

NBN Co Special Access Undertaking

Telstra's response to the ACCC's first consultation paper

Contents

Executive Summary	3
1. Introduction	5
2. Interaction between the NBN Co SAU, WBA and other regulatory instruments	5
3. Term of the NBN Co SAU	9
4. Coverage of the price controls	10
5. Information required to properly assess the reasonableness of the NBN Co SAU	13
6. The CPI/2 price control and structure of pricing for CVC Product Component	14
7. Inputs into the NBN Co building block model	15
8. The Weighted Average Cost of Capital	16
9. Prudency	18
10. Reporting	20
11. Lack of genuine stand-alone non-price principles	21
12. Product certainty	23
13. Fundamental issues of substance not addressed by the NBN Co SAU	26

Executive Summary

The terms and conditions that govern the supply of wholesale services on the National Broadband Network will fundamentally shape the price, quality and diversity of services that Retail Service Providers will be able to provide to end-users using the NBN.

NBN Co has lodged with the Australian Competition and Consumer Commission a Special Access Undertaking that seeks to set out many aspects of the terms and conditions of supply of wholesale services on the NBN for a period of some 30 years, to June 2040.

The ACCC has commenced its consultation on the NBN Co SAU and has requested stakeholders' preliminary views on the NBN Co SAU to identify the key issues that will be the focus of a supplementary consultation paper.

In this submission Telstra highlights aspects of the NBN Co SAU that it considers should be the subject of detailed consultation and consideration by the ACCC. Based on a preliminary review of the NBN Co SAU, the key issues which Telstra considers should be the subject of focussed consultation include:

- **Interaction between the NBN Co SAU, Wholesale Broadband Agreement and other regulatory instruments:** The NBN Co SAU confirms that Retail Service Providers will be required to enter into the WBA and cannot acquire access on the terms of the NBN Co SAU alone. Consideration should be given to whether this framework is appropriate or whether the NBN Co SAU, either itself or in conjunction with other regulatory instruments, should provide an alternative set of supply terms to the WBA. In this way, NBN Co would achieve regulatory certainty about the subject matter covered by the SAU (if accepted by the ACCC), and anything not covered by the SAU would remain subject to ongoing regulatory oversight through binding rules of conduct and/or access determinations.
- **Term:** In light of the many changing circumstances that are likely to be experienced over the life of the NBN Co SAU, the term of 30 years appears too long, and there is insufficient provision for review of the NBN Co SAU. The proposed term of the NBN Co SAU and the absence of meaningful review of the operation of the NBN Co SAU during this term serves to exacerbate all other concerns.
- **Coverage of the price controls:** The proposed coverage of the price controls appears to provide too much flexibility for NBN Co over pricing, particularly for new products. NBN Co indicates that the Long Term Revenue Constraint will not become binding for at least 10 years, and there is a question as to whether the Long Term Revenue Constraint will operate as a real constraint on pricing over the proposed 30 year term of the NBN Co SAU.
- **Required information to assess price terms:** There is currently no basis for assessing the reasonableness of the proposed CPI/2 price increase limit and in the absence of cost modelling it would appear difficult to conclude that the proposed price path is reasonable.

-
- **Weighted average cost of capital:** A private sector WACC (certainly before privatisation) may not be appropriate and the ACCC should consider whether the Government ownership of NBN Co has particular implications for the determination of the appropriate WACC.
 - **Regulatory oversight of cost inputs and reporting:** The commitments to prudence of expenditure appear weak and the NBN Co SAU does not provide sufficient scope for ACCC oversight of prudence. The provisions for reporting of costs and pricing also appear insufficient to allow proper ACCC monitoring of the prudence commitments and price controls.
 - **Lack of genuine stand-alone non-price principles:** Many of the non-price commitments in the NBN Co SAU are of limited value as they do no more than restate, or defer to, the terms of the WBA. The effect of this is to 'lock-in' significant discretion for NBN Co to determine the non-price terms of supply (through its WBA) and exclude the ACCC from providing ongoing oversight of NBN Co's conduct.
 - **Key product elements are not addressed:** The NBN Co SAU does not provide an appropriate degree of detail in relation to a number of critical product elements (including, for example, service levels), resulting in uncertainty as to the scope (and therefore, price) of the products to be provided.
 - **Key non-price terms not addressed in the NBN Co SAU:** The NBN Co SAU does not address, or fails to adequately address, a number of issues which are fundamental to the terms of supply. As a consequence, the NBN Co SAU fails to provide sufficient certainty that the terms of supply will be fair and provide security for ongoing supply.

Telstra explains each of these concerns in the remainder of this submission. Where appropriate, key issues for further consideration and consultation are identified.

1. Introduction

On 5 December 2011, NBN Co Limited and NBN Tasmania Limited (collectively, **NBN Co**) lodged a special access undertaking with the Australian Competition and Consumer Commission (**ACCC**) under section 152CBA of the *Competition and Consumer Act 2010 (CCA)* (**NBN Co SAU**). The NBN Co SAU includes an agreement by NBN Co to be bound by the category B standard access obligations in respect of the NBN Access Service and sets out the terms and conditions upon which NBN Co will comply with those obligations.

After considering and consulting on the NBN Co SAU, the ACCC must make a decision on whether to accept or reject it.¹ The ACCC must not accept the NBN Co SAU unless its terms and conditions are reasonable and consistent with the category B standard access obligations.² In assessing reasonableness, the ACCC must have regard to the factors in section 152AH of the CCA, including (and giving fundamental weight to) whether the terms and conditions of the NBN Co SAU promote the long-term interests of end-users (**LTIE**).³

The factors that the ACCC must have regard to in considering the reasonableness of the NBN Co SAU are similar to those that it would be required to have regard to were it to make a final access determination in respect of the NBN Access Service.⁴ In particular, the LTIE is paramount in both assessment of a SAU and formulation of a final access determination.

In this submission Telstra highlights specific issues that it considers should be the subject of detailed consideration by the ACCC as part of its initial assessment of the reasonableness of the NBN Co SAU. Telstra considers that these issues should form a part of the focus of the ACCC's supplementary consultation paper. Telstra will provide more detailed comments for the ACCC's consideration on these and other issues it identifies on an ongoing basis by 30 March 2012.

2. Interaction between the NBN Co SAU, WBA and other regulatory instruments

An important feature of the overall design of the NBN Co SAU is the manner in which it interacts with the WBA and other regulatory instruments such as access determinations and binding rules of conduct. Each of these documents operates differently both on their terms and under the statutory regime set out in the CCA in the event of any inconsistency.⁵

¹ CCA, s 152CBC(2).

² CCA, s 152CBD(2).

³ Promoting the LTIE is the over-arching object of the telecommunications access regime and is therefore seen as paramount by the ACCC, and the courts. The Federal Court noted in *Telstra v Australian Competition & Consumer Commission* (2008) 171 FCR 174 that the LTIE must be given "fundamental weight" as against the other factors.

⁴ There is one difference between the factors that the ACCC must have regard to in assessing reasonableness (CCA, s 152AH) and those that it must have regard to in making an access determination (CCA, s 152BCA). The access determination factors include one additional factor that the ACCC must have regard to, being "the value to a person of extensions, or enhancement of capability, whose cost is borne by someone else".

