25 May 2018

Mr Scott Harding
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cc: Scott.Harding@accc.gov.au

Ms Sophie Corea
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Dear Mr Harding and Ms Corea,

Re: NBN Co Special Access Undertaking – Long Term Revenue Constraint Methodology 2016-17: Draft Determination and Price Compliance reporting 2016-2017

Telstra welcomes the ACCC's review into the Long Term Revenue Constraint Methodology (LTRCM) for 2016-2017. In providing this submission, we will not be commenting specifically on the ACCC's acceptance of the proposed values (e.g. the level of nbn co's capital expenditures for 2016-17) or confirmation of nbn co's compliance with the applicable Maximum Regulated Prices in accordance with Schedule IC of the SAU for 2016-17. Instead, we wish to raise three issues relevant to the LTRCM review:

1. The classification of nbn co's newly introduced nbn50 and nbn100 bundled products as "Discounts" under the SAU's Maximum Regulated Price provisions creates significant uncertainty for retail service providers (RSPs), with flow-on detrimental impacts to end users — the products can be removed with only limited notice (six months) and without regulatory oversight.
2. The new nbn50 and nbn100 bundle products could, and in Telstra's view should, be classified as NBN Offers under the SAU, and we request the ACCC clarify how they will be classified as part of its LTRCM 2016-17 review.
3. The treatment of build costs in the LTRCM for new trial infrastructure and more broadly for enterprise ventures undertaken by nbn co.

1. Classifying new offers as "Discounts" creates price uncertainty and limits regulatory oversight.

Whether an nbn wholesale offer is classified as a NBN Offer or a Discount under the SAU has important implications for RSPs and in turn end users. Under the SAU, NBN Offers are subject to the CPI-1.5% annual price control and the ACCC can reject a withdrawal. Conversely, Discounts can be withdrawn at nbn co's discretion which can lead to uncertainty and price shocks for RSPs and their customers.

Depending on which classification is imposed, this distinction can significantly disadvantage RSPs and in turn end users. For RSPs to be able to offer stable, competitive prices, a degree of wholesale price certainty is required. Where wholesale price levels are uncertain (as in the case of Discounts which can be withdrawn with six months' notice), the competitive market will not function effectively for the benefit of end users. RSPs routinely contract with customers for extended periods, such as twelve and twenty four month contracts and if Discounts can be withdrawn with limited notice, RSPs could potentially face higher supply prices for a large proportion of the contract term.

In December 2017 nbn co sought feedback on new high bandwidth bundles designed to drive a better customer experience. The new bundles were introduced from 1 May 2018 through amendments to nbn co's Discounts, Credits and Rebates list. Whilst we welcome nbn co's ongoing engagement with industry through its Product Development Forum (PDF) process, we question the classification of the bundles as Discounts and note this creates price uncertainty for access seekers. For example, the nbn50 bundle is priced at $45. Compared to the standard NBN Offers, this equates to an effective CVC cost of $5.50 per Mbps.[1] If the bundled product is removed, RSPs would then revert to purchasing CVC under the existing dimension based discounting (DBD) scheme, and would face a price of $10.25 per Mbps of CVC[2] or a total AVC + CVC price of $54.50 (ignoring the temporary Focus on 50 pricing and also noting that the DBD regime may also be removed with limited notice). However, if the new bundles were classified as an NBN Offer, the bundle price would be constrained to a price cap of CPI-1.5%.

2. nbn co's new bundles are more appropriately classified as new NBN Offers rather than Discounts to existing offers.

nbn co's SAU is silent on whether a new offer should be treated as an NBN Offer or a Discount. We, therefore, consider that this is a matter that the ACCC should provide a view on to provide certainty to nbn co, RSPs and end users. This will be particularly relevant for when the ACCC must review compliance with the applicable Maximum Regulated Prices at the end of the forthcoming financial year. However, the ACCC's perspective is needed now so that industry understands as soon as practicable whether there is certainty and regulatory oversight in relation to the nbn50 and nbn100 bundled products.

It is Telstra's view that the newly introduced nbn50 and nbn100 bundled products should be classified as NBN Offers, and subject to the price controls and price review mechanisms in the SAU. The reasons for this view are set out below.

a) <u>*RSPs and nbn co need to invest in their systems to introduce and utilise the new bundles*</u>

For RSPs to avail themselves of these offers requires significant investment in system upgrades to facilitate the new price structures including additional NNI build, additional CVC provisioning, identification and movement of AVCs and development of IT solutions to manage changes in the sales/connection and plan changes (including changing speed tier, moving home) processes. It is also the case that RSPs will need to nominate one or more CVCs in a CSA that will be used solely for the bundled offers. These CVCs cannot be used for customers that do not take up the bundles. To take up this new pricing requires Telstra to migrate customers between CVCs and NNI infrastructure, which involves significant upgrades to tools and systems, all of which come at a cost.

The significant changes required to utilise the new bundled offers are an indication that the bundles are a significant departure from existing NBN Offers. In response to the time required to implement these changes nbn co has extended the Focus on 50 offer from 1 May 2018 to 31 October 2018. On this

[1] Given an AVC price of $34 and purchase of 2Mbps of CVC.

