



Optus Submission to the ACCC
Consultation Paper

NBN Co Limited 2012 Special Access Undertaking

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Section 1. Overview

Effective regulation is critical to a successful NBN

- 1.1 Optus has been a strong advocate for structural reform of the fixed line sector based on a wholesale-only national high speed broadband network. The planned National Broadband Network (NBN) has the potential to be a transformative piece of national infrastructure. It has the potential to deliver significant economic and social benefits to businesses and consumers across Australia and to narrow the current digital divide between urban and regional centres.
- 1.2 But deployment of the technology alone will not guarantee that the potential benefits of the NBN will be realised. How the network is managed and operated through its life cycle is equally important — inefficient roll-out and operation of the NBN will undermine many of the promised benefits.
- 1.3 To ensure that the NBN can be delivered, the Government has established the NBN as a single national network that will be used by all retail service providers. The creation of a government-owned monopoly in effect reverses the underlying trend of the past two decades for competition policy objectives to be focused on facilities based competition.
- 1.4 A critical factor in determining whether the NBN is successful as a monopoly provider of services, will be the regulatory arrangements that apply to NBN Co. As a legislated monopoly NBN Co will not be subject to the discipline of a competitive market. Regulatory arrangements that apply to NBN Co must compensate for this absence of competitive constraint. They must do so by ensuring that NBN Co continues to put end-user outcomes first by seeking to deliver the best quality of service at the lowest possible cost.
- 1.5 Optus acknowledges the importance of existing policy initiatives to shape the regulatory settings within which NBN Co must operate. This includes the requirement for NBN Co to operate as a wholesale only entity that cannot operate in retail markets. It also includes obligations to ensure that it must offer services on non-discriminatory terms and set uniform national wholesale prices.
- 1.6 These policy initiatives will avoid past problems where a vertically integrated incumbent and the dominant supplier of retail and wholesale services had both the incentive and opportunity to discriminate against its wholesale customers. NBN Co will not compete with its own customers. Thus, it should have no incentive to discriminate against its customers. This structure should ensure that NBN Co has stronger incentives to be responsive to access seeker requirements since its success will be directly dependent on the success of those access seekers.
- 1.7 However, reliance on NBN Co's wholesale-only structure can only go so far. The legislative provisions that establish NBN Co as sole supplier of services and discourage alternate high-speed networks, will give it an unprecedented market position.
- 1.8 Whilst there should be a strong correlation between the interests of NBN Co and access seekers, it should not be assumed that their interests will always align. For example, NBN Co and access seekers' interests may diverge on issues such as risk management, service quality

and price. Further, the wholesale-only structure of NBN Co will not guarantee that it will seek to operate as an efficient and highly customer focused operation.

- 1.9 To ensure that the NBN delivers the highest quality of service at the lowest cost, it must be subject to effective independent regulatory oversight by the ACCC — consistent with regulatory regimes imposed on other network industries. NBN Co expects to incur around \$64 billion in expenditure up to 2021, and substantially more over the full lifetime of the SAU.¹ The scale of this expenditure is unprecedented and even small improvements in efficiency would have substantial benefits.

SAU should provide for greater ACCC oversight

- 1.10 NBN Co's Special Access Undertaking (SAU) represents a voluntary proposal from NBN Co about how those regulatory arrangements should be structured. NBN Co has indicated that the SAU has been developed to provide certainty about how the terms of access will be set and to ensure that it can recoup its costs and price services in line with its uniform national wholesale price obligations. NBN Co has indicated that it considers the certainty provided by the SAU is superior to the alternative arrangements that would involve the ACCC regulating access terms through its powers under Part XIC.
- 1.11 Optus acknowledges that NBN Co has a legitimate claim for some level of certainty, particularly in respect of its ability to recoup efficiently incurred costs. However, the question the ACCC has to answer is not whether the SAU provides appropriate certainty for NBN Co; rather it is whether the terms of the SAU are reasonable. The reasonableness of the SAU will turn on whether it provides for an appropriate form of regulation which through time will result in access terms that promote the long term interests of end-users of services (LTIE).
- 1.12 The current SAU has been significantly modified from the 2011 version. It is now based on a modular structure that has been developed to provide differing degrees of ACCC oversight to different aspects of the process for setting access terms. This represents a positive improvement to the 2011 SAU that provided for little if any ACCC oversight over its term, albeit at a high level.
- 1.13 However, the current SAU is a complex instrument and close attention needs to be given to the detailed provisions to understand the effectiveness of the powers it confers on the ACCC and the powers it directly or indirectly excludes. A review of those detailed provisions indicates that ACCC oversight arrangements remain highly constrained:
- (a) The scope of issues which the ACCC can review is narrow. There is for example very limited ability for the ACCC to review access prices once the SAU is locked in;
 - (b) Any matter that can be reviewed by the ACCC is constrained by the need to maintain consistency with terms set out elsewhere in the SAU;
 - (c) The SAU imposes a process straitjacket on the ACCC in terms of timeframes and matters it has to have regard to in undertaking any review; and

¹ Source: NBN Co Corporate Plan 2012-2015 (\$37.4 billion in capex and \$26.4 billion in opex), p.71.

- (d) Several terms in the SAU are expressed in a subjective way so that they provide NBN Co with wide discretion and are accordingly likely to be difficult to enforce.
- 1.14 It is also clear from the ACCC's discussion paper and correspondence between the ACCC and NBN Co that there is uncertainty about how some provisions within the SAU will operate. This has the potential to create future disagreement about how the ACCC can exercise its powers under the SAU.
- 1.15 When viewed in its totality the SAU seeks to lock-in a set of rigid and complex regulatory oversight arrangements the aim of which is to deliver a high degree of regulatory certainty for NBN Co. However, this comes at the expense of removing flexibility for the ACCC to respond appropriately to changing circumstances as technology, competition and the market evolves. It is difficult to avoid the conclusion that the practical effect of these arrangements is that the ACCC's powers to take independent action remain unreasonably circumscribed. The likely implications of acceptance of the SAU, as currently drafted, would be to lock access seekers into an access regime where the control of the process is effectively 'owned' and 'managed' by NBN Co, and the scope for regulatory intervention is very limited. This raises significant questions about the ACCC's ability to ensure that access terms to the NBN will continue to serve the LTIE over time.

Price control arrangements are ineffective and create a real risk of excessive pricing

- 1.16 The risks related to inadequate ACCC oversight are best illustrated by the approach taken within the SAU to pricing and the recovery of costs. Specifically, the absence of effective ACCC oversight together with NBN Co's ownership structure and its dominant position in the wholesale market, increase the potential for over-capitalisation that could, in turn, generate higher costs of access for consumers.
- 1.17 Optus' analysis indicates that there are several problems with NBN Co's approach to pricing over the term of the SAU:
- (a) NBN Co's price control mechanism does not provide an adequate disincentive against excessive capital investment. NBN Co's revised SAU provides for a guaranteed rate-of-return on capital invested.² It is widely argued by academics and regulators that this mechanism does not contain sufficient incentives to produce, price and distribute outputs efficiently, and may contain perverse incentives for excessive capital investment.
- (b) The risk of excessive capital investment mirrors recent concerns relating to retail price increases in electricity in Australia. This issue was raised by the ACCC Chairman in a recent speech.³ Mr Sims concluded that the central flaw in the electricity regulatory regime was that it made the proposals of the "*monopoly businesses so central to the process, or so restricts the ability of the regulator to set independent*

² Schedules 1F and 2D.

³ Where it was noted prices increased by 60% in real terms over the past five years - *Addressing the key drivers of electricity price increases* – Speech by Mr Rod Sims, Chairman, 24th October 2012.

forecasts of the allowable rate of return, or of required expenditure".⁴ The provisions in the NBN Co SAU would result in the same impugned regime being applied to NBN Co for 27 years. There is a real risk that the problems currently seen in the setting of electricity prices could arise with fixed line broadband over the term of the SAU.

- (c) In combination with the ineffective price control mechanism the structure of prices in the SAU is likely to mean that the historic trends of lower broadband prices is reversed as the costs of access increase both in real and nominal terms over time. Whilst NBN Co has committed to reduce prices in the context of its Corporate Plan, there is no obligation in the SAU for this to be enforced and the SAU provides scope for prices to increase. For example, under the current price control mechanism the average cost of using the Basic Access service would be allowed to increase by 32% in the real price over the next 10 years.⁵ This compares to broadband internet prices decreasing by 18% in real terms over the last 5 years.

- 1.18 The ability of NBN Co under the SAU to unilaterally set prices and conditions is unmatched in any other regulatory regime in Australia. NBN Co is proposing a regulatory structure that has been explicitly rejected for other industries by the ACCC, Australian Energy Regulator, Australian Energy Market Operator, and Productivity Commission.⁶

A modified SAU can promote the LTIE

- 1.19 Given the concerns identified in this submission, Optus submits that the SAU in its present form should not be accepted.

- 1.20 However, Optus considers that a properly constructed SAU that better balances the certainty requirements of NBN Co with increased scope for ACCC oversight is likely to result in more effective regulation of the NBN and better outcomes for consumers. Optus has set out some detailed recommendations on the structure of the SAU in section 2, which could provide the basis for a more effective balance between NBN Co's objectives and effective regulatory oversight as well as providing better consumer outcomes. In summary it is proposed that;

- (a) Whilst it would be appropriate to lock-in some long term principles that can provide certainty to NBN Co so that it can recover its prudently incurred costs to build the network these principles should be more narrowly focused (Module A);⁷
- (b) Further, a shorter period should apply for the current proposed Long Term Cost Recovery Mechanism (LRTCM) and Price caps. The efficacy of these arrangements should be reviewed after 10 years (the likely end of the build phase) to assess

⁴ ACCC 2012, "Addressing the key drivers of electricity price increases" – Speech by Mr Rod Sims, Chairman, 24th October 2012.

