

NBN Co Special Access Undertaking

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

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Abbreviations and acronyms

ACCC	Australian Competition and Consumer Commission
ACIPA	Annual Construction in Progress Allowance
ACT	Australian Competition Tribunal
AER	Australian Energy Regulator
AVC	Access Virtual Circuit
BSS	Business Support System
CEO	Chief Executive Officer
CCA	<i>Competition and Consumer Act 2010 (Cth)</i>
CSG	Customer Service Guarantee
CVC	Connectivity Virtual Circuit
FSA	Fibre Servicing Area
ICRA	Initial Cost Recovery Account
IPR	Intellectual Property Rights
LTIE	Long-term interests of end-users
LTRC	Long Term Revenue Constraint
NBN	National Broadband Network
NBN Co	collectively, NBN Co Limited and NBN Tasmania Limited
NBN Co SAU	NBN Co's Special Access Undertaking, as lodged on 5 December 2011
NER	National Electricity Rules
NGN	Next Generation Network
NGR	National Gas Rules
NNI	Network-Network Interface
OSS	Operation Support System
PA	Priority Assistance
POI	Point of Interconnection
PDF	Product Development Forum
RSP	Retail Service Provider
SAO	Standard Access Obligation

SAU	Special Access Undertaking
UNI	User Network Interface
USO	Universal Service Obligation
WACC	Weighted Average Cost of Capital
WBA	Wholesale Broadband Agreement

Other capitalised terms in this submission that are defined in the NBN Co SAU have the meaning given to them in the NBN Co SAU.

1. Executive Summary

1.1. Background

Telstra welcomes this further opportunity to participate in the consultation process on the special access undertaking (**SAU**) lodged by NBN Co Limited and NBN Tasmania Limited (collectively, **NBN Co**) (**NBN Co SAU**) with the Australian Competition and Consumer Commission (**ACCC**) on 5 December 2011.

The NBN Co SAU, if accepted by the ACCC, is one avenue through which all relevant stakeholders can be provided with regulatory certainty as to the terms and conditions of supply. This certainty is desirable, not least of all because it facilitates efficient investment decision-making.

Telstra appreciates that no party ever gets as much regulatory certainty as it would like, but considers it important that there is a fair balance between NBN Co and each retail service provider (**RSP**), on certainty, predictability and discretion. In striking this balance, Telstra also appreciates that consideration should be given to NBN Co's unique circumstances, particularly the nascent nature of its operations and the changes to its operating environment which may occur over the next three decades.

Telstra believes that many of the issues identified in this submission can be overcome through amendments to the structure of the NBN Co SAU, as well as to particular terms. Telstra also believes that, with these changes, the NBN Co SAU is capable of providing an appropriate balance of certainty for all relevant stakeholders.

Telstra looks forward to working with stakeholders, and in particular NBN Co and the ACCC, to ensure that any SAU that applies to services supplied on the NBN Co Network is one that appropriately balances the various interests represented, and is one that is designed to achieve the ultimate goal of promoting the long-term interests of end-users (**LTIE**).

1.2. Design of the NBN Co SAU

The NBN Co SAU has four fundamental design features:

- a 30 year term with a mid-term review;
- broad coverage of NBN Co services;
- explicit interaction with the Wholesale Broadband Agreement (**WBA**); and
- utilisation of a series of largely self-executing rules, with some discrete powers conferred on the ACCC.

The proposed NBN Co SAU would operate to cover any services that could be supplied on the NBN Co Network over the 30 year term.

Constructing a SAU that will be “future-proof” and remain reasonable over a 30 year term is a challenging exercise. While some break points are provided in the NBN Co SAU to enable review of its operation, Telstra is concerned that these are insufficient in scope to provide confidence that the terms and conditions will remain appropriate for the full term.

A consequence of a 30 year framework for access, particularly in the context of a new access network technology, is that the framework must have flexibility.

In the NBN Co SAU, the flexibility required by NBN Co takes the form of high level principles that will, at some point in the future, be the subject of more precise implementation.

In relation to price terms and conditions, flexibility is achieved through the primary overarching principle of full cost recovery by NBN Co, embodied in the long-term revenue constraint (**LTRC**).

In relation to non-price terms and conditions, flexibility is achieved through the interaction between the NBN Co SAU and the WBA, where the WBA will “put into operation” the principles contained in the NBN Co SAU.

As drafted, Telstra believes there is too much discretion conferred on NBN Co with too little regulatory oversight from the ACCC. To a significant extent, it is the manner in which NBN Co has elected to build in the flexibility through the WBA which gives rise to this concern. When this is combined with a 30 year term, a requirement to execute the WBA before NBN Co will supply services, and a regulatory regime in which the executed WBA prevails over inconsistent terms in the NBN Co SAU (as well as ACCC binding rules of conduct and access determinations), the uncertainty inherent in the terms of the NBN Co SAU is amplified.

The scope of the discretion contained in the NBN Co SAU can be highlighted by reference to the introduction of new services. Where a new service is to be provided on the NBN Co Network, NBN Co is able to determine:

- the service features and performance levels that will apply;
- the initial price to apply to that service; and
- the specific detail of the non-price terms and conditions to apply to that service, subject to broadly stated principles where such principles are contained in the NBN Co SAU.

NBN Co is able to decide upon the above matters with limited constraint, review, oversight, or challenge to its determination.

There are a number of ways in which the regulatory uncertainty referred to above could be addressed, including:

- amendment of the NBN Co SAU so that it comprises a standalone set of terms and conditions of access (and therefore would only deal with those matters that are capable of being precisely stated); and
- amendment of the NBN Co SAU so that it provides RSPs with greater scope to access ACCC decisions in respect of those areas where the NBN Co SAU confers discretion on NBN Co (utilising significantly enhanced and expanded regulatory pull-through mechanisms based on those proposed by NBN Co).

Other options include a reduced term, more review points, reduced scope and general increased regulatory oversight (or any combination of these options).

1.3. Product commitments and network design rules

Telstra’s priority is to ensure that a high quality customer experience, both in terms of migration to the NBN and ongoing supply, is achieved.

To this end, Telstra is committed to offering its customers who will connect to the NBN Co

Network (at both a wholesale and retail level) an end-to-end service experience which is at least the same (in terms of quality, performance attributes and timeframe commitments) as the end-to-end service experience of equivalent end-users and downstream customers today.

Telstra recognises that NBN Co commitments on product performance and service standards must match current NBN Co capabilities. However, the community and industry expect product performance and service standards to evolve, meeting and then exceeding current expectations. NBN Co will not have an incentive to deliver such improvement with its commensurate cost, so there needs to be a process to drive the improvement of product performance and service standards.

Given the importance of ensuring a high quality end-to-end service experience, Telstra believes the ACCC must have absolute certainty that the service being delivered to RSPs can provide this service experience, in order to be satisfied as to the reasonableness of the NBN Co SAU.

Telstra considers that the current form of the NBN Co SAU does not provide adequate certainty as to the full extent of the service that RSPs will be able to offer their customers for any particular price, including those based on the Basic Access Offer. These are matters that Telstra considers are capable of being addressed in the NBN Co SAU.

On the issue of service levels more broadly, a high-level principled approach has been included in the NBN Co SAU with the stated intention to introduce (at a future date) service levels, including a more complete service level regime. Telstra considers that more could be done in the NBN Co SAU to provide RSPs (and end-users) with a higher degree of certainty as to the service levels that will apply and consequences that will flow in the event of non-compliance.

On a similar theme, Telstra considers that more could be done in respect of the Network Design Rules to provide increased clarity and certainty as to the technical requirements of: the NBN services; NBN Co's service assurance operation and service qualification processes; how the NBN network will be dimensioned and managed; and how the network will operate to deal with extreme situations (for example, carriage of voice services in emergency situations where the network may be congested).

To this end, Telstra believes that the NBN Co SAU should contain a more complete set of product and service commitments in relation to its "known" product set and a clear set of guiding principles in relation to future products to ensure end-users receive a truly world class quality of service.

1.4. Price terms

The NBN Co SAU includes definitive price commitments in respect of a limited set of initial product offerings. For example, the price of the Basic Access Offer is specified in the NBN Co SAU, is set for a period of five years, and then is subject to a specified price increase limit after that time. Subject to the comments set out below, Telstra welcomes the commitment that the NBN Co SAU provides in relation to the pricing of the Basic Access Offer.

Telstra continues to have concerns with the proposed form of the price control for the Connectivity Virtual Circuit (**CVC**). As noted in Telstra's initial submission, the establishment of a per Mbps CVC price (as opposed to a per SIO price) creates scope for very significant increases in end-user charges as data usage increases over time.

For products that may be introduced after the commencement of the NBN Co SAU, NBN Co has, in effect, full discretion as to the initial pricing of these products, which are then subject to a CPI/2 price increase once the initial prices have been set. There are two potential constraints on the pricing of initial products, but there is uncertainty as to how effective these constraints may be.

The first is that the pricing of initial products may be constrained by the pricing of existing products, in particular, the Basic Access Offer. The extent to which the pricing of existing products may be considered to “anchor” new products developed over the 30 year term will be determined by the substitutability of these products. It is difficult at this point to form a view as to whether the degree of substitutability between these products will act to appropriately limit NBN Co’s discretion in setting initial prices for new products. For at least some products that may be introduced in the foreseeable future (e.g. business grade products), the Basic Access Offer is unlikely to provide a strong constraint.

The second is the LTRC. It is difficult to assess whether the LTRC will act to constrain the pricing of new products without access to a populated cost model. However, the statements made by NBN Co and its consultant, Synergies, suggest that it is not anticipated that the LTRC will “bite”, even in the medium term.

In terms of the cost inputs that go into the LTRC, most relevantly operating expenditure and capital expenditure, the current drafting of the NBN Co SAU provides limited scope for ACCC oversight of the prudence of this expenditure. This results in significant uncertainty as to whether the stated intent in the NBN Co SAU that NBN Co only be permitted to recover prudent and efficient costs will be achieved.

1.5. Non-price terms

Given the WBA “puts into operation” the non-price principles contained in the NBN Co SAU, the NBN Co SAU can neither be assessed, nor can it operate, in isolation from the WBA.

While Telstra acknowledges that NBN Co has made a number of valuable commitments in relation to its non-price terms, Telstra remains concerned that the NBN Co SAU design features referred to in section 1.2 above, and the proposed interplay with the WBA, may operate to undermine RSP certainty with regards to the non-price term commitments.

Telstra notes that a number of the non-price terms set out in the NBN Co SAU:

- are drafted as statements of fact or intention and are not commitments *per se* nor do they provide RSPs with certainty about their application;
- confer rights or discretions on the part of NBN Co, which serve to “lock in” discretions and by their very nature, reduce certainty for RSPs about their subject matter; and
- defer to the WBA or provide commitments that only apply unless otherwise provided for in the WBA, which creates the potential for the WBA to “undo” the NBN Co SAU commitment.

Telstra would also expect to see a number of additional non-price terms that were not set out in the NBN Co SAU. Given the primacy of the “access agreement” in the NBN context, in the absence of treatment under the NBN Co SAU these matters are effectively left to NBN Co to settle without regulatory oversight.

1.6. Responses to ACCC questions

Telstra has responded to each of the questions raised by the ACCC in its Supplementary Consultation Paper in Appendix A of this submission.

2. Design of the SAU

2.1. Introduction

This section discusses the key elements of the design of the NBN Co SAU and how they interact.

Telstra considers that there are a number of elements that together comprise the design of the NBN Co SAU that could, and should, be adjusted in order to provide the required degree of certainty and / or assurance to RSPs (and end-users) that the terms and conditions of the NBN Co SAU will provide regulatory certainty for industry and remain reasonable over its period of operation. Telstra would welcome the opportunity to be involved in further discussions with the ACCC, NBN Co and the industry, on the design of the NBN Co SAU.

2.2. Overview of the design of the NBN Co SAU

NBN Co identifies the high level design of the NBN Co SAU as including:

- a 30 year term with a mid-term review;
- broad coverage of NBN Co services;
- explicit interaction with the WBA; and
- utilisation of a series of largely self-executing rules, but with some discrete powers conferred on the ACCC.¹

In approaching the design of the NBN Co SAU, NBN Co submits that it had regard to the context for the NBN Co SAU, and in particular the objectives of providing an appropriate degree of regulatory certainty to RSPs, their end-users and NBN Co, and the long-term framework reasonably necessary to achieve uniform national wholesale pricing.²

Telstra considers that the assessment of the reasonableness of the design features of the NBN Co SAU should be conducted primarily by reference to the particular price and non-price terms and conditions set out in the NBN Co SAU. Telstra therefore makes specific submissions on the design features in that context while also setting out below some general observations on the design of the proposed NBN Co SAU.

2.2.1. A 30 year term with a mid-term review

The proposed 30 year term of the NBN Co SAU may be contrasted with the regulatory periods of what could be considered NBN Co's infrastructure "peers", such as electricity transmission, and electricity and gas distribution networks. These energy networks typically have regulatory periods of five years, against the backdrop of a relatively certain and stable regulatory framework. The proposed term of the NBN Co SAU can also be contrasted with other regulatory periods that apply in the telecommunications context, including that which applies to Telstra's fixed line services which has a three year regulatory period.

While the investment in the NBN Co Network is no doubt significant, it is similar in magnitude

¹ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 4.

² Ibid.

to recent investments made in electricity markets.³ The lives of NBN Co's key assets are expected to be broadly similar to those of electricity transmission businesses. For example, electricity transmission assets such as transmission lines and cables can have standard asset lives of 50 years, and substations 40 years.⁴

While it is reasonable for NBN Co to seek to have the NBN Co SAU in operation over a long term, it will necessarily be unable to deal with a range of matters in precise detail because of the flexibility required to deal with all future uncertainties. The flexibility required in the case of the NBN Co SAU over a term of 30 years is considerable, including because there is a high degree of uncertainty as to the services that could be developed and ultimately supplied on the NBN Co Network. Telstra understands that it is not possible to specify upfront, with any level of precision, the terms and conditions that will apply to "unknown" services; however the flexibility in the NBN Co SAU needs to be designed in a manner that places NBN Co, RSPs and end-users in a position of relative certainty that they will not be exposed in the future to the imposition of unreasonable terms and conditions.

The NBN Co SAU deals with the requirement for flexibility arising from the proposed term and scope of the NBN Co SAU by providing NBN Co with considerable discretion over the precise implementation of many of the terms and conditions of access. This is particularly so in relation to new services that may be supplied on the NBN Co Network in the future. As a result, this gives rise to uncertainty, where RSPs and end-users are unsure how that flexibility and discretion will be exercised.

Telstra agrees that certainty as to the economic regulatory regime that is to be applied to infrastructure is important to encourage investment, although is not a sufficient condition to ensure efficient investment.

Certainty as to the core features of the regulatory framework can be provided other than through a long-term SAU, for example, through the use of fixed principles. Such a model would be consistent with the regulatory framework that applies to other infrastructure where key assets have lives of even greater than 30 years, such as the framework that applies to electricity transmission networks. Transmission network operators have long-term stability in relation to the regulatory regime that will apply to their networks, but the classification of the services provided on those networks, the regulated revenue that may be earned, and ultimately the prices that attach to those services, is the subject of a detailed regulatory process that takes place over a 13-month period every five years.⁵

Telstra therefore agrees that it is important that both NBN Co and RSPs have certainty that the "rules of the game" or the applicable regulatory model will not change, but notes that this does not translate into a requirement that the term of the NBN Co SAU be for a period of 30 years.

A number of the precedents that NBN Co refers to in support of a 30 year term for the NBN Co SAU do not, on closer inspection, provide such support.

³ The AER has assessed \$56b of spend by electricity companies under the NER over the past five years - Andrew Reeves (2011), 'Promoting efficient investment – protecting consumers from paying more than necessary', *AER Chairman's Address to the AEMC Public Forum*, 23 November 2011, p 3. In comparison, NBN Co's capex and opex is forecast to sum to \$55b up to and including the 2020 financial year – NBN Co (2010), *Corporate Plan: 2011-2013*, 17 December 2010, Exhibit 10.3.

⁴ See for example the AER's draft decision in respect of TransGrid, the transmission network operator in NSW, which sets out the AER's conclusion of a 50 year standard asset life for transmission lines and cables, and 40 years for substations: AER, *TransGrid Transmission Determination 20090-10 to 2013-14: Draft Decision*, 31 October 2008, p 161.

⁵ See generally Chapter 6A of the National Electricity Rules.

For example, NBN Co refers to a recent determination by the Australian Competition Tribunal to declare access to the Goldsworthy railway for a 20 year period. This is not the same as a declaration as to any price or non-price terms and conditions of access for a 20 year period. Rather, the effect of the Tribunal's determination is that third parties have a right to access specified services that permit third party trains and rolling stock to move along the Goldsworthy railway. On the basis of the declaration, third parties have an enforceable right to negotiate access to these specified services and if these negotiations are not successful, they can have the dispute resolved in an arbitration conducted by the ACCC. This is similarly the case in relation to the Tribunal's determination of a 50 year declaration period for sewage transmission and interconnection facilities provided by Sydney Water which is also referred to by NBN Co in support of the 30 year term.

The NBN Co SAU provides for a review of the NBN Co SAU at approximately mid-way through the 30 year term. The effectiveness of a review process is of significant importance where a 30 year term is being sought. There are a number of limitations in the proposed review process in the NBN Co SAU which mean that the review process is unlikely to operate in a manner that will maintain the reasonableness of the terms and conditions over time. These limitations include:

- the review is conducted by NBN Co;
- limited specified matters are the subject of the review, including:
 - the approach to prudence of capital expenditure and / or operating expenditure;
 - the process by which capital expenditure and operating expenditure will be incorporated into future calculations relevant to the building block methodology; and
 - the approach to the Weighted Average Cost of Capital (**WACC**); and
- NBN Co has discretion to review other matters.

The NBN Co SAU provides for NBN Co to submit a variation to the NBN Co SAU that addresses the matters that were the subject of the review. If the ACCC rejects that variation, NBN Co is required to submit a new proposed variation which is meant to address, but is not limited to addressing, the issues raised by the ACCC in rejecting the first variation. In the event the ACCC does not accept the new proposed variation, there is no further mechanism for addressing the issues identified by NBN Co in the review. This would potentially permit the continued operation of a term or condition which has been identified as being deficient in some way.

Telstra acknowledges that there is a general requirement for NBN Co to act in “good faith” when undertaking the mid-term review and in submitting any variation to the ACCC following that review. However, this broad requirement is unlikely to be sufficient to force NBN Co to take further action to resolve the issues raised by the ACCC.

2.2.2. Broad coverage of NBN Co services

The NBN Co SAU also seeks to operate in respect of all services that may be provided on the NBN Co Network. This design feature, combined with the 30 year term, necessitates a SAU that is sufficiently flexible to cater for any possible service that could be provided on the NBN Co Network.

The broad coverage of the NBN Co services in the NBN Co SAU, together with the 30 year term, increases the requirement for the NBN Co SAU to have sufficient “bend” to enable it to deal with a whole range of matters that at this point in time are highly uncertain or unknown. However, as with the issue of term, the “bend” needs to be provided in a way that does not place NBN Co, RSPs and end-users in a position where they may be exposed in the future to the imposition of unreasonable terms and conditions.

2.2.3. Explicit interaction with the WBA

Another design feature of the NBN Co SAU is that it will not constitute a stand-alone document or reference offer. In order to access services, RSPs will take access on the basis of the terms and conditions in the WBA (which the RSP will be required to execute).

A consequence of a design feature which inextricably links the NBN Co SAU with the WBA is that in order for the NBN Co SAU to have real effect, the WBA must contain provisions that give it this effect. This is because if there is any inconsistency between the NBN Co SAU and the executed WBA, the provisions of the WBA will prevail.

A further consequence of a design feature that requires execution of the WBA in order for an RSP to obtain access is that, unless explicit provision is made, the ACCC is forced to largely “vacate” the regulatory space with respect to the NBN Co Network. As the WBA is NBN Co’s standard form of access agreement for the purposes of the access regime, it is a document produced and published by NBN Co outside of the purview of the ACCC, and once entered into by an RSP would operate to override any inconsistency with ACCC ex ante regulatory instruments such as access determinations and binding rules of conduct. This is the case unless the WBA itself provides otherwise. The WBA therefore operates to circumscribe the ability of RSPs to, where they wish to do so, have ACCC regulatory decisions deal with future uncertainties that effect their acquisition of services.

2.2.4. Utilisation of a series of largely self-executing rules, but with some discrete powers conferred on the ACCC

The NBN Co SAU supporting submission notes that the NBN Co SAU utilises a series of “largely self-executing rules”. It is not clear what NBN Co means by this term, however it may refer to the number of high level commitments in the NBN Co SAU which leave it to NBN Co to determine how those commitments will be translated into precise terms and conditions, without any real review or oversight of this implementation. One effect of these rules is that the real nature of the commitment is unclear and, as a consequence, enforcement of those commitments is in practice likely to be difficult.

The lack of reporting against compliance with the commitments in the NBN Co SAU further entrenches the self-executing nature of these rules and raises questions as to their reasonableness. Not only is enforcement uncertain, but the means by which the ACCC is able to ascertain compliance is compromised given the lack of information provision and associated enforcement commitments.

The NBN Co SAU design also provides for some discrete powers to be conferred on the ACCC. Most significantly:

- clause 6 of the NBN Co SAU, which provides for “regulatory recourse” to the ACCC where RSPs and NBN Co cannot reach agreement on terms of access; and
- clause 14.3 of Schedule 11 of the NBN Co SAU, which provides that a RSP can seek an interim access determination or a binding rule of conduct in certain discrete

circumstances.

For the reasons set out below, Telstra considers that these mechanisms provide very limited regulatory oversight and limited ability for RSPs to be able to seek to have the outcome of the exercise of regulatory powers apply to their acquisition of services from NBN Co.

In broad terms, clause 6 provides that, if NBN Co and the Access Seeker are unable to reach agreement in respect of one or more terms or conditions, either party can notify the ACCC of a dispute.⁶ The clause sets out a number of procedures that are required to be followed in respect of the dispute and provides for the ACCC to make a decision in relation to the dispute which is final and binding on the parties.⁷

Clause 6 also provides that if the ACCC makes a decision in relation to a dispute notified to it pursuant to clause 6.1(b), NBN Co undertakes to incorporate the term or condition the subject of the ACCC's decision, should an Access Seeker or Customer elect to adopt the term or condition:

- in its WBA so that it is available for inclusion in any prospective Access Agreement; and
- any Access Agreement with a Customer that is in place at the time of the decision, provided that the Customer has notified NBN Co within 10 business days from the date NBN Co publishes the ACCC's decision on its website, that it wishes to adopt the term or condition the subject of the decision in the Access Agreement in place with the Customer.⁸

For the reasons set out below, regardless of what may have been the intent behind clause 6 of the NBN Co SAU, the operation of the clause is limited in scope and, without amendment, is unlikely to provide a sufficient degree of regulatory oversight:

- ***The mechanism is only available to an RSP who has not executed an Access Agreement.*** Not only does this provide a “once-only” opportunity to raise a “Regulatory Recourse Dispute” (and therefore fails to provide ongoing regulatory oversight), there is also ambiguity as to how this will operate for RSPs who have signed-up to the “short term” WBA as an “interim solution”. Arguably, these RSPs are excluded from the regulatory recourse mechanism, although they may receive some derivative regulatory oversight in circumstances where an Access Seeker notifies a dispute to the ACCC.
- ***The mechanism excludes any non-price terms and conditions to the extent that they are not covered by the NBN Co SAU.*** In a number of cases it is unclear the extent to which certain non-price terms and conditions “cover the field”. For example, where a high level principle is included as to a matter to be included in the WBA, it is unclear whether the specific implementation of that principle into the WBA will be able to be the subject of a dispute pursuant to clause 6.
- ***The mechanism excludes any price-related terms and conditions that have been “announced” by NBN Co prior to the SAU Commencement Date.*** The scope of “announced” terms and conditions may serve to exclude significant price related terms and conditions or at least create ambiguity as to what is covered by the regulatory recourse mechanism. There is no definition of “announced” and the NBN Co SAU does

⁶ NBN Co SAU, cl 6.1(b).

⁷ NBN Co SAU, cl 6.1(c) - (j).

⁸ NBN Co SAU, cl 6.3(b) and (c).

not set out what processes would need to be satisfied before a price-related term and condition would be considered to be “announced”.

- **The ACCC’s power to resolve the matters in dispute is significantly limited.** Under the regulatory recourse mechanism, the ACCC makes a choice between the different drafting options that each party proposes (with some limited ability to propose drafting changes). This power can only be exercised in a manner that does not have the effect of discriminating between Access Seekers. It is difficult to see how these two concepts reconcile. It is also difficult to see how this type of mechanism could be managed in the event there are multiple bilateral disputes about the same issues.

Telstra notes that in clause 14 of Schedule 11, the NBN Co SAU also contemplates a limited role for interim access determinations or binding rules of conduct made by the ACCC. These are linked to potential changes NBN Co has sought to make to the WBA. The design of this provision is such that implementation occurs only where the change is not otherwise contemplated by the terms of an Access Agreement and NBN Co elects to exercise its discretion to change the Access Agreement using the process contemplated in the NBN Co SAU (i.e. it is a discretionary right, not an obligation in relation to all changes). As the WBA provides specific processes for the amendment of a range of matters, there is very limited scope for the operation of ACCC decisions to apply to proposed amendments to the NBN Co SAU.

2.2.5. Options for addressing concerns arising from the currently proposed NBN Co SAU design

The NBN Co SAU is an ambitious document. It seeks to establish a framework that will deal with the terms and conditions of access for all services on the NBN Co Network that remains “fit for purpose” for a period of 30 years.

The NBN Co SAU seeks to deal with the uncertainties associated with the 30 year term and the scope of services covered by conferring discretion on NBN Co as to the precise implementation of a number of price and non-price terms and conditions of access. This discretion, combined with limited regulatory oversight and scope for operation of ACCC regulatory decisions, results in a risk for RSPs that the translation of some of the general principles in the NBN Co SAU into specific terms and conditions may not always be reasonable and appropriate in balancing the interests of NBN Co and RSPs.

Telstra considers that the uncertainty that arises from the NBN Co SAU can be, and should be, addressed. Telstra would encourage consideration of how particular elements of the NBN Co SAU could be adjusted to provide the required degree of certainty and / or assurance that the terms and conditions of the NBN Co SAU will remain reasonable over its period of operation. These options include, amongst others, those set out below.

- **The term of the NBN Co SAU:** As discussed above, the longer the term of the NBN Co SAU, the greater is the requirement for flexibility to ensure the NBN Co SAU can continue to operate in changing circumstances. The manner in which the flexibility is implemented in a long-term instrument is a complex issue and can itself create concerns as to the reasonableness of that instrument. Over a shorter term, there is greater certainty as to the services that are likely to be supplied and therefore greater specification of the terms and conditions is possible, avoiding the need for flexibility in the instrument. Further, a shorter term naturally creates the opportunity to review how any particular SAU has operated and allow refinement of future SAUs to continue those elements that are operating consistently with the LTIE, and refine those that are not.

-
- **The use of fixed principles:** It is beneficial for NBN Co and other stakeholders to have certainty as to the key elements of the regulatory framework that will apply to the NBN Co Network over the long-term. The NBN Co SAU does not currently propose the use of fixed principles⁹. Telstra considers that the use of fixed principles could be one way of providing certainty as to the detail of the regulatory framework to apply to services on the NBN Co Network while potentially removing the uncertainty and concern that currently arises in relation to how high level principles will be translated into specific terms and conditions of access.
 - **The scope of services covered / scope of terms covered:** The issue of the scope of services and the scope of the terms sought to be covered by the NBN Co SAU is associated with, and similar to, the issue of the term of the NBN Co SAU. The broader the scope of the services and terms covered, the greater the level of flexibility that is required to deal with unforeseen circumstances that may arise in the future. If the scope of the NBN Co SAU was more limited, it follows that the NBN Co SAU could set out highly specified terms and conditions of access.
 - **The NBN Co SAU as a standalone form of access:** De-linking the NBN Co SAU from the WBA would provide RSPs with the option of taking: (a) access on the basis of the terms and conditions in the NBN Co SAU, all of which will have been the subject of scrutiny by the ACCC and other stakeholders, and, ultimately, acceptance by the ACCC; or (b) access on the basis of the terms and conditions in the WBA. This would therefore provide RSPs with a “backstop” regulated access route to the extent they could not reach commercial agreement with NBN Co on one or more aspects of access. This would also provide RSPs with the knowledge of what the regulated access route comprises of in assessing, negotiating and potentially entering into a WBA with NBN Co.
 - **Operation of ACCC regulatory decisions:** Providing for the possible “pull-through” of terms and conditions that are the subject of ACCC access determinations or binding rules of conduct in respect of (a) those matters where the NBN Co SAU has conferred discretion on NBN Co, and (b) those areas that are not specifically addressed by the NBN Co SAU (i.e. where the NBN Co SAU is silent). This will assist in alleviating concerns that the manner in which NBN Co may exercise a particular choice will result in the imposition of terms or conditions that are unreasonable.
 - **Powers conferred on the ACCC by the NBN Co SAU:** Concerns as to how NBN Co may exercise discretions could also be dealt with by conferring powers on the ACCC to oversee the exercise of these discretions. RSPs could then have available to them the outcome of the exercise of the ACCC power or a commercially negotiated outcome that is entered into with knowledge of the ACCC determined alternative.

There is no one “correct” approach that would address the concerns that arise from the NBN Co SAU design. A combination of the above elements could be utilised and “dialled up” or “dialled down” as appropriate.

Take the NBN Co SAU structure as an example (i.e. where the NBN Co SAU drives the content of the WBA and the NBN Co SAU confers discretions on NBN Co in this regard). This design could be adjusted so that:

- the NBN Co SAU drives the content of the WBA (consistent with the approach adopted

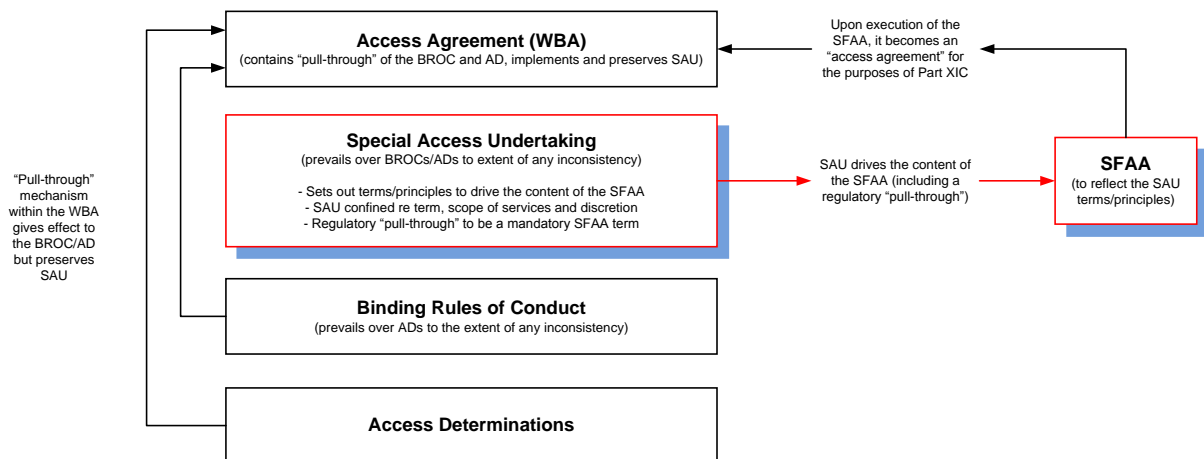
⁹ The use of fixed principles in a SAU is permitted under section 152CBAA of the CCA.

by NBN Co) including by requiring the WBA to contain an effective regulatory “pull-through” mechanism (see below);

- terms and conditions that are expressed in broad terms are narrowed so that it is clear what part of the “field” the relevant term or condition is covering;
- NBN Co discretions are limited and provided only to the extent absolutely necessary;
- the term of the NBN Co SAU is reduced to align with the life of the “known” services on offer;
- there is greater scope for the operation of ACCC regulatory decisions both before execution of the WBA (through an enhanced version of NBN Co’s “regulatory recourse” proposal) and during ongoing supply (through a regulatory “pull-through” mechanism required to be contained within the WBA) to:
 - oversee the implementation of NBN Co discretions (including those that manifest by the NBN Co SAU remaining silent on a term of access, thereby leaving the development of that term to NBN Co under the terms of the WBA); and
 - ensure RSPs are able (but not required) to take the benefit of access determinations or binding rules of conduct (subject to consistency with the SAU, but not otherwise able to be “trumped” by the WBA); and
- fixed principles are used to “carry over” from one NBN Co SAU to the next (to provide ongoing certainty as to key elements of the regulatory framework).

This option is illustrated in Figure 1 below.

Figure 1 – Regulatory “pull-through” option



In short, such an approach would operate to “pull-through” to the WBA, those terms and conditions that are the subject of an ACCC regulatory decision.

Under such a structure, NBN Co retains regulatory certainty in relation to those matters that are properly specified in the NBN Co SAU. This is because access determinations and binding rules of conduct have no effect to the extent to which they are inconsistent with a SAU that is in operation. Accordingly, terms and conditions in access determinations and binding rules of

conduct that are inconsistent with the NBN Co SAU could not be pulled through to the WBA.

This approach would not exclude or make redundant key regulatory framework features that are currently encompassed in the NBN Co SAU. For example, an appropriate building block methodology could be retained, with the ACCC able to make access determinations in respect of the pricing for new services, but with the relevant constraint that those access determinations be consistent with the LTRC.

The ACCC, NBN Co and other stakeholders may also identify other options that could address the concerns raised above. Telstra would like to further discuss these with the ACCC and NBN Co to ensure the NBN Co SAU remains reasonable and appropriately balances the interests of NBN Co and RSPs.

3. Product Commitments and Network Design Rules

3.1. Product certainty

At a principle level, Telstra supports the proposed product construct (i.e. the supply of individual “Product Components”) and the proposed network architecture (e.g. the use of GPON).

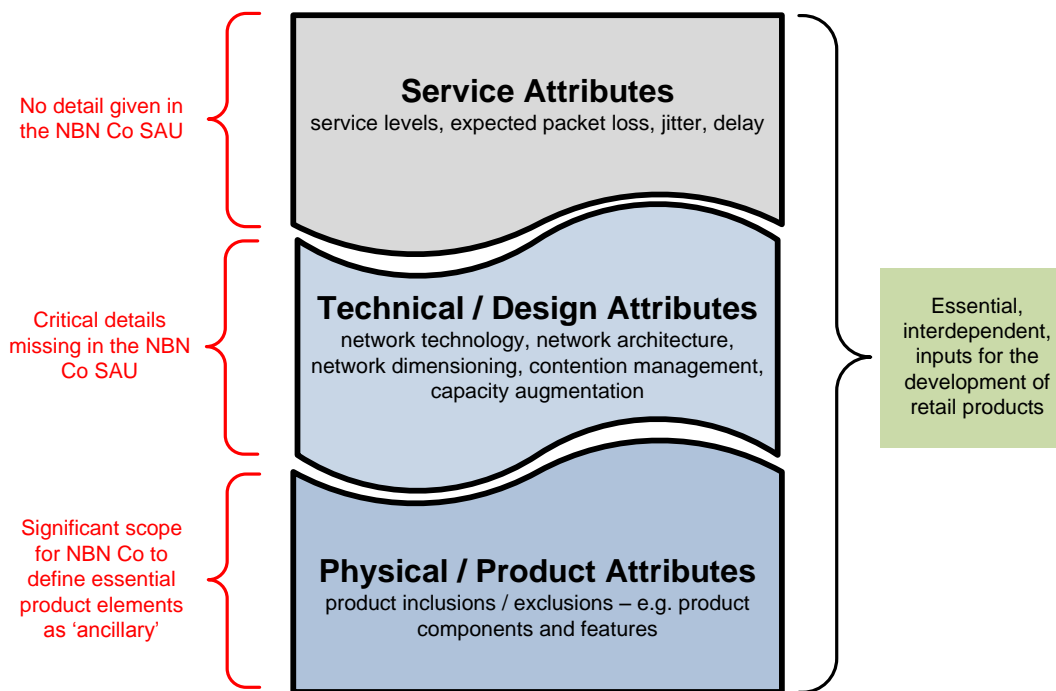
However, in order for an RSP to have the requisite degree of certainty as to the nature of a product that they propose to acquire from NBN Co (or any of its sub-wholesale providers), the RSP must have full information on the following three fundamental attributes of that product:

- **physical / product attributes** - what is included in (and excluded from) the product?
- **technical / design attributes** - what are the technical / design specifications?
- **service attributes** - how will the product perform?

These attributes are interdependent and must be provided as a “package”. It is not possible for RSPs to develop retail products if only a small part of the “package” is known.

The physical, technical and service attributes of NBN Co’s products will provide the foundation upon which retail products are able to be developed and offered to customers in retail markets. As illustrated by Figure 2 below, Telstra is concerned that the NBN Co SAU fails to adequately provide this foundation, and in so doing, does not provide RSPs with a sufficiently certain basis upon which to acquire NBN Co services.

Figure 2 – Fundamental attributes required for product certainty



The remainder of this section 3 has been structured by mapping the NBN Co SAU against each of the fundamental product attributes listed above.