⁵ Acknowledged by NBN Co in its submission in support of the SAU: NBN Co, *NBN Co Special Access Undertaking – Supporting Submission*, 20 December 2011, p 76, section 7.2.

The statutory hierarchy under the CCA in which these documents operate⁶ is now relatively well understood. Terms and conditions of, and relating to, supply of services over the NBN can be set out in one or more various “NBN corporation” specific documents including (in order of hierarchy under the CCA⁷) an “access agreement” (the primary “access agreement” for the supply of services over the NBN being an executed version of NBN Co’s WBA), a special access undertaking, binding rules of conduct and/or an access determination.

The framework proposed by NBN Co involves terms of access being governed by both the NBN Co SAU (at a ‘principle level’) and the WBA (at the ‘detail’ level). As a consequence, Retail Service Providers will not be able to acquire services over the NBN under the terms of the NBN Co SAU alone and must first enter into a WBA with NBN Co, the terms of which may be determined solely by NBN Co without any regulatory oversight by the ACCC. This is unreasonable.

Specific consideration should be given to whether NBN Co’s proposed framework is the most appropriate or whether the NBN Co SAU should form the basis for an alternative set of supply terms, either in and of itself⁸, or in conjunction with other regulatory instruments. For example, the NBN Co SAU would define a standard set of terms and conditions that are available to Retail Service Providers or, alternatively, Retail Service Providers would enter into access agreements on other terms. In this way, the Retail Service Providers are not excluded from a set of terms of access that has been approved by the ACCC, as could be the case under NBN Co’s proposed structure.

Support for this type of framework can be found in the legislative regime of the CCA which gives primacy to “access agreements” but in doing so, clearly contemplates that the ACCC would have the power, through the use of access determinations, to set alternative terms of access to NBN services or through the SAU process to approve/reject more complete terms of access to NBN services.

Through this alternative approach, the NBN Co SAU could provide certainty in relation to key price and non-price terms of supply (for NBN Co and Retail Service Providers alike), enable the ACCC to have regulatory oversight in the manner contemplated by the legislative framework and provide a default set of regulated terms for Retail Service Providers, if required.

Issues for focussed consultation

- Whether the proposed framework (which necessarily requires Retail Service Providers to enter into the WBA) is appropriate
- Whether the SAU, either itself, or in conjunction with other regulatory instruments,

⁶ See Divisions 4, 4A and 5 of Part XIC of the CCA.

⁷ The statutory hierarchy is discussed in NBN Co’s submission lodged in support of the NBN Co SAU: NBN Co, *NBN Co Special Access Undertaking – Supporting Submission*, 20 December 2011, p 75, as well as in the ACCC’s consultation paper: ACCC, *NBN Co Limited Special Access Undertaking – Consultation Paper*, December 2011, p 10.

⁸ In much the same way as the ACCC has done so in its final access determination for fixed access services - see the Final Access Determinations for fixed access services made by the ACCC on 20 July 2011 and varied on 14 December 2011.

should set out an alternative set of supply terms

2.1 Interaction with the WBA

The terms of an executed WBA can only be 'overridden' by the NBN Co SAU (or binding rules of conduct and access determinations, for that matter) if the WBA itself provides for this. There is no self-effecting regulatory mechanism or statutory right for the ACCC to intervene to otherwise give effect to the NBN Co SAU.

Notwithstanding various statements from NBN Co that the NBN Co SAU will bring certainty to Retail Service Providers about the terms of supply, there is an inherent weakness with the NBN Co SAU and its interaction with the WBA brought about by the statutory hierarchy⁹ and there is very little in the current draft of the NBN Co SAU which seeks to address this.

The NBN Co SAU does not provide any assurance that the WBA cannot, and will not, be used to deprive Retail Service Providers of the benefit of the NBN Co SAU and/or be used to exclude the ACCC from ongoing regulatory oversight. Specifically:

- there are no general provisions which ensure the principles set out in the NBN Co SAU will be reflected (whether expressly or by ensuring there is no inconsistency) in NBN Co's standard form of access agreement;
- while the proposed 'SAU alignment' mechanism¹⁰ appears to provide a one-off option to align an existing WBA after the NBN Co SAU comes into force, it does not provide any clarity on how that alignment would occur (currently determined at NBN Co's discretion), whether there will be any regulatory oversight to ensure appropriate alignment or how ongoing alignment will be assured, particularly for future variations of the WBA; and
- the proposed 'regulatory recourse' mechanism¹¹ only applies to matters 'not covered by the SAU' and can only be triggered by Retail Service Providers before they have entered into the WBA. Accordingly, there is no ability to seek intervention on matters set out in the NBN Co SAU and existing Retail Service Providers under the terms of the WBA will be deprived of the benefit of this mechanism.

As noted above, one way of addressing these issues would be to design the NBN Co SAU so that it forms the basis for an alternative set of supply terms, either itself, or in conjunction with other regulatory instruments. This would then give Retail Service Providers a choice to take supply under the WBA or the alternative proposed by the NBN Co SAU.

⁹ The ACCC noted in its consultation paper and its open letter dated 11 November 2011, that the commitment made by NBN Co to reduce the term of the WBA to 12 months "had mitigated the ACCC's immediate concerns in this respect" but that the ACCC was "committed to ensuring that there is an effective regulatory framework in place as soon as is practicable": ACCC, *NBN Co Limited Special Access Undertaking – Consultation Paper*, December 2011, p 19.

¹⁰ See clause 2.7 of the NBN Co SAU.

¹¹ See clause 6 of Schedule 11 of the NBN Co SAU.

Issues for focussed consultation

- Whether the NBN Co SAU should include general commitments to enable Retail Service Providers to align their executed WBA with the NBN Co SAU **at all times** (including by ensuring such a mechanism is contained within the terms of the WBA and protected from unilateral variation by NBN Co)
- Whether the NBN Co SAU should provide more express guidance on how SAU alignment is to occur, including a potential framework for inclusion in the WBA to manage NBN Co discretions
- Whether regulatory recourse should be made available at all times, and in relation to all provisions (including those covered in any SAU) to ensure that the setting of initial WBA terms and any future variations are subject to regulatory oversight (including to enable alignment with the SAU)

2.2 Interaction with other regulatory instruments and ongoing regulatory oversight

One of the ACCC's key considerations (to be taken into account by NBN Co in developing both its SAU and WBA) is that Retail Service Providers should not be "subject to barriers imposed by existing access agreements if they wish to respond to regulatory events, such as the making by the ACCC of a binding rule of conduct or access determination, or the acceptance of a SAU"¹². In the period preceding the publication of the WBA, similar concerns were expressed by a number of industry participants.

As drafted, neither the published WBA nor the NBN Co SAU appear to reflect this consideration, nor do they appear consistent with parliament's intention (which necessarily presupposes that the ACCC will have ongoing regulatory oversight of long term arrangements, whether they be special access undertakings or access agreements).¹³ In fact, the NBN Co SAU confirms¹³ the position adopted by NBN Co in its published WBA, where the ACCC's powers to intervene through the use of access determinations and binding rules of conduct are effectively limited to 'blocking' unilateral variations by NBN Co to the WBA.¹⁴ Consequently, under the NBN Co SAU, the ACCC's capacity to provide continuing regulatory oversight for the terms of access to the NBN will be significantly diminished.