⁵ This includes the permissible CPI increases and takes into account the expected increase in the usage and hence cost of data.

⁶ See Section 4.

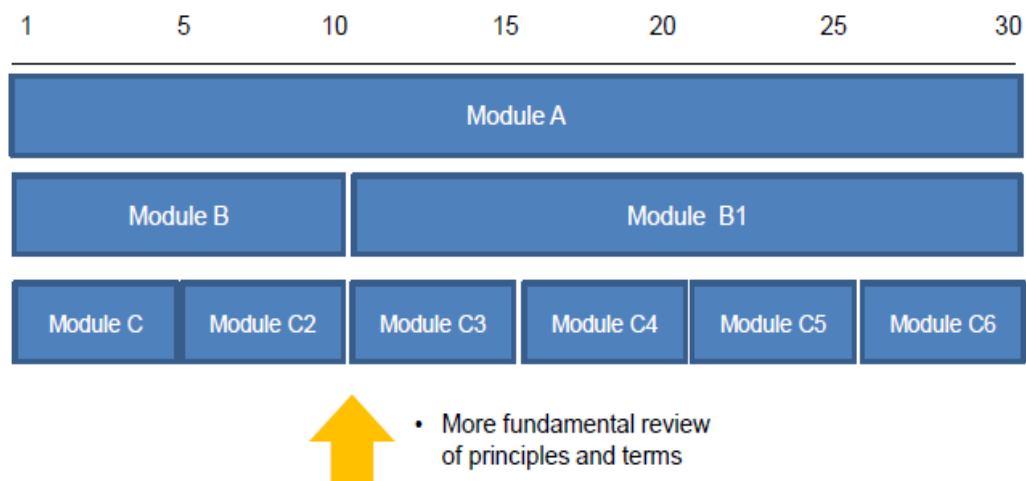
⁷ This is important given the uncertainty around the interpretation of 'fixed principles'.

whether the proposed approach to cost recovery remains appropriate for market circumstances (Module B);

- (c) The detailed terms of access, including specific price and non-price terms of access proposed by NBN Co should be subject to review every 3 to 5 years (Module C);
- (d) Any review of the arrangements within the SAU should be conducted under the Part XIC provisions that require the ACCC to have regard to reasonableness and the LTIE. The only additional constraint on the ACCC is that any decision must be consistent with any prevailing longer-term principles set out in a) and b) above; and
- (e) Further, a review on the proposed terms of the SAU should not simply be based on modifications put forward by NBN Co, it should also include consideration of modifications put forward by the ACCC and access seekers.

1.21 A schematic of this approach is set out below in figure 1.

FIGURE 1



1.22 This approach is likely to address a number of the material concerns Optus has raised in the submission about the arrangements to ensure that access terms remain reasonable and consistent with the LTIE over the next 27 years. It will also provide an appropriate means of ensuring that the arrangements remain relevant to the prevailing circumstances of the market. Further, more effective oversight arrangements are likely to act as an additional discipline on the industry to try to resolve issues on a commercial basis.

Other key issues raised in the submission

1.23 In addition to concerns raised above about the effectiveness of the regulatory oversight arrangements provided for in the SAU, Optus' submission identifies the following key issues with the SAU that will also need to be addressed.

Prudency

- The arrangements to determine the prudency and efficiency of the incurred costs are deficient as these provide neither an incentive for NBN Co to incur expenditure in a prudent

manner nor provide scope for inefficient expenditure to be excluded from access charges. This includes the fact that significant levels of expenditure are either simply deemed to be prudent or can be determined to be prudent at NBN Co's discretion.

- It also appears that the prudence provisions would be unenforceable in any dispute.

LTRCM and Price Controls

- NBN Co has confirmed that it does not expect the LTRCM to become binding during the lifetime of the SAU. As a result, the overall revenue cap will not be binding and will therefore not act to constrain NBN Co pricing.
- The Initial Pricing Principles (IPP) does not permit ACCC oversight, and are unlikely to be enforceable in the Federal Court. As such, the IPP will not act as an effective constraint on NBN Co, which means it will have the discretion to introduce prices for new and zero-rated products at whatever level it sees fit.
- NBN Co justifies the reasonableness of future prices on the combination of three constraints: overall revenue price cap; initial pricing principles; and individual CPI price increase limit. However, it is likely that only the individual CPI price increase limit is going to be in operation during the SAU. NBN Co has failed to justify that sole reliance on the individual price increase limit promotes the LTIE.
- NBN Co's proposed WACC is significantly above the real cost of financing faced by NBN Co.

Pricing Commitments in the SAU

- Optus does not consider that the initial pricing in the SAU will operate as effective anchor prices:
 - The proposed AVC/CVC price structure will result in higher prices over time as usage increases and is inconsistent with current industry pricing structures;
 - Some existing products will face higher prices for the same functionality than under legacy networks; and
 - Some new products are set at a level that prevents RSPs from using the service.

Product Development and Withdrawal process

- The efficacy and efficiency of the Product Development Forum (PDF) processes are undermined by the explicit carve out of any regulatory recourse or dispute resolution mechanism for access seekers in the likely event of a disagreement during Module 1.
- The exclusion of all products on the initial product roadmap from the PDF provides access seeker with no certainty that those product will be developed or released.
- The Initial Product Roadmap and Integrated Industry Roadmap also fail to dispel concerns surrounding the lack of detail for each of the key product attributes, allowing discretion for NBN Co to specify a sub-standard service (i.e. lower SLA) that will subsequently be supplied.

Non-price Terms and Conditions

- The SAU must ensure adequate controls over NBN Co's ability to unilaterally vary access terms and conditions — reliance on voluntary consultation with industry (particularly where there is no regulatory oversight) is not appropriate.
- The direct replication of WBA/SFAA provisions in the form of Annexures in the revised SAU is not appropriate and risks locking-in set of conditions for the length of SAU, especially as certain provisions continue to be the subject of significant disagreement between industry and NBN Co.
- Service levels proposed in the SAU do not always reflect current industry standards. Moreover, given NBN Co has no legacy systems there is no reason why it should not aim to achieve world's best practice.
- Optus recommends that the SAU adopt a principle-based approach in relation to non-price terms with the detailed provisions to be settled by the commercial agreement (subject to appropriate regulatory oversight where necessary).

SAU lacks appropriate supporting evidence

- 1.24 Regardless of Optus' view on the merits of the SAU, Part XIC of the Competition and Consumer Act (CCA) requires that NBN Co must positively satisfy the ACCC, based on all the material placed before it, that the terms and conditions specified in the undertaking are reasonable.⁸ It does not require the ACCC to satisfy itself, or to prove that the SAU is unreasonable.
- 1.25 Optus submits that NBN Co has not provided sufficient evidence to positively satisfy the ACCC that the SAU is reasonable and promotes the LTIE. NBN Co has failed to provide sufficient evidence with regards to:
- (a) The reasonableness of the initial prices in the SAU;
 - (b) The reasonableness of the future price path of products in the SAU;
 - (c) The reasonableness of the LTRCM and ICRP, especially with regards to NBN Co's expected future state of the world as expressed in the Corporate Plan 2012-2015; and
 - (d) The reasonableness of the individual price increase limit, as a stand-alone pricing rule.
- 1.26 Further, the ACCC *must* reject an undertaking where it proposes fixed principles that the ACCC does not consider should be fixed principle or that the fixed period should not be the fixed period for the fixed principles; irrespective of whether the terms themselves would be

⁸ Re Optus Mobile Pty Limited & Optus Networks Pty Limited [2006] ACompT 8 (22 November 2006); Re Telstra Corporation Limited [2006] ACompT 4 (2 June 2006); Re Telstra Corporation Ltd (No 3) [2007] ACompT 3 (17 May 2007); Application by Chime Communications Pty Ltd (No 2) [2009] ACompT 2 (27 May 2009).

considered reasonable.⁹ Optus submits that clause 2D.6 in Module 2 contains high-level principles involving judgement and discretion, and given the current level of legal uncertainty as to how fixed principles would be interpreted, it is inappropriate to place significant limitations on the ability of the ACCC to review and replace NBN Co's forecast capex, opex and revenue. These limitations are inconsistent with all other regulatory regimes in Australia.

⁹ Competition and Consumer Act, s.152CBD(4).