3.1.1. Physical / product attributes – what is included?

The NBN Co SAU is given by NBN Co in relation to the “NBN Access Service”. The “NBN Access Service” is defined in functional and technology neutral terms as:

...a Layer 2 service supplied on the NBN Co Network between and including:

(a) a User Network Interface on a Network Termination Device; and

(b) the Network – Network Interface at the Point of Interconnect associated with the relevant Network Termination Device,

for the purpose of enabling an Access Seeker (or another Service Provider that is a customer of an Access Seeker) to supply Carriage Services or Content Services.¹⁰

Clause 2.2 of the NBN Co SAU provides that nothing in the NBN Co SAU requires NBN Co to supply the NBN Access Service except through the supply of the “Product Components”. These Product Components are: a User Network Interface (**UNI**); an Access Virtual Circuit (**AVC**); a Connectivity Virtual Circuit (**CVC**); and a Network-Network Interface (**NNI**).¹¹

It is therefore implied that the Product Components will enable RSPs to acquire an end-to-end service between a Premises and a Point of Interconnect. However, it is not clear whether they comprise the complete set of “product attributes” for the NBN Access Service. In practice, there are a range of other service components which Telstra considers to be essential to the supply of an end-to-end service and it is not clear whether these services will be “included” as part of the end-to-end service or whether they are “excluded” and must therefore be acquired by RSPs separately (and at additional cost), either as Ancillary Services or as additional Product Components.¹²

For example, it is essential that RSPs are provided with effective and real time visibility of NBN Co’s network alarm monitoring and reporting. Telstra would expect this service to be provided as a standard part of any end-to-end service; however, the NBN Co SAU does not make clear that this is the case.

Ancillary Services, Product Components and Product Features are discussed in further detail below, as is the extent to which the NBN Access Service is a Layer 2 service as described in the NBN Co SAU.

3.1.1.1. Ancillary Services and Product Components

Ancillary Services

The definition of “Ancillary Service” is broadly defined in the NBN Co SAU as “a service that is ancillary to the supply of the Product Components and associated Product Features”.¹³ There are two significant consequences of defining a service as “ancillary”:

- the service will fall outside the scope of the “NBN Access Service”; and

¹⁰ NBN Co SAU, sch 2, cl 1.

¹¹ NBN Co SAU, sch 3, cl 1.1(a).

¹² In this regard, Telstra notes the ACCC’s statement that the NBN Access Service “should be one for which it is technically feasible to supply” (ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 5.1).

¹³ NBN Co SAU, sch 1.

- RSPs will have to acquire the service separately from NBN Co, and NBN Co will be able to impose additional charges for the service.

Telstra accepts that some services may be properly characterised as ancillary and that NBN Co may impose an appropriate charge for them. However, in light of the consequences outlined, it is imperative that all the essential elements of a technically feasible access service (such as the network alarm monitoring and reporting example used above) form part of the NBN Access Service and are subject to the Category B Standard Access Obligations (**SAOs**)¹⁴ (including, in particular, the obligation to supply). Service elements which are essential to the supply of any basic service are not appropriately considered “ancillary” but the NBN Co SAU is not clear about this.

Indeed, NBN Co has expressly identified the Systems Interfacing Service as an “Ancillary Service”¹⁵ yet RSPs will be unable to acquire NBN Access Services without it. The Systems Interfacing Service will therefore have to be acquired separately, and NBN Co will be able to impose additional charges for it. Telstra would not expect to have to pay additional charges to acquire the basic function of interfacing with NBN Co’s systems.

Given the consequences that flow from defining a service as an Ancillary Service, Telstra submits that it is essential to understand:

- the full scope of Ancillary Services that NBN Co expects to supply (and to determine whether it is appropriate that they be considered as “ancillary”);
- what commitments NBN Co is making in relation to Ancillary Services. It is not currently clear how the provisions of the NBN Co SAU are expected to apply to Ancillary Services. The NBN Co SAU states that NBN Co will supply Ancillary Services “subject to the terms” of the NBN Co SAU, however, it is not clear which commitments in the NBN Co SAU the Ancillary Services will be “subject to”; and
- whether, by excluding Ancillary Services from the scope of the NBN Access Service, NBN Co is attempting to exclude the application of Part XIC in relation to these services.¹⁶

An example of the need for further clarification is the Facilities Access Service. While Telstra accepts that it is legitimate to define this service as ancillary, it is difficult to ascertain whether NBN Co is undertaking to supply it, and on what terms it proposes to do so. RSPs may also wish to self-supply facilities access or seek competitive facilities access services, so it will be important that the NBN Co SAU does not undermine this fundamental principle.

Product Components

Telstra generally supports the Product Component construct that has been adopted in the NBN

¹⁴ As set out in s 152AXB of the CCA.

¹⁵ See definition of “Ancillary Services” in Schedule 1 which defines Ancillary Services as including the Systems Interfacing Service. This has also been confirmed in NBN Co’s Supplementary Submission (NBN Co, *NBN Co’s Supplementary Submission*, 23 March 2012, para 3.5).

¹⁶ In its Supplementary Submission NBN Co confirms that it does not intend for Ancillary Services to become the “declared” service under CCA s 152AL(8E) (NBN Co, *NBN Co’s Supplementary Submission*, 23 March 2012, para 3.5), however, it does not confirm whether NBN Co intends that Ancillary Services will become ‘declared’ by other means (such as through the publication of an SFAA). Telstra notes that CCA s 152CJA prohibits an NBN Co corporation supplying an eligible service unless there is an SFAA or SAU for the service, or unless the service has been declared by the ACCC.

Co SAU. Telstra also generally supports an approach that allows for the scope of the NBN Co SAU to “expand” to encompass new Product Components as they are developed over time (subject to Telstra’s overriding concerns about the scope and term of the NBN Co SAU).

However, as a threshold matter, it is unclear whether the Product Components form part of the NBN Access Service described in Schedule 2, or are simply a means of delivering the NBN Access Service. References to the “Product Components” are noticeably absent from Schedule 2 of the NBN Co SAU – while Schedule 2 refers to the UNI and the NNI, it only does so incidentally.

As discussed in section 2.2.2, it will also be important to ensure that there is an appropriate level of oversight in relation to the development and introduction of new products, including the price and non-price terms on which they are offered. Section 4.1.3 of this submission also discusses the price impacts of adopting an approach that allows for an “expanding” product suite and section 3.2 discusses the importance of an appropriate and effective product development framework.

3.1.1.2. Product Features

The NBN Co SAU provides that each Product Component will have “Product Features”.¹⁷ Product Features are the features of a Product Component that are made available by NBN Co and which are selectable and configurable by the Customer, for example, the Data Transfer Rate or traffic class associated with an AVC or the UNI-D or UNI-V associated with an NTD.¹⁸ The Product Features are a fundamental part of each Product Component because they will determine core service elements such as service speed and service quality.

NBN Co acknowledges that the Product Features will fundamentally determine the core service elements of a product. In its supporting submission NBN Co notes that, while Product Components are the “key building blocks” of an end to end service on the NBN Co Network, the Product Features will “denote the aspects of each Product Component that are selectable and configurable by an Access Seeker”.¹⁹

It is therefore important that the NBN Co SAU provides details about the relevant aspects of each Product Component for which there will be Product Features, the extent to which they will be selectable and configurable, and what limitations apply.

3.1.1.3. Layer 2 Service

The NBN Co SAU provides that in addition to Layer 2 of the OSI Model at which NBN Co makes the NBN Access Service available to an RSP, the NBN Access Service also comprises components from lower levels of the OSI Model, such as Layer 0 and Layer 1 components and some “Layer 3 awareness” that is incorporated as part of the AVC and CVC to support “certain services”.²⁰

While Telstra accepts that there may be a need for NBN Co to use elements that could be considered as “Layer 3” in order to supply a Layer 2 service – such as the examples given in clause 1.2 of Schedule 3 – the NBN Co SAU should be exhaustive about the extent of the

¹⁷ See definition of “Product Components” and “Product Features” (NBN Co SAU, sch 1).

¹⁸ See definition of “Product Features” (NBN Co SAU, sch 1).

¹⁹ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 5.3.5.

²⁰ NBN Co SAU, sch 2, cl 2.

“Layer 3” exception, and should not leave this question open-ended by referring to “certain services”.²¹

3.1.2. Technical attributes – what are the specifications?

As noted above, Telstra generally supports the proposed network architecture described in the Network Design Rules. However, further detail about critical aspects of supply, such as network dimensioning and contention management, is needed.

The requirement for further details can be illustrated by using the speed of delivery as an example. The actual speed of the service that an RSP is able to supply to an end-user, and therefore the ultimate end-user experience, will depend (amongst other things) on:

- the degree of contention for capacity amongst the ports at the NTD, and how contention is to be managed by NBN Co; and
- how the network is dimensioned and the rules that NBN Co will apply to manage and augment capacity where the maximum dimensioned throughput is reached.

These limiting factors will apply irrespective of the speed of the service that is being acquired from NBN Co. Accordingly, it is critical that RSPs are given details about how these issues will be managed.

3.1.2.1. NTD capacity management

The NBN Co SAU contemplates that each NTD connected to the NBN Co Fibre Network:

- will have four data ports (UNI-D) and two “POTS” ports (UNI-V);²² and
- will have a “Maximum Data Transfer Rate”.²³

The Maximum Data Transfer Rate will apply to the NTD, not to each port, so each of the ports will be contending for capacity at the NTD.

In order for RSPs to offer services with confidence that the service they have undertaken to supply is the service that will in fact be delivered to the end-user, it is essential that RSPs are given details about:

- what the Maximum Data Transfer Rate for the NTD will be (under the NBN Co SAU, this is a matter that will be determined by NBN Co from time to time²⁴) and how this is to be notified to RSPs;
- how NBN Co will manage capacity contention amongst the ports at the NTD and whether RSPs will be able to control and guarantee traffic contention between ports on that NTD; and

²¹ This is consistent with the clear policy intention of the Federal Government. For example, the Statement of Expectations issued by NBN Co’s shareholder Minister dated 17 December 2012 makes it clear that NBN Co “will offer open and equivalent access to wholesale services, at the lowest levels in the network stack necessary to promote efficient and effective retail level competition, via Layer 2 bitstream services” [emphasis added] (p 2).

²² NBN Co, *NBN Co Network Design Rules*, 19 December 2011, p 4.

²³ NBN Co SAU, sch 3, cl 6.4.

²⁴ See definition of “Maximum Data Transfer Rate” (NBN Co SAU, sch 1).

- whether alternative options will be available to RSPs whose services may be affected by the Maximum Data Transfer Rate (such as installing a new NTD if the Maximum Data Transfer Rate is exceeded or opting to acquire the exclusive use of the NTD).

3.1.2.2. Network dimensioning, contention and augmentation

The NBN Co Fibre Network will use GPON technology and will therefore be a shared medium. In other words, the speed that is experienced by an end-user will depend on the number of other users within the same “Fibre Serving Area” (FSA) that are using the network at the same time.

Since not all premises will be using the network at the same time, and to ensure that network assets are optimised, the capacity of the network will be “dimensioned” on the basis of the number of premises that are expected to be using the network at any given time. If the network is not dimensioned correctly, or if usage patterns change, the end-user experience will be impacted unless network capacity is augmented (and, depending on the traffic class, this may be irrespective of the peak speed being provided by NBN Co).

As noted in section 3.1.2.3, further detail about the way the network will be dimensioned, and the rules that will apply to the augmentation of capacity is needed.

To use an example, a FSA is expected to serve close to 4,000 premises. If the network is dimensioned such that the maximum aggregate throughput capacity for that FSA is 300 mbps for TC_4 traffic,²⁵ there could be up to 4,000 premises contending for that capacity. Not all premises in the FSA will be connected to the NBN (particularly in the earlier stages where take up rates may be lower), and not all of them will be using the network at the same time, so the number of premises contending for capacity may be significantly less than 4,000. However, this number will increase as more premises connect to the NBN. The level of contention will also increase as broadband usage per premises increases (as expected). As take-up and usage increases, there will be a need to manage contention and augment the maximum throughput capacity for the FSA.²⁶ Since these issues will determine the quality of the service that the end-user experiences (and the basis for offering different speed tiers of TC_4 traffic), it is crucial that the NBN Co SAU provide details about how this will be done.

3.1.2.3. Network Design Rules

The Network Design Rules will determine the type of services that can be supplied by NBN Co and the extent of the service level commitments that can be given in respect of those services. It is therefore fundamental that the Network Design Rules be developed in a manner that is able to support expectations that the NBN Co Network will provide superior, leading edge services to all Australians.

Telstra notes that a report has been prepared by Analysys Mason in relation to the NBN Co’s fibre and wireless network design. Telstra has not had sufficient time to undertake a detailed review of this report.²⁷ However, as a general comment Telstra notes that the Analysys Mason report appears to take into account material that is extrinsic to the NBN Co SAU and, in some case, not publicly available. For example the Analysys Mason report makes a reference to

²⁵ Analysys Mason, *Review of the Efficiency and Prudency of NBN Co’s Fibre and Wireless Network Design*, 2 March 2012, p 99.

²⁶ Indeed, the Analysys Mason report states that NBN Co will need to augment this bandwidth as take up increases (Analysys Mason, *Review of the Efficiency and Prudency of NBN Co’s Fibre and Wireless Network Design*, 2 March 2012, p 100).

²⁷ Supplementary comments will be provided if considered necessary.

NBN designing their network in accordance with 16 cards per OLT x 8 GPON ports per card x 32 end-users per GPON x 150kbps x 50% = 300Mbps.²⁸ Telstra would be concerned if any weight were to be given to this report in the absence of this material being made available and sufficiently incorporated into the NBN Co SAU.

As a general observation, Telstra believes that the Network Design Rules require more detail. For example, the Network Design Rules should detail:

- the rules to apply to initial network dimensioning and ongoing capacity management (including some of the points noted above);
- the description of the technical requirements of the NBN Access Service. For example, more information about traffic classes and NNI profiles is needed;
- the build and augmentation rules to apply to network operation and deployment;
- NBN Co's service assurance, operation and service qualification processes; and
- how the network will operate in dealing with "abnormal" environments, e.g. carriage of voice services in emergency situations where the network may be congested.

In the absence of these details it is difficult to provide a meaningful assessment of the Network Design Rules (see Telstra's views on the Network Design Rules in terms of prudence set out in Section 4.2).

3.1.3. Service attributes – what level of performance is expected?

Service levels are as important to NBN Co's service offering as the Product Components themselves. They are necessary for RSPs to have certainty that they will be able to market and supply robust and attractive retail products. This is recognised by the ACCC which notes in its Supplementary Consultation Paper:²⁹

In the absence of reliable service levels for the CVC, access seekers may be unable to design a network that fulfils their contractual obligations to end-users around service quality.

It follows that details about service levels are essential when making assessments as to the reasonableness of the product related commitments.

Telstra appreciates that NBN Co is currently in the nascent stages of its network development and that products will continue to evolve over the term of the NBN Co SAU. However, the requirement to cater for potential "unknowns" needs to be balanced with the legitimate need for RSPs to have a degree of certainty about the service levels that will apply to NBN Co products. A statement of intention that a service level regime will be introduced at some time in the future does not achieve an appropriate balance.

At a minimum, there should be certainty that service levels will allow RSPs to meet their downstream regulatory obligations and to deliver a service experience which is at least the same (in terms of quality, performance attributes and timeframe commitments) as the end-to-end service experience of equivalent end-users and downstream customers today (noting

²⁸ Analysys Mason, *Review of the Efficiency and Prudence of NBN Co's Fibre and Wireless Network Design*, 2 March 2012, p 100.

²⁹ ACCC, *NBN Co Limited Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 5.4.

that these service delivery standards should not be a proxy for performance targets, but rather a performance minimum). It will be important for all stakeholders to have confidence that the switch to the NBN Co Network will provide a seamless service experience for the end-user.

Telstra recognises that NBN Co commitments on product performance and service standards must match current NBN Co capabilities. However, the community and industry expect product performance and service standards to evolve, meeting and then exceeding current expectations. NBN Co will not be incented to deliver such improvement with its commensurate cost, so there needs to be a process to drive the improvement of product performance and service standards.

Accordingly, Telstra believes that the NBN Co SAU should contain a product and service evolution framework that drives NBN Co to exceed these expectations through measurable performance targets set against predefined timeframes.

Recognition should also be given to the demands of sophisticated customers who will no doubt want to acquire services with enhanced service levels (for example, where services are used by a large financial institution for real time processing of financial transactions). NBN Co should use the NBN Co SAU to provide a degree of confidence to RSPs that enhanced service levels will be available in order to meet this demand.

Certainty can also be given by committing to provide service levels in relation to certain minimum aspects of supply. Without limiting the matters that Telstra would expect to be covered, some examples of the core aspects of supply that service levels should attach to are included in Table 1 below.

Table 1 – Examples of core aspects of supply and service level requirements

Subject matter	Requirement
Activation	Clear and objective timeframes for activating NBN services.
Assurance	Fault response and repair times.
Operational performance	Appointment times to be met within specified windows. Turnaround times for standard transactions (e.g. increasing CVC capacity).
Network reliability	Key criteria includes service/network/product availability, throughput, contention and quality (e.g. error rates, delay and jitter).

Subject matter	Requirement
Planned and unplanned event management	Minimum notification periods for planned outages and maintenance (including any network augmentation or upgrades). Management of unplanned outages – timeframes (and content of) outage notifications and outage updates. Restoration timeframes for network issues and outages at different levels of impact severity.
Disconnection	Timeframes for the actioning of disconnection orders.
Platform Performance	Minimum level of systems availability and performance.

Telstra accepts that there are a series of events that could result in the degradation or interruption of a service (e.g. faults, outages and maintenance) and appreciates that each of these events may have different consequences under the service levels. For example, different consequences may flow from a fault than those that flow from planned maintenance. It follows that there is significant scope for uncertainty unless each of these events, and the consequences that flow from them, are clearly defined. NBN Co should use the NBN Co SAU to address this issue.

Furthermore, NBN Co SAU should confirm that service level commitments will not draw a distinction based on whether downstream regulated obligations (such as the Consumer Service Guarantee) apply (or based on NBN Co's interpretation of those obligations).

In all cases, service level commitments should be supported by:

- an appropriate rebate regime where service level commitments are not met;
- commitments to “put right” or remedy the underlying cause of the service level failure; and
- commitments to provide an appropriate level of reporting and transparency so that RSPs are able to measure and monitor performance.

3.2. Product development

A product development framework which promotes product evolution and innovation (by both RSPs and NBN Co) will be crucial to ensuring that the potential benefits of the NBN are realised.

The NBN Co SAU replicates in many respects the detailed regime currently proposed under NBN Co's published WBA. While Telstra believes there is merit to an approach which provides for stand-alone terms in the NBN Co SAU, Telstra queries whether it is necessary, or appropriate, to lock-in a process as prescriptive as the PDF Process for an extended period (30 years). This is particularly the case given Telstra has serious concerns about the efficacy of the proposed regime (see, for example, the concerns raised by Telstra regarding the treatment of intellectual property and confidential information in sections 5.2.1 and 5.2.7, respectively).

Telstra considers that it would be preferable for the NBN Co SAU to enshrine appropriately detailed principles, not processes, in respect of product development. These principles should be designed to:

- encourage, not discourage, RSP participation (in particular, as noted above Telstra has raised specific concerns regarding the impact that the intellectual property and confidentiality terms will have on RSP participation); and
- provide certainty that NBN Co will continuously develop and evolve its product suite, and individual products, in line with global standards and consumer demand.

These above principles, if appropriately implemented, would promote product innovation, which should be the core purpose of the PDF and PDF Processes.

In its Supplementary Consultation Paper the ACCC also notes that certain categories of Product Components and Product Features (being minor changes to products and products in the Initial Product Roadmap) are excluded from PDF Processes.³⁰ The PDF Processes also state that where NBN Co considers a product variation a minor variation it will not be considered through the PDF.

This gives NBN Co considerable discretion to exempt a broad range of products from consideration by the Product Development Forum and potentially excludes RSPs from product withdrawal and variation processes if they are not PDF participants. Telstra submits that a more balanced approach is warranted, particularly given the potentially significant impacts that any product change may have for RSPs and end-users.

3.3. Product withdrawal and variation

NBN Co's commitments about the "product package" are only as strong as the commitments that are given regarding their variation or withdrawal.

The NBN Co SAU locks-in significant exclusions and discretions for NBN Co regarding the variation and withdrawal of products, product components and product features, including in respect of the following:

- NBN Co's unilateral ability to determine whether a proposed product change has no material adverse impact on RSPs and is therefore "minor" (i.e. the test is not one of fact, but of NBN Co's opinion, albeit subject to a reasonableness requirement);³¹
- whilst NBN Co has committed to consult with RSPs, RSPs have no mechanism or recourse to dispute whether a Product Feature or Product Component should be varied or withdrawn;
- NBN Co only commits to communicating product change or withdrawal notifications through the PDF Process,³² however, not all RSPs may participate and receive relevant notifications; and
- certain other categories of Product Components and Product Features (being products covered by, or contemplated in, the Initial Product Roadmap) are excluded from the

³⁰ ACCC, *NBN Co Limited Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 5.5.

³¹ NBN Co SAU, sch 6, cl 1(b)(iii) & cl 4.

³² NBN Co SAU, sch 6, cl 3.

product development and withdrawal commitments.³³

The effect of these exclusions and discretions is to create uncertainty for RSPs. The NBN Co SAU can address this by including a commitment to establish, in consultation with industry and the ACCC, a matrix for managing changes to networks, products and services. At a minimum, the matrix should include:

- clear definitions of change types (minor, major, service affecting, non-service affecting, planned, unplanned);
- minimum notice period for each change type;
- dispute/rejection rights and conditions;
- compensation for detrimental impacts; and
- reporting commitments to RSPs stating the reasons for the change and why it is necessary and justified having regard to the relevant matters that NBN Co must take into account.

There should also be a clear set of factors to be taken into account by NBN Co when considering any product variation or withdrawal. At present, the factors specified in clause 5.3(b) of Schedule 6 of the NBN Co SAU apply only to product withdrawals. Telstra believes these factors should also apply when considering a product variation, and that the following additional factors should be included:

- the wider social impact of the variation / withdrawal (e.g. impacts to disability services, payphone services etc.);
- the cost impact of the variation / withdrawal on RSPs and end-users;
- how NBN Co intends to address or ameliorate these impacts (including sharing of cost impacts between NBN Co and RSPs), and whether these impacts are outweighed by the benefits of the withdrawal; and
- visibility of all product elements (as highlighted in Section 3.1) so that the ACCC and RSPs can assess the implications of any proposed product change.

³³ NBN Co SAU, sch 6, cl 1(b)(i).

4. Price Terms

The NBN Co SAU includes a number of price commitments in relation to certain Product Components and associated Product Features.

For a limited set of Product Components, initial prices (to apply for five years) are set out in the NBN Co SAU, with further price changes subject to the Individual Price Increase Limit. For all other Product Components and associated Product Features, there is no commitment in respect of initial pricing in the NBN Co SAU, however once initial prices are set any further price changes will be subject to the Individual Price Increase Limit.

Pricing for all Product Components and associated Product Features will be subject to the overarching LTRC. The intention of this overarching constraint is that NBN Co will be able to recover no more than its prudently incurred expenditure.

This section sets out Telstra's views on these price commitments and is set out as follows:

- Section 4.1 sets out Telstra's views on the scope and form of the proposed price controls;
- Section 4.2 provides an assessment of the proposed prudency commitments in respect of expenditure to be included in the LTRC;
- Section 4.3 sets out Telstra's concerns with the design of the LTRC itself;
- Section 4.4 assesses the adequacy of the proposed reporting framework as it applies to the price commitments; and
- Section 4.5 sets out Telstra's specific concerns regarding the lack of price oversight provided for by the NBN Co SAU.

4.1. Price Controls

The NBN Co SAU is given in respect of the broadly defined "NBN Access Service", which is split into Product Components and associated Product Features. The price terms of certain Product Components are defined in the NBN Co SAU, namely, the following Price Controlled Offers:

- the Basic Access Offer (as defined in clause 2 of Schedule 4);
- the CVC offer (as defined in clause 3 of Schedule 4); and
- the NNI offer (as defined in clause 4 of Schedule 4).

The price terms for all other Product Components and associated Product Features that are currently available are defined in the WBA.

4.1.1. Definition of Product Components and associated Product Features

Product Components and associated Product Features are broadly defined in the NBN Co SAU and the WBA. For the reasons set out in section 3 above, Telstra is concerned with the lack of detail included in NBN Co's product definitions. These broad definitions do not provide RSPs with a sufficiently certain basis upon which to acquire NBN Co services.

Nonetheless, for the purposes of assessing the proposed price terms set out in the NBN Co SAU, Telstra proceeds on the basis of the relatively broad definitions of Product Components and associated Product Features that are currently included in the NBN Co SAU and the WBA. In the context of the proposed price controls, the relatively broad definitions of Product Components and associated Product Features imply broad coverage of the price controls. Of course if these definitions become narrower, this may imply narrower coverage of the price controls and less certainty for RSPs in respect of price terms, unless there are more fundamental changes to the structure of the NBN Co SAU of the type discussed in section 2 above (e.g. reduction in product scope and/or term of the NBN Co SAU).

Telstra's understanding is that the Maximum Regulated Prices for the Price Controlled Offers (as set out in clause 2.1 of Schedule 5 of the NBN Co SAU) and prices for other products set out in the WBA apply to any Product Components and associated Product Features that fall within the relatively broad definitions of those products. More specifically, Telstra understands that, notwithstanding the product development and withdrawal process, where an RSP is acquiring services specified in the NBN Co SAU and/or WBA:

- any variation to a Product Component or associated Product Feature specified in the NBN Co SAU or WBA would not result in a change in the price of product (except as allowed under the NBN Co SAU price increase limit for that product), provided that the varied product remains within the scope of the service definition;
- the addition of a new Product Component or associated Product Feature to an existing product covered by the NBN Co SAU or WBA (including the Basic Access Offers) will not result in an additional charge or an increase in charge, provided that the new Product Component or associated Product Feature remains within the scope of the service definition;
- RSPs will not be required to bundle existing products covered by the NBN Co SAU or WBA with new Product Components, associated Product Features or ancillary services that are introduced by NBN Co in the future, to provide a complete service to end-users; and
- RSPs will not be required to take any new Product Component, Product Feature or Ancillary Service that is introduced by NBN Co in the future in order to simply maintain the same level of service to downstream customers as it was providing based on the initial set of NBN Co offerings.

If there is any doubt as to Telstra's understanding, for example if it is possible that NBN Co could add a Product Component that is necessary for RSPs to purchase but which is not covered under the service definitions, then greater clarity will need to be provided in the NBN Co SAU.³⁴

4.1.2. Scope of the Price Controls

The coverage of the initial price control in the NBN Co SAU is limited to a set of Basic Access Offers. The initial prices for other products that are currently available are set out in the WBA. An alternative approach would be to reproduce the full set of initial price terms for all known components and features of the NBN Access Service in the NBN Co SAU and the WBA. This

³⁴ Telstra's concerns in relation to products which have currently been categorised as ancillary, but which are in fact necessary to providing the NBN Access Service have been discussed in section 3 above.

would ensure consistency between the NBN Co SAU and the WBA and the effective operation of the regulatory regime.

By reproducing all price terms for existing products in the NBN Co SAU, the ACCC would have the intended oversight of price terms for all services, not just the Basic Access Offer. Further, the compliance and auditing functions in the NBN Co SAU – those that exist in the current version and those proposed by Telstra below – would apply to the prices for all services.

4.1.3. Initial pricing for new Product Components and associated Product Features introduced after the Commencement Date

It appears to be the intention of the NBN Co SAU that all future NBN Product Components and associated Product Features would be part of the broadly defined NBN Access Service and would therefore be subject to the NBN Co SAU. As noted above, if the future Product Components and associated Product Features fall within the broad definitions of the existing Product Components and associated Product Features in the NBN Co SAU and WBA, then Telstra expects that the prices of the new products will be subject to the same price commitments as those that apply to existing services falling within the same definitions.

However, no specific definitive commitments are made in respect of initial pricing for future Product Components and associated Product Features that do not fall within the broad definitions of the existing Product Components and associated Product Features in the NBN Co SAU and WBA. This is unsurprising given that the detailed nature of future services is unknown, however the absence of any oversight of pricing for these future services is a concerning feature of the NBN Co SAU design. Even more concerning is the absence of any price commitment in respect of services that NBN Co is likely to introduce in the foreseeable future (such as business-grade services) and for which it could include such commitments as part of the NBN Co SAU.

In the absence of any definitive commitment from NBN Co in respect of future Product Components and associated Product Features, there are potentially three sources of constraint on pricing. Pricing of new Product Components and associated Product Features may potentially be:

- constrained by the overarching revenue constraint in the NBN Co SAU (the LTRC);
- “anchored” by prices for existing Product Components and associated Product Features, to the extent that the new services are substitutable with existing services; and/or
- subject to the limited regulatory recourse allowed under the NBN Co SAU.

Telstra considers that the LTRC cannot be relied upon as a binding constraint on NBN Co pricing for new Product Components and associated Product Features. The LTRC is unlikely to impose any meaningful constraint on NBN Co’s actual revenues, at least in the early years of the term of the NBN Co SAU. Indeed NBN Co acknowledges that the LTRC is unlikely to be a binding constraint on pricing for at least the first ten years³⁵, and its economic consultant Synergies suggests that the initial cost recovery period (in which the LTRC will not bind NBN Co) is likely to be “prolonged”.³⁶

³⁵ NBN Co, *NBN Co Supporting Submission Special Access Undertaking*, 20 December 2011, para 6.6.1.

³⁶ Synergies, *Advice on NBN Co Ltd’s Special Access Undertaking*, January 2012, p 73.

Given the uncertainty over broadband market outcomes it is quite possible that losses will continue to accumulate for a prolonged period of time such that the Initial Cost Recovery Period comprises a significant proportion of the proposed 30 year term of the undertaking.

Additionally, even if it did constrain actual revenues, those actual revenues would make up the vast bulk relative to revenue earned from a new service. NBN Co could set a particularly high initial price for a new Product Component or associated Product Feature, at least in the short term, without that having a material impact on the performance against the revenue constraint.

Telstra also considers that the idea that prices for new Product Components and associated Product Features will be “anchored” to the prices of old NBN Product Components and associated Product Features does not necessarily result in the NBN Co SAU being reasonable. The effectiveness of anchor pricing 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. Therefore in order to have confidence in anchor pricing, any new products introduced over the term of the NBN Co SAU must 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.

The Synergies report suggests that the anchor pricing effect may recede over time, noting that NBN Co may gain more freedom over pricing by reason of customers migrating from the Price Controlled Offers in favour of a higher value, expanded range of services.³⁷ However Synergies dismisses this risk on the basis that is only likely to arise at or near a time of significant regulatory review.³⁸

An example of where the proposed “anchors” are unlikely to be effective is in respect of business grade services. The current anchors apply only to residential grade services, which may not be effective substitutes for higher grade business services. This point is not acknowledged by either NBN Co or Synergies.

Given the proposed term of the NBN Co SAU of 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 Offers) obsolete. It would therefore appear to be of significant importance to ensure an appropriate degree of regulatory oversight of pricing, rather than relying on the concept of anchor pricing to constrain pricing of all future product offerings.

Finally, for the reasons set out in section 2 above, Telstra considers that the regulatory recourse mechanism included in the NBN Co SAU is limited and cannot be relied upon to constrain pricing for new Product Components and associated Product Features.

As noted in section 2, the significant limitations on the mid-term review process results in little assurance that provisions in the NBN Co SAU that are not operating in a manner that promotes the LTIE will be addressed as part of the mid-term review. Significantly, the mid-term review clause provides NBN Co with discretion as to whether it will review the nature of any price control arrangement as part of the mid-term review process.

Telstra’s expectation is that there would be greater ACCC oversight of pricing for new Product Components and associated Product Features introduced by NBN Co after the

³⁷ Synergies, *Advice on NBN Co Ltd’s Special Access Undertaking*, January 2012, p 82.

³⁸ Synergies, *Advice on NBN Co Ltd’s Special Access Undertaking*, January 2012, p 82.

Commencement Date. Reliance on the LTRC, anchor pricing and the limited regulatory recourse arrangements in the NBN Co SAU are not sufficient to ensure that the NBN Co SAU would result in reasonable outcomes in relation to pricing for the 30 year term.

Additionally, to the extent that future product offerings are known, price commitments for these future services should be included in the NBN Co SAU. This would apply to business services that are likely to be introduced by NBN Co in the foreseeable future.

4.1.4. Price escalation and approval process for increases above CPI/2

All product components, features and ancillary services are subject to an individual price increase limit of no more than CPI/2 in any 12 month period. As previously noted by Telstra, in the absence of a populated cost model, it is difficult to assess the reasonableness of the proposed price increase limit. Telstra notes that this price escalation path could result in substantial increases in end-user charges over time, particularly for usage (see next section).

NBN Co may also seek ACCC approval for proposed price increases above the CPI/2 price increase limit. The ACCC must approve a proposal for an increase above CPI/2 if it this proposal is not inconsistent with the LTIE and any applicable laws.³⁹

Telstra considers that the proposed test for ACCC approval of price increases above CPI/2 is overly restrictive on the ACCC. This test potentially places the burden on the ACCC to demonstrate that a proposed price increase is inconsistent with the LTIE, rather than requiring NBN Co (as proponent of the price increase) to demonstrate that its proposal is in the LTIE. This is inconsistent with the broader framework for ACCC decision-making under Part XIC of the CCA, which typically requires the ACCC to reach a level of satisfaction that something *is* in the LTIE or *is* reasonable.

Telstra considers that if there is to be any scope for price increases above CPI/2, the onus should be on NBN Co to satisfy the ACCC that such price increases would be in the LTIE. The ACCC should need to be positively satisfied that such a price change would be in the LTIE in order for it to be approved.

4.1.5. Form of the CVC price control

As mentioned in Telstra's response to the ACCC's first consultation paper, Telstra has a number of concerns in relation to the proposed form of the CVC price control. Telstra considers that the CVC price control should be assessed on a per SIO basis, rather than on a per Mbps basis. To avoid doubt, this would still allow the actual CVC price charged to RSPs to be set on a per Mbps basis.

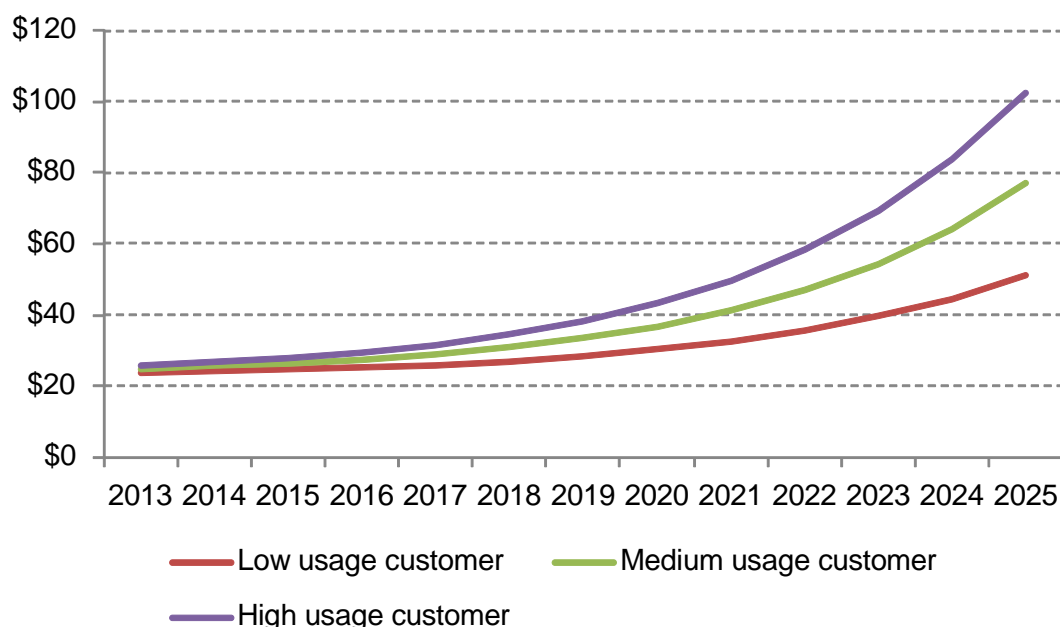
The implications for end-users of a per Mbps CVC charge are illustrated below for three types of customers with different usage. Figure 3 illustrates the sum of 12/1 AVC and CVC prices an RSP must pay for a low-usage customer (that has 50kbps average peak usage growing 30% year on year⁴⁰), a medium-usage customer (that has 100kbps average peak usage growing 30% year on year), and a high-usage customer (that has 150kbps average peak usage growing 30% year on year). For the medium-usage customer, the maximum wholesale price NBN Co would be permitted to charge would be \$25/month in 2013 (\$24 for the AVC and \$1

³⁹ NBN Co SAU, sch 5, cl 4.

⁴⁰ 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, para 9.6.2.

for the CVC⁴¹). By the end of 2025, the maximum wholesale price NBN Co would be permitted to charge would be \$77/month (\$27 for the AVC and \$50 for the CVC).

Figure 3 – Maximum permitted 12/1 AVC + CVC prices allowable under the NBN Co SAU



NBN Co has stated that its expectation is that the CVC price will decline over time as usage increases, forecasting a decline in the per Mbps charge from \$20/Mbps/month to \$8.75/Mbps/month between 2011/12 and 2024/25.⁴² However, any such price reductions will be entirely at NBN Co's discretion and there is no commitment in the SAU to adjust CVC pricing in way that promotes efficient usage or the LTIE more generally. With discretion to adjust CVC pricing as it sees fit (subject only to the CPI/2 price increase limit), it cannot be assumed that NBN Co, as the monopoly service provider, will adjust pricing in a way that promotes the LTIE. In any event, even if CVC pricing does decline in line with NBN Co's expectations, this would still result in per SIO charges increasing from \$1/SIO/month to around \$20/SIO/month by 2025 based on NBN Co's usage forecasts.