The significance of this issue is further exacerbated by the absence in the NBN Co SAU of:

- meaningful stand-alone non-price commitments (discussed further in section 11 below);

¹² NBN Co, *NBN Co Special Access Undertaking – Supporting Submission*, 20 December 2011, p 12, section 2.4.

¹³ See, for example, the Explanatory Memorandum to the Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2010 which states (p 136) : "The policy intention is that at all times NBN corporations are subject to the obligations under Part XIC – specifically, the Category B SAOs, the non-discrimination and transparency obligations and the enforcement regime. As a consequence, *the supply of services by NBN corporations is always subject to oversight by the ACCC*" [emphasis added].

¹⁴ Clause 14.3 of Schedule 11 of the NBN Co SAU.

-
- effective reporting, compliance and enforcement measures; and
 - effective review measures (discussed further in section 3 below).

Without these things (and coupled with the effective removal of ACCC binding rule of conduct and access determination powers), there are very limited means by which the ACCC is able to objectively measure and assess NBN Co's compliance with the NBN Co SAU terms and to take appropriate action where there is a need to do so. In these circumstances, it would appear difficult for the ACCC to accept the NBN Co SAU in its current form.

Issues for focussed consultation

- Whether a Retail Service Provider with an existing WBA should be able to take the benefit of a binding rule of conduct or an access determination, and if so, how/whether this right can be assured through the SAU
- Whether reporting, compliance, enforcement and review measures should be strengthened to provide more effective oversight
- The amendments that would be required to NBN Co's SAU to ensure it is an appropriate set of terms and conditions for access to services

3. Term of the NBN Co SAU

The term of the NBN Co SAU, if accepted by the ACCC, will be in the order of 30 years. Obviously the appropriateness of the length of the term is a matter that must be fully considered by the ACCC. A matter that will inform the consideration of the appropriateness of the term is the effectiveness of the review processes of the operation of the NBN Co SAU.

Telstra does not consider that a 30 year term is likely to be appropriate, particularly in light of the many changing circumstances that are likely to be experienced over the life of the NBN Co SAU and the very limited scope for review of the NBN Co SAU. The ACCC should give consideration to whether a shorter term would be appropriate, with perhaps the use of fixed principles terms and conditions (pursuant to section 152CBAA) to carry over the core elements of the SAU that the ACCC considers are necessary to provide certainty to both NBN Co and Retail Service Providers.

A shorter term (which may or may not be combined with the use of fixed principles) would institutionalise a periodic review by the ACCC of the operation of the NBN Co SAU. This is distinct from the arrangements in the NBN Co SAU which in effect provide for NBN Co to review specified matters, and to select other matters that it may wish to review, and to provide a variation to the NBN Co SAU which addresses the outcome of the review.

Issues for focussed consultation

- Whether a term of 30 years is appropriate, particularly in light of changing circumstances over the life of the NBN Co SAU

- Consider whether the currently proposed mid-term review of the operation of the SAU is sufficient

4. Coverage of the price controls

The NBN Co SAU is given in relation to the NBN Access Service, as defined in Schedule 2 of the NBN Co SAU. However, no specific price commitments are given in relation to the NBN Access Service. Rather, NBN Co makes commitments in relation to certain Product Components and Product Features as a means of implementing its obligations in respect of the NBN Access Service.

The NBN Co SAU provides for an initial price control applying to three products in the initial period until June 2017, being the Basic Access Offer, CVC offer and Network-Network Interface (collectively, the Price Controlled Offers).¹⁵

The NBN Co SAU does not address initial pricing for:

- other products that will be offered by NBN Co at the Commencement Date (although these are covered by the WBA); and
- any new products to be introduced by NBN Co after the Commencement Date, this includes new:
 - Product Components;
 - Associated Product Features; and
 - Ancillary Services.

It appears to be the intention of the NBN Co SAU that all future NBN products and services would be components or features of the broadly defined NBN Access Service and would therefore be subject to the NBN Co SAU. However no definitive commitments are made in respect of initial pricing for these future NBN products and services.

The only potential constraint on initial pricing for any new products (that is, new Product Components, associated Product Features or Ancillary Services) that may be introduced by NBN Co after the Commencement Date will be the Long Term Revenue Constraint (LTRC). However, NBN Co acknowledges that the LTRC is unlikely to be a binding constraint on pricing for at least the first ten years¹⁶, and there is a question as to the strength of the constraint on pricing even once it does become binding. As noted later in this submission (section 5) further information in the form of a populated building block model would be required to assess the point at which the LTRC is likely to practically operate as a constraint on pricing. Further, because the LTRC is a constraint on total revenues rather than individual prices, there is a question as to the

¹⁵ Clause 3.2 and Schedule 4 (Price Controlled Offers) of the NBN Co SAU.

¹⁶ NBN Co, *NBN Co Special Access Undertaking – Supporting Submission*, 20 December 2011, p 57.

strength of the constraint on the pricing of new services when most revenue is earned from existing services.

To the extent the LTRC does become a relevant constraint during the term of the NBN Co SAU, the current drafting does not include provisions of the type that would be expected when dealing with the regulation of prices under a building block methodology. Such provisions would include, for example, pricing principles by reference to which the development of prices are required to conform and, at a minimum, a requirement on the regulated entity to develop a pricing methodology in accordance with those principles which would be the subject of regular approval by the relevant regulator. To the extent the LTRC does become binding within the term of the NBN Co SAU, in the absence of appropriate pricing principles and the requirement to have in place an approved pricing methodology, the LTRC is likely to be at best a weak constraint on pricing for new or varied services.

Telstra notes that in other regulated industries where revenue constraints apply, regulators typically maintain a degree of pricing oversight, which may vary according with the relative contestability of the provision of the services, as well as establishing and monitoring compliance with the revenue cap. For example in electricity, transmission network service providers which operate under a revenue cap are required to submit a pricing methodology for approval by the regulator at the same time as they submit their revenue proposal.¹⁷ Distribution network service providers which operate under a price cap regime are required to submit a regulatory proposal for approval every five years and must also submit an annual pricing proposal for each year within the regulatory period.¹⁸ By comparison, the NBN Co SAU as currently drafted provides for very little price oversight and significant pricing flexibility for the monopoly network service provider.

The limited scope of the price controls and the degree of flexibility the NBN Co SAU gives NBN Co over the pricing of new products and ancillary charges should be a key focus of the ACCC's consultation and subsequent consideration of the NBN Co SAU. Given the proposed term of the NBN Co SAU of some 30 years, it may be anticipated that within that term many new products will be introduced as technology evolves and end-user preferences change, potentially rendering many of the current suite of products (including perhaps the Basic Access Offer) obsolete. It would therefore appear to be of significant importance to ensure an appropriate degree of regulatory oversight of pricing. This is the case even if the term of the NBN Co SAU was significantly shorter, say in the range of three to five years.