Section 2. Recommended changes to the structure of the SAU

- 2.1 As will be discussed in greater detail in section 3 and 4 of this submission, Optus has significant concerns with the structure of the regulatory arrangements proposed in the SAU.
- 2.2 The modular approach adopted by NBN Co is not of itself the problem. Optus considers there is merit in a modular approach since it can provide flexibility to deal with different aspects of the process of setting access terms in different ways. It is the specific form of the modular approach adopted by NBN Co that raises problems.
- 2.3 There are two basic problems with the structure:
- (a) First, the level of regulatory oversight provided for in the SAU is inadequate. Under the current structure the ACCC's ability to influence access terms to the NBN will be limited to a narrow range of non-price matters — price related matters are specifically excluded from any ACCC oversight.¹⁰ Many of the additional controls the SAU implements to compensate for the absence of direct ACCC oversight are inadequate and inappropriate given NBN Co's position as monopoly supplier of services. Under the approach adopted in the SAU it will be difficult for the ACCC to satisfy itself that access terms to the NBN will remain reasonable and consistent with the long-term interests of end-users.
 - (b) Second, having placed pricing outside the jurisdiction of the ACCC, the SAU attempts to apply a single framework to price setting over a 27 year period, notwithstanding the fact that there are two distinct phases of the NBN — each with unique economic characteristics and policy considerations.
 - (i) The first phase of NBN is the build phase. Over this time (which is expected to cover the first 10 years) the vast majority of capital costs associated with the network will be sunk. In this period the regulatory priority is to ensure only efficient costs are incurred. This implies a regulatory regime focused on cost efficiency. Pricing will not be cost based. Instead, it should be set at a level to promote usage and smooth the transition from legacy products to the new NBN services.
 - (ii) The second phase of NBN is the cost recovery phase. It is over this time period (expected to run for 20 years) that the build cost of the NBN is to be recovered. The regulatory priority is to ensure an efficient cost recovery profile over time. This implies a regime focused on efficient cost-based prices.¹¹ Optus considers that it will be very difficult to currently estimate the efficient cost recovery profile prior to the end of the build phase due to its timeframe and the fact that the total actual cost of the build is unknown.

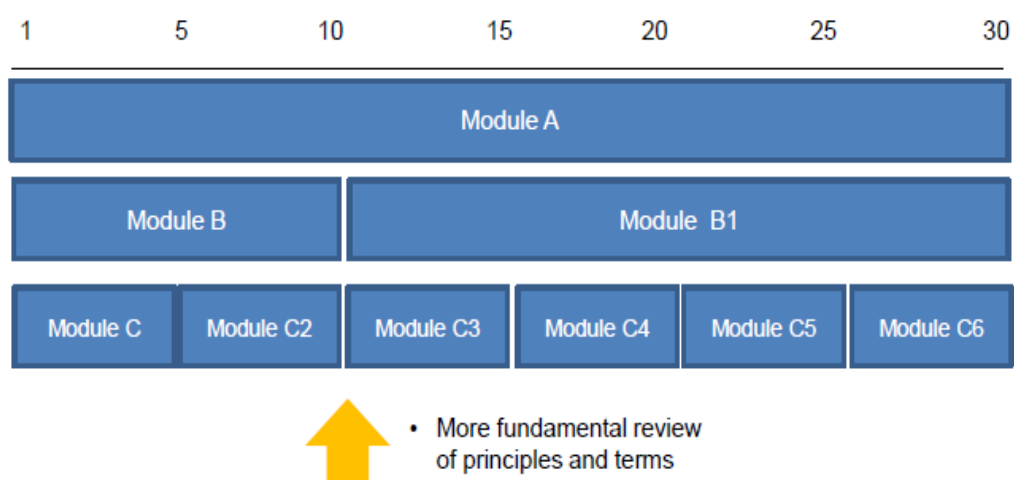
¹⁰ Clause 1B.1.2.

¹¹ Cost-based meaning that prices reflect the efficient cost recovery profile.

- 2.4 It should be noted that an SAU is not a pre-requisite to regulation of the NBN. The ACCC has existing powers under Part XIC of the CCA that can be used to fulfil this role, such as Fixed Principles Determinations and Access Determinations (ADs). These will provide the ACCC with the flexibility to ensure efficient costs are incurred and recovered over time, while at the same time enabling pricing principles to evolve to reflect the change of policy priorities and market circumstances.
- 2.5 Notwithstanding this position, Optus considers that a properly constructed SAU can enhance the effectiveness of the regulation of the NBN. In doing so, it can achieve an outcome that provides NBN Co with a greater level of regulatory certainty without unreasonably constraining the ACCC's ability to oversee the establishment of access terms. An SAU structured along the following lines is likely to be more reasonable than the current SAU proposed by NBN Co. It will specifically provide the ACCC with the ability to ensure that access terms remain consistent with the LTIE.
- (a) **Module A:** This could establish a long-term principle that NBN Co is able to recover its efficiently incurred build costs, without outlining the specific profile of recovery. This could be established as a long-term principle (beyond the term of the other modules) which would provide NBN Co with the certainty that the ACCC could not expropriate its sunk investment.¹²
- (b) **Module B:** This could deal with the method of cost recovery. It would initially include the current proposed RAB and cost recovery arrangements. This Module could apply for 10 years to coincide with the anticipated build phase. At this 10 year point it would be subject to review under Part XIC to establish whether the method and profile of cost recovery continues to promote the LTIE and to deal with future anticipated costs.
- (c) **Module C:** This should include all specific access prices and the arrangements to set prices. It would also include the commitments about updating the SFAA to ensure consistency with the SAU and any ACCC Access Determinations and Binding Rules of Conduct. This module could also set out key principles for non-price terms, with the specific provisions to be agreed commercially but subject to ACCC recourse. This module should be subject to updates and review every 3 to 5 years.
- 2.6 A review of the terms of any of the modules should be conducted under the ACCC's Part XIC powers that require it to have regard to reasonableness and the LTIE. The ACCC would therefore need to balance the interests of lower prices for consumers and the legitimate business interests of NBN Co. There should be no further process constraints built into the SAU in respect of these powers.
- 2.7 A schematic of this approach is set out below in figure 2.

¹² This in effect is the sole justification for the SAU put forward by Ordovery and Shampine.

FIGURE 2



2.8 Optus considers that this approach has significant merit:

- (a) It will provide for an increased level of ACCC oversight and therefore will better enable the ACCC to ensure that access terms to NBN remain reasonable and consistent with LTIE over time;
- (b) It will still deliver a significant degree of certainty for NBN Co that it can recover its prudently incurred costs and prevents regulatory expropriation of sunk assets;
- (c) By providing a greater level of regulatory oversight it will increase the incentives for industry to resolve matters commercially;
- (d) It will ensure that the regulatory arrangements reflect the two distinct phases of the NBN: the build and the cost recovery phase; and
- (e) It will remove significant complexity and uncertainty from the operation of the SAU by utilising the ACCC's existing powers under Part XIC.

2.9 Optus notes that the recommendations noted above are also consistent with the comments set out in the report NERA Economic Consulting (NERA) has prepared for Optus.

2.10 With respect to the multi-phased nature of NBN, NERA has observed that providing for an inflexible regulatory regime for a 27 year period will most likely lead to sub-optimal outcomes and increases the risk of inefficient expenditure. NERA recommend that any regulatory regime applied to NBN Co should reflect the two distinct phases of the NBN.¹³

2.11 NERA identified that during the build phase of the NBN, it will be difficult for the ACCC to develop or approve *ex ante* estimates of NBN costs. As such, there is merit in the SAU providing for review arrangements every 3-5 years during the build phase. The SAU should establish the principles for review, including that NBN Co has a reasonable prospect of

¹³ NERA, 2013, Review of the Long Term Revenue Constraint in NBN Co's SAU, A report for Optus, 18 January 2013 Appendix B, section 3.

recovering its prudent and efficient costs. NERA opine that the potential efficiency gains from such review would “comfortably outweigh” any costs associated with it.¹⁴ For the second period during the build phase, NERA concluded that the ACCC would have sufficient information to develop a bespoke *ex ante* incentive regime that would apply to the capital expenditure undertaken for the remainder of the build period.

- 2.12 Following the build phase of NBN, the principal task of the regulatory regime is to ensure that the efficient costs are recovered in a manner promoting the LTIE. This would most likely be achieved through a flexible pricing regime that would largely depend on the demand characteristics at the time. NERA concluded that it is impracticable to forecast demand” for current or new services for the cost recovery phase — starting around 2023 — in 2013.¹⁵ Therefore, locking-in an inflexible pricing regime now would not likely promote the LTIE.

¹⁴ NERA, 2013, Appendix B, section 3.

¹⁵ NERA, 2013, Appendix B, section 3.

Section 3. Appropriateness of the Regulatory Framework

KEY POINTS

- *The NBN Co SAU limits the powers of the ACCC under Part XIC of the CCA further than is necessary. The SAU proposes to lock access seekers into a regime where the control of the process is effectively 'owned' and 'managed' by NBN Co and the scope for regulatory intervention is very limited.*
- *Whilst the SAU should have a term longer than 3 years, the proposed 27 year term should be shorter and allow for earlier, more frequent and thorough reviews of the appropriateness of its terms.*
- *Several terms of the SAU are couched in highly subjective terms and allow wide discretion to NBN Co. Such terms are likely to be difficult or impossible to enforce, including:*
 - *Compliance with Initial Pricing Principles;*
 - *Assessment of Product Ideas in the PDF; and*
 - *Prudent Cost Conditions for capital expenditure.*
- *In the absence of appropriate ACCC oversight role, Optus submits that the ACCC cannot be satisfied that the SAU is reasonable.*

- 3.1 One of the important policy objectives the Government identified when it announced the roll-out of the NBN was to use this new infrastructure to “*fundamentally transform the competitive dynamics of the Australian telecommunications sector*”.¹⁶
- 3.2 It was recognised that to deliver this outcome significant changes would need to be made to the existing regulatory arrangements, to ensure that the NBN would provide “*a platform for retail-level competition to flourish*” in the fixed line telecommunications market.
- 3.3 To help achieve this outcome the Government has put in place some important legislative safeguards in respect of the governance arrangements for NBN Co through the *National Broadband Network Companies Act 2011* (the Companies Act).
- 3.4 A critical component of these legislative provisions is the requirement that NBN Co must operate as a wholesale-only provider of services and cannot compete with its own customers in downstream retail markets. Further, the *Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Act 2011* (the Access Act) put in place arrangements to ensure that NBN Co has to offer services to all Retail Service Providers (RSPs) on equal terms and that prevent it from discriminating between different RSPs.