Given the likely growth in usage as a result of faster download speeds and development of new content and applications, a per Mbps price control for CVC is likely to result in very significant increases in end-user charges, notwithstanding the CPI/2 price increase limit in the SAU. Telstra considers that this would not promote the LTIE.

⁴¹ 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, para 8.7.2.

⁴² NBN Co, *NBN Co's Special Access Undertaking (SAU) – Initial Industry Submissions*, 13 February 2012, p 5; NBN Co, *Corporate Plan 2011 – 2013*, 17 December 2010, p 103.

4.2. Prudence of spend

4.2.1. The need for adequate efficiency incentives

The NBN Co SAU aims to establish a pricing methodology where, ultimately, the costs of its investment are recovered. The pricing methodology passes the costs incurred by NBN Co directly through to prices. If inefficient costs are allowed to pass through to prices, then this will impact competition in downstream markets, and dampen the incentives for NBN Co to spend efficiently in the future. To be satisfied that the NBN Co SAU is reasonable and promotes the LTIE, the ACCC would need to be satisfied that there will be no substantially inefficient spend permitted to be recovered through prices.

A critical consideration in the assessment of the pricing methodology is, therefore, whether it will ensure that only efficient spend by NBN Co is recovered through the prices allowed in the NBN Co SAU. This section provides Telstra's views on:

- the unique circumstances faced by NBN Co that result in legitimate questions about the efficiency of spend;
- given those circumstances, an outline of the efficiency incentive mechanisms that would be expected to address those risks; and,
- a critical assessment of the prudence regime proposed in the NBN Co SAU.

These views are set out in the following sections.

4.2.2. The unique circumstances faced by NBN Co

NBN Co is in a unique situation relative to other access providers that are operating under building block regimes similar to that contemplated in the NBN Co SAU. For instance, NBN Co:

- is in the early phase of its investment planning, while access providers in other regimes have established operations;
- has signalled it will build its entire network very quickly, whereas access providers in other regimes have built their networks incrementally over time;
- faces considerable, albeit diversifiable, risks with respect to technology and political outcomes that make investment planning decisions difficult;
- has a spend target of \$37B that was determined prior to NBN Co deploying the network, whereas access providers in other regimes have ex-ante investment forecasts subject to ACCC review and endorsement; and
- has a new organisational framework to manage and control cost.

These unique circumstances imply that NBN Co's spend should be subject to greater regulatory review than would normally be expected for a more established network service provider. The ACCC will need to actively review the efficiency of NBN Co's spend to be satisfied that the NBN Co SAU will result in efficient outcomes. Given the speed at which NBN Co is expected to spend to satisfy its roll out plans, there is a need for such a review mechanism to be efficient and set up quickly.

NBN Co has sought a particular network design to be locked in for the term of the NBN Co SAU, and all spend that fits within that network design to be deemed prudent. However, in the circumstances just described, this is not likely to provide sufficient constraint to curb inefficiency. Instead, what is required is an appropriate structure of incentives for NBN Co to spend efficiently, and adequate oversight to ensure that it is doing so. The efficiency incentive mechanisms that would be expected in NBN Co's SAU, to suit their specific circumstances, are discussed in the next section.

4.2.3. An outline of the efficiency incentive mechanisms that would address the risks of inefficiency

The following efficiency incentive mechanisms might give the ACCC greater comfort that, over the 30 year term, NBN Co's SAU will result in outcomes that promote the LTIE:

- a commitment in the NBN Co SAU to the lowest cost of supply in the interests of end-users;
- a commitment in the NBN Co SAU to establish and maintain a commercial cost control framework, with primary emphasis on delivering efficient cost control and achieving the lowest cost of supply in the interests of end-users;
- a review framework that provides for assessment of what spend is included in the LTRC; and
- adequate reporting mechanisms aimed at identifying any inefficiency (or identifying that there is no inefficiency, as the case might be), the cause, and means of prevention for consideration in future projects.

Each of these mechanisms is discussed below.

4.2.3.1. A commitment in the SAU to the lowest cost of supply in the interests of end-users

Telstra considers that an unqualified and general commitment to the lowest cost of supply would be more likely to promote the LTIE.

It would be expected that the "lowest cost of supply" would be a critical decision factor in the commercial cost control framework discussed below. Having such a commitment would provide some assurance to the ACCC that the NBN Co board has the incentive and justification to reject inefficient spend proposals. Having this decision at the board level provides the highest level of authority for making such decisions.

While the NBN Co SAU includes a "total cost of ownership" concept, this is only used in the context of deeming prudence for certain types of expenditure and there is no overarching commitment to achieve the lowest "total cost of ownership". Moreover, as noted in section 4.2.4.5 below, this standard is broadly defined and leaves NBN Co with relatively wide discretion.

4.2.3.2. A commitment to establish an internal cost control framework

A commitment to an internal cost control framework would also give the ACCC greater assurance that any potential inefficiencies will not be passed through to end-user pricing. NBN Co might have its own internal cost control framework that it could commit to in the NBN Co

SAU, or a new framework could be modelled on those implemented by network businesses in other sectors and could include:

- development of corporate objectives and robust business planning processes, including clear and objective decision-making criteria (particularly processes for planning capital expenditure);
- implementation of a business structure with clear delineation of roles between the asset owner, manager and services provider;
- an effective corporate governance framework to measure and report on performance against the corporate objectives; and
- external review and self attestation as to implementation of the corporate governance framework.

Each of these components of the cost control framework is discussed in Appendix B.

4.2.3.3. Oversight review framework to assess what spend is included in the LTRC

Most building block regimes implemented in Australia adopt incentive mechanisms to ensure the relevant access provider faces strong incentives to spend efficiently.⁴³ Similarly, if the expenditure allowances included in the LTRC were subject to an incentive framework with strong efficiency properties this would better promote the LTIE. Of course, any such framework would need to be suited to the unique circumstances faced by NBN Co.

For instance, an incentive framework with the following structure might better promote the LTIE:

- A long-term ex-ante forecasting mechanism, comprised of:
 - a requirement that NBN Co publishes detailed biennial forecasts of capex and opex, with supporting materials to establish the efficiency of spend;
 - a process for the ACCC to approve or adjust those forecasts having regard to an objective of minimising costs in the LTIE; and
 - on approval, the LTRC is updated with those forecast values.
- A short term (perhaps lasting just five years) ex-post cost control mechanism, comprised of:
 - a requirement that NBN Co publishes detailed accounts of actual capex and opex, aligned to the individual items in the forecasts provided under the ex-ante regime to allow testing of forecasting performance and continuous learning for future forecasts;

⁴³ For instance, in the energy markets, network owners face incentive to improve efficiency, both as a result of ex ante control mechanisms and the application of efficiency benefit sharing schemes. Under these frameworks, businesses are allowed to 'keep' cost savings for a limited period, or conversely they are forced to bear the cost of overspend for a period.

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- a process for the ACCC to determine that any individual spend is inefficient (for example, a category of asset or geographic area), with a public consultation process allowing NBN Co and RSPs to provide input to that decision; and
 - spend that is determined to be inefficient is to be removed from the LTRC (that is, from Real Capital Expenditure or Nominal Opex, the Initial Cost Recovery Account, the accumulation of the Regulated Revenue, and any other relevant measure).

An ex-ante forecasting mechanism would better promote the LTIE, compared to an upfront endorsement of NBN Co's Network Design Rules, because there is no comfort that those design rules will necessarily result in efficient spend over the term of the undertaking. As noted below, the Network Design Rules themselves are a relatively loose set of engineering principles that would guide NBN Co on the architecture of the network. However, they do not restrict NBN Co to deploying the network defined by those rules efficiently. For instance, NBN Co could provision for too much capacity under the design rules, or it could pay too much for inputs relative to alternative sources. An adequate ex-ante forecasting mechanism would provide economic incentives for NBN Co to build the network defined by the design rules efficiently.

An ex-ante forecasting mechanism could work by NBN Co seeking approval for individual spend projects by the ACCC. The incentive to spend efficiently arises by allowing the ACCC to exclude spend (or a proportion of spend) from the LTRC if it is considered to be inefficient. NBN Co would need to provide the ACCC with sufficient reporting detail to the ACCC and RSPs to allow parties to identify potential inefficiency if and when it is forecast to occur (see the next section).

However, in the early years of NBN Co's investment program, parties (perhaps including NBN Co itself) may lack the information required to accurately forecast the efficient level of expenditure on an ex-ante basis. NBN Co has only just begun to embark on its investment program, so internal process and mechanisms to control cost may not yet exist. Further, NBN Co (or any other party for that matter) would understandably face difficulty in accurately forecasting costs. Therefore, for the first years (perhaps for five years), an ex-post cost control mechanism could be adopted to determine what costs are entered into the LTRC instead of the ex-ante forecasting methodology. However, it would be worthwhile operating the ex-ante forecasting methodology in parallel to the ex-post cost control mechanism, even though it would have little direct use for determining costs to be included in the LTRC, so that over a relatively short period NBN Co is given the opportunity to demonstrate that the ex-post cost control mechanism can be replaced by the ex-ante forecasting mechanism.

It would be expected that the ex-post cost control mechanism could be removed as NBN Co provide assurances through practice, that its forecasting is accurate and its internal cost control framework adequately removes inefficiency from its business. After this initial period, the ACCC would also have better information on NBN Co's expenditure patterns and potential sources of inefficiency have observed NBN Co spend and made any necessary ex-post adjustments for this period. The ACCC would therefore be better equipped to administer the ex-ante review mechanism after this initial period. Indeed, after five years, it would be reasonable for the ACCC to be given a formal role to review the past operation of the ex-post cost control mechanism and the ex-ante forecasting to determine whether such replacement can occur.

Telstra expects that such an approach would give the ACCC greater comfort that the NBN Co SAU would result in outcomes that promote the LTIE.

4.2.3.4.A comprehensive reporting mechanism

To assure the ACCC that spend is efficient, NBN Co could establish a comprehensive reporting mechanism to support the incentive framework discussed above. The benefit of a comprehensive reporting mechanism is twofold.

- First, detailed reporting allows parties to assess the efficiency of NBN Co's spend and identify over-spend or inefficiency. Once identified, it can be rectified by NBN Co for future investment decisions leading to more efficient outcomes in the future.
- Second, detailed reporting is itself a discipline that results in efficient decisions. With access to such information, NBN Co's management, CEO and board is able to make better judgements in relation to investment and spend decisions and better monitor and test the efficiency of projects. Without such information, inefficient proposals can too easily be accepted without due diligence or critical analysis.

While the NBN Co SAU includes a reporting framework in relation to Network Change Options⁴⁴, the reporting on expenditure captured under the Initial Design Scope, which is expected to cover the majority of NBN Co's spend, is much more limited.

In relation to the Initial Design Scope, NBN Co commits to report only an overall annual forecast of total spend broken down by asset category. This falls considerably short of the reporting requirements in other regimes (refer to section 4.4 below), and would make it difficult to test the prudence and efficiency of NBN Co's spending prior to it being entered into the LTRC.

Telstra has prepared a list of information that NBN Co could provide to test the ongoing efficiency of NBN Co. There are many potential causes of inefficiency, making it difficult to establish up front all the detail that would be required in a reporting framework and for this reason, the table below represents a minimum of what could be provided.

Table 2 – Reporting detail required to address potential inefficiencies

Potential cause of inefficiency	Reporting detail required to test for this inefficiency
Network deployment to low margin areas before high margin areas: brings forward losses in the LTRC that are then accumulated at the WACC. ⁴⁵	The average revenue and investment cost for each geographic area the network is rolled out to (e.g. each DFN, LFN, WSLAM), broken down into asset categories. The reporting would need to include forecasts (for areas expected to be started in the next financial year) and actuals (for areas completed in the last financial year).

⁴⁴ NBN Co SAU, sch 8, cl 5.8.

⁴⁵ For example, NBN Co suggests that it will prioritize delivering fibre to regional areas and "that's certainly not the way a purely commercial organisation would go about doing things" (<<http://www.nbnco.com.au/blog/when-nbn-coming-to-major-cities.html>>).

Potential cause of inefficiency	Reporting detail required to test for this inefficiency
Inefficient tender and contracting processes: raises the cost of investment.	Details of major tender process and decision criteria.
Deployment of fibre, wireless or satellite where an alternative would result in lower cost (within the constraints of the roll out objectives).	Benchmark costs for alternative technologies applied to each geographic area, informed by past forecasting and actual reporting.
Lack of feedback from recent projects to forthcoming projects (i.e. repeated mistakes).	Where there are discrepancies between forecast and actual spend, NBN Co should conduct a review and provide an explanation. That information should be considered when developing and assessing future forecasts.
Over-forecasting of customer demand and/or network capacity requirements.	Details of forecasts relied upon in determining network expansion or upgrade requirements.
Inadequate or improper assessment of business case in determining investment priorities.	Internal decision making documents including business cases and feasibility studies.
Replacing assets too early.	Justification for asset replacement (for example, based on asset performance, degradation etc).

More detailed consideration is given to appropriate reporting mechanisms in section 4.4 below.

4.2.3.5. Conclusion

The combination of these oversight frameworks and reporting mechanisms are similar to what is applied in other industries, but which seem suitable for the unique circumstances faced by NBN Co. They would provide a strong incentive for NBN Co to spend efficiently and would, therefore, be more likely to promote the LTIE.

4.2.4. The prudency regime proposed in the NBN Co SAU

The prudency requirements in the NBN Co SAU are intended to ensure prudency in connection with the design, engineering and construction of the relevant assets. It attempts to achieve the lowest Total Cost of Ownership through the introduction of two key conditions:

- the Prudent Design Condition, which applies to capital expenditure only and seeks to ensure the efficiency of the design of the NBN Co Network; and
- the Prudent Cost Condition, which applies to both capital and operating expenditure and seeks to ensure that the implementation of the design of the NBN Co Network is efficient and also that ongoing operating costs are incurred efficiently.

Telstra considers that a number of amendments would need to be made to the proposed prudency framework in order for the ACCC to be satisfied that it will constrain NBN Co to spend efficiently and lead to price outcomes that promote the LTIE. Telstra's key concerns with the proposed framework are set out below.

4.2.4.1. Over-reliance on the Network Design Rules

The proposed prudency regime relies heavily on the Network Design Rules and requires a presumption that these rules reflect prudent and efficient network design. Under clause 2 of Schedule 8 of the NBN Co SAU, NBN Co will be considered to have incurred capital expenditure in accordance with the Prudent Design Condition where the design, engineering and construction of the relevant assets is "*materially consistent with or within the scope of*" the Network Design Rules or a permitted variation to those rules (permitted variations are discussed later in this section).

NBN Co submits that the Network Design Rules have been established by NBN Co by reference to the objectives in the Government Statement of Expectations, and what it describes as "*a number of fundamental design objectives*". NBN Co describes its design objectives as follows:⁴⁶

- minimise cost for 93% and the last 7% coverage objectives;
- deliver the NBN Co product requirements;
- meet the network availability criteria required for NBN Co's service level agreements;
- ensure network asset lifecycles meet minimum objectives;
- maximise re-use of existing infrastructure; and
- provide a clear path for technology upgrade and "future proofing".

Telstra notes that while these objectives are said to drive the Network Design Rules which are central to the prudency regime, they do not appear to feature in the NBN Co SAU itself. Further, beyond these objectives, it appears that there is little guidance provided to, or restriction upon NBN Co in establishing the Network Design Rules which are critical to the Prudent Design Condition.

NBN Co has submitted its Network Design Rules and states that the ACCC can consider these as part of its assessment of the NBN Co SAU.⁴⁷ In effect, NBN Co is asking the ACCC to approve the prudency regime in the NBN Co SAU by reference to its Network Design Rules. Telstra considers that, in order to be satisfied that acceptance of the SAU will promote the LTIE, the ACCC must be satisfied that the Network Design Rules will constrain NBN Co to only implement prudent and efficient network design, and that this constraint will continue to bind NBN Co over the 30 year term of the NBN Co SAU.

For the reasons set out below, Telstra considers that the ACCC could not be satisfied that the Network Design Rules will constrain NBN Co to only implement prudent and efficient network design over the 30 year term, given the scope for inefficiencies within these rules. More fundamentally however, Telstra considers that the ACCC should not be required to reach this

⁴⁶ NBN Co, *Supporting Submission: NBN Co Special Access Undertaking*, 20 December 2011, p 146.

⁴⁷ NBN Co, *Supporting Submission: NBN Co Special Access Undertaking*, 20 December 2011, p 60.

level of satisfaction. It would be more appropriate for the NBN Co SAU to include mechanisms for regular review of prudence rather than requiring up-front approval of the broad design scope.

4.2.4.2. The Network Design Rules allow NBN Co to include inefficient spend in the LTRC

As noted above, the NBN Co SAU provides that any capital expenditure that is materially consistent with or within the scope of the Network Design Rules be deemed prudent. There is currently no commitment by NBN Co to implement the Network Design Rules efficiently or at minimum cost in the LTIE.

Telstra notes that the Network Design Rules are not comprehensive and leave room for many decisions to be made by NBN Co, such as:

- which geographic areas will be served by which technologies;
- priority geographic areas for network roll-out; and
- timing of investment.

In making these decisions, there is currently no requirement on NBN Co that it choose the option that is most efficient or achieves some other objective. Rather, so long as the network design NBN Co is implementing is within scope of the rules, it is allowed to roll this expenditure in to its regulatory asset base and earn a return on that expenditure.

Telstra acknowledges that given the nature of this project, the relatively short timeframe for rollout, and the long term of the NBN Co SAU, it cannot be expected that the Network Design Rules would cover the field on all of these issues. There will inevitably be room for NBN Co discretion in implementing the Network Design Rules, and scope for inefficiencies. Therefore, it is not appropriate that the Network Design rules be the basis for deeming prudence of capital expenditure over the 30-year term of the NBN Co SAU.

4.2.4.3. The Prudent Cost Condition allows inefficient capital and operating expenditure to be included in the LTRC

For both capital and operating expenditure, NBN Co will be deemed to satisfy the Prudent Cost Condition to the extent that it falls into any one of several categories listed in clause 9.2 of Schedule 8 of the NBN Co SAU. These include (inter alia):

- where expenditure is incurred in accordance with a competitive tendering process;
- where expenditure is incurred “on an arm’s length basis”; and
- where the NBN Co CEO is satisfied that incurring that expenditure would be in the best interests of the company.

Capital expenditure and “Third Party Operating Expenditure” will be included in the LTRC if it falls into any of these categories (subject to satisfaction of the Prudent Design Condition for capital expenditure), and there is no commitment that such expenditure be efficiently incurred. For operating expenditure that is not “Third Party Operating Expenditure”, this will be deemed prudent (and included in the LTRC) provided that NBN Co seeks to achieve value for money and lowest Total Cost of Ownership and manages the expenditure consistently with the Government’s Statement of Expectations.

The categories of prudent costs would appear to leave scope for inefficiency. For example, where the NBN Co CEO is satisfied that incurring expenditure is in the best interests of the company, this may not mean that the expenditure is efficient or in the LTIE. Similarly, incurring expenditure on an “arm’s length basis” does not necessarily imply that it will be efficiently incurred in all circumstances.

Telstra further notes that there are a number of situations in which NBN Co can effectively bypass both the Prudent Cost Condition and the Prudent Design Condition, creating additional scope for inefficiency. NBN Co will be deemed to meet both conditions for capital expenditure (meaning that expenditure can be included in the LTRC) in a number of circumstances, including:⁴⁸

- at the time of planning NBN Co expects that the project cost will be less than \$100 million, regardless of what the project cost actually turns out to be;⁴⁹ or
- where the expenditure is “urgent and unforeseen”.

Telstra notes that these deeming provisions appear to be modelled on provisions in the National Electricity Rules (**NER**) which exempt transmission network operators from the general obligation to apply a regulatory investment test to proposed projects.⁵⁰ However there are two important differences between the NER provisions and those in the NBN Co SAU as set out below.

- The NBN Co SAU deeming provisions are much broader and potentially apply to a wider range of projects. Of particular note, the “Minor Expenditure Limit” in the NBN Co SAU (\$100 million) is much higher than the equivalent threshold in the NER (\$5 million⁵¹).⁵²
- The effect of the deeming provisions in the NBN Co SAU is that the expenditure is rolled into the asset base without any further review, whereas the effect of the model NER provisions is much narrower. Projects that fall within the NER exemption criteria are only exempt from the general requirement that a regulatory investment test be undertaken. The expenditure on these projects is still subject to review by the Australian Energy Regulator (**AER**) and some or all of it may potentially be disallowed on the basis that it does not reflect prudent and efficient expenditure.⁵³

Given the scope for inefficiency within the broad categories of expenditure deemed prudent in the NBN Co SAU, Telstra considers that NBN Co’s approach of deeming prudence by reference to broad categories is not appropriate and will not promote the LTIE.

⁴⁸ NBN Co SAU, sch 8, cl 4.1.

⁴⁹ NBN Co SAU, sch 8, cl 4.9(a).

⁵⁰ National Electricity Rules, cl 5.6.5C.

⁵¹ National Electricity Rules, cl 5.6.5C(a)(2).

⁵² Note that it has been estimated that the AER has assessed \$56b under the NER over the past five years - Andrew Reeves (2011), ‘Promoting efficient investment – protecting consumers from paying more than necessary’, *AER Chairman’s Address to the AEMC Public Forum*, 23 November 2011, p 3. In comparison, NBN Co’s capex and opex is forecast to sum to \$55b up to and including the 2020 financial year (NBN Co, *Corporate Plan: 2011-2013*, 17 December 2010, Exhibit 10.3).

⁵³ A recent example of this is the AER’s review of Powerlink’s Revenue Proposal for the forthcoming 5-year regulatory period (Powerlink operates the Queensland electricity transmission network). In its draft decision (the final decision has not yet been made) the AER has indicated that it will disallow a large amount of capital expenditure for a major “committed project” that has already gone through a regulatory investment test and received Powerlink board approval. Powerlink had committed \$358 million to this project, but the AER only considers \$184 million of this to be prudent and efficient (AER, *Draft Decision: Powerlink Transmission Determination 2012-13 to 2016-17*, November 2011, pp 130-131).

4.2.4.4. Limited incentives for efficiency relative to other regulated entities

The efficiency incentives enshrined in the NBN Co SAU are relatively weak, compared to the types of incentives that are faced by other regulated businesses.

In other regulated industries, businesses will typically face incentives to improve efficiency over time, either through the application of ex-ante control mechanisms and/or implementation of incentive schemes. In electricity for example, network businesses are subject to ex-ante price and revenue controls which create incentives to seek out efficiencies over time – to the extent that a business can “out-perform” the forecast expenditure allowance approved by the regulator, it will keep at least some of the benefit of this efficiency gain.⁵⁴ Similarly in telecommunications, Telstra faces incentives to improve efficiency in the supply of its regulated fixed-line services since it retains the benefit of any under-spend (or conversely bears the cost of any over-spend) relative to the expenditure allowance established by the ACCC.⁵⁵

Under the NBN Co SAU as currently drafted, there is no provision for periodic review of prudence and setting of ex ante controls. Rather, NBN Co will determine its expenditure requirements subject only to the broad categories of prudent expenditure that are set out in the NBN Co SAU. Under this regime, there is little incentive for NBN Co to improve efficiency as there is no forecast allowance that it can try to out-perform.

Telstra notes that the Synergies report submitted with the NBN Co SAU is only mildly supportive of the incentive regime proposed by NBN Co. Synergies express concerns in respect of productive inefficiency, primarily in relation to the period post-2025.⁵⁶ Synergies appear to consider that incentives for NBN Co to minimise operating costs will principally arise during the period in which NBN Co is not fully recovering its costs through pricing, since any unnecessary increase in costs will flow through to higher losses. However, it is noted that:⁵⁷

In Synergies' view, incentives for NBN Co to minimise operating costs are likely to be weaker if NBN Co is confident of full cost recovery.

In Telstra's view, the fact that NBN Co is likely to be making economic losses in early years cannot be relied upon as a means of promoting efficiency over the term of the NBN Co SAU, particularly since those losses are carried forward in the LTRC to future periods by applying the WACC. It is not clear how long the loss-making period will last for and to what extent the prospect of an economic loss (i.e., a loss calculated by reference to the LTRC) will in fact create incentives for efficiency. Moreover once the loss-making period expires, incentives for efficiency will be very limited (a point that Synergies acknowledges).

⁵⁴ Under the NER, the forecasts of operating and capital expenditure that are approved by the AER are used to determine the price and revenue controls for the forthcoming regulatory period. At the end of the regulatory period there is no 'true-up' for operating expenditure, meaning that the business retains the benefit of any under-spend or bears the cost of any over-spend. There is also an efficiency benefit sharing scheme for operating expenditure which extends the benefit/penalty of any under/over-spend into the next regulatory period, so that the business retains this benefit/penalty for a full five years. Capital expenditure is trued up at the end of each period, however the business retains the benefit/penalty of the return on any under/over-spend relative to regulatory allowance in the previous period.

⁵⁵ ACCC, *Inquiry to make final access determinations for the declared fixed line services: Final Report*, July 2011, p 87. See also: ACCC, *Public inquiry to make final access determinations for the declared fixed line services: Discussion paper*, April 2011, p 82.

⁵⁶ Synergies, *Advice on NBN Co Ltd's Special Access Undertaking*, January 2012, pp 48-49.

⁵⁷ Synergies, *Advice on NBN Co Ltd's Special Access Undertaking*, January 2012, p 48.

4.2.4.5. The Total Cost of Ownership standard offers NBN Co broad discretion

Expenditure may also be deemed to meet the Prudent Design Condition if it is a “Permitted Variation” to the rules. Permitted variations include enhancements, augmentations and variations that either:

- are identified within, or “contemplated by” the Network Design Rules;
- achieve savings in the Total Cost of Ownership; or
- are reasonably necessary to establish and maintain the quality, reliability and security of the relevant assets or the supply of product components.

Once again, there appears to be significant discretion for NBN Co to determine changes to its network design (and associated expenditure requirements) without any oversight of this.

The Total Cost of Ownership test in particular creates wide scope for divergence from the Network Design Rules. Total Cost of Ownership is simply defined as:

...all costs incurred or likely to be incurred over the economic life of the Relevant Assets calculated on a net present value basis, including Capital Expenditure, Operating Expenditure and costs that arise in connection with upgrades or expansions of the Relevant Assets (including expansions of the capacity, functionality and geographic reach of the Relevant Assets).

Application of this test will clearly involve many judgements regarding future expenditure, future expansion requirements and the appropriate discount rate to be applied to future cash-flows. Depending on how judgement is exercised with respect to these future matters, the Total Cost of Ownership test could yield varying results. This highlights the need for periodic review of prudence and application of ex ante expenditure controls. Without this, there is potentially broad scope for inefficient expenditure by NBN Co, which would not be in the LTIE.

4.2.4.6. NBN Co is not required to vary the Network Design Rules where such a variation would be efficient

If a potentially efficiency-enhancing variation to the NBN design becomes possible, for example as a consequence to a new technology or more efficient processes becoming available, then NBN Co has discretion to either maintain the current network design or initiate a variation to the Network Design Rules. There is nothing requiring NBN Co to vary the Network Design Rules to implement the more efficient network design solution.

Under the NBN Co SAU, the choice as to whether to implement the design variation would likely involve weighing up the option of doing nothing, in which case any now inefficient expenditure will still be carried through to the LTRC, or engaging with the ACCC and industry in relation to a variation that will risk restricting the amount of NBN Co’s spend that will be deemed prudent.

Since this choice resides with NBN Co, it may be difficult for the ACCC to be satisfied that all future spend included in the LTRC will reflect potential future efficiency gains.

4.2.4.7. Scope for ACCC oversight of prudence is very limited

Only in very limited circumstances will the ACCC potentially have a prudence oversight role. That is, where the expenditure is a “Network Change” (not something that is within the scope of the Network Design Rules or 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 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.⁵⁸

Telstra considers that this ACCC oversight role is too limited. For the reasons set out above, Telstra submits that the NBN Co SAU should provide for much greater oversight of the prudency of NBN Co expenditure. Possible oversight mechanisms that could be included in the NBN Co SAU are set out in section 4.5 below.

4.3. The LTRC

The NBN Co SAU specifies a building block mechanism (the LTRC) that allows NBN Co to recover all costs (as determined in accordance with the provisions of the NBN Co SAU). The LTRC recognises all prudently incurred costs when they are put into service. Given the upfront nature of NBN Co’s costs, the LTRC places a modest binding constraint on prices for at least the next 20 years. Over that period, the NBN Co SAU includes price controls applied to initial individual product offerings with price rises capped at CPI/2. When revenues are sufficient to recover the LTRC’s annual revenue requirement and accumulated losses, then the LTRC begins to bind the prices charged by NBN Co for all services.

While other regulated companies operate under building block mechanisms, the LTRC is a novel approach to cost recovery and it has several limitations. These limitations contribute to the LTRC overstating the costs that should be recovered from end-users.

The purpose of this section is to outline the limitations with the LTRC in the context that the ACCC will need to make an overall assessment of the LTRC methodology based on the “reasonableness” criteria.

4.3.1. The general cost recovery framework

The ACCC must consider the general cost recovery framework for NBN Co in the context of both the private and social efficiency objectives that underlie the reasonableness criteria. On private efficiency grounds, the legitimate business interests of NBN Co (and its investor) are that the expected returns from the investment outweigh its cost. On social efficiency grounds, competition is promoted and efficient use of investment by end-users when the expected returns from the investment are earned in the most efficient way from available sources. In the case of public projects, there are generally two available sources of revenue: end-users and taxpayers.

It is important for the ACCC, in its consideration of the reasonableness of the NBN Co SAU, to account for social efficiency objectives as they have an influence on the recourse of cost recovery from end-users and, therefore, consequences for the specific criteria of promoting competition and encouraging efficient use of investment. In particular, the ACCC must make a positive determination on the amount of cost to be recovered from end-users, as this is an integral part of the NBN Co SAU. Given the operation of the LTRC, the ACCC must also make a positive determination as to the timing for when the costs attributable to end-users are recovered. This is because the LTRC accumulates and carries forward losses from one year to the next at the WACC. If losses are lower in early years, because fewer costs are attributed to end-users in those years, then the LTRC will bind earlier (see section 4.3.8 for an example).

⁵⁸ NBN Co SAU, sch 8, cl 6.5(a) and cl 7.3.

NBN Co is seeking to recover the full cost of its investment from end-users through the LTRC. However, it is not reasonable for NBN Co to assume the entire burden of cost is to be placed on end-users, as the expected return to Government from NBN Co is short of its economic costs.⁵⁹ The burden of cost recovery falls to both end-users and the Government.

Note that the burden on Government arises regardless of whether there is a direct government subsidy. Taxpayers' contributions to the return to NBN Co might materialise in the government's accounts in the form of an operating expense if there is a direct subsidy paid by government to NBN Co. Alternatively, a tax payer contribution could be realised if there is a write down in the value of the investment on the government's balance sheet, at the time NBN Co is privatised or at some other time. In either case, while these subsidies will appear as fiscal costs on the operating statement or balance sheet, fiscal costs are not necessarily equivalent to economic costs.⁶⁰

Further, the Competitive Neutrality Complaints Office has commented on the need to estimate and account for Government funding, however that funding is made.⁶¹

To comply with competitive neutrality policy, NBN Co would need to adjust its pricing model by taking into account funding by the Australian Government for its community service obligations and would need to demonstrate that the adjusted pricing model is expected to achieve a commercial rate of return that reflects its risk profile.

There are a number of alternative means by which the ACCC can assess an efficient distribution for the burden of cost recovery between end-users and Government in assessing the reasonableness of the prices expected to arise from the NBN Co SAU. Any future approach considered by NBN Co would better promote the LTIE if it attributed any expected contribution to NBN Co's economic costs from the Government early in the operation of the LTRC, as this will result in lower accumulated losses being carried forward at the WACC.

Appendix C includes a review of funding arrangements for a number of major public spend projects. This review shows that full recovery of the costs of an infrastructure project from end-users will not always be economically efficient or in the interests of end-users. Where there are positive spill-overs or externalities associated with an infrastructure project or where there are declining average costs over total output, it may be more appropriate to seek a balance between government funding and end-user funding.

4.3.2. The WACC

NBN Co has presented a number of different views of the WACC that it intends to use in the:

- NBN Co Corporate Plan, NBN Co estimates its WACC ranges from 13% during construction, to 8% after the network operations have been established;⁶²
- Officer and Bishop report, commissioned by NBN Co, NBN Co's vanilla WACC is estimated to be 9.1%;⁶³ and

⁵⁹ NBN Co states that it expects to repay the government's equity funding and provide a rate of return in excess of the government bond rate (see NBN Co Corporate Plan 2011-2013). It has outlined a cost of capital of between 8%-10% and an internal rate of return of 7 %.

⁶⁰ Any eventual gain or loss on the government's equity investment in NBN Co is accounted for as an expense on the operating statement but this does not affect the fiscal balance measure.

⁶¹ Australian Government Competitive Neutrality Complaints Office (2011), NBN Co, Investigation No. 14, Canberra, November.

⁶² NBN Co, *Corporate Plan 2011 – 2013*, 17 December 2010, p 143.

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- NBN Co response to initial industry comments, NBN Co estimates the WACC to be 7.72%, based on a contemporary estimate of the government bond yield.⁶⁴

The NBN Co SAU is quite clear that the nominal WACC to be used is the 20 business day average of the 10-year government bond yield plus 3.5%. However, it is obviously difficult to predict what the 20 business day average of the 10-year government bond yield is likely to be over the 30-year term of the NBN Co SAU.

The long-term average of the 10-year government bond yield is approximately 5.5%.⁶⁵ While the current value is much lower than this, the current yield is the lowest it has been for the last 10 years. It is more sensible to predict the outcomes of the SAU, over its term, assuming the government bond rate will average at 5.5%. This would mean a WACC of 9%.

More generally, NBN Co should face a lower WACC than Telstra, given the additional protections it has, some of which must reduce the systematic and non-diversifiable risks it faces.

4.3.3. Gamma

The NBN Co SAU proposes to use a gamma value equal to the value that was “[F]inally Determined by a Relevant Regulatory Body in its most recent consideration, prior to the commencement of the Financial Year”.⁶⁶

While consistency in the treatment of gamma within and across industries is important, it is unlikely that NBN Co’s proposed approach is likely to result in consistency across time. The reason for this is that the Relevant Regulatory Bodies – defined by NBN Co to be the ACCC, AER and the ACT – have applied gamma values that have changed markedly over time. For instance:

- in April 2009, the ACCC determined gamma to be 0.5;⁶⁷
- in May 2009, the AER determined gamma to be 0.65;⁶⁸
- in May 2011, the ACT determined gamma to be 0.25;⁶⁹ and
- in July 2011, the ACCC determined gamma to be 0.45.⁷⁰

Instead of exposing the LTRC and NBN Co to this level of uncertainty, it would be more practical to allow the ACCC to determine the appropriate gamma to apply in the NBN Co SAU prior to each financial year. This could be achieved by the ACCC setting the gamma and allowing NBN Co to apply that gamma until such time as the ACCC advises that NBN Co should adjust to an alternative number.

⁶³ Professor Bob Officer and Dr Steven Bishop, *Report on WACC component of NBN Co’s Special Access Undertaking*, December 2011, p 14.

⁶⁴ NBN Co letter to Michael Cosgrave, 13 February 2012, p 6.

⁶⁵ 10 year average to December 2011.

⁶⁶ NBN Co SAU, sch 7, cl 8.5(a).

⁶⁷ ACCC (2009), *Assessment of Telstra’s Unconditioned Local Loop Service Band 2 Monthly Charge Undertaking: Final Decision*, April 2009, p 241.

⁶⁸ AER, *Final decision: Electricity transmission and distribution network service providers: Review of the weighted average cost of capital (WACC) parameters*, May 2009, p v.

⁶⁹ *Application by Energex Limited (Gamma) (No 5)* [2011] ACompT 9.

⁷⁰ ACCC (2011), *Inquiry to Make Final Access Determinations for the Declared Fixed Line Services: Final Report*, July 2011, pp 71-76.

That determination by the ACCC would need to take into account NBN Co's ownership, tax status and the fact that this parameter might be reviewed prior to privatisation, subject to the issues raised in section 4.3.4 below.

Furthermore, the drafting of schedule 7.8.5(a) refers to the value “[F]inally Determined by a Relevant Regulatory Body in its most recent consideration”, which could be read as giving NBN Co the choice as to which of the last decisions of the AER, ACCC and AER would be used. It does not seem to require that NBN Co adopt the most recent of all the “Finally Determined” values, if this is what is intended.

4.3.4. Taxation expenses

Taxation expenses are calculated on the basis of the Nominal Taxation Depreciation Expense set out in schedule 7.8.2 of the NBN Co SAU. The Nominal Taxation Depreciation Expense is determined using a straight line depreciation profile. Telstra has the following concerns with this approach.

First, adopting a straight line depreciation profile for tax purposes and a statutory tax rate ignores the opportunity that NBN Co has under Australian Accounting Standards to minimise taxation expenses over the lives of assets by adopting an accelerated tax depreciation profile.⁷¹ Indeed, it is likely that the LTRC would result in lower revenue should NBN Co adopt an accelerated depreciation profile for tax purposes. This is because tax losses are carried forward from year to year nominally in the NBN Co SAU.