The ACCC should consider the reasonableness of the broad scope of the services covered by the NBN Co SAU particularly in light of the limited scope of the price controls. For example, whether the NBN Co SAU should cover specified services and the pricing of those services, with new products as they are developed to be potentially the subject of separate and further SAUs.

¹⁷ National Electricity Rules, clause 6A.10.1.

¹⁸ National Electricity Rules, clauses 6.8.2, 6.18.2.

Telstra recommends that the constraints on pricing, and the regulatory oversight of pricing, be a key focus of the ACCC's supplementary consultation paper and that the ACCC give consideration to mechanisms for pricing of new products and services that provides for an appropriate level of regulatory oversight. For the example, the ACCC could give consideration to the following:

- pricing principles together with the requirement for an approved pricing methodology to be applied in determining initial prices for new products as well as existing products – this pricing mechanism could potentially include a methodology for allocating Regulated Revenue under the LTRC; and / or
- a commitment by NBN Co to submit a pricing proposal for ACCC approval in respect of each new product that is introduced, which if not accepted by the ACCC would fall outside of the NBN Co SAU.

Detailed consideration should also be given to whether it is appropriate for initial price terms for the vast majority of NBN products to be set out in the WBA only and not the NBN Co SAU. Pricing under the WBA will not be subject to the same degree of oversight as the NBN Co SAU, and the ACCC will not be able to arbitrate any dispute that arises under the WBA. Telstra notes that several of the products that are governed by the WBA only and not the NBN Co SAU are core products that will be required by Retail Service Providers to deliver basic services – in particular the NBN Co SAU does not cover TC1 CVC which is required for delivery of a basic voice offering (the NBN Co SAU only covers initial pricing for TC4 CVC).

It is possible that the Price Controlled Offers may to some extent 'anchor' the pricing of other products, including those offered at the Commencement Date and those which may be introduced in future. However, the effectiveness of this anchor will depend on the substitutability of other products with the anchor products and the extent to which the anchor price constrains the pricing of these other products.¹⁹ Therefore in order to have confidence in the anchor pricing mechanism, it must be assumed that any new products introduced over the term of the NBN Co SAU will be sufficiently substitutable with existing products for their pricing to be constrained. Whilst such an assumption may be reasonable over a relatively short period (say five years) it may not be sustainable over the longer term.

Issues for focussed consultation

- Whether the NBN Co SAU should provide for a greater degree of regulatory oversight of pricing for new or varied products. Alternatively, whether the NBN Co SAU should cover specified services and the pricing of those services, with new products as they are developed to be potentially the subject of separate and further SAUs
- Whether the NBN Co SAU should include a cost allocation methodology and / or a mechanism for determination of prices across the NBN product range

¹⁹ Ofcom notes that one risk associated with having a static anchor is that the chain of substitution between anchor products and new products may weaken over time, leading to a weakening constraint on pricing of new products (Ofcom, *Future Broadband: Policy Approach to Next Generation Access*, September 2007, pp 101-107).

- Whether NBN Co should be required to periodically submit a pricing proposal for ACCC approval
- Whether the SAU should cover initial pricing for a wider range of products
- Whether it can be assumed that the initial pricing of products not covered by the NBN Co SAU will be constrained by pricing for those that are covered ('anchor products')

5. Information required to properly assess the reasonableness of the NBN Co SAU

Telstra has reviewed the NBN Co SAU and supporting submission, which detail in words the proposed price constraints and the operation of the building block model underlying NBN Co's proposed LTRC. However, NBN Co has not provided a working building block model. To be able to properly assess the reasonableness of the NBN Co SAU, parties, and mostly importantly, the ACCC, will need to have access to a working building block model populated with realistic forecast data. Having such a 'working' model will allow parties to test the price and/or revenue ceilings that can be expected to arise from the NBN Co SAU over the long run.

Without the support of a working building block model, the LTRC is largely a theoretical construct. It would be Telstra's expectation that in the absence of a working building block model the ACCC could not form a view that it was satisfied that the NBN Co SAU was reasonable. In particular, it would be difficult to assess whether the NBN Co SAU will promote the LTIE or satisfy the reasonableness criteria more generally. There would simply be too many unanswerable questions, for example:

- Would the operation of the CPI/2 price control at some stage result in above cost prices?
- Are prices that would be expected to arise from the LTRC be higher or lower relative to other technologies that exist today or might exist in the future?
- How would prices be expected to change over time under the LTRC?
- Would the LTRC result in significant changes in prices (price shocks) as vintages of assets pass their end of accounting lives in the model?
- What outcomes would be expected from the LTRC if the NBN rollout were to cease after 2014?

It seems likely that NBN Co could provide a working model populated with realistic forecasts relatively easily. Indeed, such a model probably already exists. Even if it does not currently exist, building block models are not difficult to develop and the models applied to other industries are widely available on the ACCC's and AER's websites. NBN Co could populate the model with data from its corporate plan, which is publicly available, avoiding the need for any confidentiality issues. NBN Co need not commit that those corporate plan forecasts will eventuate, nor could it, but realistic assumptions are needed.

6. The CPI/2 price control and structure of pricing for CVC Product Component

Once initial pricing has been established for each Product Component, associated Product Feature and Ancillary Service, any price changes will be subject to an Individual Price Increase Limit of no more than CPI/2 in any Financial Year. The Individual Price Increase Limit applies to all of the Product Components offered at the Commencement Date, those listed in Schedule 3 of the NBN Co SAU and identified in the Initial Product Roadmap, and any new product components introduced pursuant to Schedule 6.

A significant issue for consideration by the ACCC is whether the CPI/2 price control regime is likely to result in prices broadly equivalent to cost. As discussed above (section 5), the NBN Co SAU and supporting submission do not allow for such an assessment. If NBN Co were to provide a working building block model populated with realistic forecasts, then such an assessment could be made.

Telstra submits that the ACCC's consultation should also focus on whether the CPI/2 price control applied to CVC prices, which are proposed to be usage based, is reasonable.

Under the NBN Co SAU, the maximum CVC price would remain at \$20/mbps until 30 June 2017 and then increase at CPI/2 per year thereafter. This implies that if CPI is 2.5%, the CVC price would be \$24/mbps by 2033 (to the extent the Initial Cost Recovery Period is still in operation at that time). While these per mbps price increases may appear small, they must be assessed on a per customer basis, looking at the potential for increased customer usage over time.

On a per customer basis, in the first year of the NBN Co SAU, if an end user uses 100kbps of capacity, then the amount the wholesale customer must pay NBN Co for CVC is \$1/SIO/month.²⁰ If the end user usage increases by 30% year on year²¹, then the amount wholesale customers must pay for CVC increases from \$1/SIO/month to \$50/SIO/month by 2025.

The result highlights that the reasonableness of the CVC pricing proposal must be examined in greater detail, and the ACCC should consider whether an alternative pricing structure (e.g. one not based on usage) might better promote the LTIE.

Issues for focussed consultation

- Whether annual price increases of CPI/2 are likely to be reasonable
- Whether the structure of the CVC pricing, being usage based, will give rise to reasonable pricing outcomes
- What costs or other information would be needed to assess the reasonableness of

²⁰ This uses the same example usage as NBN Co in its Corporate Plan where the first 0.05mbps CVC is free and the second 0.05mbps CVC is priced at \$20/mbps/month: NBN Co, *Corporate Plan 2011 – 2013*, 17 December 2010, p 103, section 8.7.2.