¹⁶ National Broadband Network: Regulatory Reform for 21st Century Broadband, Discussion Paper, April 2009, p.iii.

- 3.5 These are significant policy initiatives that will help to transform how the fixed line sector will operate in the future. Many of the well documented problems of the telecommunications market over the past 15 years have their root cause in the vertically integrated structure of Telstra. An incumbent dominant wholesale and retail provider of services has strong incentives to discriminate against its wholesale customers, which has manifested itself in numerous examples of anti-competitive conduct. The governance obligations that apply to NBN should ensure that similar issues should not arise in its relationship with RSPs.
- 3.6 NBN Co's wholesale-only structure means that it will have a very different set of incentives when dealing with access seekers than a vertically integrated provider of services, such as Telstra, has had. With this structure in place access seekers can have confidence that NBN Co has no incentive to discriminate against them. Further, NBN Co should have stronger incentives to act responsively to access seeker requirements since success will be linked directly to the success of those access seekers.
- 3.7 However, reliance on NBN Co's wholesale-only structure can only go so far. Whilst it will be a wholesale-only entity it will be a monopoly provider. Given the legislative provisions that discourage alternate high-speed networks, it is likely that NBN Co will have complete monopoly status at the wholesale level. This will give it an unprecedented market position, since retail service providers (RSPs) will be wholly reliant on NBN Co for their fixed line access services having no alternate sources of supply.
- 3.8 Whilst there should be a strong correlation between the interests of NBN Co and access seekers, it should not be assumed that their interests will always align. For example, NBN Co and access seekers' interests may diverge on issues such as risk management, service quality and price. Further, the wholesale-only structure of NBN Co will not guarantee that it will seek to operate as an efficient and highly customer focused operation.
- 3.9 To the extent that those interests diverge, then NBN Co will be in a unique position to impose its will — without access to the NBN, RSPs will not be able to provide fixed-line services. This was demonstrated early last year through NBN Co's ability to manoeuvre access seekers into signing an interim WBA notwithstanding the fact that they had considerable unresolved issues with that agreement. For this reason it is important that NBN Co is subject to effective regulation that balances the interests of NBN Co and access seekers and ultimately ensures that key decisions about access terms to the NBN are set to promote the LTIE.
- 3.10 The effective operation of the NBN should not be dependent on the good will of NBN Co or the industry. The regime should be sufficiently robust to ensure the LTIE is promoted where NBN Co and industry disagrees.¹⁷
- 3.11 The form of the regulation of the NBN is therefore of utmost importance. Optus considers that it will have long term ramifications that will affect the industry structure, levels of investment, affordability and take-up of services and consumer welfare. Ultimately, the regulatory arrangements that are applied to the NBN are likely to have a significant effect on the success or failure of the NBN policy.

¹⁷ Over a 27 year period, it is not unreasonable to assume NBN Co will have disagreements with the industry: notwithstanding the current good will.

- 3.12 The SAU is a significant instrument since it is effectively a proposal from NBN Co as to how it should be regulated. If accepted, the SAU will supplant many of the ACCC's existing regulatory powers and will determine the rules of engagement with NBN Co for access to the NBN over the next decade.
- 3.13 Whilst Optus acknowledges that the legislation has encouraged NBN Co to develop such an undertaking, this approach is optional. In the absence of an SAU the ACCC has extensive powers under the CCA to regulate access to the NBN in the long term interests of end users. Thus, the shape of the SAU raises some critical threshold questions about the nature of the regulation of the NBN and the appropriate level of independent oversight of the NBN.
- 3.14 Optus and many other industry players were highly critical of NBN Co's 2011 SAU. A common and significant issue raised about that SAU was that the regulatory framework proposed provided NBN Co with significant discretion to set the rules of engagement with access seekers and to police compliance with those rules. Optus argued that this was an inappropriate model of regulation for an entity that will have such an unprecedented level of market dominance.
- 3.15 Optus acknowledges that in developing the current SAU NBN Co has made some significant improvements to help meet the concerns raised by access seekers. In particular, these changes have aimed to increase the level of ACCC oversight and to provide additional safeguards for access seekers. These changes include:
- (a) Modular framework with provision for earlier and more frequent review of the elements of the SAU;
 - (b) Provision for a mid-term review of customer engagement processes and certain non-price terms in 2018;
 - (c) Provision for the ACCC to make Access Determinations (ADs) and Binding Rules of Conduct (BROCs) on certain non-price terms of access;
 - (d) Stronger commitments to flow through ACCC decisions into the Standard Form of Access Agreement (SFAA); and
 - (e) Inclusion of prices for all current services in the SAU.
- 3.16 NBN Co has indicated that the revised SAU has been developed to provide certainty about how the terms of access will be set and to ensure that it can recoup its costs and price services in line with its uniform national wholesale price obligations. NBN Co has also indicated that it considers the certainty and flexibility provided by the SAU is superior to the alternative arrangements that would involve the ACCC regulating access terms through its powers under Part XIC.

The SAU (in combination with SFAAs) is the preferable regulatory mechanism, over an alternative that may rely on future access determinations (ADs) by the ACCC, because it can:

Provide long term regulatory certainty with more consistency; and

*Be more procedurally efficient.*¹⁸

- 3.17 Optus acknowledges that NBN Co has a legitimate claim for some level of certainty, particularly in respect of its ability to recoup efficiently incurred costs.¹⁹ However, providing certainty at the expense of flexibility is not necessary in the LTIE. NERA observe:

*In our opinion, the putting in place of a long term regulatory regime that gives such a high priority to certainty over flexibility is **likely to deliver sub-optimal outcomes**, and has **significant potential to be unsustainable**. The desirability of enshrining a degree of regulatory flexibility is essential given:*

- *the considerable uncertainty that exists now as to the cost and timing of the roll out of NBN services, which we recognise frustrates the potential establishment of ex ante cost benchmarks – however, given the ‘repeat’ nature of many aspects of the NBN Co 10 year roll out, the uncertainty surrounding these costs can be expected to reduce significantly over time;*
- *the uncertain predictions of future demand for NBN services – i.e., take up rates, willingness-to-pay, competing service providers (i.e., mobile) – in an industry characterised by disruptive technologies and innovative new services; and*
- *the potential for unforeseen events to render inflexible regulatory regimes as unsustainable in the long term – for example the onset of the global financial crisis in 2007 gave rise to the ‘unravelling’ of the highly prescriptive framework for determining the regulatory cost of capital that had earlier been established (in the name of ‘certainty’) for the electricity transmission sector.²⁰ [emphasis added]*

- 3.18 Moreover, the question the ACCC has to answer is not whether the SAU provides appropriate certainty for NBN Co, but rather whether the terms of the SAU are reasonable. The reasonableness of the SAU will in turn depend on whether it provides for an appropriate form of regulation which through time will result in access terms that promote the long term interests of end-users of services.

Powers of the ACCC under the CCA

- 3.19 Before examining the detailed oversight arrangements with the SAU it is worth briefly examining the ACCC’s powers under Part XIC of the CCA. The powers of the ACCC in the absence of the SAU are clear and well defined. These can be summarised as follows:
- (a) The ACCC has the power to declare any eligible service, being a listed carriage service or a service that facilitates the supply of a listed carriage service.

¹⁸ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.2.

¹⁹ Optus addresses NBN Co’s claim for certainty in Appendix A.

²⁰ NERA, 2013, Appendix B, p.11.

- (b) The CCA provides for a maximum term of between 3 to 5 years for a declaration made under section 152AL, unless there are circumstances which warrant a longer or shorter period. A declaration may be extended for subsequent periods of no longer than 5 years duration. In addition, the ACCC is required to hold a public inquiry and consultation process during the 18 months prior to each expiry date, to consider whether to extend (or further extend), revoke or vary the declaration, or allow it to expire.
- (c) Where a service is declared by the ACCC under section 152AL:
 - (i) the ACCC may make an access determination (**AD**) in relation to the declared service to set the price and non-price terms and conditions of access;
 - (ii) there are associated requirements for the ACCC to hold a public inquiry about a proposal to make an AD in relation to the service (under section 152BCI); and
 - (iii) the term of the AD is generally tied to the period for which the service has been declared (section 152BCF).
- (d) Section 152BD provides that the ACCC may also make a binding rules of conduct (**BROC**) to:
 - (i) specify the terms and conditions on which a carrier or carriage service provider (**CSP**) must comply with any or all of the SAOs applicable in relation to a specified declared service; or
 - (ii) require compliance with any or all of the standard access obligations (**SAOs**) applicable to a carrier or CSP in relation to a specified declared service.
- (e) An AD or BROC will be binding on carriers and CSPs to which they apply, subject to existing Access Agreements which are in place.

3.20 The ACCC also has a range of powers in relation to enforcing compliance with the requirements of the CCA.

- (a) The ACCC (or any other person whose interests are affected) can seek enforcement of the SAOs by a carrier or CSP in the Federal Court. The Federal Court can make any orders deemed appropriate, including compensation or an order to comply.
- (b) Compliance with an AD or a BROC is enforced by virtue of the fact that compliance is deemed to be a licence condition for holders of carrier licenses, and to be a service provider rule for CSPs.
- (c) In addition, an access seeker is entitled to seek orders in the Federal Court in relation to breach of an AD or a BROC, including: injunctions; orders for compensation; and any other order the Court thinks appropriate.