Second, the NBN Co SAU could result in taxation expenses that are quite different to the tax expenses that NBN Co actually incurs. Telstra considers that the tax expenses in the NBN Co SAU should be more closely linked to NBN Co's tax accounts, as they are in the building block model applied to Telstra.

4.3.5. The treatment of inflation

The calculation of Revenue Requirement in the LTRC includes the cost of inflation. After discussion with NBN Co, Telstra understands that there is an error in schedule 7.8.1c, which NBN Co has indicated would be fixed in due course. That clause of the NBN Co SAU erroneously includes the term “1+” in the formula. Removal of this term would result in an increase in value of the nominal RAB being subtracted from earnings rather than from being added. Adding an increase in value to earnings would result in over-recovery of costs. This error has a material effect on the operation of the LTRC and so needs to be fixed.

4.3.6. Annual Construction in Progress Allowance (ACIPA)

The NBN Co SAU states that “*construction in progress...will not include any allowance for interest during construction*”.⁷² However, the ACIPA includes just that, the WACC applied to the construction in progress.⁷³ NBN Co should reconcile what appears on the face of the statements to be an inconsistency.

Further, the ACIPA should only account for costs that have been determined to be efficient. NBN Co's prudence test does not seem to apply to ACIPA, and those prudence tests are

⁷¹ For the avoidance of doubt, this is not a criticism of using the straight line depreciation profile for determining Nominal Regulatory Depreciation. Indeed, it can be reasonable to have different depreciation profiles for tax and depreciation costs.

⁷² NBN Co SAU, sch 7, cl 3.4(a).

⁷³ NBN Co SAU, sch 7, cl 3.4(b).

insufficient in terms of ensuring inefficient costs are excluded from the LTRC, as discussed in section 4.2.4.

4.3.7. Asset lives and future changes to asset lives

The NBN Co SAU specifies the Asset Real Straight Line Depreciation as the net real capex divided by an assumed asset life, in clause 8.1(a) of Schedule 7. The NBN Co SAU also provides indicative asset lives in Table 8.1, but states that those lives may change from time to time as determined in a manner consistent with NBN Co's audited accounts. If NBN Co extends the life of an asset in its audited accounts, then the depreciation formula specified in clause 8.1(a) of Schedule 7 will result in total depreciation amounts that sum to an amount that is different to the cost of the asset.⁷⁴ The NBN Co SAU should specify how changes to asset lives will be treated in the LTRC to avoid any unreasonable calculations of depreciation costs should NBN Co choose to change its asset lives.

Further, asset lives that are reasonable today, might not be reasonable tomorrow. The current structure of the NBN Co SAU, if it is accepted, is to allow NBN Co to choose between the asset lives in Table 8.1 and whatever might be reasonable in the future. If it suits NBN Co to continue using what have become unreasonable asset lives, it would presumably do so if that were in its interests. The only constraint appears to be that changes are "*determined in a manner consistent with NBN Co's audited accounts*".⁷⁵ This is unlikely to be a constraint that would limit NBN Co from adjusting its asset lives to change price outcomes over the 30-year duration of its SAU. Consequently, the NBN Co SAU can lead to unreasonable outcomes in terms of depreciation expenses. The ACCC should be given the right to accept or reject NBN Co's proposed changes to asset lives in the implementation of the LTRC methodology to prevent any unreasonable outcomes from occurring.

Given the lack of a working building block model, Telstra is unable to test the likely impact of assuming shorter or longer asset lives. However, in other models, the asset life assumptions can change overall revenue requirements and prices materially.

In terms of the specific asset lives listed in Table 8.1 of the NBN Co SAU, many of the asset categories are not explained or the assets that would sit within each category have simply not been purchased or planned. However, two categories look as if their asset lives are too short as set out below.

- Duct, trench, pipe and similar assets have an assumed asset life of 30 years. The ACCC applies a 35 year life to these assets in Telstra's building block model.
- Antennae assets have a life of 6 years, which appears low.

4.3.8. The Initial Cost Recovery Account (ICRA)

The ICRA acts as an accumulated loss account, recording the losses that are intended to be recovered by future users. Each year the standing accumulated loss is indexed by the WACC, to account for NBN Co's cost of holding those losses. It would be akin to having a debt with the bank, which would obviously accumulate interest payments if left unpaid.

⁷⁴ For example, assume a \$100 asset is depreciated initially over 10 years. After year 5, there is a remaining asset value of \$50. Assume the asset life is extended to 20 years. Under NBN Co's proposed depreciation formula depreciation from year 5 to 20 will be \$5 per year (\$100/20). The total amount of depreciation over the 20 years will be \$125 (\$10 per year for the first 5 years and \$5 per year for the remaining 15 years).

⁷⁵ NBN Co SAU, sch 7, cl 7.8.1(a).

This structure means that the earlier that capital is spent, the earlier losses accumulate, and the greater the cost of the WACC applied to those accumulated losses. Costs over the long run are higher and, therefore, the Building Block Revenue Period is delayed and less constraint on is placed on NBN Co's prices. The ACCC must, therefore, place greater emphasis on assessing the efficiency of NBN Co's costs generally and also the timing of NBN Co's costs, early in the term of the NBN Co SAU.

This is illustrated in the very stylised example below, where it is assumed that NBN Co has the same cost (ABBRR) over 6 years. It is also assumed that an efficient spend profile would involve NBN Co's costs being \$10 for the first three years and \$20 for the last three years, and an inefficient spend profile would involve NBN Co's costs being the reverse. Under the inefficient spend profile the ICRA is \$53 in 2016, while it is \$42 under an efficient spend profile.

FY		2011	2012	2013	2014	2015	2016
Revenue		\$2	\$4	\$8	\$10	\$15	\$20
Efficient capex timing	ABBRR	\$10	\$10	\$10	\$20	\$20	\$20
	ICRA (start)	\$0	\$8	\$15	\$18	\$30	\$38
	Unrecovered Cost	\$8	\$6	\$2	\$10	\$5	\$0
	ICRA (end)	\$8	\$15	\$18	\$30	\$38	\$42
Inefficient capex timing	ABBRR	\$20	\$20	\$20	\$10	\$10	\$10
	ICRA (start)	\$0	\$18	\$36	\$51	\$57	\$57
	Unrecovered Cost	\$18	\$16	\$12	\$0	-\$5	-\$10
	ICRA (end)	\$18	\$36	\$51	\$57	\$57	\$53

4.3.9. Review and variation of the LTRC

The NBN Co SAU allows for a number of inputs into the LTRC to be reviewed during the SAU Review Period that begins when the Communications Minister declares the NBN built and fully operational and the date the Finance Minister declares that conditions are suitable for the privatisation of NBN Co, or alternatively no later than 1 July 2027.⁷⁶ During this period, NBN Co must conduct a review into the approach to prudence, incorporation of capex and opex into the regulatory asset base, and the WACC. NBN Co may also review the treatment of tax, depreciation profiles, the value of the regulatory asset base, etc.

NBN Co must then draft an SAU Variation that is essentially designed by NBN Co without any significant constraint. The ACCC can reject the variation, in which case NBN Co must submit a Subsequent SAU Variation that "*will address, but not be limited to, the issues raised by the ACCC*".⁷⁷

Telstra has several concerns about this mechanism as set out below and also referred to in section 2.

First, there does not appear to be any specified process for assessing the Subsequent SAU Variation made by NBN Co. If it too should be unreasonable, then it appears that the first SAU will be maintained. This puts NBN Co in a position of having a choice as to whether the first SAU should be maintained (for example, by lodging variations the ACCC is unlikely to consider reasonable) or any variation should be made. This means that in assessing the current SAU,

⁷⁶ NBN Co SAU, sch 9, cl 3.2(a).

⁷⁷ NBN Co SAU, sch 9, cl 3.6(b).

the ACCC must be satisfied that it will continue to be reasonable, even in the situation that NBN Co chooses not to submit reasonable SAU variations under Schedule 9.

Second, NBN Co appears to be able to prevent reviews of all the matters other than those listed in clause 3.3(a) of Schedule 9 by not including them in a review, regardless of whether those elements are operating in a manner that does not promote the LTIE. A broad requirement for NBN Co to exercise its rights and perform its obligations under Schedule 9 in “good faith” is insufficient to address the fundamental structural concerns arising from the mid-term review mechanism. Similarly, this means that in assessing the current SAU, the ACCC must be satisfied that it will continue to be reasonable, even in the situation that NBN Co chooses not to review particular matters under Schedule 9.

Notwithstanding, a review of the LTRC at the time of sale of NBN Co is very important as it is at this time that the market value of NBN Co might be identified. The market value of NBN Co could be very different to the remaining book value of NBN Co’s assets as recorded in the LTRC (including accumulated losses). Indeed, given the government expects an IRR of 7% and NBN Co expects a long run WACC ranging from 8% to 13%, the market value is likely to be substantially lower.

Indeed the NBN Co SAU should allow the ACCC and industry to review key elements of the SAU in the event of any significant unanticipated event, not just the sale of NBN Co. For instance, should a change in government result in a material change to the objectives of NBN Co, then there might be very good reasons to change inputs into and the operation of the price control or LTRC.

4.4. Reporting

Schedule 10 of the NBN Co SAU sets out NBN Co’s commitments to periodically report certain expenditure and revenue information. NBN Co emphasises that these reporting commitments are in addition to the general powers that the ACCC has to request information from NBN Co and are not intended to limit these powers.⁷⁸

Telstra is concerned that the proposed reporting commitments will not be sufficient for the ACCC and other relevant stakeholders to assess compliance with the NBN Co SAU. Schedule 10 of the NBN Co SAU provides for reporting of aggregated amounts for capital expenditure, operating expenditure, depreciation, opening and closing RAB values and rate of return parameters. However, Schedule 10 does not provide for NBN Co to report the types of information which might allow for an assessment of whether these amounts have been calculated and incurred in accordance with the NBN Co SAU.

By contrast, electricity and gas network businesses are required to report large amounts of information to allow the regulator to perform its review functions. Basic reporting obligations are contained in the NER and National Gas Rules (**NGR**), and the regulator has specific powers to request additional information that is required for the performance or exercise of its regulatory functions.

Telstra considers that, unless there are good reasons for departure, the reporting obligations in the NBN Co SAU should be consistent with those imposed on other regulated service providers.

⁷⁸ NBN Co, *NBN Co’s Special Access Undertaking (SAU) – Initial Industry Submissions*, 13 February 2012, p 7.

4.4.1. Comparison of NBN reporting commitments with obligations imposed on other regulated service providers

NBN Co's reporting commitments, as they are currently set out in Schedule 10 of the NBN Co SAU, are not nearly as comprehensive as the reporting obligations that are typically imposed on other regulated service providers. For example, electricity and gas network businesses are required to report in much greater detail than is provided for in the NBN Co SAU in respect of matters such as depreciation, the asset base and expenditure forecasts. These businesses are also required to report substantial amounts of information to support the forecasts and other model inputs that they propose.

Electricity and gas network businesses are subject to periodic review (typically every five years), with a combination of ex ante and ex post controls imposed at each review. The AER establishes ex ante operating and capital expenditure allowances for each business at each review based on the proposal that is submitted by the business and the relevant expenditure criteria. For electricity businesses, the relevant criteria are:⁷⁹

- that the forecast reasonably reflects the efficient costs of achieving the expenditure objectives (such objectives include: meeting or managing expected demand; complying with applicable regulatory obligations or requirements; and maintaining the quality, reliability and security of supply);
- that the forecast reasonably reflects the costs that a prudent operator in the circumstances of the relevant business would require to achieve the expenditure objectives; and
- that the forecast reasonably reflects a realistic expectation of the demand forecast and cost inputs required to achieve the expenditure objectives.

In addition to the ex ante control based on these criteria, there is an ex post review of expenditure at each review, with a true-up of capital expenditure to be included in the RAB and (for electricity businesses) carryover of any operating expenditure efficiency gains/losses.

In order to administer these ex ante and ex post controls, the AER typically seeks a large amount of information from the business in advance of each review. This is not limited to actual and forecast expenditure amounts, and includes a large amount of information that is relied on by the AER to assess the prudence and efficiency of forecast amounts. Some of this information is required to be submitted under the NER/NGR, while other information is provided in response to information notices issued by the AER.

For electricity distribution businesses for example, Schedule 6.1 of the NER sets out basic requirements for the contents of the revenue proposal that is to be submitted in advance of each review. These include detailed information on inputs into the revenue and pricing models, as well as information to support these proposed inputs. A summary comparison of NBN Co's commitments with the requirements in Schedule 6.1 of the NER is set out in the table below.

⁷⁹ NER, cl 6.5.6(c) / 6.5.7(c) (distribution businesses) and 6A.6.6(c) / 6A.6.7(c) (transmission businesses).

Table 3 – Comparison of NBN Co reporting commitments with NER requirements

Matter	NBN reporting commitment	NER requirement
Capital expenditure	Capital expenditure, by asset type	<p>Forecast capital expenditure by asset class or category driver, identifying in respect of material assets: the location of the proposed asset; the anticipated or known cost; and categories of service which are to be provided by the asset.</p> <p>The revenue proposal must also include: the method used for developing the forecast; forecasts of load growth relied upon; key assumptions underlying the forecast; actual capital expenditure for the previous period; an explanation for any significant variation in forecast expenditure from historic expenditure; and a certification of reasonableness of key assumptions by the directors of the business.</p> <p>(NER, clause S6.1.1).</p>
Operating expenditure	Operating expenditure, by expense type	<p>Forecast operating expenditure by reference to well accepted categories, such as particular programs or types of expenditure, identifying for each category: to what extent costs are fixed and variable; and categories of service to which the forecast expenditure relates.</p> <p>The revenue proposal must also include: the method used for developing the forecast; forecasts of key variables relied upon and the methods used to develop those forecasts; key assumptions underlying the forecast; actual operating expenditure for the previous period; an explanation for any significant variation in forecast expenditure from historic expenditure; and a certification of reasonableness of key assumptions by the directors of the business (NER, clause S6.1.2).</p>

Matter	NBN reporting commitment	NER requirement
Regulatory asset base	Opening and closing values of the RAB Asset disposals, by asset type Depreciation (nominal and real)	The business' calculation of the opening RAB using the AER roll forward model, together with: details of all amounts, values and other inputs used for that purpose; a demonstration that those amounts, values and inputs comply with the NER requirements; and an explanation of the RAB calculation (NER, clause S6.1.3(7)).
Depreciation	Nominal regulatory depreciation	Depreciation schedules, categorising the relevant assets by asset class or category driver (the same categorisation as for capex), together with: details of all amounts, values and other inputs used to compile the depreciation schedules; a demonstration that the depreciation schedules comply with the NER requirements; and an explanation of any depreciation calculation (NER, clause S6.1.3(12)).
Rate of return	Risk free rate Nominal vanilla WACC	Averaging period for determining rate of return parameters (NER, clause S6.1.3(8)). Calculation of the proposed rate of return, including any proposed departure from values in a statement of regulatory intent (NER, clause S6.1.3(9)).
Revenue and prices	Annual building block revenue requirement	The businesses' calculation of revenue or prices for the purposes of the control mechanism together with: details of all amounts, values and other inputs relevant to that calculation; an explanation of all amounts, values and other inputs relevant to that calculation; and a demonstration that those amounts, values and inputs comply with the NER requirements (NER, clause S6.1.3(6)).
Modelling	There is no commitment to provide a working building block model	The populated post-tax revenue model and roll-forward model (NER, clause S6.1.3(10)).

In addition to the basic requirements for a revenue proposal set out in the NER, the AER typically requires provision of further information pursuant to its information gathering powers. Under section 28F of the National Electricity Law (and section 42 of the National Gas Law for gas businesses), the AER may issue a regulatory information notice or make a general regulatory information order if it considers this to be reasonably necessary for the performance or exercise of its functions or powers under the NEL or the NER (or NGL/NGR in the case of a

notice issued under the NGL). The AER frequently issues regulatory information notices to businesses in advance a periodic review, requiring provision of further information (beyond what is required by the NER) such as:⁸⁰

- further detail on key drivers of capital expenditure forecasts, including specification of demand assumptions and/or relevant changes in regulatory obligations;
- explanation for any change in operating expenditure from previous periods, including any escalation factors used or step changes to account for changes in operating conditions;
- justification for why proposed forecasts meet the relevant criteria in the NER (or NGR for gas businesses);
- any relevant internal decision making documents including business cases, feasibility studies, forecast demand studies and internal reports and the date of board resolution/management decisions relating to approval of the forecast capital expenditure;
- details of any capital contributions (i.e. contributions to capital expenditure received from network users);
- for gas businesses, amounts of “speculative capital expenditure” (i.e. expenditure that does not conform to the relevant criteria at the time of review, but which may be rolled into the asset base at a later time when the type of volume of services changes to such an extent that the capital expenditure meets the criteria);
- details of any related party contracts or outsourcing arrangements, including the name of the external contractor(s), details of how the contract was awarded (for example, by competitive tender), details of fees and charges and a description of the goods or services provided and reasons why the functions were outsourced; and
- information on financing practices and actual financing costs.

Finally, the broader legal framework for regulatory oversight of energy network pricing provides strong incentives for businesses to fully disclose all information that may be relevant to a regulatory review. Under the NER, the AER is required to accept a forecast if it is satisfied that it reasonably reflects the expenditure criteria,⁸¹ and therefore businesses have a strong incentive to disclose all information that may be necessary for the AER to reach this level of satisfaction. As noted in section 4.5 below, the NBN Co SAU provides for very little ongoing oversight by the ACCC, and therefore NBN Co will not face the same incentives for full information disclosure.

4.4.2. Additional reporting obligations that should be included in the NBN Co SAU

The NBN Co SAU provides for reporting of various inputs into the LTRC, including historic and forecast expenditure, opening and closing asset values and rate of return parameters. This information is important and necessary to allow monitoring by the ACCC of the operation of the LTRC. However, Telstra considers that this information will not be sufficient for the ACCC to monitor compliance with the LTRC, in terms of both its mechanical operation and the determination of key inputs.

⁸⁰ For an example of regulatory information notice requirements, see: Jemena Gas Networks (NSW) Ltd, *Regulatory information notice compliance checklist (Appendix 1.2 to the Access Arrangement Information)*, 26 August 2009.

⁸¹ NER, cl 6.5.6(c) / 6.5.7(c) (distribution businesses) and 6A.6.6(c) / 6A.6.7(c) (transmission businesses).

The comparison above demonstrates that monopoly network service providers in other industries are required to report in much greater detail than what NBN Co is committing to, in respect of matters such as depreciation and expenditure forecasts. Businesses in other industries are also required to report information that allows for assessment of their proposed inputs by the regulator.

Telstra considers that at a minimum, the NBN Co SAU should provide for periodic reporting of information that will allow the ACCC to replicate and verify NBN Co's administration of the LTRC. Without having seen the building block model that NBN Co intends to use, it is difficult to say precisely what information will be needed in this respect. However, Telstra expects that the NBN Co building block model will require more detailed inputs than what is to be reported under Schedule 10, particularly in respect of matters such as depreciation.

Additionally, the SAU should provide for reporting of information that will allow for assessment of LTRC inputs by the ACCC, particularly the prudence of expenditure incurred. As noted above, electricity and gas businesses are typically required to report a range of information to support forecast expenditure, including information on key expenditure drivers, details of outsourcing arrangements and internal decision-making documents or business case materials relating to planned expenditure. By contrast, NBN Co has simply committed to certify that all expenditure included in annual building block revenue has been prudently incurred.

It is important to note that absent any SAU commitment (and without stronger oversight mechanisms – see next section), NBN Co will have little incentive to provide the ACCC with information to demonstrate the prudence of its expenditure or the reasonableness of other LTRC inputs. Since the ACCC has no role in periodically reviewing or determining these inputs, NBN Co has no real incentive to voluntarily provide this information to the ACCC. This can be contrasted with the incentives facing electricity and gas businesses to disclose all information that is necessary to convince the AER of the reasonableness of their proposed forecasts or other inputs.

In Telstra's view, the reporting obligations imposed on electricity transmission network service providers under the NER (referred to above) provide a reasonable starting point for what can be expected of NBN Co. The NER framework requires network service providers to report both modelling inputs (so that the AER can replicate modelling of revenue and price constraints) and information that can be used to test the reasonableness of these inputs. The ACCC should consider how the NER framework could usefully be adapted for the NBN Co SAU.

4.4.3. Other ACCC powers to obtain information

The ACCC Consultation Paper notes that other information-gathering powers are available to the ACCC under the CCA, chiefly under section 155 and section 151BU.

While these information-gathering powers may potentially be used by the ACCC to monitor compliance with the SAU, they should not be viewed as a complete substitute for an appropriate reporting framework as part of the SAU itself. Given that the SAU purports to establish a relatively complex revenue constraint and price cap regime to operate for up to 30 years, it should include mechanisms that allow the ACCC to monitor the administration of these revenue and price caps. The ACCC's statutory information-gathering powers may be used to supplement and fill any information gaps, but should not be viewed as a substitute for a reporting regime.

This is consistent with the approach in the electricity and gas sectors, where the primary reporting obligations are contained in the pricing rules and the AER has supplementary powers to gather additional information that may be necessary for the performance of its regulatory functions.

4.5. ACCC oversight (price related)

The scope for ACCC oversight of NBN Co's pricing commitments under the SAU is limited in a number of respects:

- in respect of those products that are within the scope of the initial price control, there is no provision for the ACCC to regularly review NBN Co price changes and assess compliance with the LTRC (including prudence requirements) and price controls;
- oversight is limited in respect of pricing for several products because the pricing of these products is set out in the WBA and not the NBN Co SAU;
- there is limited scope for the ACCC to review initial pricing for any new products that may be introduced by NBN Co over the 30 year term of the SAU; and
- the NBN Co SAU fails to provide the ACCC with visibility and oversight of how costs are allocated between services.

Whilst there is provision for recourse to the ACCC on certain pricing matters, the scope of the recourse mechanism, as that mechanism is currently constructed, is likely to be very limited. In Telstra's view, the NBN Co SAU should provide for a greater role for the ACCC in monitoring compliance with the SAU and taking positive steps to remedy any instances of non-compliance.

4.5.1. Oversight powers that would be available to the ACCC in the absence of an SAU

In the absence of an accepted SAU, the ACCC would have a wide range of oversight powers under Part XIC of the CCA. These include those set out below.

- The ACCC may declare a service that is to be supplied by NBN Co, and in doing so define the scope of the service which is to be subject to regulation and time period over which regulation is to have effect.⁸²
- Once a service is declared, the ACCC may make an access determination,⁸³ which:
 - may establish a price or method of ascertaining price;
 - may be for a long or short period as the ACCC determines, with scope for new access determinations to be made upon expiry of the initial access determination; and
 - may include fixed principles that are to be included in future access determinations.
- If the ACCC sees a need to vary or revoke an access determination at any time, it may do so.⁸⁴

⁸² CCA, s 152AL(8A).

⁸³ CCA, s 152BC.

- Through relatively short-term access determinations, the ACCC may frequently review pricing for the declared service(s).
- When in future NBN Co commences supply of new services, the ACCC may choose to declare those services and make access determinations.
- The ACCC may allow declaration of certain services to lapse if it no longer considers that declaration is in the LTIE.

While some of these oversight powers will still be available to the ACCC if the NBN Co SAU is accepted, these will be significantly curtailed. In particular, due to the very broad scope of the NBN Co SAU and its long term, the ACCC's powers to determine the scope of regulation will be significantly curtailed. Moreover, any ACCC access determination (including access determinations in respect of future products) will not have effect to the extent that it is inconsistent with the SAU.⁸⁵

Since many of the ACCC's ordinary oversight powers will be removed if the NBN Co SAU is accepted, it is important that the SAU itself contains adequate regulatory oversight mechanisms.

4.5.2. ACCC oversight of ongoing compliance with price and revenue controls under the NBN Co SAU

The NBN Co SAU does not explicitly provide for regular ACCC review of NBN Co's pricing and its compliance with the LTRC and price controls. While the ACCC may proactively do this as a matter of practice, the absence of any review mechanism in the SAU may make it more difficult for the ACCC to monitor and remedy any potential breaches of the LTRC and/or price controls.

Telstra would expect that given the relatively wide scope of the NBN Co SAU and the proposed 30-year term, it would include mechanisms for regular ACCC oversight. Telstra notes that such mechanisms are often included in long-term access undertakings, for example:

- The Australian Rail Track Corporation (ARTC) access undertaking for the Hunter Valley coal network includes provision for an annual compliance assessment by the ACCC. As part of its compliance assessment, the ACCC is to determine (inter alia) whether ARTC has undertaken the RAB roll-forward in accordance with the undertaking, whether its calculations of access revenue have been correctly undertaken, and whether it has incurred efficient costs in accordance with the undertaking.⁸⁶ As part of a review, the ACCC may determine ex post adjustments to the RAB or expenditure amounts to ensure compliance with the undertaking. The ACCC power to determine adjustments as part of its review were not originally included by ARTC in its undertaking, but were subsequently added at the request of the ACCC. The ACCC considered that it should have explicit powers to disallow inefficiently incurred operational expenditure and costs and that the inclusion of this power was necessary to ensure ARTC does not face incentives to operate inefficiently.⁸⁷

⁸⁴ CCA, s 152BCN.

⁸⁵ CCA, s 152CBIA.

⁸⁶ Australian Rail Track Corporation, *Hunter Valley Coal Network Access Undertaking*, 23 June 2011, cl 4.10.

⁸⁷ ACCC, *Position Paper in relation to the Australian Rail Track Corporation's proposed Hunter Valley Rail Network Access Undertaking*, 21 December 2010, p 95.

- The Dalrymple Bay Coal Terminal (DBCT) access undertaking provides for ex ante review of revenue allowances by the Queensland Competition Authority (QCA) on annual basis. The undertaking requires DBCT management to submit its revenue allowance to apply in the forthcoming financial year for approval by the QCA.⁸⁸ The QCA must approve the revenue allowance if it considers that it has been calculated in accordance with the undertaking. DBCT management must also seek QCA approval for amendments to the revenue allowance or reference tariff where a “Review Event” occurs – this includes where there is a change in terminal throughput and/or completion of a terminal expansion phase.⁸⁹

In industries with different models of price regulation (other than undertakings), the regulator will typically have a direct oversight role that is provided for by statute. For example in electricity network regulation, the AER undertakes detailed reviews at regular intervals (usually every five years) in which it establishes expenditure allowances, rate of return settings, asset values and revenue/price caps (refer to section 4.4.1 above).

By contrast, the NBN Co SAU does not provide for any oversight by the ACCC of NBN Co’s administration of the LTRC and price controls. If the ACCC wishes to assess NBN Co’s pricing against the commitments in the SAU, it must do so proactively and rely on the enforcement provisions in the CCA. These enforcement provisions would require the ACCC to satisfy the Federal Court that NBN Co has breached the undertaking before obtaining an order directing NBN Co to comply.⁹⁰

Telstra submits that given the broad scope of the NBN Co SAU and its long term, the ACCC should have an express role in regularly monitoring compliance with the LTRC and price controls. More importantly, the ACCC should have powers to direct NBN Co to adjust LTRC inputs and/or prices if it considers NBN Co has not complied with any aspect of the SAU. Similar powers have been included in Telstra’s structural separation undertaking (**SSU**) and the NBN Co SAU could include provisions modelled on those in the SSU.⁹¹ Telstra notes that a SAU may provide for the ACCC to perform functions or exercise powers in this way.⁹²

The critical feature of the oversight mechanism would be the ACCC power to make adjustments to the LTRC or price controls (either ex ante and/or ex post adjustments) as a consequence of its review. This will ensure that the ACCC has an immediate remedy where it considers that NBN Co’s administration of the LTRC or price control mechanisms is inconsistent with the SAU. It will also create incentives for NBN Co to:

- operate efficiently, since the ACCC will have powers to adjust for any inefficiency; and
- fully disclose all information that is relevant to its administration of the LTRC and price controls in advance of the periodic review, since it will want to satisfy the ACCC that it has fully complied with the terms of the SAU.

A mechanism for periodic pricing review could potentially be included as part of Schedule 9 to the NBN Co SAU, which currently includes a mechanism for periodic review of customer

⁸⁸ DBCT Management Pty Ltd, Dalrymple Bay Coal Terminal Access Undertaking, Schedule C, Part A, clause 4(c).

⁸⁹ DBCT Management Pty Ltd, Dalrymple Bay Coal Terminal Access Undertaking, Schedule C, Part A, clause 4(g).

⁹⁰ CCA, s 152CD.

⁹¹ Under Schedule 11 of the SSU, the ACCC may issue a “Rectification Direction” directing Telstra to take steps to remedy a possible breach of the overarching equivalence commitment in clause 9(a) of the SSU.

⁹² CCA, s 152CBA(10A).

engagement and product development processes. The key features of this mechanism would include those set out below.

- Reviews would be undertaken at regular intervals (potentially every year), with the ACCC to report publicly on the findings of any such review. This would offer certainty to both NBN Co and RSPs that the SAU is being complied with, or that any breach is being remedied.
- The ACCC's review would cover compliance with the price controls, administration of the LTRC and determination of inputs to the LTRC, including rate of return parameters, expenditure forecasts and roll-forward of asset values. The purpose of the review would be to determine whether NBN Co has complied with the SAU in respect of each of these and other matters.
- NBN Co would be required to report certain information to the ACCC in advance of the periodic review (see section 4.4 above).
- The ACCC would be required to make a finding that NBN Co had complied with the SAU over the relevant period if it was satisfied that the price controls and LTRC had been complied with and that the relevant LTRC inputs had been determined in accordance with the SAU. This would create an incentive for NBN Co to provide the ACCC with all relevant information required for it to reach this level of satisfaction.
- In the event that non-compliance was found by the ACCC, it could require NBN Co to take steps to remedy this, including adjustment of LTRC inputs and potentially consequential adjustments to prices.
- In addition to this regular compliance review, a review of prudence of expenditure would be undertaken less regularly (say every two years), with the ACCC to approve or amend forecasts on an ex ante basis for use in the LTRC (see section 4.2.3.3 above).

Telstra would be keen to engage with the ACCC and NBN Co on the precise formulation of this review mechanism.

4.5.3. Price terms set out in the WBA and not the SAU

Telstra notes that initial price terms for the vast majority of NBN products that are currently available are set out in the WBA only and not the NBN Co SAU. This linkage with the WBA is a feature of the NBN Co SAU in relation to both price and non-price terms.

As noted in section 2 above, a consequence of this design feature is that in order for the NBN Co SAU to have real effect, the WBA must contain provisions that give it this effect. This is because if there is any inconsistency between the NBN Co SAU and the WBA, the provisions of the WBA will prevail.

There are a number of ways in which the design of the NBN Co SAU could be amended to promote certainty in respect of those terms and conditions that are set out in the WBA. For price terms specifically, these could include one, or a combination, of the following:

- reduced scope, for example only dealing with prices for a discrete set of product components that can be defined with a sufficient degree of precision in the SAU;
- reduced term and / or more review points, with perhaps the use of fixed principles to carryover key elements of the regulatory framework;

-
- the NBN Co SAU being an alternative, stand-alone, avenue of access not linked to the WBA;
 - RSPs being able to acquire services on terms and conditions that incorporate relevant ACCC regulatory decisions (e.g. access determinations) where they elect to do so; and / or
 - more regulatory oversight powers conferred on the ACCC where the NBN Co SAU provides NBN Co with significant discretion as to how prices will be determined for new product components (this issue is discussed in section 4.5.4 below).

4.5.4. ACCC oversight of new product pricing

As noted in section 4.1 above, the scope of the initial price control is relatively limited. Beyond these initial price controls, NBN Co appears to have broad pricing discretion for new products, with little scope for ACCC oversight. There is no requirement for NBN Co to seek pricing approval for new products and no scope for ACCC review.

As the ACCC has previously noted, offering a regulated firm some degree of pricing flexibility within a revenue cap may potentially result in movements towards efficient price structures. However, as the ACCC has also noted, the extent to which regulated firms have in practice exercised this flexibility to set efficient price structures is less clear and will depend on a number of factors.⁹³ More importantly in this context, the tendency towards efficient pricing requires the revenue cap to be binding on the regulated entity.

For the reasons set out in earlier sections, Telstra considers that the LTRC in its current form is unlikely to be a binding constraint on NBN Co, at least for the first decade or so. NBN Co itself acknowledges that the LTRC is unlikely to be a binding constraint on pricing for at least the first ten years.⁹⁴ This implies that allowing NBN Co wide discretion in respect of new product pricing may not result in efficient price structures and therefore may not promote the LTIE.

Even if Telstra's concerns with the LTRC are addressed and to the extent that the LTRC does become a relevant constraint during the term of the NBN Co SAU, Telstra considers that it would be prudent for there to be provision for some oversight by the ACCC of NBN Co's pricing of new services. Such provisions would include, for example, pricing principles by reference to which the development of prices are required to conform, plus either:

- a requirement for ex ante approval of new pricing based on those principles; or
- provision for regular ex post review of pricing implemented for new services to ensure that it conforms to the pricing principles.

Telstra notes that in other regulated industries where revenue constraints apply, regulators typically maintain a degree of pricing oversight, 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.⁹⁵ Distribution network service providers which operate under a price cap regime are required to

⁹³ ACCC, *Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service: Draft Decision*, December 2007, pp 82-84.

⁹⁴ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, p 57.

⁹⁵ National Electricity Rules, cl 6A.10.1.

submit a regulatory proposal for approval every five years and must also submit an annual pricing proposal for each year within the regulatory period.⁹⁶ By comparison, the NBN Co SAU as currently drafted provides for very little price oversight and significant pricing flexibility in respect of new services for the monopoly network service provider.

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.

There a number of options for introducing greater ACCC oversight of new product pricing, including:

- as part of each regular review of NBN Co's compliance with the price commitments in the SAU (discussed in section 4.5.2 above), the ACCC could review pricing for any new products introduced over the most recent period. This assessment would need to be undertaken against a set of pricing principles to be set out in the SAU; and/or
- the SAU could include a commitment by NBN Co to submit a pricing proposal to the ACCC for approval in respect of any new product it intends to introduce. Again, this assessment would be conducted against the pricing principles to be set out in the SAU

As with the other oversight mechanisms proposed in this section, Telstra would be keen to engage with the ACCC and NBN Co on the precise formulation of this mechanism.

4.5.5. Adequacy of the regulatory recourse currently included in the SAU

NBN Co appears to consider that the NBN Co SAU provides for sufficient ACCC oversight through the "regulatory recourse" clause. In the submission NBN Co has lodged in support of the NBN Co SAU, NBN Co notes that the regulatory recourse clause in clause 6 of the NBN Co SAU:

...confers powers and functions on the ACCC...to create a transparent and efficient mechanism which can be used by an Access Seeker or NBN Co where agreement cannot be reached in respect of non-price terms and conditions not covered by the SAU or price-related terms and conditions (where pricing is announced by NBN Co after the SAU Commencement Date).⁹⁷

Telstra's concerns with the regulatory recourse mechanism, as currently drafted in the NBN Co SAU, are explained in section 2. For the reasons set out in that section, Telstra does not consider that this mechanism will provide for sufficient ACCC oversight of NBN Co pricing, particularly in relation to new products that may be introduced over the 30 year term.

⁹⁶ National Electricity Rules, cl 6.8.2, 6.18.2.

⁹⁷ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, p 4.

5. Non-Price Terms

5.1. General observations and structure

5.1.1. Context

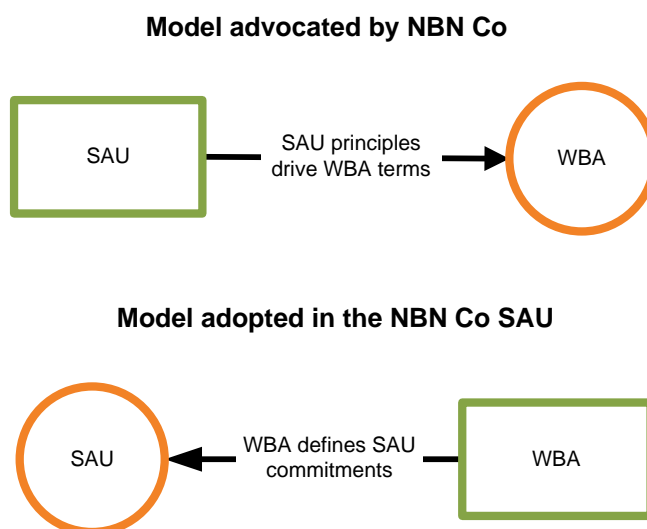
NBN Co's approach to both the content and form of its non-price term commitments in the NBN Co SAU appears to be influenced by its proposed 30 year term and its desire to take a "principles-based" approach where appropriate.

In addition, rather than having the NBN Co SAU operate and become an enforceable instrument in its own right *vis-à-vis* the application of its content, NBN Co proposes that RSPs exercise remedies in the WBA if NBN Co fails to comply with a commitment under the NBN Co SAU.

Accordingly, in order to comply with the NBN Co SAU, NBN Co need only include terms in its WBA which "put into operation" the principles contained in the NBN Co SAU. The substance of the commitments are not enforceable through the NBN Co SAU itself.

This creates a structure where the efficacy of the NBN Co SAU can only be measured by reference to the terms of the WBA and the remedies available in that document for non-compliance. The WBA is in fact inextricably linked to the NBN Co SAU and the NBN Co SAU can neither be assessed, nor can it operate, in isolation to the WBA.

Figure 4 – Interplay between SAU and WBA



5.1.2. Impact of NBN Co's approach

There is a concern that the influencing factors referred to above, and the proposed interplay with the WBA, operate to undermine RSP certainty (contrary to one of the key objectives of the NBN Co SAU).⁹⁸ The approach taken may in fact have the consequence of reducing, rather than increasing, RSP certainty.

