overall take-up of 73 to 75 per cent[2] in fixed-line areas is a safe assumption.

NBN Co has stated that end-users are willing to pay more for their home broadband, but this may be inconsistent with consumer behaviour that is observable in the market. The proposed wholesale charges in the NBN Pricing Paper suggests that NBN Co believes consumers would be willing to pay more for increased usage *of the same service*, but this is inconsistent with the fact that the retail market is predominately selling 'all-you-can-eat' home broadband plans with a fixed monthly access fee. NBN Co does not address this inconsistency at all.

For NBN Co's plans to work, it must believe that regardless of the pricing model, *all* RSPs will have to increase retail prices for their product offerings. Those RSPs that cannot, will be forced to exit the market altogether. There are signs that consolidation is already starting to

[2] NBN Co Corporate Plan 2021, p. 53.

occur due to poor RSP economics.

The core misalignment is that NBN Co has pricing power and readily uses that power by periodically increasing bundled prices, changing the composition of bundles, and via overage charges. While on the other hand, RSPs are unable to make commensurate pricing changes in the retail market quickly so must absorb increasing costs.

While NBN Co trumpets the level of competition in the retail market, such competition is one dimensional. There is no product innovation and there is no differentiation beyond $79/month versus $80/month (for example). The field of retail rivalry is dictated by NBN Co rather than market dynamics. This is without a doubt why one only has to squint a little to see that every popular NBN broadband product on the market looks the same or are trending that way. The opportunity that AVC-only pricing presents is that by simplifying NBN wholesale products, RSPs have the incentive to focus on what they can offer in the retail market and compete with RSPs on their merits, rather than spending costs and finite resources trying to manage CVC costs, overage and short-term promotions on a daily basis.

From NBN Co's perspective, its business plans dictate that it must reach a certain level of earnings and free cash flow, so its pricing optimises for these metrics. We can only guess that this plan is built upon the need to achieve a particular level of cost recovery and financial commitment, which NBN Co has never made public so RSPs are left to speculate what the long-term steady state looks like. RSPs cannot make long-term business decisions in such an environment.

The primary short-term issue from TPG Telecom's perspective is not necessarily the appropriateness of NBN Co's pricing, although we believe that will naturally be discovered through developing a BBM, but that the ongoing variability and unpredictability of NBN Co's pricing decisions is forcing RSPs to be captive to NBN Co's short-term promotions. From an RSP perspective, this will ultimately turn out to be a bad position to be in as wholesale costs take a step change upwards after the promotion period ends. This is not a sustainable situation.

TPG Telecom has in previous submissions said that NBN Co can use promotional offers, but there must be a better way than the current punitive pricing construct. It cannot be good practice that whenever there is a sudden spike in utilisation – for example due to COVID lockdowns – RSPs must accept significant and unpredictable overage charges.

We have previously said that a better model would be that NBN Co fixes a list price and offers standing discounts off the list price for RSPs that meet a predetermined criterion, for example a percentage base mix above NBN 100. We remain convinced that this model will realign NBN Co's and RSPs' incentives, providing a better outcome than the status quo.

We believe the increasingly complex distortion of NBN Co's prices are the consequence of the

CVC-based charging framework. Therefore, we believe an AVC-only charging model must be implemented as soon as possible for RSPs to make concrete long-term plans to invest into the business and drive uptake and usage of the network.

We disagree with the Accenture Report conclusions that there are significant benefits arising from CVC pricing. Furthermore, we do not believe that low speed tier end-users would be worse off under an AVC-only scenario. Fundamentally, no matter what construct is adopted by NBN Co, it will make itself revenue neutral. That is, by and large, NBN customers end up in the same situation under any scenario.

The transformation to an AVC-only pricing model cannot happen overnight. The market will need a period of adjustment. TPG Telecom believes that during any transition period, there must be a principle that no RSP would be worse off relative to the status quo. A potential baseline could be the WBA4 prices while RSPs adjust to an AVC-only regime.

The issues related to NBN pricing are well known to the ACCC, NBN and RSPs, and have been known for a number of years. It is not feasible for the status quo to continue and we urge the ACCC to step-in and take immediate action.

Preliminary views regarding proposed pricing constructs in NBN Pricing Paper

The flat fee pricing structure and the general concept in construct 3 of the NBN Pricing Paper must be adopted as soon as possible. As we have repeated in this submission, we believe it premature to discuss actual pricing levels and price caps without having first developed a BBM with the ACCC. Nonetheless, we are able to provide the following general comments.