- 3.21 The ACCC has the ability to actively participate in negotiations in relation to Access Agreements.
- (a) Under section 152BBA of the ACCC may, at the request of either party, give directions in relation to negotiations between a carrier / CSP and an access seeker seeking to enter into an Access Agreement. If the ACCC gives such a direction it is enforceable in the Federal Court and pecuniary penalties (up to a maximum of \$250,000 for each contravention by a corporation) may apply in relation to a breach.
- (b) Under section 152BBC the ACCC may, at the request of both parties, attend or mediate at negotiations between a carrier or CSP and an access seeker seeking to enter into an Access Agreement.
- 3.22 The above summary demonstrates that the CCA provides the ACCC with clear and flexible scope to set the terms of supply for essential access services. However, this flexibility is tempered by the fact that any ACCC ruling must only be made following consultation and that any such decision has to be made in a manner that accords with procedural fairness and which aims to promote the LTIE. Each of the requirements necessarily means that the ACCC has to have appropriate regard to the interests of both the access provider and access seeker in reaching its decision. More importantly, there are also specific provisions within the CCA for the ACCC to set long-term pricing principles that can provide increased certainty of regulatory decision making.
- 3.23 Amendments to Part XIC of the CCA introduced in 2010 provide powers for the ACCC to determine fixed principles to apply for a stated period which may extend beyond the duration of the access determination (e.g. how depreciation is treated).²¹ This has the effect of ‘locking-in’ the matters dealt with until a particular termination date, which can be after the expiry date of the access determination in which the fixed principles appear.
- 3.24 Any access determination that replaces the original access determination must include fixed principles the same as the fixed principles in the original access determination. The nominal expiry date of the fixed principles must be the same or later than the date in the original access determination.²² These Fixed principles are designed at increasing regulatory certainty by enabling the ACCC to specify a long-term approach to pricing for specified access services.
- 3.25 It is worth noting that the ACCC’s powers under Part XIC have been refined from time to time through various legislative amendments with the aim of improving their effectiveness to set access terms in markets that are not subject to competition. With the exception of BROCs many of these powers have been well tested and have proven to be capable of establishing access arrangements that both balance the interests of access providers and access seekers and promote the LTIE. What this means is that in the absence of the SAU there are clear powers for the ACCC to regulate the NBN in a manner that promotes the LTIE and whilst still providing long-term certainty for NBN Co.

²¹ CCA, s.152BCD.

²² CCA, s.152BCD(3).

Powers of the ACCC under the SAU

- 3.26 Optus acknowledges that a primary purpose of an SAU is to define the rights of intervention and powers of the ACCC in relation to regulation of the service to which the SAU relates. Consequently, it is inevitable that the SAU will limit the powers of the ACCC to some degree. However, Optus submits that the form of the SAU which has been proposed by NBN Co goes further than necessary in limiting the powers of the ACCC in a number of key areas.
- 3.27 The likely implications of acceptance of the SAU as currently drafted would be to lock access seekers into an access regime where the control of the process is effectively 'owned' and 'managed' by NBN Co, and the scope for regulatory intervention is very limited. Some key examples of the limitations include:
- (a) limits on the requirement of NBN Co to comply with ADs and BROCs;
 - (b) limited role for the ACCC in influencing the price terms of access;
 - (c) limits on enforceability of the SAOs, ADs and BROCs;
 - (d) limits on the scope for the ACCC to participate in the negotiation of Access Agreements; and
 - (e) limits on the ACCCs ability to provide regulatory oversight on a regular basis, through mandated processes of review.
- 3.28 These examples are discussed in more detail below.

Requirement to comply with ADs and BROCs

- 3.29 A clear example of the inadequacy of the oversight arrangements in NBN Co's 2011 SAU was the absence of any ability for the ACCC to make Access Determinations (ADs) or Binding Rules of Conduct (BROCs) in the event of a dispute arising between NBN Co and access seekers. The terms of the 2011 SAU in conjunction with the then Wholesale Broadband Agreement (WBA) effectively left access terms to be dealt with as a private matter to be dealt with commercially. This issue was highlighted as a critical factor by many RSPs as to why the ACCC should not approve the 2011 SAU.
- 3.30 It is encouraging, therefore, that the present SAU includes the scope for the ACCC to make ADs and BROCs. These provisions relating to regulatory oversight are set out in Schedule 1B.
- 3.31 However, a closer examination of the provisions indicates that the scope for the ACCC to make ADs and BROCs is narrowly circumscribed.
- 3.32 Once the SAU has been accepted by the ACCC it will prevail over an inconsistent AD or BROC to the extent of any inconsistency (sections 152CBIB and 152CBIA). This means that a regulatory determination would generally be binding on NBN Co only to the extent it is not inconsistent with the SAU. However, the SAU explicitly provides that, during the Initial Regulatory Period, any AD or BROC made by the ACCC which relates to the NBN Access Service or the Ancillary Services will have no effect to the extent that:

- (a) It relates to price (other than as outlined below);
 - (b) It is inconsistent with the terms of the SAU;
 - (c) Directly or indirectly has the effect of discriminating between access seekers; or
 - (d) Is not otherwise compliant with Part XIC of the CCA.
- 3.33 Inherent in this drafting is the fact that NBN Co will make a subjective determination as to whether any of these factors apply. If NBN Co determines that they do, it is under no obligation to give effect to the AD or BROC.
- 3.34 These are significant limitations on the ACCC's ability to make an AD or a BROC. In practice it means that such rulings can only apply to non-price matters. But even in respect of these matters the scope for the ACCC to make a ruling is significantly constrained by the fact that the SAU contains quite detailed provisions on key non-price matters. This includes detailed terms and conditions relating to:
- (a) Dispute Management rules;
 - (b) Confidentiality and Intellectual Property Rights;
 - (c) Risk Management and Liability;
 - (d) Product Development Processes; and
 - (e) Service Level commitments.
- 3.35 As an example, the SAU includes detailed contractual provisions relating to liability arrangements including liability caps. The liability caps might be appropriate at the time that the SAU is approved, but these may need to be changed in the future to reflect changes in levels of risk or to reflect new industry practices. If NBN Co was unwilling to make such a change then the ACCC could not enforce it since any AD would necessarily be inconsistent with the SAU. This same example will also apply to other non-price terms that may need to be modified over time (see section 9 for a discussion on non-price terms).
- 3.36 Further, where NBN Co undertakes to give effect to an AD or BROC it will only do so by ensuring that the next iteration of the SFAA published in accordance with clause 1B.1.3(a) of the SAU will be consistent with the AD or BROC. There are some important implications of this practical limitation;
- (a) This undertaking is made under Module 1 of the SAU and the undertaking therefore only applies during the Initial Regulatory Period;
 - (b) There is no undertaking to update the SFAA other than in accordance with the proposed biennial timeframe established by the SAU. In fact the SAU explicitly states that there will be no requirement to give effect to an AD or BROC by amending any existing published SFAA (clause 1B.2.2(c));
 - (c) In other words, the SAU contains a 'drag along' clause which has the effect of limiting the ACCC's ability to impose an AD or BROC on NBN Co, even where it is

consistent with the requirements of the SAU, by up to two years. This delay is compounded by the fact that BROCs only have an application for 12 months. This raises questions about the ability of the ACCC to make an effective BROC under the SAU. That said, the SAU also sets out that NBN Co may amend any SFAA to remove the effect of an 'expired' Regulatory Determination (clause 1B.2.2(d)); and

- (d) Absent the operation of the SAU, NBN Co would be required to comply with an applicable (i.e. not inconsistent) AD or BROC in accordance with its terms, from the commencement date specified by the ACCC, which includes the provision for ADs to be back-dated where deemed appropriate.

3.37 Finally, Optus notes that NBN Co retains discretion over how to interpret the implementation of the terms of an ACCC ruling. This opens the scope for uncertainty relating to the implementation of an ACCC ruling and the timeliness of its implementation. At the extreme access seekers may face a situation where a second ACCC AD is required to clarify how an original AD should be implemented, with the potential for a lengthy delay to an ACCC AD being implemented.

3.38 In summary, whilst there is now scope within the SAU for the ACCC to make an AD or BROC, such scope is so narrowly defined that in practical terms access seekers are likely to face considerable hurdles in establishing the ACCC's right to consider such a dispute and have a subsequent ruling applied.

Regulatory oversight in relation to price

3.39 The regulatory oversight arrangements are particularly constrained in respect of price related terms and conditions of access to the NBN.

3.40 Whilst Optus acknowledges that the current SAU assessment process provides the ACCC with some ability to assess the reasonableness of NBN Co's prices, for the reasons discussed later in this submission, the lack of information to support these prices means that the ACCC can do little more than apply a "finger in the air test". Beyond this limited assessment there is little oversight of prices for the next 27 years.

3.41 Clause 1B.1.2 provides that, with two limited exceptions, provisions in relation to regulatory recourse will not apply in relation to the pricing of any product or component of the NBN access service. The exceptions are:

- (a) ADs or BROCs which relate to introduction of a price for previously zero-priced Reference Offers (clause 1C.4.5(b)); and
- (b) ADs or BROCs which relate to introduction of a price for previously zero-priced Other Charges associated with a Reference Offer service (clause 1D.4.3(b)).

3.42 Accordingly, during the Initial Regulatory Period, the ACCC's ability to intervene in relation to price issues is expressly excluded except in the very limited circumstances outlined above.

3.43 During the Subsequent Regulatory Period, Schedule 2C of Module 2 will operate. This provides similar price setting principles to those set out in Schedules 1C and 1D of Module 1, including identical provisions allowing for ACCC intervention in relation to the pricing of previously Zero-

Priced Reference Offers, Non-Reference Offers and Other Charges. There is no equivalent in Module 2 to the regulatory oversight provisions contained in Schedule 1B of Module 1, which expressly limit the ACCC's ability to intervene in relation to price. However, as Module 2 provides that the pricing of services (including new services) will be set by NBN Co, it would follow that any attempted intervention by the ACCC to set prices would be inconsistent with the SAU.