⁹⁸ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2012, p 69.

To illustrate this point, Telstra makes the following general observations about the NBN Co SAU non-price terms (a number of which were raised by the ACCC in its Supplementary Consultation Paper):⁹⁹

- **Statements of fact or intention.** Certain non-price terms are drafted as statements of fact or intention (e.g. “*NBN Co is committed to establishing and maintaining positive working relationships*”).¹⁰⁰ These terms are not commitments on the part of NBN Co nor do they provide RSPs with certainty about their application.
- **Statements that confer rights/discretions on NBN Co.** Certain non-price terms confer rights or discretions on the part of NBN Co (e.g. regarding changes to Access Agreements “... *NBN Co may make other changes to Access Agreements in accordance with the terms of those Access Agreements ...*”).¹⁰¹ These terms serve to “lock in” discretions and therefore, by their very nature, reduce certainty for RSPs about their subject matter.
- **Commitments that defer to the WBA and other documentation.** Certain non-price terms defer to the WBA (or other documentation) or provide commitments that apply unless otherwise provided for in the WBA (e.g. indemnity related commitments which are provided “*subject to and in accordance with the terms of the Wholesale Broadband Agreement*”¹⁰² and rights to disclose confidential information where “*permitted to do so under ... the Wholesale Broadband Agreement*”). This construct creates the potential for the WBA to “undo” the NBN Co SAU commitment.
- **Lacking key non-price terms.** There are a number of non-price terms that Telstra would have expected to see in the NBN Co SAU that are not covered (e.g. intellectual property rights, enabling downstream regulatory compliance and preservation of ACCC regulatory powers). Given the concerns raised earlier in this submission about the primacy of the “access agreement” in the NBN context, these matters are left to NBN Co to settle without regulatory oversight.
- **Mixing the WBA/Access Agreement and Customer/Access Seeker.** There is a mixture of WBA and Access Agreement related commitments (e.g. change management relates only to changes to Access Agreements¹⁰³ while the Dispute Management Rules apply only to the WBA).¹⁰⁴ While it is clear why this construct has been developed,¹⁰⁵ the distinction creates complexity and confusion in relation to who can enforce the particular commitment, when they can enforce and how.
- **Unclear rationale for the mix of generality and specificity.** Many of the commitments remain at a principle level when it would appear more appropriate to set out commitments with specificity (e.g. features relating to dispute resolution) while others have high degrees of specificity when it would have been more appropriate to leave these more general (e.g. the specific processes relating to the product development

⁹⁹ See for example ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 4.1.4.

¹⁰⁰ NBN Co SAU, sch 11, cl 2(a).

¹⁰¹ NBN Co SAU, sch 11, cl 14.3(a).

¹⁰² NBN Co SAU, sch 11, cl 13(c).

¹⁰³ NBN Co SAU, sch 11, cl 14.3.

¹⁰⁴ NBN Co SAU, sch 12, cl 2.1(b).

¹⁰⁵ NBN Co has distinguished between those obligations that relate to the terms of NBN Co’s SFAA (and thereby commitments it is making to Access Seekers) and those that relate to an executed “access agreement” (and thereby commitments it is making to existing RSPs).

forum). It remains unclear why different approaches have been taken for different concepts.

The consequence of these features is that many of the non-price commitments may operate to undermine RSP certainty (by locking in discretions, locking out the ACCC or providing an avenue to “undo” the NBN Co SAU through the terms of the WBA) rather than provide the RSP certainty that NBN Co advocates.

5.1.3. Outline of this section

As referred to earlier in this submission (see section 1), Telstra remains of the view that the NBN Co SAU could provide a very effective regulatory tool for the industry, providing NBN Co and RSPs alike with certainty in relation to material terms of supply.

Telstra provides feedback in relation to certain non-price terms throughout this section 5. The feedback is intended to:

- identify material aspects of supply that Telstra believes should be, but have not been, covered by the NBN Co SAU;
- assess the merits of the non-price terms that have been set out in the NBN Co SAU; and
- provide suggestions, where possible, to achieve certainty in a way that balances NBN Co's and RSPs' needs (noting that these are often driven by competing pressures).

This feedback is not exhaustive. It is intended to identify a number of key areas for further consideration by the ACCC.

This section 5 is structured to align with the order in which the ACCC's Supplementary Consultation Paper addresses non-price terms and conditions, with priority given to a series of material matters that were not addressed in the NBN Co SAU.

5.2. Key non-price terms and conditions

5.2.1. Intellectual Property

5.2.1.1. Background

Recognition and appropriate treatment of an RSP's intellectual property rights (IPR) (both current and future) are fundamentally important to preserving the value of those assets and enabling a collaborative working environment between NBN Co and RSPs. The same principle applies to IPRs that an RSP may access from third parties.

Telstra believes that any contractual regime dealing with an RSP's IPR must not compromise or undermine the economic and competitive value of IPR to RSPs and their shareholders. It must also provide an incentive for future innovation and collaboration. Without this, RSPs, downstream customers, end-users and ultimately the industry itself will be negatively impacted.

5.2.1.2. Assessing NBN Co's position

The non price terms and conditions in the NBN Co SAU only address IPR in the limited context of product development (set out in Schedule 6 to the SAU). Given that the NBN Co SAU remains silent on IPR in other contexts, the overall IPR regime can only be assessed having regard to the terms of the WBA.

IPR in the NBN Co SAU and WBA

Accordingly, it is critical for the ACCC to consider the WBA alongside the NBN Co SAU. Together, the WBA and the NBN Co SAU establish an IPR regime that:

- asserts NBN Co's ownership of all IPR in the "Products" (notwithstanding the likelihood of third party inputs, including from RSPs);
- mandates a licence of "Customer Background IPR"¹⁰⁶ to NBN Co on broad terms, for no consideration, as a condition of supply - the licence is granted without any specificity as to the IPR necessary for NBN Co to exercise its rights and perform its obligations under the WBA;
- mandates an assignment of IPR developed "pursuant to the Agreement" to NBN Co, for no consideration, as a condition of supply;
- mandates a perpetual licence and/or assignment of valuable IPR (including "Customer Background IPR" and third party IPR), for no consideration, as a condition of participation in the PDF; and
- requires RSPs to provide a series of warranties and indemnities, including in relation to third party IPR, to ensure NBN Co receives full value in the IPR referred to above as part of the terms of the WBA or as a condition of participation in the PDF.

Telstra believes that such a scheme is not appropriate for the treatment of an RSP's IPR.

Competing objectives in relation to IPR

Telstra acknowledges NBN Co's objective to have long-term certainty as to its IPR in the Products (including enhancements and modifications). However, it appears that NBN Co considers:

- there is something inherent in the nature of the NBN Co / RSP supply relationship that justifies a "transfer" of all "Customer Background IPR" to NBN Co in order to supply Products under the WBA (i.e. as a condition supply); and
- that participation in the PDF must necessarily require extensive IPR related commitments at the time of submitting an idea, irrespective of whether that idea is ultimately productised by NBN Co.

Telstra believes that NBN Co's proposed IPR structure will negatively impact the industry as a whole. Telstra believes that the NBN Co SAU and WBA model:

- is inconsistent with the positions adopted in the wholesale market at this time, both domestically and internationally. For example:
 - when considering the domestic market, Telstra does not seek to impose these obligations on its wholesale customers and previous regulated non-price terms

¹⁰⁶ Defined in the WBA to include "...any Intellectual Property Rights owned by Customer or a Related Body Corporate of Customer, whether coming into existence before or after the Execution Date...".

-
- do not seek to impose similar terms and conditions;¹⁰⁷ and
- when considering international examples:
 - in New Zealand, under the Chorus UFB Services Agreement, the only licensing or transfer of IPR is from the supplier to the acquirer;¹⁰⁸
 - in Singapore, the terms provide for the parties to negotiate arrangements regarding new intellectual property that has been jointly developed by the parties under the agreement and there are no default licences granted by the acquirer of wholesale products;¹⁰⁹ and
 - in the United Kingdom, the only licences contained in the BT Wholesale Master Services Agreement are from BT (as supplier) to the acquirer to enable it to use software, documentation and materials provided as part of its wholesale service;¹¹⁰
 - fails to recognise the economic and competitive value of IPR to RSPs and their shareholders;
 - does not appreciate that attributing commensurate value to IPR fosters innovation by incentivising RSPs to develop new IPR in order to remain competitive, ultimately benefiting consumers;
 - makes the mandatory acquisition (by way of broad licence or assignment) of IPR (on unjust terms) a condition of supply. Telstra remains concerned that this mandatory approach is only conceivable due to NBN Co's monopoly position in relation to upstream supply;
 - dampens the incentive for RSPs to participate in the PDF, or otherwise become involved in new product development;
 - has the potential to reach into competitive layers of the industry (through layer 3 awareness and NBN Co's participation in certain retail markets such as government utilities), undermining core policy objectives; and
 - puts RSPs at a disadvantage to other IPR owners (potential vendors to NBN Co) merely by virtue of their status as an acquirer of NBN Co's products.

¹⁰⁷ ACCC, *Model Non-Price Terms & Conditions Determination 2008 made under section 152AQB of the Trade Practices Act 1974 (Cth)*, ACCC,

<<http://www.accc.gov.au/content/item.php?itemId=849828&nodeId=c52a075c80666405125162bd265e7c04&fn=Final%20Determination%20%E2%80%93%20Model%20Non-price%20Terms%20and%20Conditions.pdf>>.

¹⁰⁸ Chorus UFB Services Agreement General Terms, cl 14 (Intellectual Property Rights), in particular clauses 14.2 and 14.3, available at

<<http://www.crownfibre.govt.nz/media/17778/chorus%20ufb%20services%20agreement%20general%20terms.pdf>>.

¹⁰⁹ IDA Singapore, *Nucleus Interconnect Pte. Ltd Master Interconnection Offer (ICO) Agreement*, IDA Singapore, <http://www.ida.gov.sg/doc/Policies%20and%20Regulation/Policies_and_Regulation_Level3/20100503153659/Master_ICO.pdf> see clause 14 in particular clauses 14.3-14.5.

¹¹⁰ British Telecommunications PLC Master Services Agreement for the provision of BT Wholesale Products & Services, available online at https://www.btwholesale.com/shared/document/Library/Pricing_and_Contractual_Information/BTW_Master_Services_Agreement/MSA_GTCs_Issue_3_0_290509.doc, accessed on 24 March 2012, see clause 16.

While Telstra will continue to advocate that the intrinsic economic and competitive value of IPR be appropriately recognised in the WBA (consistent with its previous public submissions in relation to the WBA),¹¹¹ Telstra believes the NBN Co SAU should confirm and enshrine appropriate intellectual property principles and not defer these issues to the WBA.

A “whole of approach” review is therefore required to address the shortfalls in the NBN Co SAU and the WBA.

5.2.1.3. Proposed principles

Overriding principles

Telstra considers that any IPR regime must not compromise or undermine the economic and competitive value of IPR to RSPs and their shareholders. It must also appreciate that attributing commensurate value to IPR fosters innovation, including by incentivising RSPs to develop new technologies to remain competitive, ultimately benefiting consumers.

Given the significance of this issue, Telstra has carefully considered the details of a regime that could, on the one hand, provide NBN Co with certainty about its supply and product development related commitments, while on the other hand, preserving the overriding principles discussed. These details are set out in the Appendix D to this submission.

5.2.2. Enabling Downstream regulatory compliance

5.2.2.1. Assessing the NBN Co SAU

Telstra acknowledges that NBN Co operates in a legislative environment governed by a number of obligations that are specific to it.¹¹² RSPs, in turn, operate downstream with their own regulatory obligations,¹¹³ many of which may not be directly imposed on NBN Co and/or may be unique to a particular RSP. By way of example, at this time:

- Telstra faces service performance obligations under the Universal Service Obligation (USO)¹¹⁴ and its licence condition to provide Priority Assistance (PA);¹¹⁵ and
- all RSPs are subject to the legislated Customer Service Guarantee (CSG) standard obligations¹¹⁶ and to the Australian Consumer Law.¹¹⁷

Regulatory obligations on RSPs will also evolve over time. While it is right to consider the regulatory environment at this point in time, and these commitments should drive the content of the WBA to enable immediate compliance, it is also important to have a regime in place that can adapt to a changing legal and regulatory landscape.

¹¹¹ Telstra Corporation Limited, *Submission to the Australian Competition and Consumer Commission in response to the NBN Co Limited Special Access Undertaking Consultation Paper*, 20 January 2012.

¹¹² Not least of all the *National Broadband Network Companies Act 2011* (Cth) and the *Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Act 2011* (Cth).

¹¹³ For the purposes of this section, reference to “regulatory obligations” is a reference to all obligations applicable to the RSP at law, whether under statute, regulatory instrument/direction, licence condition or otherwise.

¹¹⁴ *Telecommunications Act 1997* (Cth); *Telecommunications (Consumer Protection and Service Standards) Act 1999* (Cth).

¹¹⁵ Telstra is the only carrier required to provide priority assistance services to its customers as a condition of its Carrier Licence.

¹¹⁶ *Telecommunications (Consumer Protection and Service Standards) Act 1999* (Cth); Australian Media and Communications Authority (Cth), *Telecommunications (Customer Service Guarantee) Standard 2011*, F2011L00413, 11 March 2011.

¹¹⁷ CCA, sch 2.

Given NBN Co will (indirectly) set the terms and conditions of downstream supply through its WBA, an RSP's ability to meet its own regulatory commitments, whether now or in the future, will be directly affected by the extent to which NBN Co enables this compliance.

The NBN Co SAU does not address the issues raised above. Given this, in assessing the "reasonableness" of the NBN Co SAU, the ACCC will need to also consider the specific terms of the WBA.

Although the WBA recognises certain downstream obligations (e.g. CSG and PA), it remains Telstra's view that the WBA does not adequately address or enable compliance with regulatory obligations at this time. By way of example, in the WBA:

- migrations are considered to be non-CSG eligible and connection timeframes (and associated appointments) for migrations are outside of the CSG timeframes;¹¹⁸
- there is no "headroom" provided by NBN Co on PA timeframes;¹¹⁹ and
- it is not clear whether RSPs will be able to back-to-back their upstream commitments in the face of "Unfair Contract Terms" obligations.¹²⁰

Furthermore, neither the NBN Co SAU nor the WBA look to set out commitments to address downstream regulatory obligations as they evolve.

While these factors have a direct "compliance" effect on the RSP, ultimately, RSP non-compliance will impact upon end-users.

5.2.2.2. Proposed principles

Telstra believes that NBN Co should consider taking a principles-based approach into account for both current and future regulatory obligations imposed on RSPs. This could manifest in the following ways:

- an express acknowledgement of the role that NBN Co plays in enabling compliance with downstream regulatory obligations (both current and future) and a commitment that NBN Co will develop and maintain its terms of supply to enable this compliance;
- NBN Co commitments to ensure downstream regulatory compliance by providing adequate "headroom" referable to RSP regulated timeframes, deferring to RSP legislative or regulatory instruments as a baseline for setting this "headroom";
- NBN Co commitments that minimum service delivery standards will be set to enable downstream regulatory compliance (noting that these service delivery standards should not be a proxy for performance targets, but rather a performance minimum);
- RSP contractual relief if compliance with a downstream regulatory obligations would result in non-compliance with the WBA;
- RSP rights to withhold amounts due to NBN Co, or be recompensed for amounts paid to end-users, in circumstances where NBN Co does not enable regulatory compliance; and

¹¹⁸ Australian Media and Communications Authority (Cth), *Telecommunications (Customer Service Guarantee) Standard 2011*, F2011L00413, 11 March 2011, pt 2, div 2.

¹¹⁹ *Telecommunications (Consumer Protection and Service Standards) Act 1999* (Cth).

¹²⁰ See the unfair contract terms regime in the CCA sch 2, pt 2.

- a review mechanism through which an RSP can request an independent third party (the ACCC may well be appropriate given the end-user impact) to ensure the terms of supply enable compliance.

5.2.3. WBA Development and Access Agreement change management

5.2.3.1. Assessing NBN Co's SAU

NBN Co states in its supporting submission that its non-discrimination obligation makes it challenging for NBN Co to commit to make changes to the WBA in place with each RSP by agreement only.¹²¹

Telstra accepts that there are challenges for NBN Co in effectively implementing its non-discrimination obligation. Telstra also acknowledges that there is a need for certain flexibility in the terms of supply, to enable the arrangements to develop with time and so to preserve consistency across NBN Co's customer base for operational and technical reasons.

However, Telstra believes that NBN Co's need for flexibility must be balanced against the need for contractual, operational, procedural and commercial certainty for RSPs (which, in turn, can be "flowed-down" with confidence to downstream customers / end-users).

As noted by the ACCC, the "regulatory recourse" provisions set out in clause 6 of the NBN Co SAU will not apply to variations of existing access agreements.¹²²

As stated by NBN Co, clause 14.3 of Schedule 11 of the NBN Co SAU is intended to "*mitigate the impact of NBN Co's unilateral change rights on Customers*".¹²³

Telstra welcomes this initiative, including the commitment that NBN Co will always "*give prior written notice of the change to the Customer*".¹²⁴ However, Telstra submits that the approach adopted by NBN Co in relation to the "change management" could be further enhanced to achieve this objective.

Telstra makes the following specific observations about clause 14.3 of Schedule 11:

- Clauses 14.3(a) and (c) confirm that NBN Co can make changes in accordance with an existing WBA. By deferring to the WBA, the NBN Co SAU does not provide certainty about the specific change mechanisms.
- Clause 14.3(d) provides an additional "right" for NBN Co to change an Access Agreement through consultation. This is drafted as a "right" to exercise changes, not an obligation to follow this process. Accordingly, it is unclear when NBN Co would exercise change rights in this way.
- Clause 14.3(d) only applies in circumstances that are not already set out in the WBA.¹²⁵ Given the WBA contains a comprehensive (near exhaustive) list of change rights, it is difficult to envisage the circumstance where clause 14.3(d) would apply.

¹²¹ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 7.5.19.

¹²² ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, p 61.

¹²³ NBN Co, *Submission in Support NBN Co Special Access Undertaking*, 20 December 2011, para 7.5.19.

¹²⁴ NBN Co SAU, sch 11, cl 14.3(b).

¹²⁵ This is slightly at odds with the ACCC view, that the effect of clause 14.3(d) is that NBN Co "must follow" the procedure set out in this clause.

Given the NBN Co SAU largely defers to the WBA on this point, it is necessary to consider the change rights set out in the WBA itself. These rights are heavily in favour of NBN Co and, while consultation is prescribed in certain circumstances, the decision to implement change ultimately resides with NBN Co. Some limited examples include:

- the notification and consultation periods are generically applied and commonly insufficient to fully determine operational, procedural, product and cost impacts of changes on RSPs and end-users;
- the right for NBN Co to unilaterally impose (and change) binding “Business Rules” (including NBN Co’s “Fair Use Policy”¹²⁶) without agreement and only limited consultation requirements;
- the right for NBN Co to make minor variations or enhancements based on whether NBN Co considers the change to have a “material adverse impact”;¹²⁷
- the right for NBN Co to make changes to the PDF Processes in accordance with the terms of the PDF Processes (a document drafted by NBN Co); and
- the right for NBN Co to change the terms of the Operations Manual (a document that contains aspects of supply that extend beyond the purely “operational”).¹²⁸

It also appears that the WBA, itself, confines the scope for ACCC intervention to changes not covered by the list of change scenarios set out in the WBA. The combined effect of both the NBN Co SAU and the WBA is that the ACCC’s role may well be limited when there is a change proposed by NBN Co.

5.2.3.2. Proposed principles

Telstra submits that the NBN Co SAU should provide a stand-alone change management framework that can be assessed without the need to consider the change mechanisms that are available to NBN Co under the WBA.

To this end, consideration should be given to a framework guided by the following general principles:

- recognition that the need for industry confidence and stability is important and that this must not be undermined by contractual uncertainty;
- recognition that it is the impact of the relevant change that should determine the level of consultation and consensus that is needed, rather than the “type” of change (i.e. the extent of the impact on each of NBN Co, the RSP and (importantly) end-users should be assessed);
- changes must be proportional (i.e. – do no more than is necessary to adequately

¹²⁶ This is a document which is loosely defined in the WBA dictionary as a “policy of that name published from time to time by NBN Co applicable to the Products”.

¹²⁷ The phrase “material adverse impact” is not defined. In any event, it appears to set a significantly high threshold for unilateral changes that can be imposed on as little as 30 business days notice and without consultation.

¹²⁸ WBA, clauses F4.1(h) and F4.1(j). Significant issues are dealt with in the supporting documents (e.g. service levels and associated rebates). It follows that any change to these documents could potentially have significant impacts on Access Seekers and downstream customers. There is no requirement for NBN Co to consider these impacts when making changes of this kind.

address the reason for making the change);

- clear guidance and certainty should be provided on matters material to RSPs and end-users, for example product withdrawal and product development / enhancement through the PDF;
- there should be no scope to change “ancillary documents” (for example, Business Rules) as a means to circumvent the agreed change processes;
- a distinction should be made between changes that are “operational” or “procedural” as opposed to “commercial” or “legal”, and the process for effecting these changes should be different (i.e. there can be more flexibility for NBN Co in genuinely operational matters that have no detrimental impact on the RSP or end-user); and
- the change processes should include escalation, dispute and ACCC intervention rights, as well as compensation / remediation obligations where a change has been notified by NBN Co and is either not implemented or delayed, or otherwise has a detrimental impact on the RSP without notification / consultation procedures being adhered to.

5.2.4. Dispute Resolution

5.2.4.1. Assessing the NBN Co SAU

To be effective, a process for resolving disputes must be respected and regarded as legitimate by all of the parties to it. To achieve this status, Telstra believes a dispute resolution system should embody the following characteristics:¹²⁹

- the process should be just, efficient and certain;
- dispute resolution facilitators/decision makers should be independent, impartial and appropriately qualified;
- all parties who are materially affected by a dispute should have the opportunity to be heard and have their evidence and submissions taken into account; and
- in the case of NBN Co, the Non-Discrimination Obligation should be appropriately and consistently applied.

Schedule 12 of the NBN Co SAU (Dispute Management Rules) is largely consistent with these characteristics,¹³⁰ including through the following features:

- the ability for third parties to apply to be joined as parties to the dispute where the outcome of the dispute could materially affect their interests;
- referral of any disagreement about appointments of the Resolution Advisor and Pool Members to an independent authority, namely, the President of the IAMA;

¹²⁹ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 7.4.1, which concludes that it is necessary that “NBN Co and Customers have certainty of access to a stable dispute resolution process” and that the dispute process should be “robust, speedy, open and non-discriminatory”.

¹³⁰ Telstra also notes that the Dispute Management Rules have been largely derived from the dispute resolution process under Chapter 8 of the National Electricity Rules (the NER Process), a process which has now been in effect for more than a decade. However, importantly, the telecommunications industry is a significantly more dynamic sector and the dispute resolution process (under both the SAU and WBA) needs to accommodate these aspects of the industry.

- the use of arbitration, under the *Commercial Arbitrations Act 2010* (NSW), as the default dispute resolution process; and
- the reasonably short timeframe allowed for the resolution of the dispute by Panel Arbitration (with provision for any necessary extensions of time).

Telstra is concerned, however, that Schedule 12 does not provide sufficient detail at this time (deferring to the WBA) and, accordingly, efficacy of the commitments will depend on how they are incorporated and implemented in the WBA.

5.2.4.2. Proposed principles

To provide “*certainty of access to a stable dispute resolution process*”¹³¹ and “*sufficient clarity to ensure that parties understand the rights and obligations that arise*”,¹³² Telstra submits that details of the Dispute Management Rules contained in the WBA could be imported into Schedule 12 of the NBN Co SAU, subject to appropriate amendments, including the following:

- Strengthening the independence and impartiality of the Resolution Adviser and Pool Members.¹³³ For example:
 - Providing an appropriate degree of oversight and transparency in relation to the engagement of the Resolution Advisors and Pool Members.
 - Providing the Resolution Advisors with the same tenure as Pool Members. Alternatively, making decisions to remove a Resolution Adviser subject to a finding by an independent person such as the President of the IAMA.
 - Rather than having a Resolution Advisor appoint a Panel from the Pool, having each of the initial parties to a dispute each appoint one Pool Member to the Panel. Those nominated would then together agree on the appointment of the third Panel member from the Pool, who will chair the Panel.
 - Having an independent party (such as a Panel or the Resolution Adviser), rather than NBN Co, determine the criteria to be applied by a Panel when deciding if a party is materially affected by an Industry Relevant Dispute.
- Recognising that the substance of the disputes which are likely to arise will be varied, and some will be technically complex, which will require the appointment from the Pool of a Panel that has appropriate expertise to deal with the intricacies of that particular dispute. This will require that some Pool Members have more than just an understanding of the Australian telecommunications industry. In some disputes, it might be more appropriate that a Panel member have less dispute resolution experience but more specific technical expertise.
- Including more specific guidance, including materiality thresholds, on matters which will be classified as Industry Relevant Disputes rather than Bilateral Disputes.

¹³¹ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 7.4.1.

¹³² ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 7.2.

¹³³ Although NBN Co states that it has “devised safeguards against bias and the appearance of bias”, (NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 7.4.5) Telstra is concerned to ensure there is no potential for actual or perceived bias.

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- Providing a process by which a party may apply to fast-track a dispute where a quick resolution is imperative, for example, where a party may be materially compromised by an ongoing obligation to perform, or alternatively for a relatively minor dispute (e.g. a minor operational matter).
 - Including clear joinder guidelines, in order to assure RSPs of eligibility to participate in matters affecting them.
 - Enabling a dispute to be referred by the Panel to the ACCC, where the Panel considers it is more appropriately dealt with by the ACCC.
 - Not precluding RSPs from raising disputes (recognising that this must be balanced against the raising of frivolous or vexatious disputes).
 - Including clear guidelines on the circumstances where judicial intervention is appropriate.
 - Including clear principles as to how the non-discrimination obligation is to be applied in the context of dispute resolution, and preserving the role of the Federal Court of Australia as the ultimate arbiter of this.¹³⁴

5.2.5. Default Management

5.2.5.1. Assessing the NBN Co SAU

Telstra acknowledges that NBN Co needs to retain the ability to exercise certain pre-agreed remedies or undertake service related intervention, particularly when there is a threat to safety or network integrity during emergencies. Telstra also acknowledges that these may be appropriately triggered following a breach of a provision in the WBA by the RSP.

However, it is important that all parties have certainty about:

- the specific circumstances when NBN Co is able to exercise pre-defined contractual remedies, the process required to be followed before those remedies are able to be exercised and the precise nature of those remedies; and
- the nature of remedies available to the RSP, noting that disconnection of ordered products / termination of the WBA are largely illusory remedies for an RSP when there is no alternative supplier.

The NBN Co SAU sets out NBN Co specific “Default Management” commitments in clause 12 of Schedule 11. While Telstra welcomes these commitments, Telstra notes they are very limited and simply reflect ordinary commercial supply principles.¹³⁵

Notwithstanding this, the NBN Co SAU gives no certainty as to the scope of the remedies and when they can be exercised. The practical effect is that NBN Co is able to determine the

¹³⁴ Under the current terms of the Dispute Management Rules, the Panel must have regard to the Non Discrimination Obligation when deciding whether to join a party to a dispute and an Expert must have regard to whether its decision will require NBN Co to treat any customer in a manner that does not comply with the Non Discrimination Obligation. To ensure consistent application and interpretation of this obligation between the Panels and the Experts, there should be an avenue for review by the Court of their decisions in that regard.

¹³⁵ The commitment in Schedule 11 clause 12 is limited to notifying the RSP before exercising contractual remedies and ceasing to apply those contractual remedies as soon as reasonably practicable.

remedies that are available to the parties and the circumstances in which those remedies may be exercised, through the WBA.

When examining the terms of the WBA, it should be noted (amongst other things) that NBN Co is able to:

- impose, and exercise concurrently, potentially severe remedies (such as ordering freezes, service reductions, suspensions and disconnections) for a “material” default, which will necessarily affect the ability of RSPs to supply services to downstream customers and end-users; and
- “self define” the triggers for its own contractual remedies, because the question of whether a breach has occurred, and whether it is “material”, is largely subjective and a breach will arise if NBN Co “reasonably considers” it has occurred.¹³⁶

Telstra also notes that the NBN Co SAU does not preserve any RSP remedy options and, accordingly, NBN Co will be free to set (or limit) these without regulatory oversight. Under the WBA, the key remedies available to RSPs (including for material default by NBN Co) are escalation within NBN Co (an unsuitable remedy in and of itself) and/or a right to disconnect services or to terminate their WBA (an impractical remedy given there is no supply alternative). Service level rebates are also available for service level failure, however as discussed earlier in this submission, the WBA does not currently contain appropriate service levels or “compensatory” rebates.

5.2.5.2. Proposed principles

Telstra submits that the NBN Co SAU should provide more detail around the “default management” principles so that all parties can be assured that there is a balance between the need for NBN Co to take steps to deal with material breach and the need to ensure those steps are an appropriate and proportionate response to the relevant breach.

To this end, Telstra submits that the NBN Co SAU should contain further detail in relation to the application of NBN Co remedies consistent with the following:

- Remedies imposed by NBN Co should be a reasonable and proportionate response to the relevant breach. Accordingly, the suite of pre-defined contractual remedies should be limited and set out in the NBN Co SAU so that RSPs have certainty that NBN Co will not introduce further remedies through its rights to amend the WBA.
- Given the potential gravity of consequences, “material default” should be objectively determined (or, if it remains a subjective determination it should be open to challenge / review).
- Certain service performance affecting remedies (e.g. “service reductions” or service “choking”) should be reconsidered given the impact on the end-user in a situation where there may be no ability to take alternative supply. In any scenario, service performance affecting remedies should be a “last resort”.
- While an element of discretion may be required if the remedy is being exercised to protect health and safety, or network integrity, any relevant trigger event should be capable of being objectively and definitively determined.

¹³⁶ WBA, cl F5.1(a) – (b).

- Consistent with the ACCC's statement in the Supplementary Consultation Paper,¹³⁷ a defaulting party should be given a reasonable opportunity to rectify a breach prior to a pre-defined contractual remedy being applied.

In relation to RSP remedies, as noted above, disconnection or termination are unlikely to be particularly effective in the NBN context given there are no alternatives to NBN Co supply (and also given that these rights should be available to an RSP for convenience in any case). The NBN Co SAU should include appropriate RSP remedies (including access to common law remedial rights) where NBN Co has failed, is unable or has refused to comply with the terms of the WBA. Failure to include appropriate RSP remedies will place significantly more pressure on NBN Co to provide adequate service levels, associated rebates and potentially incentives to drive compliance. See the discussion earlier in this submission on service level expectations.

5.2.6. Risk management and liability

5.2.6.1. Assessing the NBN Co SAU

The management of risk and liability is of key significance to both NBN Co and RSPs¹³⁸, and Telstra acknowledges that there is a balance to be struck between the legitimate business interests and asset protection rights of the supplier with the requirements for supplier accountability.

The allocation of risk between the parties (and the willingness of a party to take on risk) is part of an overall value assessment. In the context of the NBN, the ability to reach an appropriate balance through negotiation is compromised because, in the absence of regulatory oversight, the terms of the WBA will be solely determined by NBN Co.¹³⁹

Telstra submits that an imbalance of risk allocation in favour of NBN Co could:

- create significant barriers to entry for many RSPs;¹⁴⁰ and
- perhaps more significantly, give those RSPs who do elect to contract with NBN Co (with no supply alternative) little choice but to take on the risk. In this circumstance, the only real avenue to mitigate disproportionate risk exposure is to flow this further downstream where legally permitted and possible.

Notwithstanding statements by NBN Co that the NBN Co SAU gives Customers "comfort" about certain aspects of the regime,¹⁴¹ Telstra submits that the current NBN Co SAU falls short for a number of reasons:

- the risk management principles are made expressly subject to the terms of the WBA, which may have the effect of "undoing" the NBN Co SAU commitment depending on how NBN Co addresses the issue in the WBA;¹⁴²

¹³⁷ ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 7.3.

¹³⁸ As acknowledged by NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 7.5.18.

¹³⁹ Telstra acknowledges that NBN Co has implemented a "Contract Development Process" to address concerns in relation to the transition to appropriate "long term" supply terms.

¹⁴⁰ A point noted by the ACCC in the ACCC report, *Model Non-Price Terms & Conditions Determination 2008*, November 2008, p 19.

¹⁴¹ See for example NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 7.5.18.

- the SAU touches on only a very small proportion of those matters that are material to any risk allocation model,¹⁴³ so there is a vast array of risk allocation principles left for NBN Co to set, at its discretion, in the WBA; and
- the NBN Co SAU, through references to “*the Wholesale Broadband Agreement or its subject matter*”, may extend the scope of the principles beyond the WBA itself, potentially encroaching on other contracted or non-contracted agreements relating to the “subject matter” of the WBA.¹⁴⁴

Given this, any assessment of the NBN Co SAU requires a parallel assessment of the WBA.

Telstra notes that the risk management regime in the WBA seeks to “codify” the liability regime in a manner that removes common law contracting principles and the backstop of judicial interpretation. It sets out a liability regime that is more detailed and comprehensive than any regime Telstra has encountered, whether domestically or internationally. The regime is drafted heavily in NBN Co’s favour and the complexity of the layered exclusions and limitations makes it difficult to ascertain the extent to which liability attaches to NBN Co. By way of limited example only:

- liability only applies when it has been “expressly accepted” by a party, however it is unclear how this will apply given there are no further statements “expressly accepting” liability;
- service level rebates are specified as the “sole and exclusive remedy” in the case of service level failure, however the WBA does not contain any “compensatory” rebates (effectively meaning that there is no compensatory recourse in the case of service level failure);
- NBN Co specific liability exclusions lack reciprocity and are so extensive that NBN Co appears to absolve itself of almost all liability (except in the case of fraud, limited instances of negligence and acts intending to cause loss); and
- the RSP is called upon to provide extensive indemnity protection to NBN Co, effectively uncapping the RSP’s liability in relation to a number of onerous obligations contained within the WBA, without reciprocity and with limited scope to conduct the defence of those claims.

Telstra submits that the practical effect of shifting risk to RSPs in this way is that:

- RSPs will be pressured to either absorb the risk or reflect the imbalanced risk profile by back-to-backing the exposure to downstream customers / end-users (to the extent to which this is legally or commercially viable);¹⁴⁵ and

¹⁴² Clause 13(a) makes a commitment in relation to “Indirect Loss” which applies “except as expressly provided otherwise by the Wholesale Broadband Agreement”; Clause 13(c) sets out a number of indemnity related commitments which are applied “subject to and in accordance with the terms of the Wholesale Broadband Agreement”. The ACCC also acknowledges the concern that commitments provided in clause 13 of Schedule 11 of the NBN Co SAU are expressed to be “subject to” the WBA or are qualified “except as expressly provided for” in the WBA (ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 7).

¹⁴³ The NBN Co SAU deals with “Indirect Loss” exclusions, uncapped liability for certain negligence or wilful acts / omissions and certain limited indemnity principles.

¹⁴⁴ ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 7.4.

¹⁴⁵ This issue has been acknowledged by the ACCC which notes that: “... if there are extensive protections in favour of NBN Co, it may result in customers including and enforcing strong protections in downstream customer or end-
Footnote continued on the next page

-
- the regime will provide limited incentives for NBN Co to take reasonable and prudent steps to manage risks which it is best placed to manage.

While Telstra acknowledges that it is legitimate for NBN Co to seek to limit its liability and exclude liability in certain limited circumstances, the WBA contains very little accountability for NBN Co beyond (currently very limited) service level rebates and certain specified “extreme” events e.g. fraud, limited instances of negligence, and acts intending to cause loss. In most other respects, the risk is carried by the RSP, either directly or through indemnity protection.

5.2.6.2. Proposed principles

Telstra submits that the NBN Co SAU should set out the details of a risk management framework which allocates risk fairly between NBN Co and RSPs and does not leave room for NBN Co to use the terms of the WBA to undo the commitments given in the SAU.

Industry positions on risk allocation are now relatively well settled and there does not appear to be any justification for NBN Co to adopt a risk allocation regime that departs from that generally adopted by the industry to date.

Given the current form of the NBN Co SAU and the WBA, Telstra acknowledges that this will require a substantial “whole approach” review including consideration of:

- liability for conditions implied or imposed by law;
- liability exclusions for consequential loss (and the extent to which this concept should be defined consistently with common law principles);
- appropriate liability caps and associated exclusions (e.g. exclusions for indemnities and payment of charges and rebates);
- indemnities for matters such as death and damage to tangible property arising from negligent or intentional acts, and the conditions that attach to indemnity obligations;
- circumstances where an indemnifying party can control the defence of a claim; and
- liability reductions when there is a failure to mitigate or where losses are caused or contributed by the indemnified party.

5.2.7. Confidential information

5.2.7.1. Assessing NBN Co’s SAU

Telstra agrees with NBN Co that it is important that RSPs are reassured that “*their confidential information will not be used or disclosed in ways which are unjustified or would harm their interests ...*”.¹⁴⁶ Telstra also acknowledges that this must necessarily be balanced by NBN Co’s need for information to enable it “*to deliver services under the WBA and comply with its regulatory obligations*”.¹⁴⁷

user contracts, which may result in limited customer choice and consumer detriment” (ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 7.4).

¹⁴⁶ NBN Co, *Supporting Submission NBN Co Special Access Undertaking*, 20 December 2011, para 7.5.16.