²¹ See, for example, NBN Co's Corporate Plan where 30% growth appears to be the approximate assumption used by NBN Co: NBN Co, *Corporate Plan 2011 – 2013*, 17 December 2010, pp 127-129, section 9.6.2.

the proposed CPI/2 price control

7. Inputs into the NBN Co building block model

As noted above, it is difficult to assess the reasonableness of the proposed price constraints without a working model. Nonetheless, based on an initial review of the description of the proposed building block model (as it is described in the NBN Co SAU and supporting submission), there appear to be several important issues which should be the subject of further consultation.

Telstra questions whether it would be reasonable for NBN Co's assets to be consistently valued at their depreciated purchase cost, in all circumstances that might reasonably arise over the next 30 years. There are potential circumstances when, for the purposes of determining a revenue cap, a valuation at purchase cost is inappropriate.

For instance, it is anticipated by Government that NBN Co might be privatised after the roll out of the NBN is complete. Should the value of NBN Co at the time of privatisation differ substantially from the value of its RAB, then this might be cause to revalue the RAB and/or the Weighted Average Cost of Capital (WACC). While NBN Co has included a review mechanism approximately at the time of a potential privatisation, pursuant to which NBN Co itself conducts a review of specified aspects of the operation of the NBN Co SAU, the value of the RAB is not a compulsory element of this review. If there are expectations today about the future sale/privatisation price of NBN Co, then that might warrant valuing assets purchased prior to privatisation but still in use post privatisation at something other than their purchase cost.

Further, if there are external social benefits from the NBN that are realised by government (or the Australian population), then the minimum required return to the government from NBN Co could be the sum of the internal rate of return from NBN Co and the additional external rate of return derived from the realisation of external social benefits. The cost of government's investment in NBN Co could, therefore, be spread across Retail Service Providers (through wholesale prices) and the populace generally benefiting from the external social benefits (through the tax system). In such circumstances, it may be reasonable to value the RAB at the purchase cost net of the present value of external social benefits.

If, in the future, the government were to direct NBN Co to incur additional capital (or expense) to achieve a particular policy goal it is not necessarily the case that Retail Service Providers should pay for that additional expenditure – the government should directly fund any such changes to NBN Co's plans. The NBN Co SAU appears not to deal with this scenario adequately as there is little scope for any party (including the ACCC) to review NBN Co's expenditure before it contributes to higher prices.

Finally, it is unclear how several key components of the building block model would operate in practice. For example, it is not clear how the "construction in progress allowance" would be accounted for in practice, and whether the inclusion of this allowance in building block revenues is reasonable.

Issues for focussed consultation

- The information that would be required from NBN Co in order to assess the likely effectiveness of the LTRC
- Whether the mechanism to revalue the RAB will result in a revaluation in all circumstances that one would expect a revaluation to be required
- Under what circumstances is valuing assets at purchase cost reasonable, given government ownership and any external social benefits arising from the NBN

8. The Weighted Average Cost of Capital

The LTRC uses a rate of return based on an estimate of the WACC of approximately 8.6%. There is a question as to whether this WACC is consistent with the LTIE criteria because it would mean that:

- Government's expected return would likely exceed the cost of its investment;
- NBN Co would more than recover its cost;
- Prices would be unnecessarily high.

In private markets, the expected return from an investment is the internal rate of return (IRR) and any external benefits are not internalised by the firm. However, for public projects, such as the NBN, the Government's expected return from an investment is made up of the IRR and the external rate of return from external social benefits. At the time of deciding to proceed with the project, the IRR from the Government's investment in NBN was calculated to be 7.0%, which is less than the WACC that would be expected to result from NBN Co's SAU²² (8.6%²³). Nonetheless, the Government proceeded with the investment.

It appears that the WACC that would be expected to result from the NBN Co SAU is akin to a private sector WACC. Further, it is likely that the public sector WACC for NBN Co is less than 8.6% and less than a private sector WACC, for at least the following reasons:

- Public sector risk, assessed by the covariance between the project's social returns and with the aggregate consumption risk to which tax payers are exposed, is lower than private market risk, assessed by the covariance between the project's pecuniary returns and the market²⁴; and,

²² It is not clear whether NBN Co's estimate of the WACC is a public sector or private sector WACC. Given that NBN Co is a wholly government owned government trading enterprise (GTE), the conventional WACC to use is a public sector WACC.

²³ The risk free rate is estimated to be 5.11% by Officer and Bishop: B Officer and S Bishop, *Report on WACC Component of NBN Co's Special Access Undertaking*, December 2011, p 14; and NBN Co's risk margin is proposed to be 3.5% under the SAU.

²⁴ See, for example, Grout, P. (2003), "Public and Private Sector Discount Rates in Public-Private Partnerships", *The Economic Journal*, vol. 113, March, C62-C68 (working paper available at <http://www.bristol.ac.uk/cmpo/publications/papers/2003/wp59.pdf>).

- Government has changed legislation and policy to reduce the risk faced by NBN Co, presumably including systematic or non-diversifiable risks, the same risks that continue to be faced by private firms such as Telstra.

The correct discount rate to apply in a building block model such as the one proposed in NBN Co's SAU depends, critically, on the valuation of the assets to which the discount rate will be applied. For instance, if the assets are valued at their purchase cost and the discount rate applied to those asset is the full public sector WACC, then the government's total return from its investment in NBN (which is comprised of the internal rate of return from NBN Co and the external rate of return derived from any external social benefits) could greatly exceed the cost of its investment.

This would be contrary to the LTIE and the reasonableness criteria more generally:

- If the government, being the sole investor in NBN Co, earned a total return greater than the public sector WACC, this would lead to economically inefficient investment incentives;
- Wholesale prices would be higher than necessary, which would likely result in less incentives for Retail Service Providers to compete with one another through retail-level investment, innovation and service development; and
- Retail prices would also be higher than necessary leading to economically inefficient social losses.

A potential solution to this problem might be to ensure the LTRC returns only a proportion of the public sector WACC to the government.

If at some point in the future NBN Co is privatised, then the discount rate and / or the value of the RAB used in the building block model would need to be reassessed through a meaningful change mechanism in the NBN Co SAU.²⁵ This would be required as a public sector rate of return (or a proportion thereof) would likely be insufficient to attract private equity.

Possible approaches to address this issue would be, upon privatisation, having the RAB changed to reflect the sale price and the rate of return set equal to the private sector WACC. Alternatively, the privatised NBN Co could continue to set prices on the basis of the public sector rate of return (or a proportion thereof) on the RAB and the Government could provide a subsidy to NBN Co to compensate for the difference between that return and the private sector WACC.