- 3.44 Optus acknowledges that in lieu of broader ACCC oversight powers the SAU provides for a number of specific price protection measures. However, as will be outlined in section 4, Optus considers that many of these safeguards are subject to significant practical limitations. In combination with the very limited role for the ACCC to intervene on price it is unclear how the ACCC can satisfy itself that NBN Co's pricing will remain consistent with the interests of end-users over time.

Enforcement of SAOs, ADs and BROCs

- 3.45 It is unclear how the SAU is intended to operate in conjunction with provisions of the CCA which provide that SAOs, ADs and BROCs are enforceable. Due to the hierarchy established by section 152AY of the CCA, NBN Co is required to comply with the SAOs in relation to a particular matter on such terms and conditions as are set out in:
- (a) an Access Agreement which is in operation;
 - (b) if an Access Agreement is not in operation in relation to the matter, a special access undertaking which is in operation in relation to the matter;
 - (c) if neither an Access Agreement nor a special access undertaking is in operation in relation to the matter, a BROC that specifies terms and conditions about the matter; and
 - (d) if neither an Access Agreement, special access undertaking nor BROC is in operation in relation to the matter, an AD that specifies terms and conditions about the matter.
- 3.46 Therefore, although the ACCC, or any other person whose interests are affected, can seek enforcement of the SAOs in the Federal Court, once the SAU (or an Access Agreement) is in place, enforcement options will effectively be limited to those provided for by the SAU (or relevant Access Agreement).
- 3.47 It appears that the SAU may also be intended to have the effect of overriding the provisions of the CCA which provide that compliance with an AD or BROC is deemed to be a licence condition for holders of carrier licenses, and to be a service provider rule for CSPs under the CCA.²³

²³ CCA, sections 152BCO, 152BCP, 152BDF, 152BDG.

Participating in negotiations

- 3.48 Under sections 152BBA and 152BBC of the CCA, the ACCC has a clear role in relation to negotiation of individual Access Agreements. This includes ability to, for example, require a carrier or CSP to provide certain information to an access seeker.
- 3.49 In contrast, the process of multilateral consultation established under the SAU in relation to amendments to the SFAA (under clause 1B.3) lacks clarity and certainty. Although the SAU states that this process will 'allow access seekers to suggest changes to the SAU', the process will be 'owned' and the forum will be convened by NBN Co. The SAU does not contemplate an active role for the ACCC in connection with the forum. Again the powers the ACCC would otherwise have under the CCA have been significantly constrained under the SAU.
- 3.50 It is implicit that, in its role as convenor of the forum, NBN Co will be in a position to determine and prioritise issues raised by access seekers in accordance with its own preferences.
- (a) The SAU provides that NBN Co reserves to right to reject a suggested change made by an Access Seeker by notice at any time up to **4 months after** convening a forum, by notice to the ACCC.
 - (b) The only available recourse for the access seeker in this situation appear to be an application to the ACCC for an AD or BROCC which will, subject to the limitations highlighted above, be incorporated in the next published iteration of the SFAA.
 - (c) NBN Co has also explicitly excluded any obligation to consider interpretation or implementation of regulatory determinations (i.e. ADs or BROCCs) as part of the multilateral SFAA forum.
- 3.51 In contrast to the scope of section 152BBA, the ACCC has no ability to direct NBN Co: to do anything; conduct any research; provide any information; or not to impose an unreasonable procedural requirement.

Providing regulatory oversight on a regular basis, through mandated processes of review

- 3.52 The scope of the ACCC to provide regulatory oversight of proposed processes to review and vary the terms on which access is provided under the SAU is also limited.
- 3.53 The CCA generally provides for review of a declared service and associated AD every 3 - 5 years. In addition, the ACCC is required to hold a public enquiry and consultation process during the 18 months prior to the expiry date of each declaration, to consider whether to extend (or further extend), revoke or vary the declaration, or allow it to expire.
- 3.54 In contrast the current term of the Initial Regulatory Period is 10 years (or 11 years if extended). Although the SAU provides for a mid-point review during the Initial Regulatory Period, the scope of this review is limited in comparison to the review which would apply under the CCA.
- 3.55 For example, the SAU sets out the process for the mid-point review, the timeframes for the review and the information to be provided by NBN Co. In other words, NBN Co has already

nominated the aspects of the SAU which will and will not be subject to the review and the assessment criteria by which the review will be conducted.

- 3.56 In addition, the ACCC is subject to strict time limits nominated by NBN Co under the SAU to consider and accept or reject proposals made by NBN Co in connection with the mid-point review. Where the ACCC does not meet those time limits there is a 'deemed' acceptance of proposals made by NBN Co.
- 3.57 At the end of the Initial Regulatory Period the ACCC has a role in reviewing Replacement modules. However, this role is similarly circumscribed:
- (a) The process of updating and replacing a Module is under the control of NBN Co. There appears to be no scope for the ACCC to pro-actively seek a change to any of the terms set out in Module 1. The ACCC has to wait for NBN Co to lodge a replacement module.
 - (b) Once a replacement module is submitted to the ACCC it can then initiate a change by rejecting a replacement Module and then seek modifying the terms of the SAU by making an AD or BROCC. However, any such ruling will only take effect to the extent that it is not inconsistent with the terms of this Special Access Undertaking (including those principles and conditions set out in Module 0 and 2).
 - (c) The timeframes for the ACCC to assess and respond to a replacement are unreasonably circumscribed. The ACCC is effectively given a 9 month period to assess the replacement module, after which it is deemed to apply. Whilst there are provisions to enable the ACCC to continue its assessment, any subsequent decision has to be made within the next 12 months otherwise it may have no impact. Even where an ACCC decision is made within that 12 month period the implementation of any change proposed by the ACCC will be delayed. Further, there appears to be a risk that any ACCC AD will be invalidated by the deeming of the terms into the SAU as a consequence of the ACCC making a decision within the timeframe prescribed under the SAU.
- 3.58 In summary, whilst the modular structure allows for some increased flexibility for access terms to be reviewed the review process is tightly circumscribed and provides the ACCC with a significantly narrower role to make decisions than it would otherwise have in the absence of the SAU. In practical terms the ACCC's oversight role will be limited to specific non-price elements of the SAU.

Fixed Principles under Module 2

- 3.59 NBN Co proposed that all of Module 0 and Module 2 are fixed principles.²⁴ As such, the CCA prevents the ACCC from rejecting a Replacement Module "for a reason that concerns" the fixed principles term or condition, the notional period or the specification of qualifying circumstances. The ACCC noted in the Supplementary Information Paper that:

²⁴ SAU Main Body, Clause 5.

... if a fixed principles term or condition sets out high-level principles involving judgment and discretion, there is a question as to whether the ACCC may reject a variation for the reason that the variation does not comply with these principles.²⁵

- 3.60 Optus is concerned that Module 2 contains terms that could have the effect of preventing the ACCC from reviewing the revenue, capex or opex forecasts proposed in any Replacement Module. For example, clause 2D.6 outlines those criteria that NBN Co is to base its forecasted value on. However, ACCC may be prevented from rejecting a Replacement Module for a reason that concerns clause 2D.6 — for example, if ACCC disagrees with the forecast.
- 3.61 It is not clear how much ability the ACCC will have to conduct a full review of NBN Co forecasts, and where necessary, to insert its own forecast in replacement of a rejected NBN Co forecast. Any restriction on the ability of ACCC to do so risks replicating the flawed elements in the previous electricity regulatory regime, which has now been amended to allow the AER more freedom to review and replace forecasts. Optus reiterates that any proposal which prevents the ACCC from having full *ex ante* and *ex post* review powers is inconsistent with existing regulatory regimes applied in Australia.

Term of the SAU

- 3.62 NBN Co has justified the term of the SAU on the basis that:

NBN Co's commercial context (marked by long-lived assets, a long payback period for the initial investment, and long-term commercial arrangements) necessitates that the SAU be specified for a long term, and the specific expiry date of 30 June 2040 was selected because it aligns with the 30 year Corporate Plan published by NBN Co in December 2010 (and in this regard, it should be noted that the same end date is maintained in NBN Co's 2012-15 Corporate Plan).²⁶

- 3.63 In support of this position NBN Co notes that the proposed 30 year term is supported in the reports of each of its expert advisors, Ordover and Shampine, and Synergies.²⁷
- 3.64 It is clear from NBN Co's comment above in adopting a long timeframe; NBN Co has given primacy to its commercial considerations. It has clearly been chosen to align with the objectives of its Corporate Plan to achieve commercial return over a 30 year period. Further, Optus notes that the opinions put forward by both Ordover and Shampine and Synergies are framed in the context of what best meets NBN Co's commercial interests. Relevantly Optus notes that in addressing the question of the reasonableness of the 30 year term, Synergies was required to have regard to:

...the magnitude and timeframe of NBN Co's investment, the expected payback period and the supply and demand uncertainty that is likely to be faced by NBN Co over this

²⁵ ACCC, Supplementary information paper about the Special Access Undertaking given to the ACCC by NBN Co Limited and NBN Tasmania Limited on 18 December 2012, p.3.

²⁶ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.51.

²⁷ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.53.