¹⁴⁷ *Ibid.*

These competing pressures have been in play in the telecommunications industry for many years. Telstra, itself, is subject to regulatory obligations that require disclosure of confidential information (in specific and defined circumstances).

The principles that achieve this balance are therefore relatively settled in the industry at this time.

Structural issues

Clause 11 of Schedule 11 of the NBN Co SAU exhibits similar structural flaws to those inherent in a number of NBN Co's other non-price commitments:

- a number of the confidentiality commitments are made expressly subject to the terms of the WBA (potentially “undoing” the NBN Co SAU commitment);¹⁴⁸
- the NBN Co SAU only covers a very small proportion of those matters that are usually evident in an effective confidentiality regime; and
- while the provisions in the NBN Co SAU that relate to “Network Information” are welcomed (because the WBA itself does not make it clear that such information is confidential), the NBN Co SAU again indirectly defers disclosure rights to those set out in the WBA.

The consequence of this structure is that the NBN Co SAU gives little certainty to RSPs in relation to principles of confidentiality.¹⁴⁹

Telstra has raised a number of concerns regarding the WBA confidentiality regime in response to the WBA consultation papers issued by NBN Co.¹⁵⁰ Telstra does not propose to restate these concerns in this submission, suffice it to say that Telstra continues to hold many of these concerns and the NBN Co SAU does little to resolve them.

As a general observation, the WBA is asymmetrical in its approach to the rights and obligations of the parties. It provides multiple layers of complexity which often result in NBN Co having extensive and overlapping rights to use and disclose information, with each option imposing different requirements in relation to the disclosure.

Misuse of confidential information

The ACCC suggested in its Supplementary Consultation Paper that:

... in the context of vertical integration, there may be competition concerns if the access provider were to use the confidential information of its downstream competitors (that is,

¹⁴⁸ □ Clause 11.1 of Schedule 11 sets out a commitment by NBN Co not to disclose any confidential information, but this does not apply “to the extent that NBN Co ... is otherwise permitted to do so under ... the Wholesale Broadband Agreement”; and Clause 11.2 of Schedule 11 limits disclosure rights to purposes “contemplated by ... the Wholesale Broadband Agreement or any other agreement between NBN Co and that Customer”.

¹⁴⁹ This has been noted by the ACCC where it said “This could mean that the circumstances in which confidential information may be disclosed or used by NBN Co under the SAU is largely within NBN Co’s own control, through the confidentiality terms included by NBN Co in the WBA.” (ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 7.5).

¹⁵⁰ See: Telstra Corporation Limited, *Response to NBN Co Consultation Paper: Introducing NBN Co’s Wholesale Broadband Agreement* (26 November 2010), p 5 and para 52-59, <<http://www.nbnco.com.au/assets/documents/telstra-26-nov-10.pdf>>; and Telstra Corporation Limited, *Response to NBN Co Consultation Paper: NBN Co’s Wholesale Broadband Agreement – Consultation II*, 17 June 2011), p 5 and para 106-121, <<http://www.nbnco.com.au/assets/documents/telstra-response-to-nbn-co-wba-17-jun-11.pdf>>.

*access seekers) to its advantage. In the NBN Co context however, this should be less of a concern.*¹⁵¹

Telstra would be concerned if this underlying principle was to influence the assessment of NBN Co's confidentiality commitments. Importantly:

- while NBN Co is “generally” restricted from supplying services at the retail level:
 - NBN Co will be able to participate at the retail level for the supply of services to the various utilities and other organisations that are covered by the exemptions in sections 10 to 16 of the *National Broadband Network Companies Act 2011* (Cth); and
 - it cannot be assumed that NBN Co will not be competing with RSPs at the wholesale level (given there is a legitimate NBN sub-wholesale market contemplated by the current regime); and
- NBN Co will be collecting significant volumes of information from the market and protection of this information is critical to maintaining the efficacy of downstream markets.

A lack of appropriate controls could result in use or disclosure of information that has a detrimental effect on industry confidence, innovation and competition which cannot be readily rectified (whether through the payment of compensation or otherwise).

Product development forum

NBN Co has separately referenced a confidentiality proposal for the PDF. In essence, the NBN Co SAU confirms that confidentiality in this context will be treated differently (however, it gives no indication as to the principles guiding product development related confidential information).

Clause 12(b) of the PDF Processes (as included in the NBN Co SAU) notes that all product development confidential information will be “*subject to the multilateral confidentiality agreement notified to Customers during registration for participation in the Product Development Forum*”. In doing so, it obliges RSPs to agree to the terms of the “multilateral confidentiality agreement” as a condition of participation, in much the same way as it makes IPR commitments a condition of participation.

This proposal does not provide certainty to RSPs about the terms that may apply to confidential information in this context. While NBN Co has published a form of “multilateral confidentiality agreement” as part of the WBA, this document does not satisfactorily protect the confidentiality of information supplied by an RSP in connection with the PDF (in fact if anything it enhances the use and disclosure rights for this information, thereby unreasonably prioritising the ambition of the PDF over usual principles of confidence).

Telstra submits that the lack of clarity on this issue in the NBN Co SAU will further reduce an RSP's incentive to participate in the PDF.

5.2.7.2. Proposed principles

Telstra submits that the NBN Co SAU should set out a comprehensive, stand-alone, reciprocal (with justified exceptions) set of confidentiality related provisions that can be

¹⁵¹ ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, para 7.5.

assessed on its merits without the need to delve into and unpack the layers of complexity which currently exist in the WBA.

These rights and responsibilities should provide an appropriate balance between:

- the legitimate interests of the discloser to ensure the confidentiality of its information is protected and not misused; and
- the legitimate needs for the recipient to use and, where necessary, disclose the information to third parties.

To this end, the NBN Co SAU should include measures which provide RSPs with confidence that:¹⁵²

- their confidential information will not “leak” (whether intentionally or not) to their competitors or any unauthorised third parties;
- the internal use and disclosure of information by NBN Co is appropriately ring fenced, and third party permitted use and disclosure is appropriately constrained and clearly defined;
- RSPs are able to use NBN Co confidential information for the purposes of supplying products or services on the NBN to downstream customers / end-users;
- downstream customer details, and RSP customer traffic, are considered to be the confidential information of an RSP, are adequately and appropriately protected, and are only required to be disclosed to NBN Co consistent with applicable laws (including privacy laws);
- product related confidential information submitted to the PDF is similarly protected and regulated;
- NBN Co will not use or disclose RSP information in a manner that would be likely to enable NBN Co to gain or exploit an unfair commercial advantage over RSPs in any market;¹⁵³ and
- appropriate, practical and legally compliant data security and privacy protections are in place.

These principles are consistent with industry best practice. Telstra sees no reason why the NBN Co SAU provisions should depart from the relatively settled confidentiality principles which have been accepted by industry as providing this balance.

¹⁵² Subject to settled positions on “Aggregated Information” and the treatment of this information as “non-confidential”.

¹⁵³ This is a similar commitment to the commitment given by Telstra in clause 10.3 of the SSU. A further example can be found in clause 10.2 of BT Openreach *Contract for Generic Ethernet Access Service Conditions*, 16 July 2010.

5.2.8. Billing, payment and credit management

5.2.8.1. Assessing NBN Co's SAU

Clear charging (and payment-related) principles are vital for RSPs to effectively manage their payment processes with NBN Co, as well as to facilitate clear and certain contracting with downstream customers and end-users.

While the NBN Co SAU seeks to address certain specific “billing and payment” and “credit management” non-price terms and conditions, these are limited.¹⁵⁴ Specifically, in relation to those aspects covered by the NBN Co SAU, Telstra submits that:

- commitments to “ensure that the Wholesale Broadband Agreement includes processes in accordance with which Customers can raise a billing dispute”¹⁵⁵ do not provide any certainty as to what those processes will be (or even the principles that would guide those processes);
- while commitments to ensure that the WBA gives RSPs the right to withhold disputed amounts¹⁵⁶ and includes obligations on NBN Co to pay interest¹⁵⁷ are welcome, the NBN Co SAU provides only limited comfort in relation to a limited scope of billing and payment concepts. The NBN Co SAU is silent on a number of other substantive charging principles, some of which were raised in Telstra’s Response to the ACCC’s First Consultation Paper on NBN Co’s SAU as examples of matters that should form part of the NBN Co SAU consultative process;¹⁵⁸ and
- commitments to “develop, publish and maintain a credit policy” and to then “comply with that policy” do not provide any certainty as to the content and application of that policy.¹⁵⁹

Telstra also notes that the NBN Co SAU billing and payment commitments merely confirm principles that are evident in most commercial supply arrangements. While clarity is welcomed, the NBN Co SAU would be a more effective document if it provided certainty across a broader suite of charging and payment related concepts.

5.2.8.2. Proposed principles

To this end, Telstra would expect to see principles included in the NBN Co SAU that give RSPs comfort that billing, payment and credit management processes will:

- leverage off accurate, verifiable data; and
- provide RSPs with certainty of charging terms, and that those terms will be clearly and consistently applied.

Telstra submits that the NBN Co SAU should include a broader and more detailed range of billing, payment and credit management commitments to address these principles.

¹⁵⁴ For example, the billing and payment commitments are limited to: (a) giving RSPs the ability to raise billing disputes; (b) giving RSPs the ability to withhold disputed amounts; and (c) imposing interest payments on NBN Co for amounts overpaid by an RSP (NBN Co SAU, sch 11 cl 8).

¹⁵⁵ NBN Co SAU, sch 11, cl 8.1.

¹⁵⁶ NBN Co SAU, sch 11, cl 8.2.

¹⁵⁷ NBN Co SAU, sch 11, cl 8.3.

¹⁵⁸ Telstra Corporation Limited, *Submission to the Australian Competition and Consumer Commission in response to the NBN Co Limited Special Access Undertaking Consultation Paper*, 20 January 2012, para 13.

¹⁵⁹ NBN Co SAU, sch 11, cl 9.

Specifically, Telstra submits that the NBN Co SAU should contain a mechanism, or appropriate in-built flexibility, to enable RSPs to verify the accuracy of billing data, particularly in the early stages of NBN Co's operations where manual work-around solutions and new B2B interfaces may impact on accurate or timely data collection. This could manifest itself through:

- mechanisms to ensure that accuracy is not “deemed” but is based on verifiable data (particularly during early periods in the life of NBN Co's billing platform);
- RSP flexibility in relation to the right to raise billing disputes, noting that this must be balanced against the need to prevent vexatious or frivolous disputes (which must be applied in a proportionate and non-arbitrary manner);¹⁶⁰
- RSP flexibility in relation to billing medium requirements, so that RSPs are provided with sufficient time to manage the evolution of NBN Co's billing platform and the impact that this may have on the RSP's downstream billing and payment systems (this is particularly important given the potential for significant RSP expenditure based around NBN Co billing platform solutions); and
- clarity in the NBN Co SAU in relation to how NBN Co will distinguish between billing disputes and general disputes, recognising the need for flexibility in each of these processes to address the principles set out above.

In relation to credit management, while Telstra recognises this is an area where NBN Co may need to depart from strict interpretations of non-discrimination,¹⁶¹ Telstra submits there are ways in which NBN Co can provide certainty to RSPs through the NBN Co SAU, including by:

- setting out specifics in relation to those aspects which NBN Co currently intends to defer to the “Credit Policy”; and
- providing a baseline creditworthiness floor (i.e. an acceptable credit rating, consistent with the terms of the WBA at this time) which gives RSPs that are above this floor comfort that they will not be subject to a credit review or be required to provide financial security.

In relation to those charging matters that are not currently contemplated by the NBN Co SAU, Telstra submits that that NBN Co SAU should include:

- principles associated with the application of minimum term commitments and break fees (recognising that break fees or early termination fees ordinarily apply to recoup bespoke investment or discounted/reduced charges provided on the basis of a term commitment – two scenarios which do not apply in the NBN context). The ability of RSPs to place product disconnection orders for convenience should similarly be addressed (and enabled) in this context;
- commitments to ensure that NBN Co does not charge for products or services that are not received by an RSP, particularly when delay or cessation of supply is due to an NBN Co act or omission or a matter otherwise outside the control of the RSP. Telstra notes

¹⁶⁰ The current approach included in clause B5.6 of the WBA (potentially) arbitrarily restricts an RSP's right to raise a billing dispute for 12 months where the RSP has raised 3 or more billing disputes in any 6 month period and in at least 3 (or more than half) of those billing disputes it is determined that there was no error in the charges.

¹⁶¹ Telstra notes that the CCA specifically contemplates exceptions to the Category B SAOs to address credit management issues (CCA s152AXB(7)(a)).

that this necessarily involves clarity around when billing for the RSP starts and stops as well as the various circumstances in which charges should not apply, and that these principles should not be compromised by inefficiencies in NBN Co's implementation processes;

- principles to ensure certainty of billing processes, including whether invoices will be issued in advance or arrears (and how the right to withhold disputed amounts is to be implemented for invoices issued in advance), as well as proportional consequences for failure to make payment by the due date; and
- principles associated with the pass-through of tax costs, including specifically to ensure that the trigger event for any pass-through is tax related, that the pass-through is limited to new taxes applicable to NBN Co only, and that the taxes are directly related to network / infrastructure.

5.2.9. Points of interconnect

5.2.9.1. Assessing NBN Co's SAU

The number and location of the POIs in the NBN is of critical importance to the future operation, functioning and structure of the telecommunications industry in Australia.

The NBN Co SAU provides NBN Co reasonable flexibility to conduct a review of POI locations (with a compulsory 5 yearly review and a more general review discretion, which NBN Co may not commence within 12 months of the completion of a previous POI review).

While there is a stated intention to consult, and the review process provides some guidance to industry on how the review will be conducted, there are few details on the nature and extent of the consultation (including how NBN Co will assess RSP contributions during these consultations). It is also appears that the NBN Co SAU is designed to only enable NBN Co to initiate a review, not RSPs.

In relation to POI closures and relocations:

- the NBN Co SAU appears to require the ACCC to approve the closure or relocation “*in accordance with the published results of the POI review*”;¹⁶² and
- the applicable commitments to seek approval from the ACCC are drafted as discretions and it is unclear whether by stating “*NBN Co may...*”, NBN Co is intending for this to read “*NBN Co may only...*”.

As a consequence of this construct, it remains unclear whether the ACCC will be obliged to accept the outcome of a POI review and whether NBN Co anticipates having the discretion to bypass the ACCC.

Furthermore, apart from the commitment to provide 6 months' notice of the closure of a temporary POI, there are no commitments in the NBN Co SAU in relation to temporary POIs.

5.2.9.2. Proposed principles

Notwithstanding the mitigating factors referred to by the ACCC (i.e. the Category B SAOs),¹⁶³

¹⁶² NBN Co SAU, sch 11, cl 6.4.

¹⁶³ ACCC, *NBN Co Special Access Undertaking Supplementary Consultation Paper*, February 2012, p 71.

Telstra submits that robust and timely consultation relating to the establishment of new POIs, and POI closure or relocation, remains essential.

Telstra also believes that the NBN Co SAU should acknowledge, and all POI number and location decisions should be subject to, the overriding principles of promoting the LTIE (including by ensuring that the current number of POIs will not become a proxy ceiling on POI numbers).

Further detail also needs to be included in the NBN Co SAU in relation to potential POI changes. Specifically, the NBN Co SAU should:

- include the principles to be applied in determining technical and operational feasibility of further potential interconnection points, to provide clarity to industry as to where it may make sense to build or buy backhaul;
- ensure that as much notice as possible is given to RSPs about any changes to existing POIs or the introduction of new POIs (whether temporary or permanent) with the minimum notification requirements assessed relative to the impacts on both NBN Co and RSPs;
- provide detail in relation to transition period arrangements, including whether there will be any change in POI management protocols during a notice period;
- provide contingency and back-up commitments in the case of material technical failure at a POI (including disaster recovery principles and guidance on how RSPs will be managed in this scenario); and
- consider the impact on RSPs planning activities resulting from inaccurate or incomplete POI change details, and provide measures to adjust POI notice periods to account for the impact of incorrect or incomplete information.

5.2.10. Management of multiple service providers and end-user premises issues

5.2.10.1. Assessing NBN Co's SAU

At any one point in time, NBN Co will be managing upstream backhaul interconnect parties, as well as multiple RSPs providing services at end-user premises (and consequently indirectly managing many downstream customers and end-users).

Effective management of these various parties, and the interaction between them, will be critical to the success of the NBN. While the complexity inherent in NBN Co's role will be particularly acute during the initial roll out phase of the NBN, it remains an issue that will require careful management on an ongoing basis.

Telstra acknowledges that NBN Co has a unique challenge with regards to the management of multiple RSPs. While Telstra is familiar with the dynamics associated with managing multiple RSPs on existing networks, it believes that the issues inherent in NBN Co's approach will become clearer with time. Given the relatively limited roll out to date, the issues impacting RSPs have been relatively self-contained and manageable. Once the NBN roll out gets into "full swing", these issues will become more acute and will be felt by NBN Co, RSPs, downstream customers and ultimately the end-user.

At the same time there are likely to be a range of industry associated processes relating to migration and post-migration activities where NBN Co will need to complete a range of steps to

ensure customer-impacting changes operate smoothly, e.g. the steps NBN Co will take in effecting smooth migrations of customers from copper to fibre and post migration transfers between RSPs (currently being progressed and trialled with the Communications Alliance).

To minimise disruption, and ensure a smooth transition to the NBN, these difficult issues need to be considered now and wherever possible, provided for in the NBN Co SAU.

Telstra acknowledges that NBN Co has given commitments in the NBN Co SAU in relation to common property. In clause 10 of Schedule 11, NBN Co accepts responsibility for acquiring consents to access common property where this is required by NBN Co.

It is not clear, however, why NBN Co does not also secure these access rights for its RSPs at this time (particularly given the significant disruptions likely through NBN Co's roll out). NBN Co's approach has the potential to create a very poor end-user experience, particularly if multiple parties seek consents at different times for ostensibly the same activity i.e. providing an NBN service to an end-user.

Apart from the management of common property consents, the NBN Co SAU does not appear to address end-user premises issues and the need to clearly delineate responsibilities between NBN Co and RSPs, and between RSPs themselves.

Accordingly, the terms of the WBA must be reviewed to confirm NBN Co's approach. As stated earlier in this submission (refer to section 5.2.6, Risk Management and Liability), NBN Co has sought to deal with this issue by, in part, transferring responsibility and risk downstream.

Various examples of this appear throughout the WBA:

- NBN Co pushes significant “on-premises” network management responsibilities, risks and costs to RSPs (e.g. responsibility for maintaining and replacing battery back-up including manufacturer warranty issues);
- NBN Co secures common property for itself and not its RSPs (yet it requires its RSPs to secure common property for NBN Co when an RSP secures common property for itself);
- the concept of “Designated Customer” is used to allocate responsibilities for battery back-up (i.e. in an attempt to ensure RSPs manage battery back-up units, responsibilities are progressively and continually reallocated over time), but the WBA is otherwise silent on risk allocation for other parts of the in-premises network;¹⁶⁴
- there is a lack of clarity in relation to the management of end-users during installation, including:
 - how end-users are kept fully informed of their rights and charging alternatives;
 - the accountability that NBN Co will take for ensuring RSPs are not exposed to additional “non-standard installation” costs agreed between the end-user and NBN Co installers; and
 - how installation will be effected in a household where there is more than one

¹⁶⁴ Telstra acknowledges that the concept of “Designated Customer” has been developed by NBN Co to deal with battery management only.

RSP; and

- there is a lack of certainty as to how risks that are allocated to RSPs are then managed between those RSPs.

All of these examples illustrate where the WBA (and the NBN Co SAU) fall short of expectations and demonstrate the need for the NBN Co SAU to provide greater certainty for all stakeholders regarding their respective responsibilities (where they start and stop), and how ultimate accountability to NBN Co (or between RSPs) will be managed.

5.2.10.2. Proposed Principles

Telstra acknowledges that the issues identified above are complex. Despite this, Telstra believes it is incumbent on NBN Co to address these issues now. The NBN Co SAU is the most appropriate vehicle to recognise and support the dynamics inherent in a multiple RSP environment (a feature that goes to the core policy foundation of the NBN and the desire for robust RSP competition) and provide certainty to all participants.

To this end, Telstra submits that the NBN Co SAU should provide for the following:

- primary responsibility for all provision, support, repair, maintenance and upkeep of all physical and operational elements of NBN Co's network (before, during and after installation) should rest with NBN Co. This includes responsibility for all elements of NBN Co's infrastructure that are housed at end-user premises (including battery support);
- if any element of network or equipment management is considered better managed by the RSP, then there must be a clear and fair methodology to ascertain which of the RSPs at a particular premises should take primary responsibility, and when they do so, the costs of that need to be ultimately borne by NBN Co (and therefore form part of NBN Co's overall cost base), rather than fall with a particular RSP;
- an obligation on NBN Co to inform end-users and/or RSPs of particular installation types to enable a fully informed decision about installation costs (i.e. knowing precisely what parameters will enable a standard installation). NBN Co must then stand behind any installation agreement it makes with the end-user so that the RSP is not left managing a cost related decision it had no involvement with;
- during the initial roll out phase in particular, NBN Co should be required to secure and maintain all rights of access to Common Property, public land, public spaces for the provision of network and products, both for itself and its RSPs, irrespective of whether it is subject to an RSP demand order; and
- principles to manage NBN Co claims against an RSP when there are multiple RSPs supplying to a single end-user and no clear line of accountability. In this scenario, NBN Co may be best placed to carry this risk. This is particularly important if the current risk allocation model is retained.

5.2.11. Major NBN Upgrades

5.2.11.1. Assessing NBN Co's SAU

The NBN Co SAU provides a series of limited commitments in relation to "Major NBN Upgrades" (as defined). The term is defined by reference to the NBN Program of Works (being

any program of works issued by NBN Co from time to time) and is further constrained by the requirement that those works must (a) require the RSP to take particular actions to continue to use a product component, feature or ancillary service, (b) result in a product component, feature or ancillary service no longer being supplied or (c) require an RSP to commit material capex.

By defining Major NBN Upgrade in this way, it will always be at NBN Co's discretion to dictate what will or will not fit within the scope of the NBN Co SAU commitments. If NBN Co can change its list of Major NBN Upgrades within its Program of Works at will, then the commitment to RSPs under the NBN Co SAU is only as strong as NBN Co permits.

Further information is also needed in relation to the interplay between upgrades and general product withdrawal rights. For example, there are conflicting notice periods between the NBN Co SAU (re. Major NBN Upgrades) and the WBA (re. product withdrawals). The two concepts are intertwined, given that an upgrade may, in practice, effect a product withdrawal.

5.2.11.2. Proposed principles

NBN Co has the opportunity to clarify its position on all upgrade related matters in the NBN Co SAU.

Telstra believes that this can be achieved in a way that does not compromise the general principles proposed by NBN Co specific to "Major NBN Upgrades" in the NBN Co SAU (rather, they are strengthened and broadened to provide more certainty for RSPs).

To this end, Telstra submits that the NBN Co SAU should:

- contain objective criteria to assess whether an upgrade justifies a specified notice period prior to implementation (the defined term or criteria should not be linked to any "Program of Works" or similar self-defined documentation);
- ensure that "major upgrades" (as objectively defined) are subject to sufficient notice periods and commitments to minimise service interruptions;
- clarify the interplay between the concepts of product "upgrade" and product "withdrawal" to ensure shorter notice periods imposed in one scenario do not undermine the notice periods in another (i.e. the integrity of the "withdrawal" notice requirements must be maintained);
- clarify the interplay between the concepts of product "upgrade" and product "maintenance" to ensure the processes for one do not undermine or cut across the processes for the other; and
- ensure that upgrades occur in a manner consistent with notified impact statements (provided to RSPs at the time of the upgrade) and NBN Co reports regularly on these commitments.

5.2.12. Access to the NBN Co platform

5.2.12.1. Assessing NBN Co's SAU

While Telstra acknowledges the ACCC's observation that the NBN Co SAU is the first undertaking considered by the ACCC under Part XIC of the CCA that includes OSS and BSS commitments, the OSS and BSS components of NBN Co's network are critical for ensuring an

effective NBN Co / RSP interface. At an operational level, most of the day-to-day interaction between NBN Co and the RSP will occur through the NBN Co Platform.

5.2.12.2. Proposed Principles

Given the early stages of the NBN development, Telstra would expect NBN Co to be benchmarking its OSS/BSS performance against international best practice and, accordingly, would expect the NBN Co SAU to acknowledge and enable this to occur.

This should include detail as to how NBN Co and the RSP will interact through the NBN Co Platform and detail in relation to functionality, features and interface requirements. Substantial investment may be required by RSPs to ensure an effective interface with the NBN Co Platform (both in terms of direct interface and the manner in which these processes then flow through to downstream customers and end users). Given this, Telstra believes that industry participants would benefit from more specificity in the NBN Co SAU about the features and functionality of the NBN Co Platform and the proposed timing for implementation.

While aspects of this are particularly relevant at this point in time (i.e. this issue is acute given NBN Co is yet to fully establish and automate its systems), these principles will have ongoing relevance.

Finally, while manual work-arounds are in place during the initial roll-out of the NBN, there remains a concern about contingency arrangements to support and back-up the NBN Co Platform on an ongoing basis. These aspects should also be drawn out in the NBN Co SAU.

5.2.13. Rollout information and reporting

Telstra welcomes NBN Co's proposal to include commitments to provide construction and rollout progress information. Telstra remains confident that NBN Co can exceed the commitments it has in the NBN Co SAU and so would encourage continued information sharing in a manner that is not constrained by the NBN Co SAU. This is in the common interests of all of industry.

Appendix A: Responses to the ACCC's questions in the Supplementary Consultation Paper

Item	ACCC Question	Response
Regulatory context		
1	Are there terms and conditions that are not contained in the SAU which you consider should be established prior to parties entering into long-term Access Agreements?	<p>The answer to this section is contingent on the structural/design issues identified in section 2.</p> <p>Telstra has identified, throughout the submission, areas which it considers should be included in the NBN Co SAU and accordingly should be established prior to entering into long-term Access Agreements.</p>
Operation of the SAU		
2	Are the types of disputes that may be notified through the dispute resolution process sufficient to resolve disputes between NBN Co and access seekers about access to the relevant services? In providing your views, please consider that the ACCC has powers under Part XIC of the CCA for setting terms and conditions of access to declared services, such as making Access Determinations and Binding Rules of Conduct, and can issue Procedural Directions in relation to negotiations.	Refer to section 2.2.4.
3	Is the dispute resolution procedure likely to result in the effective resolution of disputes? Are the dispute resolution timeframes, the permitted ACCC decisions, and the criteria to be applied by the ACCC when making a decision, likely to result in the effective resolution of disputes?	Refer to section 2.2.4.
4	Is it appropriate that the ACCC only has a choice of adopting one set of terms and conditions proposed by the parties without amendments? For instance, there may be a scenario where the ACCC considers that neither set of terms and conditions promotes the long-term interests of end-users.	Refer to section 2.2.4.

Item	ACCC Question	Response
5	Is it clear that the ACCC decisions under the dispute resolution processes will be binding on all parties?	Refer to section 2.2.4.
6	Overall, are the regulatory recourse dispute resolution provisions contained in NBN Co's proposed SAU consistent with the legislative criteria in section 152CBD of the CCA?	Refer to section 2.2.4.
7	Are the commitments in the SAU likely to satisfy the legislative criteria for the proposed term of the SAU? Please identify those commitments that do.	Refer to section 2 generally.
8	Are there commitments in the SAU that are unlikely to satisfy the legislative criteria for the proposed term of the SAU? Please identify these commitments.	Refer to section 2 generally.
9	Do the obligations in the SAU for NBN Co to review the SAU and give variations to the ACCC mean that the commitments in the SAU are likely to be reasonable and in the long-term interests of end-users for the proposed term?	Refer to section 2 generally.
10	Does the good faith review obligation in clause 1.2 of Schedule 9 (Review and Variation of Aspects of SAU) enhance the effectiveness or independence of the reviews that NBN Co is required to conduct under the SAU?	Refer to sections 2 and 4.3.9.
Common approaches adopted in the SAU		
11	Are there any significant issues caused by references to "the WBA" or other documents in the SAU?	<p>Telstra has expressed concerns throughout the submission on the effect that references to the WBA has on the efficacy of the NBN Co SAU commitments.</p> <p>In particular, refer to section 2 and 5.1.</p>
12	Have references to "the WBA" or "Access Agreements" been used appropriately in the SAU?	Telstra understands the reason for using the different references (i.e. one to apply to executed access agreements and the other to apply pre-execution of the

Item	ACCC Question	Response
		<p>Access Agreement), however, Telstra considers that clarification is needed, particularly given that NBN Co intends the NBN Co SAU to be enforced through the WBA once executed.</p> <p>Refer to sections 2 and 5.1.</p>
13	<p>Have the terms “Access Seeker” and “Customer” been used appropriately in the SAU?</p>	<p>Refer to the response to question 12.</p>
14	<p>Do the recitals or assertions of fact in the SAU assist in the interpretation of other parts of the SAU?</p>	<p>While statements in the NBN Co SAU, which are not commitments, may provide interpretation assistance, Telstra is more concerned that these statements do not constitute commitments from NBN Co, and therefore do not provide certainty for RSPs.</p> <p>Refer to sections 2 and 5.1.</p>
15	<p>Are there any other systems, documents and processes that should be included in the SAU?</p>	<p>Telstra believes that the commitments to develop systems, documents and processes serve to illustrate that fundamental aspects of supply remain in the nascent stages of development.</p> <p>While commitments to develop these systems, documents and processes are welcome, it will be important to ensure that these things are developed with an appropriate degree of industry engagement and oversight from the ACCC (including to ensure they are consistent with generally accepted practices).</p> <p>Refer to section 2 and section 5.</p>
16	<p>Are the features or qualities that NBN Co has specified for these systems, documents and processes appropriate?</p>	<p>Refer to the response to question 15.</p>
17	<p>Has NBN Co proposed to undertake consultation at appropriate times in the SAU?</p>	<p>While documentation and processes are under development, robust and meaningful consultation is critical. This consultation should be undertaken based on agreed principles of good faith and in recognition of the impact on</p>

Item	ACCC Question	Response
		<p>RSPs and their end-users.</p> <p>Telstra would hope that NBN Co will continue to engage constructively on both a bilateral and multilateral basis but, to this end, believes that NBN Co should be willing to make specific commitments about the extent and timing of consultation (e.g. broader consultation coupled with deep dive sessions).</p> <p>An example of the kind of consultation that Telstra would expect to see is the Contract Development Process that has been established to resolve issues arising out of negotiations of the WBA.</p> <p>Recognition should also be given to the value that can be derived from the ability to engage bilaterally (particularly with those RSPs that service significant numbers of end-users).</p> <p>It is also important to note that while consultation processes are important, they should not be a substitute for ensuring acceptable principles are associated with variations to agreed and/or settled supply terms.</p> <p>Telstra accepts that the ACCC is very familiar with effective consultation and would encourage it to review the NBN Co SAU to in light of this.</p>
18	Do the consultation processes cover the issues that are likely to require input from access seekers, the ACCC or the general public?	Refer to the response to question 17.
19	Are the consultation processes set out adequate? Do they give interested parties sufficient time to consider and comment on issues?	Refer to the response to question 17.
20	Do the consultation processes sufficiently set out the obligations of NBN Co to communicate/provide reasons for its decisions?	Refer to the response to question 17.
21	Is the extent to which the SAU requires	Refer to the response to question 17.

Item	ACCC Question	Response
	NBN Co to take into account material provided through consultation processes sufficient?	
22	Should there be greater ACCC oversight of consultation processes? Does the SAU provide sufficient opportunity for the ACCC to review consultation processes in order to assess whether they have been effective?	Consultation processes would benefit from independent oversight if NBN Co is unable to independently implement effective processes.
23	Do the publishing obligations in the SAU provide sufficient detail and types of information?	<p>Telstra welcomes the commitments to publish the relevant information. Telstra recognises that these commitments are necessary to ensure transparency. However, Telstra does not believe that they should be viewed as the <i>benchmark</i>. These commitments should be considered the <i>minimum</i> level of disclosure and could be supported by more general principles (which are not linked to specific events) to ensure appropriate levels of transparency for RSPs.</p> <p>Telstra accepts that it may be appropriate to draw distinctions between “Customers”, “Access Seekers” and the public at large for this purpose because Customers, followed by Access Seekers more generally, will naturally require greater levels of transparency.</p>
24	Is there other information that access seekers or other members of the public would require in relation to the supply of the NBN Access Service?	Refer to the response to question 23.
25	Is the proposed timing and location of publication appropriate?	Refer to the response to question 23.
26	Are the constraints on NBN Co contained in the SAU in relation to its exercise of contractual rights effective and reasonable?	<p>As highlighted in Telstra’s submission, Telstra holds concerns about the unfettered discretions which are afforded to NBN Co through the WBA on a number of levels (not least of all the ability to self-define contractual remedies).</p> <p>Accordingly, Telstra believes the NBN Co SAU is the appropriate vehicle to</p>

Item	ACCC Question	Response
		<p>place limits and constraints around these discretions. This issue impacts upon a number of aspects of the submission and the WBA, including the interplay that occurs between the SAU, Access Agreements and the WBA. Refer to section 2.</p>
Service description and products under the SAU		
27	<p>What services supplied by NBN Co fall outside the scope of this service description? Are there any services supplied by NBN Co for which this is unclear?</p>	<p>Critical details regarding all physical, technical and service attributes of the service are needed. Refer to section 3.1.</p>
28	<p>Does the SAU provide terms and conditions of access in relation to all the services which NBN Co supplies that downstream users require in order to supply carriage services or content services?</p>	<p>Further detail is needed regarding the “inclusions” and “exclusions” of the service to be supplied by NBN Co under the NBN Co SAU. Refer to section 3.1.1.</p> <p>In relation to Ancillary Services, the terms on which NBN Co is undertaking to supply these services is unclear and should be clarified.</p> <p>In relation to new Product Components, it will be important to ensure that there is an appropriate level of oversight of the terms on which these new products are to be supplied. Refer to section 3.1.1.1 and section 3.2.</p>
29	<p>Does the service description in the SAU sufficiently describe the service that NBN Co purports to supply? Are there any missing essential elements in the service description?</p>	<p>Critical details regarding all physical, technical and service attributes of the service are needed. Refer to section 3.1.</p>
30	<p>Does the service description in the SAU accurately describe the service? Are there any elements of the service description that are unclear or ambiguous?</p>	<p>Critical details regarding all physical, technical and service attributes of the service are needed. Refer to section 3.1.</p>
31	<p>How does the service description for the NBN Access Service compare against the principles that the ACCC has previously specified for service descriptions?</p>	<p>Refer to Appendix E.</p>

Item	ACCC Question	Response
32	Is the service description sufficiently technology neutral to remain applicable as technology changes in the future, particularly given the proposed term of the SAU?	<p>Telstra does not object to the functional approach used by NBN Co to describe the service. However, critical details regarding all physical, technical and service attributes of the service are needed. Refer to section 3.1.</p> <p>In addition, while technical neutrality is important, it must not compromise the fundamental layer 2 service offering. Refer to section 3.1.1.3.</p>
33	Is an appropriate interconnection protocol specified in the service description?	Telstra believes there are some gaps in the protocols and the roadmaps to delivery are not defined. For example, IPV6 is not supported and NBN Co has not provided a timeframe by which this will be done.
34	How should appropriate mechanisms for handling congestion in shared network elements be specified? What are appropriate mechanisms?	<p>Critical details regarding the rules to be applied by NBN Co to manage congestion and augment capacity are needed. Refer to section 3.1.1.2.</p> <p>These details should be specified by NBN Co in the Network Design Rules and must form part of the NBN Co SAU.</p> <p>It is a matter for NBN Co to develop and provide these rules. Once provided, the appropriateness of the rules can be assessed on their merits.</p>
35	Should a stand-alone low committed information rate product suitable for voice-only services be supplied?	Telstra notes that this is a relevant consideration in the context of assessing the LTIE.
36	Is the “Product Component” construct reasonable? What are the effects of the product component-based product construct on downstream markets in which carriage services or content services are supplied?	<p>Telstra does not object to the “Product Component” construct adopted by NBN Co. However:</p> <ul style="list-style-type: none"> • critical details regarding all physical, technical and service attributes of the service are needed – refer to section 3.1; • Telstra is concerned that there is significant scope for NBN Co to define essential service elements as “ancillary” - refer to section 3.1.1.1; and

Item	ACCC Question	Response
		<ul style="list-style-type: none"> Telstra believes that this construct requires the product development commitments to be reconsidered and warrants an appropriate level of oversight of the terms on which these new products are to be supplied – refer to section 3.1.1.1 and section 3.2.
37	<p>Is the definition of “Product Component” to include product components other than the AVC, CVC, UNI and NNI appropriate? What is the effect of including product components identified within the Initial Product Roadmap or offered for supply by NBN Co at the date of acceptance of the SAU in the definition of “Product Component”?</p>	<p>The effect of an “open ended” definition for “Product Component” means that the scope of the NBN Co SAU will “expand” to encompass new Product Components as they are developed over time.</p> <p>As noted, in section 3.1.1.1, Telstra generally supports this approach, however, if this approach is taken it will be critical to ensure that:</p> <ul style="list-style-type: none"> the product development commitments are appropriate and effective (refer to section 3.2 generally); RSPs have certainty about all physical, technical and service attributes of new products (refer to section 3.1 generally); and there is an appropriate level of oversight of the nature and terms on which new products are to be supplied (refer to section 3.1.1.1 and section 3.2).
38	<p>Does the limitation that the NBN Access Service is only to be supplied through the “Product Components” adversely affect the supply of the NBN Access Service to access seekers?</p>	<p>Telstra does not object to the “Product Component” construct adopted by NBN Co. However, Telstra notes the concerns that have been raised in section 3.1.</p> <p>Specifically, Telstra notes the interplay between Ancillary Services, Product Components and other essential service elements which are not provided for in the NBN Co SAU.</p> <p>Telstra also notes that the NBN Co SAU should clarify whether the “Product Components” form part of the NBN Access Service.</p>

Item	ACCC Question	Response
39	Are the definitions of the AVC, CVC, UNI and NNI satisfactory and complete?	Critical details regarding all physical, technical and service attributes of the service are needed. Refer to section 3.1 generally.
40	Are the clauses around product components likely to remain reasonable for the proposed term of the SAU?	Telstra's views around the reasonableness and relevance of the provisions which relate to Product Components is directly linked to the term of the NBN Co SAU. It is not possible to opine on whether these clauses are capable of remaining future proof for a 30 year term. Refer to sections 2 and 3.
41	Are the definitions of the ancillary services accurate and complete? Are there ancillary services supplied by NBN Co which would fall outside the scope of the definition but which should be included?	Telstra has addressed the issue of Ancillary Services (including the broad definition that is used in the NBN Co SAU) in section 3.1.1.1.
42	What are the consequences of the exclusion of the ancillary services, for example, the Facilities Access Service, from the NBN Access Service?	Refer to section 3.1.1.1.
43	Is it sufficiently clear which commitments in the SAU do and do not apply to ancillary services?	Telstra does not believe there is sufficiently clarity. Refer to section 3.1.1.1.
44	Are the commitments in the SAU with regard to service level regimes sufficient to ensure that the SAU promotes the long-term interests of end-users and is reasonable for the proposed term of the SAU?	Telstra does not believe the service level commitments are sufficient (both in terms of the nature of the service level and consequence of non-compliance). Customers who connect to the NBN (at both a wholesale and retail level) should have confidence that the end-to-end service experience will be at least the same (in terms of quality, performance attributes and timeframe commitments) as the end-to-end service experience of equivalent end-users and downstream customers today. The service level regime should also be agile and adapt to technology advances, product efficiencies and customer

Item	ACCC Question	Response
		<p>expectations.</p> <p>Refer to section 3.1.3.</p>
45	Should service levels be specified in the SAU for the NBN Access Service?	Refer to section 3.1.3.
46	Is the process described in the SAU appropriate for the development of a service level regime?	Refer to section 3.1.3.
47	Are the quality criteria specified by NBN Co (network performance, service delivery, communication with customers and planned and unplanned event management) sufficient to define the service level regime for the fibre network? Are there additional criteria that should be specified?	Refer to section 3.1.3.
48	Should the service level regime also apply to the wireless and satellite networks?	As Telstra notes in section 3.1, service levels are a fundamental attribute of any product. It follows that service levels should apply to wireless and satellite networks.
Price-related terms and conditions		
49	What are the potential impacts of NBN Co's proposed price structures on downstream markets?	As noted in section 4.1.5, the proposed price structure which sets usage charges on a per Mbps basis could result in very substantial increases in end-user prices.
50	Will NBN Co's proposed price structures promote the efficient use of and investment in infrastructure?	The scope for very substantial increases in end-user prices as usage increases (refer to section 4.1.5) may not promote the efficient use of and investment in infrastructure.
51	Are the proposed price structures reasonable, and are they likely to remain reasonable over the proposed term of the SAU?	<p>Telstra does not consider the proposed price structure for usage charges to be reasonable (refer to section 4.1.5).</p> <p>Moreover, as noted in section 4.1.3, there is broad scope for NBN Co to develop price structures for new products introduced over the 30-year term of the NBN Co SAU. This may lead to price structures that are not</p>

Item	ACCC Question	Response
		reasonable.
52	Are the proposed price structures reasonably necessary to achieve uniform national wholesale pricing?	Telstra does not consider that the proposed price structure for usage charges is necessary to achieve uniform national wholesale pricing.
53	Is the scope of the initial prices included in the SAU likely to provide sufficient certainty to access seekers to make efficient investments? Should the SAU specify initial prices for a broader range of NBN Co's products?	Refer to section 4.1.2.
54	Are the maximum regulated prices for NBN Co's price controlled offers likely to be reasonable? In particular, do these prices decrease the possibility of price shocks for access seekers and end-users in migrating to the NBN?	As noted in Telstra's initial submission and in this submission, it is difficult to assess the reasonableness of the proposed price terms (including the maximum regulated prices for NBN Co's price controlled offers) in the absence of a working building block model.
55	Is the "anchor" effect of the price controlled offers likely to provide reasonable certainty to access seekers over prices for other products NBN Co intends to offer at the commencement of the SAU?	Refer to section 4.1.3.
56	Does the setting of prices for new product components and product features provide a reasonable balance between the interests of NBN Co and its customers? Should the SAU set out principles and/or a more detailed process by which NBN Co will set prices for new products? Should the ACCC have a role in relation to setting initial prices for new products?	Refer to sections 4.1.3 and 4.5.4.
57	Is the "anchor" effect of currently supplied products likely to provide reasonable certainty to access seekers over the initial prices for new products introduced throughout the proposed term of the SAU?	Refer to section 4.1.3.
58	Will the processes by which NBN Co will consult with customers on prices for new products ensure that prices are set	Refer to section 4.5.4.