Issues for focussed consultation

- Whether it is appropriate for the government to earn a rate of return equal to the public or private sector WACC
- What is an appropriate estimate of the public sector WACC
- Whether the discount factor in the LTRC be discounted to account for the external

²⁵ While NBN Co's SAU does have a review mechanism, it is limited in the sense that it is NBN Co that conducts the review of various specified matters and has the discretion to review other matters: clause 3 of Schedule 9 of the NBN Co SAU. In relation to the valuation of the RAB and the ICRA, clause 3.3 of Schedule 9 provides that NBN Co may, in its discretion, review these matters.

rate of return likely to be earned by government from the realisation of external social benefits

- What future circumstances would reasonably warrant a change in the WACC that is not contemplated by NBN Co's SAU

9. Prudency

Telstra has a number of concerns regarding the adequacy of the prudency regime proposed by NBN Co. The NBN Co SAU would appear to deem a wide range of expenditure to be prudent without providing a role for oversight by the ACCC.

To satisfy the Prudent Design Condition, capital expenditure must either:

- be materially consistent with, or within the scope of the Network Design Rules; or
- be a Permitted Variation to the Network Design Rules; or
- be one of the classes of expenditure that is deemed to meet both the Prudent Design Condition and the Prudent Cost Condition, which includes variations or augmentations that are either “minor” (less than \$100 million) or “urgent and unforeseen”; or
- be a Network Change that is endorsed by either customers or the ACCC.

These conditions of course imply that the Network Design Rules represent prudent network design. Telstra considers that this cannot be assumed and that the ACCC should give careful consideration to the NBN Co Network Design Rules document and whether NBN Co's network design is in fact prudent and efficient.²⁶ In other network industries, regulators closely scrutinise the prudency of proposed network upgrades and expansions prior to approving any capital expenditure amounts.²⁷ Similarly close scrutiny should be applied by the ACCC in respect of NBN Co's proposed network design, given that any capital expenditure falling within this network design will be deemed to satisfy the Prudent Design Condition.

It is important to note that in only one of the above situations will the ACCC possibly have an oversight role. That is, where the expenditure is a “Network Change” (not a “Permitted Variation”) NBN Co may seek ACCC endorsement. Where the Network Change is “Product-Related” NBN Co may choose either ACCC endorsement or customer endorsement. If ACCC endorsement is sought by NBN Co (or if the ACCC is

²⁶ For example, the NBN Co Network Design Rules document on p 12 states that to a Single Dwelling Unit (SDU) NBN Co intends supply three fibres on average per premise. The ACCC should consider whether the allocation of this number of fibres to a SDU represents a prudent and efficient allocation of fibres.

²⁷ For example, under the National Electricity Rules, the Australian Energy Regulator (AER) must not accept a business' forecast of capital expenditure unless it is satisfied that the forecast reasonably reflects (inter alia) the costs that a prudent operator in the circumstances of the relevant network service provider would require to achieve the expenditure objectives set out in the Rules (National Electricity Rules, clauses 6.5.7 / 6A.6.7). In a recent draft decision in respect of the Queensland electricity transmission network, the AER has proposed a very substantial reduction in forecast capital expenditure on the basis that the business' proposal did not represent prudent and efficient expenditure. A large part of the AER's proposed reductions related to a network augmentation project which the AER did not consider prudent in the circumstances (AER, *Draft Decision: Powerlink Transmission Determination 2012-13 to 2016-17*, November 2011, pp 97-160).

required to resolve a prudency dispute between NBN Co and customers), the ACCC's discretion will be limited to situations where there is an alternative augmentation option for which the Net Economic Benefit materially exceeds that of NBN Co's option.²⁸

It appears likely though that NBN Co will not be required to seek either ACCC or customer endorsement for the vast majority of its capital expenditure. That is because much of its capital expenditure is likely to either fall within the scope of the Network Design Rules or come within the definition of a Permitted Variation. The criteria for Permitted Variations are broad and allow deviation from the Network Design Rules in a range of circumstances, including:

- variations that are reasonably necessary to establish and maintain the quality, reliability and security of the Relevant Assets or the supply of Product Components;
- variations which improve performance or functionality of the Relevant Assets and which will result in the same or lower Total Cost of Ownership; or
- variations which will achieve savings in the Total Cost of Ownership.

The Total Cost of Ownership criterion which is central to the concept of a Permitted Variation is loosely defined in the NBN Co SAU, offering scope for a wide range of network augmentations to be viewed as Permitted Variations, bypassing any need for ACCC endorsement. Total Cost of Ownership simply means all costs incurred over the life of the Relevant Assets calculated on a net present value basis. Depending on NBN Co's assessment of future capital and operating costs and the discount rate applied, this calculation could deliver varying results.

Whilst there is some scope (albeit limited) for ACCC oversight of NBN Co prudency in respect of network design, there appears to be no scope for ACCC oversight of costs. Expenditure will need to satisfy certain criteria for it to be considered prudent and included in building block revenue, however there appears to be no scope for ACCC monitoring of prudency. Rather, the prudency assessment is to be undertaken by NBN Co with no ACCC oversight.

Moreover, the criteria for determining prudency of costs are broad and include:

- where expenditure is incurred "on an arm's length basis";
- where the NBN Co CEO is satisfied that incurring that expenditure would be in the best interests of the company; and
- where the expenditure is either "minor" (less than \$100 million) or "urgent and unforeseen".²⁹

These criteria will need to be met for all Capital Expenditure and Third Party Operating Expenditure. For Operating Expenditure that is not Third Party Operating Expenditure, this will be deemed prudent provided that NBN Co seeks to achieve value for money and lowest Total Cost of Ownership and manages the expenditure consistently with the Statement of Expectations.

²⁸ Schedule 8, clause 6.5(a), and clause 7.3 of the NBN Co SAU.

²⁹ Schedule 8, clause 4.1 of the NBN Co SAU.

Issues for focussed consultation

- Whether the Network Design Rules represent prudent network design and can therefore be relied on as a basis for deeming prudence of expenditure
- Whether it is appropriate to draw a distinction between Permitted Variations to the Network Design Rules and Network Changes. That is, whether all variations to the Network Design Rules should be required to go through the same process.
- For Permitted Variations, whether the criteria (including the Total Cost of Ownership criterion) are sufficiently well defined to ensure prudence of any network augmentations
- The appropriateness of the deeming provisions, including the threshold for “minor” variations and whether the scope of these provisions is appropriate
- Whether ACCC involvement may be necessary for all Product-Related Network Changes, rather than just those where NBN Co elects for ACCC endorsement or where there is a prudence dispute
- Whether the criteria for ACCC acceptance of Network Changes and resolution of prudence disputes provide for sufficient regulatory oversight
- Whether it is sufficient that expenditure be incurred on an “arm’s length basis” or for the NBN Co CEO to be satisfied that expenditure is in the best interests of the company for it to be considered prudent

10. Reporting

Whilst the NBN Co SAU includes various commitments by NBN Co as to the prudence of its expenditure and administration of the LTRC, the requirements for reporting are limited and provide little scope for proper ACCC monitoring of costs and pricing. The NBN Co SAU in its current form largely provides that it is for NBN Co to administer the price constraints and the ACCC would need to proactively investigate any potential breaches.

This is in contrast to the extensive reporting obligations that are typically imposed on regulated network service providers. Businesses subject to price and / or revenue control are typically subject to frequent regulatory review of matters such as:

- prices charged and revenue received;
- proposed pricing for forthcoming periods;
- capital and operating expenditure (both historic and forecast); and
- prudence of expenditure incurred.