*period, as well as the evolving market position of NBN Co over the proposed 30 year term.*²⁸

- 3.65 Whilst Optus recognises that NBN Co has a legitimate claim for some level of regulatory certainty, the question that really has to be addressed is whether such a term is consistent with the interest of end-users.
- 3.66 Optus notes that a 27 year term is unprecedented. There is a significant risk that it will lock the industry into a set of regulatory arrangements that may become out dated and unresponsive to the market conditions and the needs of end-users. In this respect it is important to note that since 1997 there have been several quite fundamental changes to the telecommunications regulatory framework to deal with issues or circumstances that were not envisaged at that time. These changes have sought to improve competitive outcomes and deliver positive benefits for end-users.
- 3.67 The ACCC's consideration of the SAU put forward by the FANOC on behalf of the G9 consortium is instructive. Whilst the FANOC SAU only proposed a term of 15 years, the ACCC expressed some clear concerns with the length of this term;

*The ACCC does, however, have concerns as to whether it can be satisfied that the specific terms and conditions of access in FANOC's SAU, if applied over 15 years, will continue to promote competition and remain in the interests of access seekers.*²⁹

- 3.68 Optus submits that these same concerns will also be relevant to NBN Co's SAU. As indicated in the Appendix A to this submission it is questionable whether the usual claims for certainty apply in the case of NBN. Such certainty is normally required to encourage commitment of capital by *private* sector investors. In the case of the NBN, the investment will be fully funded by Government,³⁰ and there is significant legislative protection that will assist NBN Co in achieving its desired return on its investment.
- 3.69 Optus submits that whilst it would be appropriate for the SAU to have a term beyond the usual three year duration for ordinary access undertakings, this term should either be shorter or allow for earlier, more frequent and more thorough review of the appropriateness of its terms.

Enforcement of the SAU

- 3.70 A final consideration in assessing the effectiveness of the regulatory oversight arrangements set out in the SAU is the ability for the ACCC to enforce compliance with the SAU.
- 3.71 The enforcement provisions are set out section 1.1 of the SAU. However, these powers may be of benefit in limited circumstances. That is, where the SAU imposes a clear and objectively demonstrable obligation on NBN Co. For example, if NBN Co failed to incorporate regulatory

²⁸ Synergies Consulting, September 2012, p.22.

²⁹ ACCC, Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.102.

³⁰ At a funding rate significantly less than the private level. See Australian Government Competitive Neutrality Complaints Office, 2011, NBN Co Investigation No. 14, Canberra, November.

determinations into new SFAAs as per the (limited) commitment in Schedule 1B.1.3(a) or if SFAAs were not aligned with the SAU³¹ the relevant commitments are probably sufficiently clear to be enforced pursuant to s.152CD.

3.72 However, Optus notes that many of the key issues to be determined by NBN Co pursuant to the SAU are couched in highly subjective terms and allow a wide discretion to NBN Co and accordingly are likely to be difficult or impossible to enforce. Examples of parts of the SAU where enforcement by the ACCC or others is unlikely to be effective include the following:

- (a) **Compliance with the Initial Pricing Principles (IPP)** set out in 1D.6 of the SAU. As discussed in more detail in section 4, the provisions requiring compliance with the IPP's are so broad that except in extreme circumstances would be very difficult to seek enforcement action under section 152CD in respect of the IPPs.
- (b) **Process for Assessment of Product Ideas.** Schedule 1I relates to the introduction, variation and withdrawal of Products, Product Components and Product Features during the Initial Regulatory Period.³² Clause 1I.3.3 governs NBN Co's consideration of Product Ideas. It confers a broad discretion on NBN Co to "*weigh as it considers appropriate, such criteria as it determines appropriate in selecting Product Ideas to develop through the PDF Process*". The schedule also lists a number of matters which NBN Co may take into account. While there are certain principles set out in clause 1I.1.2 which apply to the product development process, these are inherently vague and relate to the permitted scope of NBN Co activities in relation to product development rather than offering specific guidance on the decision making process. The effect of 1I.3.3 is that any decision by NBN Co regarding consideration of Product Ideas is virtually impossible to challenge given the breadth of the discretion allowed to NBN Co.
- (c) **Prudent Cost Condition for Capital Expenditure.** Clause 1E.4.1(f) sets out a number of grounds on which NBN Co may establish that it has satisfied the Prudent Cost Condition. Pursuant to 1E.4.1(f), NBN Co can meet the Prudent Cost Condition if NBN Co's Chief Executive Officer is satisfied that one of four broad and relatively vague criteria (such as that "it is in the best interests of the company to incur such Capital Expenditure...") is met. This built-in subjectivity means that the ability to enforce compliance with the Prudent Cost Condition is effectively of no value. Establishing breach of 1E.4.1 is virtually impossible due to the fact that, even where Capital Expenditure is incurred in circumstances which fall short of the remaining subclauses, any Capital Expenditure may be defended by NBN Co on the basis of the satisfaction of its Chief Executive Officer in relation to the listed matters. In order to establish a breach of the SAU in these circumstances, it would be necessary for the ACCC (or other affected person) to demonstrate not that the decision did not meet the relevant criteria, but rather that the CEO was not satisfied that they had been met, a virtually impossible task.

³¹ SAU, Main Body, Clause 6.

³² After the Initial Regulatory Period, assessment of Product Ideas is governed by Schedule 2E and the same issues outlined below apply in relation to the relevant clause contained therein (clause 2E.4.3).

Conclusion

- 3.73 The above analysis has indicated that whilst the SAU has increased the scope of regulatory oversight from the very modest level set out in NBN Co's 2011 SAU, it nevertheless remains very limited.
- 3.74 The likely implications of acceptance of the SAU as currently drafted would be to lock access seekers into an access regime where the control of the process is effectively 'owned' and 'managed' by NBN Co, and the opportunity for the ACCC to intervene is either excluded or so narrowly circumscribed that it will have very limited impact.
- 3.75 Furthermore, the use of Fixed Principles in Module 2 risks that the ACCC will be effectively prevented from rejecting a Replacement Module on the basis of the forecasted values. This undermines the sole justification of the reasonableness of the Replacement Module process.
- 3.76 This is a fundamental failing of the SAU. In the absence of appropriate ACCC oversight role, Optus submits that the ACCC cannot be satisfied that;
- (a) The SAU is reasonable; nor
 - (b) That it will operate in manner that is consistent with the LTIE over its term.
- 3.77 Optus considers that material changes will be required to structure of the SAU to address these concerns that significantly enhance the level of ACCC oversight. These changes are discussed in section 2.
- 3.78 Without these changes, the SAU should not be considered reasonable. Further, the SAU contains Fixed Principles which should not be Fixed Principles: as such, the ACCC cannot accept the SAU.

Section 4. The risk of excessive expenditure and pricing

KEY POINTS

- *The position of NBN Co in the market and the proposed price control mechanisms in the SAU provide an insufficient deterrent to NBN Co incurring excessive expenditure over the 27 year term of the SAU. Optus finds that:*
 - *The prudence provisions are ineffective and will be difficult to enforce;*
 - *There is no ability of ACCC to review roll-over of the RAB in Module 1 or Replacement Modules*
 - *NBN Co has confirmed that it does not expect the revenue cap to apply during lifetime of SAU;*
 - *IPP is unlikely to ensure efficient new charges and prices;*
 - *Individual price increase limit results in real price increases of 2.7% after 5 years and 32% after 10 years.*
- *The SAU contains many of the same features that the ACCC Chairman observed enabled excessive expenditure in electricity markets, which are inconsistent with recent changes to the NER.*

- 4.1 NBN Co has identified that managing the risk of long-term investment and regulatory expropriation of sunk assets are key justifications for the SAU. However, the level of uncertainty faced by NBN is likely to be significantly less than it claims due to:
- (a) Government ownership and requirement to make sub-commercial returns;
 - (b) NBN is not subject to competition, and is in effect, a legislatively protected monopoly; and
 - (c) Part XIC provides NBN Co with some specific protection against ACCC intervention.³³
- 4.2 In addition to managing these risks, the SAU must also contain sufficient protections against the risk of monopoly behaviour: such as excessive expenditure and excessive pricing. NBN Co submits that the SAU does contain protections sufficient for the risks posed.³⁴
- 4.3 In this section, Optus assesses:
- (a) the drivers of these risk over the proposed 27 year lifetime;

³³ See Appendix A.

³⁴ See for example, *Expert Report of Janusz A. Ordovery and Allan L. Shampine*. 24 September 2012; *Synergies Economic Consulting - Advice on NBN Co Ltd's Special Access Undertaking - A Report Prepared for Webb Henderson* – September 2012. Both documents have suggested that the revised SAU contain mechanisms to protect against risks associated with government monopoly behaviours.

³⁴ The proposed term of the SAU is to 30 June 2040.

- (b) the mechanisms contained in the SAU to manage the risk of excessive expenditure; and
- (c) the mechanisms to control the ability to recover these costs through higher prices.

- 4.4 This shows that the arrangements NBN Co has proposed in the SAU raise significant risks of excessive expenditure during the 27 year term of the SAU. Evidence from other industries confirms that the proposed regulatory structure, NBN Co's ownership, and its position in the market will increase the risk of inefficient and excessive expenditure. This outcome has been observed in the electricity market, which has similar regulatory oversight, levels of market power and government ownership.³⁵ As a result, the electricity regulatory regime has been amended to provide the regulator greater power and flexibility to fully assess — and reject where needed — expenditure on an *ex ante* and *ex post* basis.
- 4.5 Notwithstanding claims made in the SAU Supporting Submission, Optus finds that the mechanisms contained in the SAU lack the necessary controls on NBN Co, and the independent oversight, to adequately manage the risk of excessive expenditure and pricing. Optus notes that there is no *ex ante* role for the ACCC to review expenditure or price increases, and the drafting of the SAU makes *ex post* enforcement through the Federal Court very unlikely. NERA advises that such a regime is without precedent in Australia, and is unlike any other regulatory regime in place.³⁶
- 4.6 In the absence of adequate provisions, the ACCC cannot be satisfied that the current provisions in the SAU adequately manage the risk of excessive expenditure of the 27 year lifetime of the SAU; or that the SAU contains sufficient safeguards to ensure that prices are not increased at a level inconsistent with the LTIE.