[2] Assumes an average CVC provisioning of 2Mbps.

basis, Telstra believes the new bundles should not be positioned as Discounts to existing offers, but rather as new NBN Offers, which provides further protections and certainty for RSPs in exchange for the significant IT investment required.

b) *The bundled offers are a new pricing construct*

A discount is generally understood to be a reduction in the usual price of something. The new bundles are unlike the standard composition of NBN Offers, which to date have priced AVC and CVC separately. That is, before the introduction of these new bundles, nbn co did not provide an offer which bundled together AVC and CVC. Also, the concept of a wholesale excess usage price in the new bundle products is new and is not a feature of nbn co's existing offers. Given the construct of the bundled offers is different to pre-existing offers, this suggests that the new bundles should be classified as new NBN Offers rather than Discounts.

c) *nbn co has marketed the plans as new offers which will complement existing NBN Offers*

Throughout nbn co's recent consultation on its pricing structure and ultimate introduction of the new bundles, it has consistently referred to the new bundles as being new offers. In launching the new offers, nbn co stated "*We plan to introduce a new nbn™ 50 wholesale bundle charged at $45 a month with 2Mbps of bandwidth included and a new nbn™ 100 wholesale bundle at $65 a month with 2.5Mbps capacity included*.[3] (emphasis added).

Similarly, material provided as part of its consultation has consistently referred to the plans as new bundles, including that they complement existing NBN Offers: "*Bundled Offers will complement [the] existing set of TC-4 products, enabling accessible high quality, high speed plans*".[4] This terminology is inconsistent with their introduction through the Discounts, Credits and Rebates list.

d) *The new bundle pricing is not always cheaper relative to its component parts*

While nbn co has introduced the bundles as a Discount, pricing of the nbn100 bundle (which includes 2.5Mbps of CVC) is higher than buying AVC and CVC separately. Further, under the dimension based pricing scheme a CVC unit price of $9 applies when an average 2.5Mbps of CVC is provisioned for each customer. Under the new $65 bundle, CVC is priced at $10.80 per Mbps (given an AVC charge of $38). In this circumstance, it is unclear how the nbn100 bundle can be positioned as a Discount.

Given the above issues, Telstra considers that to ensure the SAU and the Maximum Price Cap operate as intended there must be some guidance as to the classification of nbn co offers. As part of its current LTRCM review, Telstra requests that the ACCC clarify whether the new bundles will be treated as NBN Offers under the SAU. This will give certainty to both RSPs and nbn co. We do not wish to discourage nbn co from engaging in promotional activity where genuine discounts are offered to RSPs but consider that a plan should only be classified as a Discount if the following criteria are met: (i) the Discount is clearly related to an existing offer, (ii) enforceable commitments regarding the duration of the Discount and the nbn wholesale price post removal of the Discount, (iii) implementation of the new pricing requires no or limited changes to the way customers are supplied services and (iv) implementation of the new pricing requires no or limited investment by RSPs to take advantage of the Discount. In our view, where these conditions cannot be met, a new construct should be considered a new NBN Offer not a Discount.

3. Treatment of build costs for trial and other enterprise ventures by nbn co.

[3] https://www.nbnco.com.au/blog/the-nbn-project/new-nbn-wholesale-pricing-options-set-to-improve-customer-experience.html.

[4] Nbn co, Pricing Evolution Customer Pack, December 2017.

The ‘Prudent Design Condition’ under the SAU defines which capital costs can be included in nbn co’s regulatory asset base. Generally, capital expenditure meets the Prudent Cost Condition if it was incurred in connection with the design, engineering and construction of the relevant assets under a ‘conforming contract’ or in an open and competitive market, or through another ‘value for money’ process.[5] Whilst there are strict requirements governing which costs can be incurred for new capital investment, the treatment of the cost of services that could be regarded as being outside nbn co’s core business remain unclear. For example, in 2016 it was reported that Qantas would trial an nbn satellite service to offer inflight wi-fi.[6] End customers would not be charged for this service during the trial. For proof of concepts such as this it is unclear whether the costs have been included as part of the LTRCM and if they have, are the costs treated in the same manner as other nbn broadband rollout costs and therefore added to the Interim Cost Recovery Account? Similarly, it is unclear to us how expenditure undertaken by nbn co for enterprise customers (including upgrades from FTTN infrastructure to FTTP) is treated under the SAU and LTRCM and we request further clarity on these important elements.

Telstra considers that as nbn co seeks to expand its scope beyond that of its core broadband rollout, it is vital that the ACCC continues to maintain an appropriate level of scrutiny through the LTRCM process to ensure that only costs pertaining to the core roll out of infrastructure is captured and therefore can be recovered. This is particularly important as nbn co seeks to enter competitive markets and will help ensure a level playing field.

We would be happy to meet with the ACCC to discuss further these important issues. Should you have any queries on this submission, please contact Kim Longin on (03) 8649 2030 or kim.longin@team.telstra.com.

Yours sincerely

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[5] Clause 1D.3.2(a)(i)(B) of the SAU

[6] https://www.theaustralian.com.au/business/technology/qantas-taps-nbn-satellites-for-free-inflight-wifi/news-story/9fc585f0aaf20739067704c0d4e0818e.