The ACCC should give detailed consideration to the forms of reporting and review mechanisms that should be provided for in the NBN Co SAU that would permit the ACCC to verify the prudence of expenditure and compliance with the price control regime. Whilst some reporting commitments are offered in Schedule 10 of the NBN Co SAU, Telstra is concerned that these may not be adequate for the ACCC to properly assess ongoing compliance.

In particular, to allow proper ACCC oversight of expenditure and pricing, it will be necessary for NBN Co to report forecast expenditure and prices sufficiently in advance of the period to which they apply. Currently, the NBN Co SAU only provides for reporting of forecast information the day before the beginning of the relevant financial year during the Building Block Revenue Period, offering no opportunity for ex ante ACCC consideration of proposed expenditure and pricing.

Additionally, Telstra considers that all matters that are disputed by Retail Service Providers (including prudency disputes) should be reported by NBN Co. At a minimum, such reporting should include the matter(s) in dispute, the parties to the dispute and the resolution of the dispute.

Finally, it may be necessary for NBN Co to make commitments to adjust calculations of building block revenue on an ex post basis where the ACCC finds any element of reported expenditure to have been imprudent. At present, there appears to be no such commitment in the NBN Co SAU.

Issues for focussed consultation

- What reporting commitments should be included in the SAU
- What powers should the ACCC have where expenditure is found to have been imprudent, based on NBN Co's reporting

11. Lack of genuine stand-alone non-price principles

NBN Co submits that terms of access will be governed by both the NBN Co SAU and the WBA and that these documents are intended to operate as complementary documents.³⁰ As Telstra understands it, NBN Co proposes that the NBN Co SAU will operate so as to provide the 'guiding principles' for NBN Co's pricing methodology and key non-price terms and conditions, and that the WBA will 'put into operation' these guiding principles.³¹

Telstra submits that the NBN Co SAU does not appear to deliver this framework.³²

There is little comfort for Retail Service Providers when commitments largely defer, or remain subject, to unspecified terms of the WBA. By way of example, the NBN Co SAU contains:

- commitments that "NBN Co will set out in the Wholesale Broadband Agreement the basis on which Customers may connect to and access the NBN Co Platform"³³;
- billing dispute related commitments that are subject to "...terms addressing such disputes and withholdings"³⁴;

³⁰ NBN Co, *NBN Co Special Access Undertaking – Supporting Submission*, 20 December 2011, p 76, section 7.2.

³¹ NBN Co, *NBN Co Special Access Undertaking – Supporting Submission*, 20 December 2011, p 76, section 7.2.

³² Noting that a more complete SAU (setting out full supply terms) should be considered as part of the NBN Co SAU consultation process.

³³ See Schedule 11, clause 7 of the NBN Co SAU.

³⁴ See Schedule 11, clause 8 of the NBN Co SAU.

- confidentiality commitments that are subject to matters “otherwise permitted” under the WBA³⁵;
- risk management commitments that are “subject to and in accordance with the terms of the WBA”³⁶; and
- confirmation that NBN Co may make changes to Access Agreements “in accordance with the terms of those Access Agreements”³⁷.

The consequence is that the NBN Co SAU is largely absent of any meaningful non-price principles which stand independently of the WBA, and therefore fails to provide any clear principles against which NBN Co’s conduct (as well as the WBA terms) can be measured, assessed and enforced by the ACCC. As a result, NBN Co retains significant discretion to determine the non-price terms of access.

Moreover, the rationale for essentially restating some of the WBA non-price terms and not others is not self evident. For example, the NBN Co SAU replicates the very detailed PDF Processes currently set out in the published WBA (including very prescriptive administrative requirements). It is not clear why these processes have been set out in such detail while other areas are less developed. This example also illustrates the conflict between NBN Co’s stated objective on the one hand – to have a SAU which provides a set of guiding principles that are ‘put into operation’ in the WBA³⁸ – and what it has committed to in the NBN Co SAU on the other – a set of terms which either restate, or defer to, the terms of the WBA.

A further consequence is that the NBN Co SAU effectively operates so as to ‘lock-in’ specific terms for the proposed term of the NBN Co SAU (30 years), including significant NBN Co discretions. This not only compromises the Retail Service Provider ‘certainty’ benefits advocated by NBN Co, but also immediately undermines the process NBN Co has established for negotiation of the ‘long term’ WBA (referred to as the “Contract Development Process” or “CDP”). Under the CDP, a comprehensive multilateral and bilateral engagement process is intended to further refine the details of the WBA. If the NBN Co SAU is accepted, specific terms will be ‘locked-in’ and their further negotiation would appear futile.

Issues for focussed consultation³⁹

- Whether the ACCC’s assessment of the NBN Co SAU should include an assessment of (and consultation on) the terms of the WBA itself – since the non-price terms of the NBN Co SAU have no effect or meaning independently of the WBA
- Whether NBN Co’s approach to non-price commitments needs to be reconsidered, so that the SAU contains stand-alone guiding principles, rather than terms which

³⁵ See Schedule 11, clause 11 of the NBN Co SAU.

³⁶ See Schedule 11, clause 13 of the NBN Co SAU.

³⁷ See Schedule 11, clause 14.3 of the NBN Co SAU.

³⁸ NBN Co, *NBN Co Special Access Undertaking – Supporting Submission*, 20 December 2011, p 76, section 7.2.

³⁹ Noting that the ACCC should first consider whether the proposed framework is the most appropriate: see section 2.

defer to the WBA

- What impact does the absence of such principles have in terms of the ACCC's ability to provide ongoing oversight of NBN Co's conduct and to ensure that the SAU continues to meet the test for acceptance

12. Product certainty

12.1 Key product elements not addressed

Product components and features are not supplied in isolation. While certainty as to a product's base components and features is important, network performance criteria, service level commitments and ancillary support services are inextricably linked and may necessarily form part of the "product package" (both in terms of scope and price). Given the NBN Co SAU contemplates securing an 'anchor' product set for a significant term (upwards of 30 years) and a construct that materially restricts the ability for ongoing regulatory oversight, the need for certainty as to the full scope of the product set becomes particularly important.

In circumstances of significantly diminished regulatory oversight, without certainty as to the full scope of the "product package", it remains very difficult to assess the merits of NBN Co's price commitments, which could be easily undermined as further product-related charges are imposed through other mechanisms. As noted above, the ACCC should consider the reasonableness of the broad scope of the services covered by the NBN Co SAU particularly in light of the limited scope of the price controls.

In relation to the scope of the "product package", and particularly given the term and regulatory oversight constraints inherent in the NBN Co SAU, Telstra submits that the NBN Co SAU fails to provide an appropriate degree of detail or certainty in a number of key areas:

- product component/feature details including hardware and service commitments both at the NNI and NTU, including on and off-site service testing, traffic class commitments on wireless/satellite and on the CVC, replacement or supplementary port commitments and clarity on customer-side network boundary obligations;
- network standards, minimum service levels and performance notification/reporting (with appropriate accountability on the part of NBN Co, including appropriate rebates) for key inputs such as network availability (including resilience), service availability, appointments and installation/activations (including connections), lead times for planned and unplanned outages or response times, and fault management and handling (including response/restore times);
- principles associated with access to NBN Co's facilities and the freedom for Retail Service Providers to self-supply facilities access or seek competitive facilities access services;
- electronic, B2B interface details and associated delivery commitments;

- responsibility for the supply of power, battery back-up and maintenance and replacement of back-up units; and
- other ancillary services (the scope of which is unclear under the proposed terms of the NBN Co SAU).