Item	ACCC Question	Response
	reasonably over the proposed term of the SAU?	
59	Are the dispute resolution processes in relation to prices for new products likely to ensure prices are set reasonably over the proposed term of the SAU?	Refer to section 2.
60	Are the price controls in the SAU likely to ensure that NBN Co's prices are reasonable, and are likely to remain reasonable over the proposed term of the SAU? Are they likely to provide sufficient certainty to access seekers to make efficient investments?	Refer to section 4 generally, and section 4.1 in particular.
61	Is the process by which NBN Co can request ACCC approval to increase prices by an amount greater than permitted by the price controls reasonable? Should the ACCC's decision on NBN Co's pricing proposal be limited to either accepting or rejecting the proposal? Is the timeframe for the ACCC to make a decision on NBN Co's pricing proposal reasonable?	Refer to section 4.1.4
62	Is the process for NBN Co to review the price controls at the SAU review period reasonable? Should the ACCC have the ability to initiate a review of the price controls?	Refer to section 2.
63	Are there sufficient provisions to prevent NBN Co from avoiding or circumventing the price controls by withdrawing/introducing new product components or features, or by removing discounts, rebates and allowances?	In light of the threshold issues raised in section 4 as to the reasonableness of the price controls more generally, this question has not been answered specifically.
64	Is the anti-avoidance provision likely to prevent NBN Co from avoiding the price controls by introducing new charges for product components or product features for which customers were not previously charged?	In light of the threshold issues raised in section 4 as to the reasonableness of the price controls more generally, this question has not been answered specifically.
65	Is the process for applying the price control to bundles of products likely to	In light of the threshold issues raised in section 4 as to the reasonableness of the price controls more generally, this

Item	ACCC Question	Response
	be reasonable?	question has not been answered specifically.
66	Is NBN Co's proposed long-term revenue constraint methodology reasonable? If so, is it likely to remain reasonable over the proposed term of the SAU?	Refer to section 4.3.
67	Does the long-term revenue constraint methodology encompass all relevant costs and revenues?	Refer to section 4.3.
68	Is the approach to deferring cost recovery through the proposed initial cost recovery mechanism reasonable? What are the implications for NBN Co's prices over the initial loss recovery period and for the later years of the SAU period?	Refer to section 4.3.8.
69	Should NBN Co be required to allocate costs between services supplied in competitive and non-competitive markets? If so, how might these costs be allocated? How might this requirement change over the proposed term of the SAU?	In light of the threshold issues raised in section 4 as to the reasonableness of the price controls more generally, this question has not been answered specifically.
70	Is NBN Co's approach to determining the allowance for construction-in-progress reasonable? Is this approach likely to remain reasonable over the proposed term of the SAU?	Refer to section 4.3.6.
71	Are the methodologies for determining depreciation and tax allowances reasonable? Is it likely that these methodologies will remain reasonable over the proposed term of the SAU? Are the asset lives used in the calculation of depreciation and tax reasonable?	Refer to section 4.3.4.
72	What, if any, further economic modelling is required from NBN Co to assess whether the SAU is reasonable?	As noted in Telstra's initial submission and in this submission, it is difficult to assess the reasonableness of the proposed price terms in the absence of a working building block model.

Item	ACCC Question	Response
73	Does NBN Co commit to supplying the ACCC with sufficient information to enable it to assess whether NBN Co is complying with the commitments made in Schedule 7 (Long Term Revenue Constraint Methodology)?	Refer to section 4.4.
74	What aspects, if any, of the long-term revenue constraint methodology are reasonably necessary to achieve uniform national wholesale pricing?	Telstra does not consider that any particular aspect of the LTRC is necessary to achieve uniform national wholesale pricing.
75	Is NBN Co's approach to the WACC reasonable? Is it likely to encourage efficient investment in and use of infrastructure?	Refer to section 4.3.2.
76	Is a risk margin of 350 basis points likely to reasonably reflect NBN Co's systematic risk over the proposed term of the SAU? Is the appropriate risk margin likely to vary over the proposed term of the SAU?	Refer to section 4.3.2.
77	Should the ACCC assess NBN Co's WACC against a return on capital calculated using the weighted average of the cost of debt and the cost of equity?	Refer to section 4.3.2.
78	Is it reasonable to use a benchmarking approach to assess NBN Co's WACC? Which industries are likely to provide appropriate benchmarks for assessing NBN Co's WACC?	Refer to section 4.3.2.
79	Is it reasonable that the SAU does not set out a process for periodically reviewing the WACC approach within the SAU period?	Refer to sections 4.3.2 and 4.3.9.
80	Is the process for NBN Co to review the WACC approach at the SAU review period likely to ensure NBN Co's WACC remains reasonable over time?	Refer to sections 4.3.2 and 4.3.9.
81	Will the prudency mechanisms proposed by NBN Co be effective in encouraging prudent capital expenditure by NBN Co?	Refer to section 4.2.4.

Item	ACCC Question	Response
	Are they an effective substitute for ACCC oversight of expenditure?	
82	Are the Network Design Rules sufficiently detailed to ensure that they will only allow prudent capital expenditure to be included in the RAB?	Refer to section 4.2.4.1.
83	Will the proposed customer engagement model be effective in encouraging prudent capital expenditure over the proposed term of the SAU? Are there examples of other industries where customer engagement has been effective? Should customer engagement processes apply to other aspects of NBN Co's proposed prudency mechanisms?	Refer to section 4.2.4.
84	Will the operating expenditure principles proposed by NBN Co be effective in encouraging prudent operating expenditure by NBN Co? Are they an effective substitute for ACCC oversight of expenditure? Are there any other aspects of the SAU that may encourage prudent operating expenditure?	Refer to section 4.2.4.
85	Are the "deemed prudent" categories reasonable? Are these categories sufficiently defined to ensure that they only encompass prudent expenditure?	Refer to section 4.2.4.
86	Is the annual compliance process sufficient to assess compliance with the prudency commitments? Is sufficient information provided by the annual compliance reports to enable the ACCC to determine whether expenditure has been prudently incurred?	Refer to section 4.5.
87	Will the prudency mechanisms be effective in encouraging prudent expenditure over the proposed term of the SAU? Will the processes for reviewing the prudency and customer engagement processes ensure that they remain effective over time?	Refer to section 4.2.4.

Item	ACCC Question	Response
88	What aspects, if any, of the prudency mechanisms are reasonably necessary to achieve uniform national wholesale pricing?	Telstra does not consider that any particular aspect of the prudency mechanism is necessary to achieve uniform national wholesale pricing.
Non-price terms and conditions		
89	Should the SAU contain commitments around the scope of the WBA? If so, are the current commitments likely to be effective, and are they sufficient and reasonable?	<p>The answer to this is contingent on the key structural questions associated with the inter-play between the WBA and other ACCC and NBN Co documents, including the SAU.</p> <p>Refer to sections 2 and 5.1.1.</p>
90	Are the consultation obligations in the SAU relating to development of the WBA reasonable? Should they apply more broadly, to “Access Seekers” and not just “Customers”?	<p>Consultation processes (and associated details) in the NBN Co SAU are very limited.</p> <p>Telstra notes, the Contract Development Process currently provides the only real mechanism to deal with development of the WBA. The efficacy of this process may impact on the need for further consultation within the NBN Co SAU itself.</p> <p>Wider consultation involving interested parties may be appropriate (and certainly, access seekers will have an interest along with existing customers).</p> <p>Refer to section 5.1.1. Also refer to section 3 in relation to service levels commitments.</p>
91	Is it sufficiently clear to whom and in what circumstances these commitments apply?	<p>It is not clear how or who would enforce these particular commitments. The nature of these commitments are such that compliance is unlikely to be a concern for NBN Co.</p> <p>Telstra remains concerned about provisions in the NBN Co SAU that defer to the WBA or do not contain any commitments of substance.</p> <p>Refer to sections 2, 3 and 5.1.1.</p>
92	Are customers provided with reasonable notice of changes to be made to their Access Agreements by NBN Co under	A more fundamental assessment is required in relation to change processes. The NBN Co SAU commitments do not

Item	ACCC Question	Response
	the SAU?	<p>apply if the change process is already set out in the WBA and the proposal in clause 14.3 of Schedule 11 is drafted as a “right” and not an obligation.</p> <p>Refer to section 5.2.3.</p>
93	<p>Are customers provided with a reasonable opportunity to consult with NBN Co regarding possible changes to their Access Agreements? The ACCC notes that clause 14.3 of Schedule 11 (Non-price Terms and Conditions) does not currently set out specific timeframes in which consultation is to occur.</p>	<p>See comments immediately above. If clause 14.3 was amended so that it had noticeable application, then consultation periods will be a relevant consideration.</p> <p>Refer to section 5.2.3.</p>
94	<p>Is NBN Co’s obligation to “reasonably consider” any feedback given by a customer or the ACCC reasonable?</p>	<p>See comments above. Also refer to section 5.2.3.</p>
95	<p>Is NBN Co’s undertaking to only implement a change that is consistent with an interim Access Determination or Binding Rules of Conduct reasonable?</p>	<p>See comments above. Also refer to section 5.2.3.</p> <p>At a more fundamental level, Telstra is concerned that this is the only mechanism in the NBN Co SAU that appears to acknowledge the ACCC’s BROCC/AD powers and it does so in a very confined manner. Wider concerns in this regard are set out in the body of the submission. Refer to section 2.</p>
96	<p>Are the “Changes to Access Agreements” provisions reasonable, and are they likely to remain reasonable over the proposed term of the SAU? Please outline those aspects of the provisions that you consider to be reasonable and/or unreasonable.</p>	<p>Telstra has concerns about the reasonableness of the change management provisions given: (a) the limited application of clause 14.3; (b) the process artificially pushes a review through to the ACCC’s ex-ante regulatory powers (without recognising the intended ex-ante role of these instruments); and (c) provides little comfort about those change provisions contained in the WBA (that are expressly out of scope of the NBN Co SAU).</p> <p>Refer to section 5.2.3.</p>
97	<p>Is it sufficiently clear to whom and in what circumstances these commitments apply?</p>	<p>It appears that the change provisions are set out for the benefit of existing customers. This would seem appropriate</p>

Item	ACCC Question	Response
		<p>given existing customers will be impacted by the changes.</p> <p>Application and enforcement remains unclear. Refer to section 5.1, section 5.2.3 and section 2.</p>
98	<p>Does the SAU enhance the likelihood that reasonable contractual dispute resolution processes will be able to be agreed to in Access Agreements? For example, in the event that access seekers and NBN Co cannot agree to a contractual dispute resolution process, is there sufficient scope for regulatory intervention to resolve the issue?</p>	<p>The NBN Co SAU does not appear to contemplate an “agreed” dispute resolution procedure in the manner inferred by this question. The NBN Co SAU “locks-in” the WBA model. See Telstra’s detailed comments in section 5.2.4.</p> <p>The NBN Co does not appear to contemplate regulation intervention in relation to disputes with existing RSPs. Telstra notes that a “regulatory recourse” process is available for access seekers only (i.e. not existing customers). Telstra has a number of concerns with this proposed model. See Telstra’s detailed comments in section 2.</p>
99	<p>Does the SAU ensure that access seekers will have access to a dispute resolution process for resolving contractual disputes that is independent and free from bias?</p>	<p>Telstra has concerns about the potential for bias and the NBN Co SAU does not specifically address this concern (apart from an acknowledgement of the issue).</p> <p>Telstra believes the NBN Co SAU could provide more comfort in this regard by bringing the dispute resolution provisions from the WBA into the NBN Co SAU (subject to a number of material changes). Refer to section 5.2.4 for further detail.</p>
100	<p>Are the dispute resolution terms and conditions reasonable and described with sufficient specificity?</p>	<p>The NBN Co SAU does not contain appropriate specificity in relation to dispute management. The lack of detail in the NBN Co SAU remains a significant concern in this regard. Refer to section 5.2.4 for further detail.</p>
101	<p>Are the provisions relating to the appointment of resolution advisors, selection of arbitrators and timeframes for each stage of the dispute resolution process reasonable?</p>	<p>Refer to section 5.2.4.</p>

Item	ACCC Question	Response
102	Do interested parties consider that it is reasonable to conduct arbitrations in accordance with the <i>Commercial Arbitration Act 2010</i> (NSW)?	Refer to section 5.2.4.
103	Is the proposed process reasonable, and is it likely to remain reasonable over the proposed term of the SAU?	<p>Please see comments above.</p> <p>Assessment of the reasonableness of the proposed process must be made alongside the WBA</p> <p>Telstra is not able to form a view as to whether the proposed process will remain reasonable over the term of the SAU given the more general concerns above.</p> <p>Refer to section 5.2.4.</p>
104	Is it sufficiently clear to whom and in what circumstances these commitments apply?	The dispute management commitments are made “at large” by reference to the WBA. Application and enforcement remains unclear. Refer to section 5.2.4 and section 2.
105	Is NBN Co’s proposed commitment in relation to default management reasonable, and likely to remain reasonable over the proposed term of the SAU?	<p>The NBN Co SAU contains very little detail in relation to default management.</p> <p>Telstra is not able to form a view as to whether the default management commitments will remain reasonable over the term of the SAU given the more general concerns above.</p> <p>Refer to section 5.2.5.</p>
106	Is it sufficiently clear to whom and in what circumstances the commitment applies?	Application and enforcement remains unclear. Refer to section 5.2.5 and section 2.
107	Do the risk management and liability provisions clearly describe the types of liability (that is, the legal responsibilities, duties and obligations) of each party?	<p>Telstra does not believe the risk management and liability provisions clearly describe the types of liability of each party.</p> <p>Telstra notes that the risk management commitments are made expressly subject to the terms of the WBA.</p> <p>Assessment of the reasonableness of the risk management commitments must be made alongside the WBA.</p>

Item	ACCC Question	Response
		Refer to section 5.2.6.
108	Do the risk management and liability provisions clearly describe the indemnities (that is, the circumstances where one party will compensate the other party for the losses resulting from the first party's actions)?	While the NBN Co SAU does address certain indemnity scenarios, Telstra remains concerned that these commitments are made expressly subject to the terms of the WBA. Refer to section 5.2.6.
109	Does the scope of the proposed risk management and liability regime enable NBN Co and its customers to efficiently operate and invest in their services, networks and facilities?	Telstra does not believe the risk management and liability provisions provide a fair allocation of risk as between the parties and, accordingly, do not enable the efficient operation and investment by NBN Co and its customers in services, networks and facilities. Telstra believes a "whole approach" review is required. Refer to section 5.2.6.
110	Are the risk management and liability provisions, reasonable and are they likely to remain reasonable over the proposed term of the SAU?	Telstra has a number of concerns regarding the proposed risk management and liability commitments. Telstra is not able to form a view as to whether the risk management and liability commitments will remain reasonable over the term of the SAU given the more general concerns above. Refer to section 5.2.6.
111	Is it sufficiently clear to whom and in what circumstances the commitments apply?	Application and enforcement remains unclear. Refer to section 5.1, section 5.2.6 and section 2.
112	Is the proposed confidentiality regime appropriate, taking into account the wholesale-only structure of NBN Co? Do the confidential information provisions clearly describe NBN Co's and its customers' rights and obligations in respect of the disclosure and use of customer confidential information?	Telstra has a number of concerns about the proposed confidentiality regime (in the WBA and the PDF). Telstra does not believe that NBN Co's status as a "wholesale-only" provider should influence the assessment of NBN Co's confidentiality commitments. Refer to section 5.2.7.
113	Are the confidential information provisions reasonable, and are they	See comments above. Telstra is not able to form a view as to

Item	ACCC Question	Response
	likely to remain reasonable over the proposed term of the SAU?	<p>whether the confidentiality provisions will remain reasonable over the term of the SAU given the more general concerns above.</p> <p>Refer to section 5.2.7.</p>
114	Is it sufficiently clear to whom and in what circumstances the commitments apply?	Application and enforcement remains unclear. Refer to section 5.1, section 5.2.7 and section 2.
115	Do the billing and payment provisions clearly describe NBN Co's commitments in respect of billing and payment disputes? Is it sufficiently clear to whom and in what circumstances the commitments apply?	<p>NBN Co's billing and payment commitments are limited and merely confirm principles that are evident in most standard commercial supply arrangements.</p> <p>Telstra does not consider that commitments to "ensure that the Wholesale Broadband Agreement includes processes in accordance with which Customers can raise a billing dispute" provide certainty as to what those processes will be (or the principles that would guide those processes).</p> <p>Application and enforcement remains unclear.</p> <p>Refer to section 5.1 and section 5.2.8.</p>
116	Do the billing and payment provisions create an incentive for NBN Co to provide accurate and timely billing?	<p>The NBN Co SAU does not specifically address this point. Telstra would like to ensure that mechanisms are in place to provide confidence in the accuracy of billing data.</p> <p>Refer to section 5.2.8.</p>
117	Are the billing and payment provisions reasonable, and are they likely to remain reasonable over the proposed term of the SAU?	<p>See comments above.</p> <p>Telstra is not able to form a view as to whether the billing and payment provisions will remain reasonable over the term of the SAU given the more general concerns above.</p> <p>Refer to section 5.2.8.</p>
118	Do the credit management provisions	The credit management provisions do

Item	ACCC Question	Response
	clearly describe NBN Co's rights and obligations in respect of credit management? Is it sufficiently clear to whom and in what circumstances the commitments apply?	not provide any material level of detail and defer to the Credit Policy. Refer to section 5.2.8.
119	Do the credit management provisions enable NBN Co to respond to changes in customer circumstances over time?	See comments above. Refer to section 5.2.8.
120	Are the credit management provisions reasonable, and are they likely to remain reasonable over the proposed term of the SAU?	See comments above. Telstra is not able to form a view as to whether the credit management provisions will remain reasonable over the term of the SAU given the more general concerns set above. Refer to section 5.2.8.
121	Is the specification of the POI locations sufficient to promote the long-term interests of end-users, comply with the Category B SAOs, and likely to be reasonable, and remain reasonable over the proposed term of the SAU?	The NBN Co SAU does not appear to address the issue of POI location. Amongst other things, the NBN Co SAU should include the principles that will be applied in determining technical and operational feasibility of further POIs, to provide clarity to industry re. backhaul investment decisions. Refer to section 5.2.9.
122	Will the proposed POI review mechanism ensure that the locations of POIs promote the long-term interests of end-users and comply with the Category B SAOs over the proposed term of the SAU?	While the process for the POI review is set out, there is no detail on how the consultation will take place (beyond written submissions) and how RSP feedback will be assessed. Refer to section 5.2.9.
123	Is it sufficiently clear to whom and in what circumstances the commitments apply?	Telstra notes that this commitment appears to be an undertaking that exists as a separate and independent commitment from the WBA / Access Agreement. Application and enforcement remains unclear. Refer to section 5.2.9 and section 2.
124	Should the SAU include a commitment that NBN Co will permit interconnection at its facilities, including the POIs it owns	Telstra supports a regime under which NBN Co will permit access to those POIs that have been specifically

Item	ACCC Question	Response
	and controls directly and those it leases from Telstra, consistent with its obligation under section 152AXB(4) of the CCA?	<p>identified, designated and allocated in accordance with statutory processes (i.e. 121 POIs at this time).</p> <p>Refer to section 5.2.9.</p>
125	Are the circumstances and criteria for the creation of a temporary POI adequate?	<p>Telstra would welcome more detail in the NBN Co SAU in relation to the processes for temporary POIs. As drafted, the NBN Co SAU only addresses temporary POI notification periods.</p> <p>Refer to section 5.2.9.</p>
126	Should the SAU include a commitment that temporary POIs will close and provide details about the criteria, timeframe and processes for closure?	<p>Telstra would support of commitment of this kind.</p> <p>Refer to section 5.2.9.</p>
127	Are the situations where NBN Co proposes to take responsibility for procuring access to common property reasonable, and are they likely to remain reasonable over the proposed term of the SAU?	<p>Telstra welcomes NBN Co's commitment to obtain access to common property.</p> <p>However, in the context of a potentially disruptive roll out, Telstra believes NBN Co would be well placed to obtain consents for itself and its RSPs.</p> <p>Telstra believes there are a range of other fundamental issues relevant to the management of multiple RSPs at end user premises.</p> <p>Refer to section 5.2.10.</p>
128	Is it sufficiently clear to whom and in what circumstances the commitments apply?	<p>Telstra notes that this commitment appears to be an undertaking that exists as a separate and independent commitment from the WBA / Access Agreement.</p> <p>Application and enforcement remains unclear. Refer to section 5.2.10 and section 2.</p>
129	Does the proposed process for how NBN Co will inform and consult with customers in relation to major NBN upgrades assist customers with the planning and provision of services to end-users? Are the proposed timeframes for providing notice of	<p>Telstra considers that a more comprehensive set of commitments, which deal with upgrades of all types, as well as the interplay with other concepts such as product withdrawals, is needed.</p> <p>Telstra also notes that NBN Co has</p>

Item	ACCC Question	Response
	upgrades adequate? Do the matters that NBN Co will consult on assist customers to minimise disruptions to existing services?	broad discretion to determine whether an upgrade is a “Major Upgrade” and therefore whether it is subject to the commitments provided. Refer to section 5.2.11.
130	Does the proposed process for how NBN Co will inform and consult with customers in relation to major NBN upgrades minimise the operational and cost impact on the provision of services by customers?	Telstra would support a commitment which ensures that operational and cost impacts are taken into account by NBN Co, as well as impacts to downstream customers and end-users. Refer to section 5.2.11.
131	To what extent do the commitments about major NBN upgrades in the SAU affect incentives for investment in downstream markets?	Telstra welcomes the commitments that have been given in relation to major NBN upgrades but, as noted in the response to question 130 above, considers that a significantly more comprehensive regime is needed to provide an adequate degree of certainty for RSPs. Uncertainty in relation to timing, frequency and the impact of the upgrade may affect investment decisions. Refer to section 5.2.11.
132	Should NBN Co also supply information to, and consult with, access seekers or the general public about major NBN upgrades?	Given the impact that an upgrade may have on current and future services, Telstra would support a commitment of this kind. The manner in which information is actually disseminated may require further consideration. Refer to section 5.2.11.
133	Are the commitments reasonable, and are they likely to remain reasonable over the proposed term of the SAU?	Telstra is not able to form a view as to whether the upgrade provisions will remain reasonable over the term of the SAU given the more general concerns set out above.
134	Is it sufficiently clear to whom and in what circumstances the commitments apply?	Telstra notes that this commitment appears to be an undertaking that exists as a separate and independent commitment from the WBA / Access Agreement. Application and enforcement remains unclear. Refer to section 5.2.11 and

Item	ACCC Question	Response
		section 2.
135	Do the SAU provisions clearly describe NBN Co's commitments in respect of access to the NBN Co platform?	Telstra would expect to see more comprehensive NBN Co Platform commitments, particularly given the importance of the OSS/BSS interfaces and the lack of development at this time.
136	Are NBN Co's commitments in respect of access to the NBN Co platform in the long term interests of end-users? Are they likely to remain so over the proposed term of the SAU?	Telstra would expect NBN Co to be benchmarking OSS/BSS performance against international best practice (particularly given the systems are yet to be fully operational) and, accordingly, would expect to see commitments from NBN Co to this effect.
137	Does the proposed content and functionality of the NBN Co platform assist customers to efficiently invest in and operate their services, networks and facilities?	<p>There is a high degree of collaboration in the development of the NBN Co platform. More work is needed to develop clear functionality that will be delivered in each release and the timeframes for delivery (and NBN Co should commit to clear deliverables).</p> <p>Delays in the development of deliverables and associated timeframes will result in delays to RSP investment and capability to support services to end users.</p>
138	Is it sufficiently clear to whom and in what circumstances the commitments apply?	<p>Telstra notes that this commitment appears to be an undertaking that exists as a separate and independent commitment from the WBA / Access Agreement.</p> <p>Application and enforcement remains unclear. Refer to section 5.2.12 and section 2.</p>
139	Does the proposed process for how NBN Co will provide information about the rollout of the network assist access seekers and customers to efficiently invest in and operate their services, networks and facilities? Are the proposed timeframes for providing information adequate? Is the information that NBN Co will provide adequate? Is it sufficiently clear where this information	<p>Refer to section 2 and section 5.2.13.</p> <p>Further clarity should also be given about where and how this information will be made available.</p>

Item	ACCC Question	Response
	will be published?	
140	Should NBN Co commit to providing construction and service rollout progress information to “Access Seekers” as well as “Customers”?	Telstra would support a commitment of this kind.
Enforcement of SAU commitments		
141	Are the commitments made by NBN Co in the SAU sufficiently clear and unambiguous that they will be enforceable by a Court?	The NBN Co SAU contains a mixture of specified terms and conditions and more high level terms and conditions. The high level terms and conditions are often expressed in the terms of guidance as to how precise terms and conditions should be developed. In relation to these terms and conditions it is often unclear exactly what is the nature of the “commitment” being made. It follows that where there is uncertainty as to the nature of the commitment, it will be challenging to enforce those commitments. Refer to section 2.2.4.
142	Does the design of the SAU provide effective arrangements for enforcement of the commitments in the SAU?	Refer to section 2.
143	Does the SAU include sufficient reporting commitments to assess compliance with the SAU? If not, what other reporting obligations would be required, and how should these obligations be established?	The NBN Co SAU does not contain reporting commitments that would provide the ACCC (and potentially other stakeholders) with an ability to assess NBN Co’s compliance with the NBN Co SAU. There is also a threshold issue of whether it is practically possible to assess NBN Co’s compliance with many of the terms and conditions in the NBN Co SAU which are expressed as high level or guiding principles (refer question 141). In relation to the lack of reporting requirements that would enable assessment of compliance with many of the price terms and conditions, including the LTRC, refer to section 4.4.

Appendix B: Internal commercial cost control frameworks

An internal cost control framework could be modelled on frameworks implemented by network businesses in other sectors and could include:

- development of corporate objectives and robust business planning processes, including clear and objective decision-making criteria (particularly processes for planning capital expenditure);
- implementation of a business structure with clear delineation of roles between the asset owner, manager and services provider;
- an effective corporate governance framework to measure and report on performance against the corporate objectives; and
- external review and self attestation as to implementation of the corporate governance framework.

Each of these components are discussed further below.

B.1 Corporate strategy and business planning

The NBN Co SAU could include a commitment by NBN Co to provide transparency around its business objectives and planning rules. This would allow the ACCC to assess the efficiency of NBN Co's operations and the prudence of expenditure incurred.

For NBN Co it may be expected that its corporate plans would at least explain:

- current and forecast financial performance, including:
 - capital investment profiles, and in time, comparisons with capital investment profiles of international comparators or similar types of investment spending from historic infrastructure asset builds;
 - core operating and maintenance costs associated with running the network on a forecast basis, and then through time comparing actual performance against forecasts, and then in comparison with an appropriate international peer group; and
 - forecasts levels of corporate overheads, and in time comparing actual performance against forecasts, and then comparisons with an appropriate peer group.
- how it plans to drive efficiencies and achieve the lowest cost of supply and/or savings in the Total Cost of Ownership, including:
 - how it has determined its own design standards for asset building (the Network Design Rules) in the absence of guidance from an independent technical regulator, and how it plans to implement these design standards;
 - how it will seek to minimise the size of its investment to meet the performance and coverage requirements;

-
- how it plans to stage the rollout in a way that achieve lowest Total Cost of Ownership; and
 - what internal measures it plans to implement to drive operating efficiency.
 - how its operations will be organised to deliver efficiency improvements, including:
 - tendering and contract management processes aimed at promoting productive efficiency; and
 - engagement with large users of NBN Co services to ensure that these parties are sufficiently involved in the development and deployment of the network;

In established regulated businesses (with similarly established strategies), the focus of the strategy process is primarily on revision and adjustment as required periodically (usually annually), or in response to a particular stimulus. In NBN Co's case, a "clean sheet" approach would be expected initially – which is somewhat more in-depth, and requires greater involvement in its development from the Executive and Board than a standard annual review process.

B.2 NBN Co corporate structure

The SAU could also include a commitment to a corporate structure which promotes efficient and prudent behaviour by NBN Co.

A model commonly adopted by infrastructure businesses is the "Strategic Asset Management" (**SAM**) model. The typical SAM model defines four key roles: Asset Owners, Asset Managers, Asset Service Providers, and Support Services. Most importantly, a typical SAM model assigns accountability for:

- specifying desired outcomes (asset, customer) and budget constraints to the Asset Owner, and
- selecting the most appropriate solution *to the Asset Manager*.

The delineation between these roles is illustrated in Figure 5 below.

Figure 5 – Strategic Asset Management Model

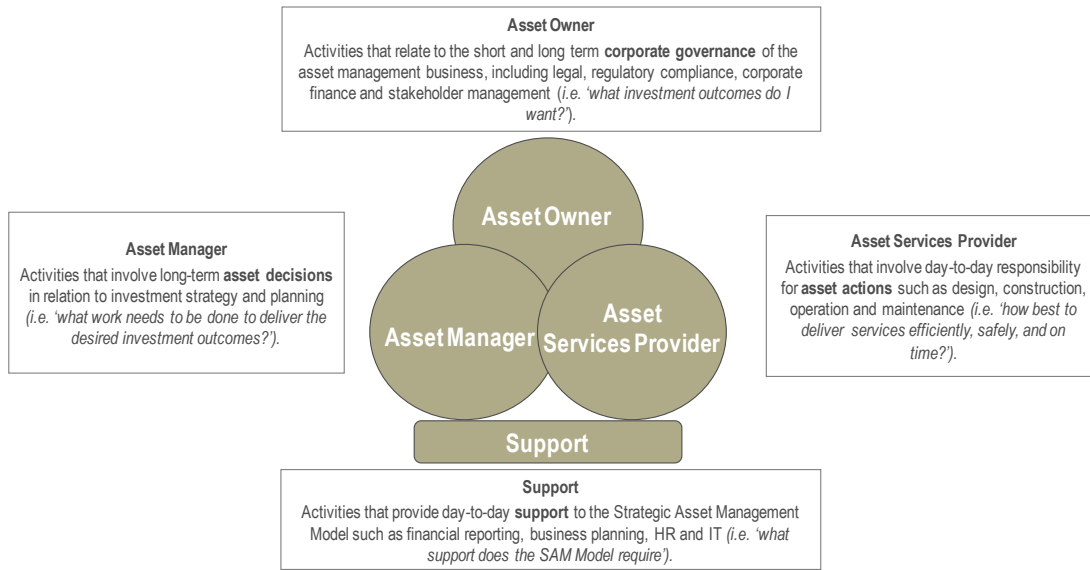


Figure 6 below illustrates how the SAM model is implemented in selected electricity network businesses. While the delineation of roles varies slightly among the six businesses listed in Figure 6, all businesses have some delineation between strategic and management roles, and between asset management and service provision.

Figure 6 – Implementation of the Strategic Asset Management Model within electricity network businesses

SPAusNet	Asset Management	Service Provision	Reg & Strategy	Co. Sec.	Finance	Human Resources	Information Technology	Business Development
PCR-CIT	Asset Management	Service Provision	Reg & Strategy	Co. Sec.	Finance	Human Resources	Information Technology	Customer Services
ETSA	Asset Management	Service Provision	Service Provision	Stakeholder Relations	Reg & Strategy	Finance	Shared Services	
Aurora	Asset Management	Service Provision	Strategy	Co. Sec.	Shared Services	Business Development		
WPC	Asset Management	Service Provision	Strategy	Co. Sec.	Finance	Human Resources		
Ergon Energy	Asset Management	Service Provision	Stakeholder Engagement	Finance & Strategy	Customer Services	Shared Services	Business Development	General Counsel

Key: AM SP AO CSS

Key: AM = Asset Manager; SP = Service Provider; AO = Asset Owner; CSS = corporate support structures.

The focal point of the SAM model is the separation of the four key roles. This is commonly out-worked by infrastructure businesses at the executive level of their organisation structure. In mature asset management businesses, this means that:

- Each of the four roles is represented by at least one position on the business' executive; and
- Each of the executive roles can be classified into one of the four key roles.

This delineation of roles at the executive level drives an appropriate level of tension between the interests of the various roles. In some cases, it also provides a basis for businesses to out-source one or more of the SAM roles (e.g. support services), based on their desire to retain control over certain aspects of the business' operations.