Unlimited data plans are the norm

The industry is trending towards unlimited data plans for NBN services. In the period from December 2019 to December 2020 the proportion of retail NBN plans provided with no data limit has increased from 76 per cent in the December 2019 reporting period to 80 per cent in the December 2020 reporting period.[3] So it is clear that data cap plans are being phased out rapidly. This is consistent with TPG Telecom's expectations that almost all customers will migrate and switch to unlimited plans. Those that do not will predominately have very high cap limits (e.g., 500Gb monthly cap) meaning they are already on plans that for usability purposes are already unlimited.

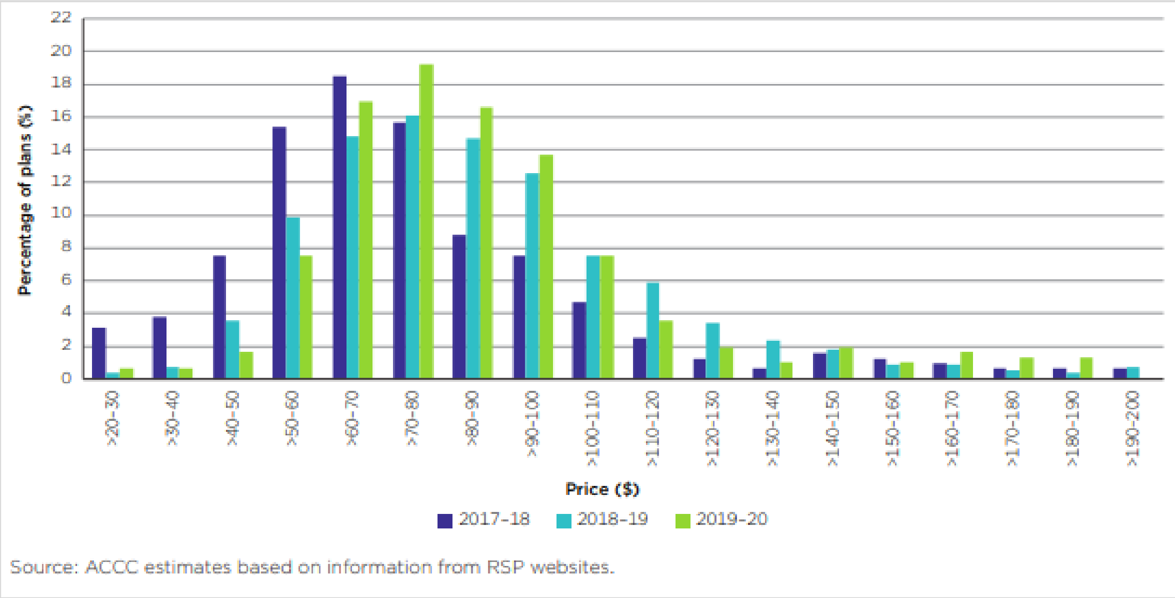
Consumers appears anchored to sub-$100 per month for broadband access

The ACCC Communications Market Report 2019-2020 (December 2020), found that *'the top three price points for NBN plans with the highest concentration remains in the $60 to $90 price range in 2019-20, which is the same as 2018-2019. The most popular price point in 2019–20*

[3] ACCC Internet activity report – for period ending 31 December 2020, p. 3.

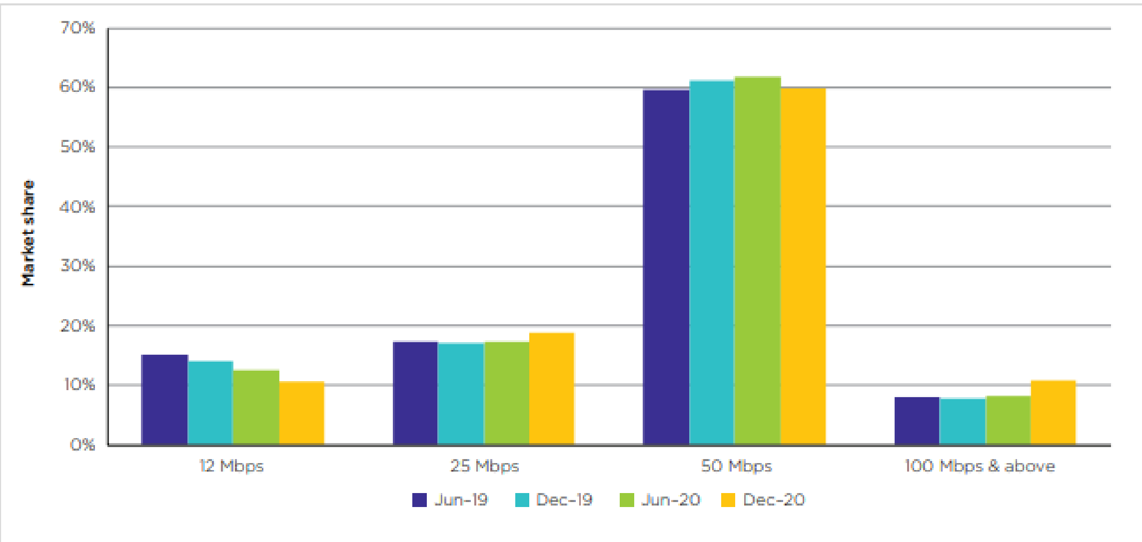
also remains unchanged from 2018–19 with plans in the $70–$80 price point contributing to 19% of NBN plans, an increase from the 16% observed in 2018–19.' This suggests that most of the consumers' willingness to pay asymptotes to ~$90 per month for fixed broadband.