12.2 Product development

The Product Development Forum and PDF Processes proposed by NBN Co in the NBN Co SAU appear to replicate the regime currently proposed under NBN Co's published WBA.

Telstra is very concerned about the level of inflexibility in the proposed regime, its onerous participation requirements (including significant upfront obligations, very broad intellectual property transfer terms and inadequate protection for confidential information) and the absence of any clear commitment from NBN Co to develop and continuously evolve its product suite in line with global and industry best practice. Furthermore, many of the onerous obligations appear to be triggered at the time a 'Product Idea' is submitted (whether or not that idea is likely to be productised).

Telstra remains of the view (a view set out in previous submissions on NBN Co's WBA) that the proposed regime has the potential to discourage participation and stifle innovation. Accordingly, product development principles that are set out in the NBN Co SAU should look to enshrine principles that will encourage Retail Service Provider participation.

12.3 Product variations and withdrawal

A lack of detail about the precise product components and features makes it difficult to assess the appropriateness of the commitments that have been given in relation to product variations and withdrawals. However, even if the NBN Co SAU was to provide an adequate level of detail about critical product elements, Telstra considers that they would be significantly weakened by the proposed product variation and withdrawal commitments in the NBN Co SAU. Put another way, NBN Co commitments in relation to both the "product package" and continuity of supply are only as strong as the commitments that are given regarding their variation or withdrawal.

Telstra's key concern is that the proposed product variation and withdrawal commitments lock-in significant discretions for NBN Co and compromise certainty for Retail Service Providers. For example:

- The NBN Co SAU provides⁴⁰ that the commitments in Schedule 6 (which includes the product variation and withdrawal commitments) do not apply to a range of products and product features, such as product components that are covered by the Initial Product Roadmap. There does not appear to be any justifiable reason why this should be the case.

⁴⁰ See clause 1(b) of Schedule 6 of the NBN Co SAU.

- The NBN Co SAU does not to make any commitments regarding the variation or withdrawal of other key aspects of supply, such as 'Ancillary Services'.
- The NBN Co SAU does not make any genuine commitments in relation to variations of product components and features (notwithstanding that Schedule 6 is expressed to apply to such variations)⁴¹.

Without being exhaustive, other areas of concern which Telstra considers should be the subject of focussed consultation include:

- the express exclusion of 'Minor Product Variations', which provides NBN Co with the discretion to 'self-determine' what is and is not subject to the requirements of the NBN Co SAU;⁴²
- NBN Co discretions to determine whether the impact on Retail Service Providers of a particular contract variation will have a 'material adverse impact' (i.e. variation discretions that extend beyond operational components); and
- NBN Co discretions to determine whether transitional arrangements will apply to product withdrawals and the principles of such transitional arrangements.

Issues for focussed consultation

- Whether further detail is required to ensure clarity around the regulated product set and product performance commitments (including whether the NBN Co SAU should more effectively regulate a wider product set)
- Whether the nature of 'Ancillary Services' needs to be further clarified and commitments included in the SAU around scope, performance and pricing
- Whether Product Development Processes need to be more flexible and can be designed to encourage participation through recognition of value in intellectual property, protection of confidential information and facilitation of bilateral engagement
- Whether positive commitments should be given by NBN Co to develop and evolve its product suite in line with global and industry best practice
- Whether the proposed product variation and withdrawal commitments should be enhanced so as to provide adequate certainty for Retail Service Providers
- Whether the proposed transitional arrangements provide sufficient certainty that transition will minimise disruption and costs

⁴¹ Although clause 4 of Schedule 6 deals specifically with 'Minor Product Variations', the effect of this clause is to exclude 'Minor Product Variations' from the operation of Schedule 6 (and gives NBN Co the discretion to determine what constitutes a 'Minor Product Variation'). It does not impose specific requirements on NBN Co.

⁴² As noted above, clause 4 of Schedule 6 expressly excludes 'Minor Product Variations' from the operation of Schedule 6 and gives NBN Co the discretion to determine what constitutes a 'Minor Product Variation'.

13. Fundamental issues of substance not addressed by the NBN Co SAU

Consideration should also be given to fundamental non-price supply principles which have not been addressed in the NBN Co SAU (either because the content of the NBN Co SAU does not adequately address the issue or because the NBN Co SAU is silent on the issue). A number of these have been discussed in detail above.

While it appears that NBN Co is prepared to give a number of relatively 'soft' non-price term commitments (for example in relation to consultation, relationship management and roll-out reporting), Telstra is of the view that the NBN Co SAU should contain more tangible, material principles of supply. Principles that will give Retail Service Providers genuine confidence that terms will be fair and will provide security of ongoing supply.

By way of example (and without being exhaustive), Telstra queries NBN Co's position on the following, and believes that these and other significant principles of supply need to form part of the NBN Co SAU consultation process:

- NBN Co's rights to impose minimum term commitments and break fees, and any limiting parameters that may be appropriate given NBN Co's control over upstream supply;
- NBN Co's rights to charge for services that are not supplied, particularly when delay or cessation of supply is due to an NBN Co act or omission (or not as a result of the Retail Service Provider's acts or omissions);
- responsibility for faults, outages and POI relocations, including ensuring that Retail Service Providers and ultimately end users will not be subject to inappropriate costs (whether due to inadequate notification or inappropriate cost allocation);
- the core principles associated with the pass-through of tax related costs;
- those principles that will ensure Retail Service Provider confidential information is appropriately managed and protected;
- NBN Co's unilateral rights to amend the terms of supply, particularly given the NBN Co SAU appears to provide more flexibility than that contained in NBN Co's published WBA;
- NBN Co's role in securing access to premises, and whether, as part of its rollout, NBN Co should be securing common property access for itself and all Retail Service Providers (to minimise end user disruption);
- recognition and protection of Retail Service Provider intellectual property rights (including appropriate recognition of the value inherent in this intellectual property), and the nature of intellectual property assignment or licensing obligations;
- establishment of a liability and indemnity regime that is consistent with industry practice, in order to ensure that NBN Co is accountable for its actions (both in relation to Retail Service Providers and third parties);

-
- recognising and enabling compliance with customer downstream regulatory obligations (including the Customer Service Guarantee, Priority Assistance and Universal Service Obligations) and ensuring the contract terms respect a Retail Service Provider's obligations under the Australian Consumer Law; and
 - clarifying the role of NBN Co in relation disputes about the supply of its own services (in particular, how genuine independence of dispute resolution advisors and adjudicators can be assured).

Issues for focussed consultation

Whether the NBN Co SAU should address a wider and more tangible set of non-price principles of supply, and if so, what non-price principles of supply should be contained within the NBN Co SAU