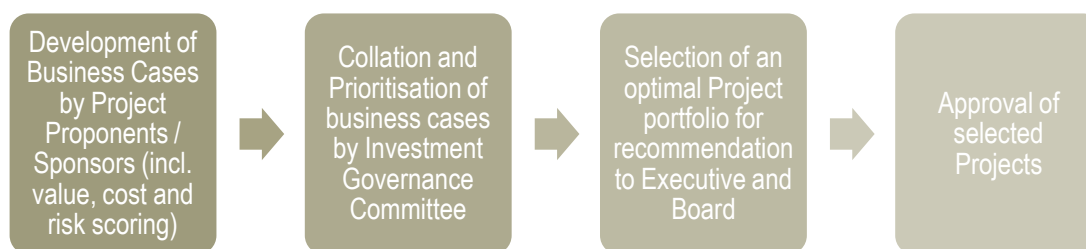
A commitment by NBN Co to a SAM model or something similar would provide some assurance to the ACCC and stakeholders that it faces incentives through its corporate structure to operate efficiently.

B.3 Corporate governance

A commitment to a particular structure which promotes efficient decision-making (such as a SAM structure) should be supported by appropriate governance frameworks to provide for transparent decision-making and measure performance against the corporate objectives.

Typically in infrastructure businesses, an internal "Investment Governance" or "Capital Prioritisation" Committee is responsible for evaluating and ranking investment priorities and allocating capital funding internally. A standard Capital Prioritisation process is shown in Figure 7 below.

Figure 7 – Model capital prioritisation process



Business cases will typically be documented in a standard format and accompanied by appropriate cost estimates and some documentation of expected benefits – usually expressed in the form of value or risk, and giving consideration to financial, safety, environmental, legal, stakeholder and/or customer impacts. The framework, policies, processes and documentation for capital investment decisions and operating and maintenance outcomes for that matter, are usually expected to explicitly link to the infrastructure business' overarching efficiency objective in meeting service standard, reliability and quality of service outcomes.

An important aspect of the capital prioritisation process is documentation of business cases and decision-making criteria. This allows the business to provide transparency to the ACCC and other stakeholders around its decision-making on key expenditure projects.

B.4 External review and self-attestation

Finally, regulated network businesses will typically be required to regularly report on decision-making under the corporate governance framework. This may include:

- Reporting on key decisions made under the governance framework, including approval of major expenditure projects;
- Reporting the results of external audits of compliance with the governance framework in development of capital expenditure programs;

-
- Reporting the results of benchmarking studies undertaken to assess the business' efficiency, compared to other similar businesses; and
 - Attestation by senior managers as to compliance with the governance framework.

In network industries where there is regular review of the prudence and efficiency of expenditure, this information will be critical for the regulator in making its assessment.

Appendix C: Options for funding of public infrastructure projects

1. Introduction

This appendix compares how the mix of funding between end-users and taxpayers can be determined for publicly provided goods and services by reference to a number of examples. The examples are used to provide an indication of the different kinds of funding arrangements that can apply to publicly provided goods and services in order to illustrate the economic principles that are involved, how these principles can be applied in theory, and how they are applied in reality.

The examples of considering and implementing these economic issues may be useful for the ACCC's consideration of the NBN Co SAU and, in particular, for examining how the mix of funding interacts with the economic efficiency components of the long-term interests of end-users criterion.

There are two main classes of situations which might lead governments to vary the funding mix as between taxpayer funding and user pays funding:

- positive spill-overs or externalities (or in the extreme case, pure public goods); and
- declining average costs.

There is also a third - but conceptually separate - class of situations, where governments may not find it desirable for users to pay the full cost of a project in order to pursue equity or other policy objectives. All three classes of situations are discussed below.

In theory, the appropriate private-public funding mix for any good or service lies at some point along a continuum which ranges from 100% user payments (or even more than 100% if the good is taxed) on the one hand, to 100% of required funding covered by general taxpayer contributions on the other.¹⁶⁵ This appendix provides a number of examples of such arrangements across the entire range of the private/public funding continuum. The examples are summarised in **Table 4** below.

Table 4 – Examples of funding arrangements

Source	User charge as a fraction of total costs
The cost of regulation (under certain circumstances)	100% (cost recovery fee or levy)
Agricultural industry programs	100% (industry cost recovery levy)
Private health insurance	60-100%
Higher education	40 -100%

¹⁶⁵ There are cases where production as a whole is funded through user charges, but some users subsidise others, with transfers within the industry compensating suppliers for any losses they incur. We classify those as involving financing through user charges, though conceptually, they should be viewed as involving a loss, financed by a tax (the excess payment imposed on the subsidising consumers), and a corresponding subsidy.

Source	User charge as a fraction of total costs
Primary and secondary education (non-government schools)	Up to 86.3% of recurrent expenses
Prescriptions under the Pharmaceutical Benefits Scheme	13.8% (on average)
National defence	0%

2. Economic Principles

This section sets out the economic and other criteria that have recently been applied by governments and/or regulatory agencies in determining the appropriate balance between public funding and user charging. In summary, where there are significant positive externalities, governments have usually provided some degree of taxpayer contribution to cost recovery.

2.1. The Australia's Future Tax System Review

A useful starting point for the analysis of the appropriate funding mix for public projects is the Australia's Future Tax System (AFTS) Review (2009). The AFTS Review's general principles for user charging are summarised in Table 5 and are couched in terms of economic efficiency. Efficient supply means that governments supply services up to the point where the marginal social benefit of the last unit of services provided (which is captured by the increase in consumer marginal benefits and producer profits) equals the marginal social cost of supplying the service.¹⁶⁶

Under the AFTS approach, which is standard in economics, the appropriate mix of funding for government projects depends on the characteristics of the good or service being provided. In particular, the key characteristics are rivalry and excludability, which are defined and discussed below.

Table 5 – Principles for the efficient funding mix of public projects¹⁶⁷

	Rivalrous	Non-Rivalrous
Excludable	Private good (100% user charges)	Club good (levy / beneficiary taxation)
Non-excludable	Common pool resource (100% user charges)	Pure public good (general taxation)

¹⁶⁶ Note that this is only the 'marginal' condition for efficiency. For supply to be efficient, as well as this condition, the 'total' condition must also be met, which requires that the benefits from total supply are no less than the costs of that supply.

¹⁶⁷ Adapted from: AFTS Secretariat, *Australia's Future Tax System – Report to the Treasurer*, December 2009, p 328, Chart E1-1.

2.2. Rivalry and Excludability

Rivalry refers to whether Individual A's consumption of a good or service reduces Individual B's ability to enjoy it at the same time. Most consumer goods are rivalrous, but some (ideas, for example, or a television or radio broadcast) are not.

Excludability refers to the ability of a producer to prevent potential consumers from consuming the good or service once it has been produced. In the absence of excludability, producers will have little incentive to produce, since they cannot charge a price in exchange for selling the good. Moreover, absent a price, there will be no mechanism for individual users to signal their willingness to pay for the good, and without excludability, all consumers will be forced to consume the same quantity of the good. Most goods and services are excludable, but some (for example, clean air) are not.

There are cases which fall between these extremes. For example, some services (such as a swimming pool or a road) are non-rivalrous if there are sufficiently few consumers, but become rivalrous once there are many consumers (due to congestion). When these goods are excludable, they are known as club goods; when they are not, they are referred to as 'common pool' goods (for instance, an untolled road). These are discussed further below.

Under this framework, the NBN public investment is probably best categorised as a club good.

2.3. Implications for Taxpayer Funding and User Charges

2.3.1. Pure private goods

As Table 5 shows, the two characteristics of rivalry and excludability determine the appropriate (i.e. economically efficient) funding and regulatory arrangements. At one end of the spectrum, there are purely private goods, in the top left hand cell of Table 5. Since these goods are rivalrous and exclusion is possible, levying a charge equal to the full opportunity cost of each unit is efficient, even if they are supplied by governments. Consumers who value the good in excess of this charge will consume the good, and those who do not, will not. Since such a pricing scheme aligns marginal social benefits with marginal social costs, it is efficient.

In this situation, efficiency requires that the economic costs of the service should be recovered.

2.3.2. Pure public goods

At the other extreme, there is the case of pure public goods in the bottom right hand cell of Table 5, which are both non-rivalrous and non-excludable. A pure public good is an extreme case of a positive externality, which is discussed further below.¹⁶⁸ Because such goods are completely non-rivalrous, the social opportunity cost of Individual A consuming an additional unit is zero. Hence, even were exclusion possible, charging users a price would not be efficient - some consumers with low valuations would not consume the good, even though their valuation exceeds the marginal social cost (zero). In this extreme case, it would be efficient for the project to be funded by the taxation system. The only remaining issue is whether the social benefits of providing the public project exceed its economic cost, including

¹⁶⁸ Of course, at least in principle, one could have pure public bads, which would amount to a universal negative externality.

the deadweight costs of taxation (also known as the marginal cost of public funds). Where the benefits net of taxation are positive, it will usually be efficient for the project to be undertaken so long as the costs of raising tax revenue are sufficiently low at the margin.

2.3.3. Summary of AFTS Approach

In summary, the AFTS review recommends that in situations where the project is a pure public good, it is efficient for the cost of the service to be covered by general taxation revenues. Conceptually the AFTS classification is very straightforward and provides a useful guide. But in practice certain difficulties may arise, particularly where public projects are neither pure private nor pure public goods – they are mixed goods, with some distinct and easily identifiable direct beneficiaries, but for which there are also (often diffuse) external beneficiaries.

3. Complications and intermediate cases

3.1. Recovery of fixed costs

In general, economic efficiency requires that a service should be provided up to the point where the marginal opportunity cost of the service equals its marginal economic benefit. As discussed above, in the case of purely private goods, charging individuals a cost recovery fee that is equal to the marginal costs of supply would achieve this outcome. However, if there are fixed costs involved in the publicly provided service or government project, then the revenue raised from marginal cost pricing will not cover fixed costs (unless marginal costs are rising at the point of efficient supply), and so there will tend to be under-recovery of costs.

An alternative to marginal cost pricing would be average cost pricing, where the fee is computed by dividing total costs by the number of units provided. This would allow the supplier of the service to cover fixed costs. However, when average costs exceed marginal costs (as tends to occur when there are significant fixed costs), average cost pricing tends to lead to an inefficiently low level of consumption and production of the good in the relevant market.¹⁶⁹ Alternatively, the government could implement marginal cost pricing and cover any revenue shortfall with general taxpayer funding. A two-part tariff (or other non-linear pricing scheme) functions to some extent as an intermediate solution, in which there is a quantity-related charge that depends on marginal costs and a fixed charge that is the “tax” which finances the difference between marginal and average cost.

Hence the choice between marginal cost pricing, average cost pricing, or some other form of pricing (such as a two part tariff) is an important design issue for the individual user charging arrangements that are put in place for particular public projects. It may also be the case that the most theoretically appropriate pricing regime is overly difficult or too costly to implement in practice, so “second best” pricing schemes may have to be implemented instead. These schemes may necessitate general taxpayers funding some of the costs of the project, even where it may not be fully efficient to do so (i.e. where, under first best conditions, users could be taxed directly through user charges to ensure cost recovery).

3.2. Club goods

Between the two extremes of pure private and public goods, there are two important intermediate cases which often arise.

¹⁶⁹ Moreover, the average cost curve may cut the demand curve at more than one point, creating an issue of equilibrium selection.

The most significant for this purpose is where a good is excludable but not completely or not always rivalrous.¹⁷⁰ As discussed earlier, these are known as club goods. Since exclusion is possible, a user charge can be levied. As the number of users increases, the good or service becomes congested and the value of consumption to all users falls. The appropriate charge should therefore reflect the cost that the marginal user imposes on the other users at the efficient outcome. If the government operates the project to maximise profits, then the profit maximising charge will automatically take account of these congestion costs. Once again, however, such charges may not fully cover fixed costs, and so some taxpayer funding may still be appropriate.

3.3. External effects

Interesting examples can arise when the provision of a good generates external uncompensated benefits to individuals who are not direct participants in the relevant market. In other words, there may be benefits flowing to those who do not directly consume the product that is being supplied. In economic terms, this externality is analogous to a public good element in the supply or consumption of the product at issue.¹⁷¹ For example, it is likely that government passenger screening at airports creates benefits for the wider Australian public, not just for airports or travellers.

In situations where the good creates significant external benefits, charging users on the basis of full cost recovery will likely lead to inefficient outcomes – too little of the service will be consumed. On the other hand, full taxpayer funding will also be inappropriate. Partial cost recovery may be desirable in principle, but in this would require the identification and quantification of the separate private and public good components of the activity. Where goods are supplied publicly, a specific form partial cost recovery can take is a reduced rate of return requirement on the public enterprise responsible for supply, though care then needs to be taken that the reduced cost of capital does not distort decisions about factor (e.g. labour/capital) intensity.

4. Other objectives

Governments often provide goods and services to meet equity objectives. Usually these equity objectives are assessed on the basis of income, age, location or health status of potential recipients.

Another set of criteria often used (particularly with reference to health, education and the arts) is that certain goods and services must be supplied by the government when individuals do not consume them in efficient amounts. Such goods are known as merit goods. There are several analytical problems with merit goods, and unlike the concepts of rivalry, excludability and externality, the concept itself does not provide much guidance on the appropriate mix of private and public funding.

5. Broad classes of funding mechanisms

In addition to various mixes of funding arrangements there are a number of regulatory and funding mechanisms which can be used in the provision of government goods and services. Common mechanisms include:

¹⁷⁰ The other case involves goods that are rivalrous but not fully excludable, i.e. common pool resources.

¹⁷¹ Indeed, all goods can be considered to have degrees of “public-ness” depending on the extent of their externalities in consumption or production. See E. J. Mishan (1969) “The Relationship between Joint Products, Collective Goods, and External Effects”, *Journal of Political Economy*, Vol. 77, No. 3, pp. 329-348.

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- regulations that require or allow a producer to undercharge all consumers, with any shortfall being funded through consolidated revenue;
 - regulation to force a producer to undercharge certain groups (e.g. consumers in high cost areas);
 - pure cash subsidies to all users or targeted users;
 - cash subsidies to producers;
 - vouchers to all users or targeted users; and
 - cross- subsidies (undercharge on some services, overcharge on others), which may be as an offset to the second mechanism listed above.

The following examples provide instances of most of these mechanisms.

6. Examples

Discussions of the efficient funding approach for government supplied goods have occurred in many other sectors. This section identifies some sectors where these issues have arisen and, where possible, illustrates the mix of funding that has been adopted.

6.1. Health

6.1.1. The Pharmaceutical Benefits Scheme

The Pharmaceutical Benefits Scheme was established in 1948 and is an Australian Government subsidy program for medicines. It is currently managed by the Department of Health and Ageing and administered by Medicare Australia. The PBS is universal, covering all Australian residents with a Medicare card. Only certain medicines are subsidised, with the PBS Schedule listing the medicines available to be dispensed to patients at a Government-subsidised price.

The PBS has a form of user-charging. Under the PBS, patients must make a co-payment towards the cost of PBS-listed medicines. As at 1 January 2012, individuals must pay up to \$35.40 for most PBS medicines, with concession card holders (pensioners, seniors, etc) paying only \$5.80. The remaining cost is covered by taxpayers. In addition, individuals and families facing large overall expenses for PBS-listed medicines are further subsidised through the existence of safety nets, whereby taxpayer funding rises to 100% once a certain limit is reached in a year. The amount of co-payment is adjusted on 1 January each year in line with the Consumer Price Index (CPI). On the supply side of the market, the Government enters agreements with drug manufacturers, wholesalers and pharmacies in order to contain the prices of PBS-listed medicines.

In the year to June 2011, PBS expenditure totalled \$8,872.7 million, with patient contributions of \$1,423.8 million.¹⁷² Thus, patient contributions amounted to 13.8 per cent of total prescription expenses under the PBS.¹⁷³ The average dispensed cost per prescription of

¹⁷² See: Department of Health and Ageing, *Summary of Pharmaceutical Benefits Processing, Year Ending 30 June 2011*, at (<http://www.health.gov.au/internet/main/publishing.nsf/Content/pbs-stats-pbexp-jun11>), accessed 4 April 2012.

¹⁷³ Ibid.

PBS medicines was \$46.57 for the year ending June 2011, with the average taxpayer cost equal to \$39.¹⁷⁴

6.1.2. The private health insurance rebate

The Private Health Insurance Incentives (**PHII**) Act 1998 (now repealed) introduced a 30% rebate for private health insurance in January 1999, replacing the previous private health insurance incentives (PHII) subsidy for low income earners. From April 2005, the rebate for persons aged 65 -69 years increased to 35 per cent and for persons aged 70 years and over it increased to 40 per cent. Recent changes outlined in the Fairer Private Health Insurance Incentives Bill 2012¹⁷⁵ will reduce these rates, resulting in a tiered system by level of income, age and family status.

According to the Bills Digest for the PHII Act 1998, the private health insurance rebate was “aimed at reducing the decline in private health insurance membership and restoring the balance in the health system.”¹⁷⁶ That is, the legislation was (in part) intended to reduce pressure on the public health system by reducing surgery waiting lists and congestion in public hospitals. Returning to the theoretical arguments outlined earlier, the public hospital system can be regarded as a rivalrous, deliberately non-excludable service which is susceptible to problems usually associated with common pool resources (that is, inefficient over-utilisation).

Direct exclusion via the establishment of property rights or tradeable quotas or permits is not possible in this case, due to the overarching policy objective of providing universal access to the public health system and of not imposing direct user charges for public hospitals. Instead, queues, waiting lists and overcrowding act as a rationing device for scarce public hospital resources. A policy which subsidises private substitutes could, in principle, reduce problems associated with the “tragedy of the commons” in the public health system.¹⁷⁷

6.2. Education

6.2.1. Higher education funding

Higher education in Australia is subsidised by governments in two main ways:

- base funding through Commonwealth Grants paid directly to universities and which includes funding for teaching, administration, capital works and research; and
- Student fee payments (known as the Higher Education Loan Program (HELP), previously known as the Higher Education Contribution Scheme (HECS) scheme.

Much of the funding for higher education in Australia is administered under the *Higher Education Support Act (2003)* (Cth) (**HESA**). Other funding is administered through annual appropriations. The majority of funding for higher education non-research operating resources is funded via the Commonwealth Grant Scheme (**CGS**) which was established in the HESA. This provides for a specified number of “Commonwealth supported places”, for

¹⁷⁴ Ibid.

¹⁷⁵ See http://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r4597_aspassed/toc_pdf/11108b01.pdf;fileType=application%2Fpdf

¹⁷⁶ See http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd9899/99BD023

¹⁷⁷ For an analysis of the situations in which governments may subsidise private facilities to reduce congestion in public facilities, see Glazer, G. and Niskanen, E. (1997) “Why Voters May Prefer Congested Clubs,” *Journal of Public Economics*, 65: 37-44.

which students pay a contribution. Institutions which receive CGS funding must enter an agreement with the Commonwealth. Table 6 below sets out the total funding from these sources for Australian institutions in 2010.

Table 6 – Australia's higher education funding mix, 2010

Source	Amount (\$ billion)	Share of total
Australian Government Grants	\$9.38 billion	42.3%
Direct User Fees and Charges	\$5.17 billion	23.3%
HECS-HELP Payments	\$2.59 billion	11.7%
Other Income	\$1.39 billion	6.3%
Consultancies and Contracts	\$0.89 billion	4.0%
Investment Income	\$0.82 billion	3.7%
State and Local Government Financial Assistance	\$0.8 billion	3.6%
Upfront Student Contributions	\$0.54 billion	2.4%
FEE-HELP Payments	\$0.49 billion	2.2%
Royalties, Trademarks and Licenses	\$0.10 billion	0.4%
Total	\$22.16 billion	\$4.8 billion

Source: DEEWR (2010).

The recently released Higher Education Base Funding Review (the Lomax-Smith (LS) Review) examined the issue of the appropriate private/public funding mix for higher education, using a simple Pigouvian subsidy framework that was originally applied to higher education in the UK by Barr (2003).¹⁷⁸ The LS Review Panel commissioned Professor Bruce Chapman from the Australian National University to prepare a study that estimated the value of the public benefits of higher education. It then used OECD estimates of private returns to higher education in Australia and other advanced economies and, applying Professor Chapman's results, found that public benefits account for approximately 40 to 60 per cent of

¹⁷⁸ Barr, N (2000), "The benefits of education: what we know and what we don't" in *Economic Growth and Government Policy*, HM Treasury, www.hm-treasury.gov.uk/d/252.pdf

the average base funding amount. The review therefore argued that “the Government should contribute anywhere between 40 to 60 per cent of the total base funding for a unit of study, with students contributing the balance.”

As matters currently stand however, the funding proportions vary, depending on the course of study. Some relatively low cost courses receive a low absolute subsidy; that is especially so for courses which are viewed as yielding high private returns, as is commerce, for which the proportionate subsidy is very low. In contrast, some courses, such as medicine and nursing, are subsidised by a much higher absolute amount and at a much higher proportionate subsidy rate.

The recommendations of the review therefore raise two sets of issues: what is the right benchmark for the subsidy rate? And how should that be implemented given that the various courses have differing ‘costs to serve’? These issues are currently being examined.

6.2.2. Primary and secondary education

Primary and secondary schools in Australia are supported financially by a mix of government and non-government funding. Most (78 per cent of a total of \$36.4 billion in 2007-08) government funding comes from State and Territory governments, and most support (79.1 per cent of all funding in 2007-08) is provided to government schools.¹⁷⁹

Commonwealth funding of recurrent costs in non-government schools is governed by the *Schools Assistance Act 2008* (Cth), and is determined by applying a non-linear formula to the socioeconomic status (SES) index of the school community.¹⁸⁰ Under this formula, funding ranges from between 70 per cent of Average Government School Recurrent Costs (AGSRCs) to 13.7 per cent. Capital funding is provided under separate arrangements, which generally involve a smaller subsidy to non-government schools than is provided for recurrent costs.

The recent Review of Funding for Schools (the Gonski review) proposes moving to a system where subsidy rates, for both recurrent and non-recurrent costs, would become somewhat more uniform as between government and non-government schools. A new funding instrument, the school resourcing standard, would be introduced, and would be determined and implemented by a National Schools Resourcing Body.

In economic terms, the essence of the approach proposed by the Gonski review lies in the application of a ‘capacity to pay’ test to non-government schools, along with a set of adjustment factors intended to compensate for unusually high costs (as might be incurred in teaching, for example, students with a disability). In that sense, the scheme involves a tax for opting-out of the government school system, where the extent of the tax depends on income. As matters currently stand, that tax is not implemented through a direct means test on the parents; rather, it is—and for the immediate future will remain—based on the family background of the entire student body at the non-government school at issue. However, the review recommends ultimately moving to a more granular income assessment, which would involve direct means-testing.

¹⁷⁹ Department of Education, Employment and Workplace Relations, *How are Schools in Australia Funded: Review of Funding for Schooling*, (<http://www.deewr.gov.au/Schooling/ReviewofFunding/Pages/FactSheets.aspx>, accessed 4 April 2010).

¹⁸⁰ A summary of the precise way in which this is done can be found at <http://www.deewr.gov.au/Schooling/ReviewofFunding/Documents/Non-GovtSchools.pdf>.

To the extent that primary and secondary education has positive externalities, education subsidies may be justified on efficiency grounds. Efficiency considerations are also important for determining the appropriate principles that should govern the structure and design of education subsidies (e.g. government ownership versus cash grants versus vouchers).

6.3. The Australian Government cost recovery guidelines

The recovery of regulatory costs at the Commonwealth level is governed by the Australian Government's Cost Recovery (**AGCR**) Guidelines, which state that where appropriate, the full costs of a regulatory activity should be recovered from industry.¹⁸¹ For example, under the AGCR guidelines, the costs of Australian Government container inspections at ports are recovered from importers.

The full economic cost of each regulatory activity is the value of all resources used in providing each of those outputs. Basic cost recovery principles (as outlined in the AGCR Guidelines) dictate that user fees for regulatory services should, as closely as possible, reflect the economic costs of providing those services, and that fees charged to users of services should reflect all these costs.

Broadly speaking, the AGCR guidelines provide details regarding:

- **Classification of activities:** For cost recovery purposes, regulatory activities are classified according to their broad regulatory function. This classification scheme is discussed further below.
- **Assessment of cost recovery arrangements:** Once activities have been classified, the AGCR guidelines provide detailed guidance on the principles which must be used (and the questions which must be asked and answered) to assess the appropriateness of funding arrangements.

6.3.1. Principles of cost recovery and user charging under the AGCR Guidelines

The following guiding principles are outlined in the ACGR guidelines:

- **Activity Basis:** Cost recovery arrangements should be undertaken on an activity basis, rather than across agencies as a whole.
- **Legal Authority:** Cost recovery arrangements should have clear legal authority.
- **Efficiency:** Costs should be fully recovered where it is efficient to do so. For example, imposing a fee or levy in relation to a particular activity might unduly restrict or reduce competition or innovation in the relevant industry or industries. Alternatively, there may be some instances in which a fee is charged for a service and this encourages "free-riding" by other market participants, which indicates that a levy may be the more appropriate cost recovery mechanism.
- **Cost Effectiveness:** Costs should not be recovered where it is not cost effective to do so (i.e. where the revenue that would be collected would be less than the administrative and other costs of collection). For example, the cost of calculating, implementing, collecting,

¹⁸¹ The guidelines can be found at http://www.finance.gov.au/publications/finance-circulars/2005/docs/Cost_Recovery_Guidelines.pdf.

enforcing and administering a fee for a particular function that is performed in relation to regulatory activity may itself exceed the fee that is collected.

- **Policy Consistency:** Cost recovery arrangements and fees should be assessed keeping government policy objectives in mind and should not be inconsistent with those objectives.
- **Integrity:** Costs that are not directly related or integral to the provision of goods or services should not be recovered.

6.4. Agricultural levies

As outlined in the AFTS Review, the Australian Government imposes a large number of agricultural levies.¹⁸² The levies, which are designed in consultation with industry, are intended to cover the costs of club goods (such as research and development or testing for contaminants, which have spill-over effects and tend to benefit the entire industry). The levies are administered by the Australian Government.

For example, the National Residue Survey involves the oversight and performance evaluation of sampling and testing of residues of agricultural and veterinary chemicals and environmental contaminants in Australian food commodities. Sampling and testing information is requested by industry to facilitate access to export and domestic markets. The tests are undertaken based on a random sampling approach within each industry group. The vast majority of the costs of this program are covered by industry levies or contracts with peak industry bodies. Industry members voluntarily participate (i.e. at their own request), and earmark a percentage of their general industry levy to cover the program costs.

6.5. Public transport

Public transport is heavily subsidised in all Australian urban areas. Typically, the extent of the subsidies is measured by reference to operating expenses on the one hand, and total long run costs (including capital charges) on the other. There are significant differences in definitions used as between states and operators, so some element of estimation is inevitable in making inter-jurisdictional comparisons.

Bearing that in mind, for rail, the working expense recovery proportion varies in the range 63 – 26%. The highest-performing system is Melbourne (63%); three systems—Sydney, Perth and Brisbane—are ‘moderate’ performers, recovering 40-37% of expenses; while Adelaide only recovers 26% of expenses. Equally, for bus transport, the working expense recovery varies from 36% for Brisbane to 24% in Melbourne. Particularly for rail, cost recovery is significantly lower when a long run cost benchmark is used, with even Melbourne’s rail system only recovering 24% of its costs.

Typically, these subsidies are explained on three grounds. First, the absence of congestion charges on roads means that the road mode is ‘under-priced’ on congested routes, in that usage is pushed to the point where each driver faces the average cost, rather than marginal social cost, of road use. As congestion implies that the marginal social cost of added road use exceeds the marginal private cost, there is a corresponding welfare loss. In principle, subsidies to public transport shift some of that traffic off the roads, reducing the welfare loss. Whether there is indeed such a welfare gain (or more strictly, a reduction in the welfare loss)

¹⁸² For a complete list, see: AFTS Secretariat, *Australia’s Future Tax System – Report to the Treasurer*, December 2009, pp 333-335.

obviously depends on the elasticity of substitution between modes and on the marginal cost of public funds (as taxes must be raised to pay for the subsidies).

Second, public transport, particularly rail, has high fixed costs and low marginal costs. A subsidy may avoid some part of the allocative distortion that would be caused by average cost pricing.¹⁸³ Here too, whether this results in a welfare gain depends on the net benefits from this policy relative to alternatives (for instance, peak-load and multi-part pricing).

Finally, equity considerations may play a part, all the more where subsidising public transport provides gains in terms of socially (and potentially economically) beneficial goals such as labour force participation and social integration.

¹⁸³ For some forms of public transport, the Mohring law approximately holds, so charging marginal cost would recover total costs.

Appendix D: Intellectual Property Proposal

Customer Background IPR

- There must be no mandatory acquisition (including licence, transfer or assignment) of Customer Background IPR to or by NBN Co, or its related entities.
- NBN Co's access to Customer Background IPR must be separately agreed on commercial terms and documented between the parties (consistent with any other 3rd party IP supplier to NBN Co).
- RSP representations and warranties in relation to Customer Background IPR should not be included in the WBA, on the basis that there is no default acquisition of Customer Background IPRs. These types of issues should be the subject of separate commercial negotiation (i.e. as part of the commercial terms agreed between the parties).
- If NBN Co receives any licence of Customer Background IPR (as part of an agreement on commercial terms), NBN Co must not use that licence as security, including as a security under the Personal Properties Securities Act 2011. Accordingly, any licence, or other right, granted for the benefit of NBN Co should be non-transferable (or an undertaking signed that it cannot be used for the purposes of security).

New IPR

- While it may be appropriate for "New IPR" to vest in one party, this regime needs to be reconciled with that dealing with product development more generally (where most of the "New IPR" will be developed). The outcomes of the NBN Co SAU regarding the PDF will provide the context for then assessing what would be an appropriate regime for New IPR.
- Ultimately, Customer IPR (i.e. both Customer Background IPR and intellectual property the Customer acquires from third parties) must never be subject to mandatory "New IPR" acquisition (including licence, transfer or assignment).

Product Ideas and Development

- It is critical that there is no compulsion on RSPs to submit an idea to NBN Co (and RSPs should not be precluded from the benefits of the PDF if they do not submit ideas).
- NBN Co has the option to source IPR inputs for its product development from RSPs, or from parties other than RSPs (i.e. other vendors), or to develop its own IP. Accordingly, bilateral commercial arrangements in this context are entirely appropriate.
- Where an RSP submits a "Product Idea" into the PDF:
 - Prior to submitting the idea, RSPs may seek to separately negotiate an arrangement with NBN Co which adequately addresses any specific IPR of that RSP.
 - No default acquisition (including licence, transfer or assignment) of any Customer IPR should be provided.
 - No RSP representations, warranties or indemnities should be given in relation to its Customer IPR (again, unless these are specifically negotiated and agreed).

- Telstra believes the following “two-tiered” regime would create a process for dealing with new product ideas and development which encourages participation, innovation and competition between RSPs.

Ideas Stage

- There should be a high level “idea” submission stage e.g. a submission which gives NBN Co a high level understanding of an “idea”, sufficient for NBN Co to discuss the “idea” within the PDF to gauge interest and potential development opportunities.
- At this time, the RSP would forgo any rights to claim IPR in the copyright in the written expression of the “idea” submitted to NBN Co and would grant NBN Co a limited licence for the purpose of considering the idea in the PDF only (i.e. not for adaptation, exploitation, commercialisation or productisation).

Product Stage

- If, following the “Ideas Stage”, NBN Co is interested in using any Customer IPR to develop and “productise” an idea submitted by an RSP, then the parties will separately negotiate commercial terms to do so, including terms relating to access, consideration and any warranties/indemnities etc (to the extent commercially appropriate).
- If NBN Co receives any licence of Customer IPR, NBN Co must not use that licence as security, including as a security under the Personal Properties Securities Act 2011. Accordingly, any licence, or other right, granted for the benefit of NBN Co should be non-transferable (or an undertaking signed that it cannot be used for the purposes of security).

NBN Co's IPR

The NBN Co SAU and WBA must not include any potentially misleading statements as to IPR ownership by NBN Co, e.g. ownership of IPR is not established merely by stating it – an express grant or assignment is required.

Third Party IPRs

Any obligations to procure third party IPR must be set against the reality that IPR licences will depend on external factors (e.g., existing contractual terms, third party licensing practices) along with the commercial value inherent in those IPR. An RSP would likely pay more to acquire a broader licence from its third party suppliers e.g. a licence broad enough to benefit not only the RSP customer but also the RSP's supplier (NBN Co) plus the supplier's (NBN Co's) other customers.

Appendix E: Telstra's assessment of the service description against ACCC principles

Item	ACCC Criteria	Telstra's assessment
ACCC service description principles		
1	The service should be described in terms which are as functional as possible, to leave the access provider with flexibility to determine the most efficient way of supplying the service and access seekers with flexibility in the type of service that can be provided within the ambit of the declared service. Technical terms may, however, be appropriate where a functional description would provide scope for ambiguity.	<p>Telstra does not object to the functional approach used by NBN Co to describe the service. However, as the ACCC's principle states "[t]echnical terms may, however, be appropriate where a functional description would provide scope for ambiguity".</p> <p>Critical details regarding all physical, technical and service attributes of the service are needed (refer to section 3.1).</p>
2	The eligible service should be described in a manner which provides sufficient clarity for application of the Category B SAOs.	<p>Critical details regarding all physical, technical and service attributes of the service are needed (refer to section 3.1). Without these details, it is difficult to discern which services are "included" as part of the NBN Access Service (and are therefore subject to the Category B SAOs) and which services are "excluded".</p>
3	The service should be one for which it is technically feasible to supply and charge.	<p>As Telstra understands it, NBN Co intends to deliver the NBN Access Service by supplying the "Product Components". In other words, NBN Co will supply and charge for the individual Product Components, rather than the "NBN Access Service".</p> <p>While Telstra does not object to the "Product Component" construct adopted by NBN Co, it is not clear whether the Product Components form part of the NBN Access Service (refer to section 3.1.1.2).</p>
ACCC's Bitstream Access criteria		
4	A Layer 2 bitstream access service, which may be offered at a variety of rates but should include a product that is not throttled as well as a product that is symmetric to the extent that technology permits. Products (both consumer and business grade) should be equally available to all access seekers on a non-discriminatory basis.	<p>While Telstra acknowledges that the service description for the NBN Access Service would encompass services provided at a variety of rates, the NBN Co SAU does not provide any firm commitments regarding the types of services that will be made available (beyond the Basic Access Offer). This includes business grade products.</p>

Item	ACCC Criteria	Telstra's assessment
		<p>Telstra also notes that NBN Co has referred to its "Product and Pricing Paper" in the NBN Co Supporting Submission (at page 44), however, this document has no bearing on NBN Co's commitments under the NBN Co SAU.</p> <p>Refer to section 3.</p>
5	<p>A service (whether the bitstream or another service) that allows access seekers to provide a voice service and that provides for standard E 164 numbering and addressing.</p>	<p>Telstra understands that the NBN Network is agnostic to the requirement to support E 164 and that RSP's will be required to ensure that their voice solution using the NBN Network caters for this requirement.</p>
6	<p>A wholesale service which offers:</p> <ul style="list-style-type: none"> • a range of data packet priority options; • a range of quality of service options to allow retail service providers to offer commercially viable services; • interfaces that permit a retail service provider to control the network and service configuration (including fault status, if relevant) of its own customers. 	<p>Beyond the basic Product Features that are included as part of the Basic Access Offer, the NBN Co SAU does not provide any firm commitments regarding the range of data packet priority and quality of service options that will be available.</p> <p>Further, in the absence of critical details regarding the physical, technical and service attributes of the service, it will be very difficult for RSPs to offer commercially viable services (refer to section 3.1).</p> <p>NBN Co has also indicated that there will be very limited direct testing capability of end user services (and it is not clear whether the testing capability will have to be acquired as an Ancillary Service (refer to section 3.1.1.1)).</p>
7	<p>POIs which are commercially feasible for service providers and support competition, including competition for backhaul services from the first point of aggregation.</p>	<p>Refer to section 5.2.9.</p>
8	<p>Interconnection protocols based on well-accepted standards for broadband, voice and, if applicable, video, which are sufficiently well described to allow access seekers to design and build their own interconnecting facilities.</p>	<p>To date, NBN Co has not provided sufficient information to enable full development of voice and video capabilities. The NBN Co SAU should be clear as to whether NBN Co will fully implement industry accepted standards to cater for the provision of feature sets that are equivalent to today's offerings.</p>

Item	ACCC Criteria	Telstra's assessment
9	Arrangements for access to buildings, shelters and facilities for interconnection.	The NBN Co SAU confirms that NBN Co will provide a "Facilities Access Service" as an Ancillary Service. However, further detail about this service, including the terms on which it is to be supplied, is needed. Refer to section 3.1.1.1.
10	Equivalent treatment of access seekers in relation to all interfaces (including quality of service provision) required to provide a service.	Telstra notes NBN Co's obligation to supply services on a non-discriminatory basis under the CCA.
11	An appropriate process for amending service specifications in later periods as needed or desirable, and adequate notice periods for any change.	<p>The effect of an "open ended" definition for "Product Component" means that the scope of the NBN Co SAU will "expand" to encompass new Product Components as they are developed over time.</p> <p>As noted, in section 3.1.1.1, Telstra generally supports this approach, however, if this approach is taken it will be critical to ensure that:</p> <ul style="list-style-type: none"> • the product development commitments are appropriate and effective (see section 3.2 generally); • RSPs have certainty about all physical, technical and service attributes of new products (see section 3.1 generally); and • there is an appropriate level of oversight of the terms on which new products are to be supplied (see section 3.1.1.1 and section 3.2).