Figure 1: Percentage of NBN fixed broadband plans at various price points from 2017-18 to 2019-20[4]



Furthermore, the NBN 50 Mbps speed tier remains consistently the most popular service, as demonstrated by the following ACCC data.

Figure 2: NBN retail broadband internet by wholesale speed tier – market share[5]



[4] ACCC Communications Market Report 2019–20 (December 2020), p. 23.

[5] ACCC Internet activity report – for period ending 31 December 2020, p. 6.

It is unclear whether consumer product choice is driven by price or whether consumers' willingness to pay is driven by product needs. TPG Telecom's hypothesis is that the limiting factor is price, i.e., NBN 50 is the most popular product because it is at the upper limit of what most customers are willing to pay for fixed broadband.

It is difficult to compare NBN Co's construct proposals

We note that NBN Co has not been explicit about overage assumptions for construct 1 and 2, which fail to remove uncertainty for RSPs. This makes it difficult to compare the constructs on a like-for-like basis because there will be overage costs to RSPs under constructs 1 and 2. Furthermore, it is also unclear what promotions NBN Co will implement under those constructs which also causes the actual prices RSPs pay and the list price to diverge.

Another issue is that we cannot forecast how NBN Co will increase AVC-only prices year-on-year. We understand that NBN Co wishes to turn the pricing constructs into 'regulated offers', and these regulated offers would then be subject to price increases at a rate above CPI – i.e. CPI+X per cent. The consequence, as we understand it, is that NBN Co would in theory be subject to maximum regulated prices or price ceiling. However, 'X' is an unknown variable.

To the extent that we could, we have tried to forecast TPG Telecom's NBN costs based on NBN Co's pricing constructs benchmarked against NBN Co's WBA4 prices for 2022. To make the relationships clearer, we have kept our base mix assumptions constant between various scenarios and applied a usage growth filter and an uplift filter on AVC-only prices (i.e., an overage sensitivity and an CPI+X per cent sensitivity).

[c-i-c]

There are a few things to point out in this analysis. First, it is no surprise that lower usage of the network equals less TPG Telecom must pay to NBN Co. Second, under NBN Co's proposed price points, TPG Telecom is only better off under construct 3 pricing if traffic growth is more than the 'High' scenario and NBN Co imposes a low CPI+X per cent uplift on prices. Third, within the context of the constructs, TPG Telecom is asked to make a judgement call about traffic growth predictions and effectively gamble on it because it will have a material impact on TPG Telecom's NBN costs. We assume other RSPs will arrive at similar conclusions.

A simple takeout NBN Co should consider deeply is that if it continues with the status quo, the clear incentive is for RSPs to reduce usage of the network as this is the only economically rational thing to do to minimise the ever increasing and unpredictable NBN costs, increase retail prices, or otherwise consider whether it is feasible to continue offering NBN services.

Flat fee pricing does not mean higher prices for low-speed tier users

NBN Co suggests that an AVC-only pricing construct means higher prices for low-speed tier users. TPG Telecom does not agree with this assertion.

First, the Accenture Report is deficient in several areas, as addressed in the CIE Report in **Part C**. Second, the prices NBN Co has proposed is not grounded in anything. Price points can only be conceived after a BBM is developed. Third, NBN Co's argument is a red herring because under all of the proposed constructs, NBN Co is revenue agnostic, meaning RSPs and end-users ends up in the same spot regardless of NBN Co's price structure. The only difference is the level of transparency in getting there.

Too many products/speed tiers

We also believe there is an opportunity for NBN Co to revisit the number of speed tiers that it supplies. It is complicated to manage the menu of NBN products and it makes the purchasing difficult for customers to decide. This is compounded by the fact that NBN Co cannot deliver the speeds on the sticker of its products and rather advertises 'speed ranges' (i.e. the 100 Mbps wholesale product that an RSP acquires is actually a '25 Mbps to 100 Mbps' product, but in every other context, NBN Co refers to that plan as a 100 Mbps' product.) For example, the NBN products could be made simpler by NBN Co offering 'best you can get' higher end speed tiers by collapsing the 100Mbps / 250 Mbps / 1000 Mbps products into a single product and make that product more widely available for sales and marketing.