Drivers of the risk of incurring excessive expenditure

- 4.7 In the Supporting Submission³⁷ NBN Co states that the purpose of the SAU is “*to provide an appropriate degree of certainty to Access Seekers, their End Users and NBN Co*” about the products, prices and non-price terms and conditions of access. This is one component of long term interest of end-users. Another component central to the promotion of the LTIE is ensuring efficient costs are constrained effectively and prices are set in a manner that encourage efficient use of, and investment in, infrastructure. In other words, the SAU must also contain sufficient provisions to manage the risks associated with the monopoly position of NBN Co over the proposed 27 year timeframe.
- 4.8 The monopoly position of NBN Co in the wholesale fixed-line market raises the risk over the proposed 27 year timeframe of:
- (a) Excessive capital and operating expenditure; and

³⁵ See ACCC 2012, “Addressing the key drivers of electricity price increases” – Speech by Mr Rod Sims, Chairman, 24th October 2012; and Productivity Commission 2012, Electricity Network Regulatory Frameworks, Draft Report, Canberra.

³⁶ NERA, 2013, Appendix B

³⁷ NBN Co, Supporting Submission NBN Co Special Access Undertaking, 28 September 2012

(b) Excessive pricing of services over which NBN Co has market power.

4.9 This sub-section looks at the risk of excessive expenditure by NBN Co as a result of its ownership structure, the proposed regulatory framework, and its market position in the wholesale market.

4.10 Optus' analysis shows that:

(a) NBN Co's price control mechanism creates a systematic bias favouring excessive investment in capital expenses. As outlined in NBN Co's revised SAU³⁸, a rate-of-return³⁹ on capital is imposed based on the WACC and the nominal RAB. It is widely accepted by academics and regulators that this mechanism does not contain sufficient incentives to produce, price and distribute outputs efficiently, and may contain perverse incentives to excessive capital investment (i.e. through inflating the RAB to increase the allowable regulated revenue cap).

(b) Excessive capital investment mirrors recent concerns relating to retail price increases in electricity in Australia. This issue was raised by the ACCC Chairman in a recent speech.⁴⁰ Mr Sims concluded that the central flaw in the electricity regulatory regime was that it made the proposals of the "*monopoly businesses so central to the process, or so restricts the ability of the regulator to set independent forecasts of the allowable rate of return, or of required expenditure*".⁴¹ The provisions in the NBN Co SAU would result in the same impugned regime being applied to NBN Co for 27 years. This implies that similar problems as currently seen in the electricity market might arise with fixed line broadband internet over the 27 year term.

(c) Finally, NBN Co is a wholly government-owned enterprise that will be the dominant provider of wholesale of fixed line services. Incentive regulation was designed to operate with profit maximising private firms. Evidence shows that government-owned firms operating under electricity regulations (which are very similar to the rules put forward in the SAU) are more likely to lead to overinvestment and ineffective cost controls.⁴² Fundamental economics also indicates that private companies, even in the case of a monopoly, are more efficient than public

³⁸ Schedule 1F.

³⁹ Rate-of-return regulation was a development of an incomplete long term contractual relationship that offered public utilities a fair rate of return in exchange for the ability to renegotiate the terms of the contract without excessively costly haggling. See, for example, Williamson, O.E. 1985. *The economic institutions of capitalism*, New York: Free Press.

⁴⁰ Where 60% increase in real terms over the past five years in real terms: ACCC 2012, "Addressing the key drivers of electricity price increases" – Speech by Mr Rod Sims, Chairman, 24th October 2012.

⁴¹ ACCC 2012, "Addressing the key drivers of electricity price increases" – Speech by Mr Rod Sims, Chairman, 24th October 2012.

⁴² Productivity Commission, 2012, *Electricity Network Regulatory Frameworks*, Draft Report, Chapter 7.

companies. This view is again supported by empirical evidence in the electricity industry.⁴³

- 4.11 Each of these elements is discussed in more detail below. Optus submits that if the SAU does not effectively manage these risks, it cannot be assessed as being reasonable and in the long term interest of end-users.

Rate of return regulation creates a systematic bias favouring excessive expenditure

- 4.12 NBN Co's price control mechanism (LTRCM) provides for an overall revenue cap. In effect it is rate of return price regulation. Rate of return regulation is often used to ensure that the price set by the monopoly provider reflects the costs that are reasonably necessary to ensure efficient supply of services. Rate of return regulation has an advantage for the infrastructure owner in that it ensures that it can recover costs incurred, and typically provides sufficient regulatory certainty over time. However, this method of price control creates a systematic bias favouring excessive investment in capital expenses. It is therefore widely accepted that rate of return regulation requires robust regulatory oversight — typically both *ex ante* approval and *ex post* review.
- 4.13 NBN Co appears to be aware of the benefits of rate of return regulation – a method that “*explicitly guarantee firms an appropriate return on investment.*”⁴⁴ As commented by Ordover and Shampine:

*... the LTRCM continues to provide the opportunity for NBN Co to earn a return on investment, but also functions in part as a revenue cap based on a forecast of demand and costs. Because the cap is based on forecasts incorporating the allowed rate of return, it will provide appropriate incentives for investment (i.e., NBN Co's revenue cap will include the allowed return on previous and planned investment, which offers assurance that the investment will not be expropriated).*⁴⁵

- 4.14 Aspects of the claims made are indeed correct: rate of return regulation should provide the necessary regulatory certainty to promote investment. Although, in the specific case of NBN Co, doubts are raised whether such certainty is required (see Appendix A).
- 4.15 However, a focus on cost recovery misses the key objective of monopoly price regulation: encouraging efficient use of, and investment in, infrastructure. The key question is whether the LTRCM ensures efficient expenditure and the resulting price caps result in efficient prices. It is proposed that the LTRCM is a fixed principle for 27 years. This timeframe magnifies the importance of ensuring the LTRCM is appropriately designed.
- 4.16 Importantly, there has been no existing regulation or any empirical research to show that the combination of a price cap and a rate of return will work absent adequate regulatory oversight. NERA conclude that the LTRCM is inconsistent with any other regulatory regime it is

⁴³ Productivity Commission, 2012, *Electricity Network Regulatory Frameworks*, Draft Report, Chapter 7.

⁴⁴ Expert Report of Janusz A. Ordover and Allan L. Shampine, September 24 2012, paragraph 25.

⁴⁵ Expert Report of Janusz A. Ordover and Allan L. Shampine, September 24 2012, paragraph 25.

aware of within Australia.⁴⁶ There is a clear risk that over the 27 year period, NBN Co will maximise its rate of return through expenditure above that necessary for the efficient supply of fixed-line services. Under the proposed LTRCM, all these costs will be passed through to end-users through the price cap regulation without any independent regulatory oversight.

- 4.17 Rate of return price regulations allow utilities to insure against the risks of adverse technical progress or regulatory expropriation which limits the ability to recover the cost of “stranded assets”. But such control may lead to inefficiencies. This form of regulation has a high risk of rate padding (through practices such as gold plating and over staffing). Rate of return price regulation has been strongly criticised as being effectively a 100% profits tax, with poor incentives for efficiency as a tendency to encourage excessive capital intensity.⁴⁷
- 4.18 Optus is concerned with the likely ways NBN Co could overinvest: it could maintain or create excess capacity through, say, excess labour, and/or invest in unnecessary parts or equipment, coined “gold-plating”, as a method of increasing a monopolistic public utility’s net income.⁴⁸
- 4.19 This mirrors recent concerns in relation to retail price increases in electricity — 60% increase in real terms over the past five years in real terms — which might be the result of gold-plating of existing electricity grid infrastructure.⁴⁹ This is supported by NSW IPART’s white paper highlighting that “*recent network costs increase...are responsible for most of the recent retail price increases, may be higher than necessary due to aspects of the regulatory framework which are contributing to inefficient outcomes.*”⁵⁰
- 4.20 Optus submits that the ACCC must be satisfied that the LTRCM provides sufficient safe guards against the risk that the monopoly fixed-line provider will be able to incur and recover inefficiently high expenditure over the 27 year time frame of the SAU.

Risk mirrors recent concerns with retail electricity price increases in Australia

- 4.21 There has been debate recently over the role of regulation and ownership structures with regards to the incentive and ability of infrastructure firms to excessively invest in equipment to secure higher regulated returns. One recent example is electricity pricing.

⁴⁶ NERA, 2013, Appendix B

⁴⁷ Newbery, D. M. 1997, “Rate of return regulation versus price regulation for public utilities. Department of Applied Economics, Cambridge, UK. See also Averch, H. and Johnson, L. L., 1962, Behavior of the Firm under Regulatory Constraint, *American Economic Review*, Vol. 52, 5, pp. 1052-1069; Baumol, W. J. and Klevorick, A. K., 1970, “Input Choices and Rate-of-Return Regulation: An Overview of the Discussion”, *The Bell Journal of Economics and Management Science*, Vol. 1, No. 2, pp. 162-190; Petersen, H., 1975, “An Empirical Test of Regulatory Effects”, *Bell Journal of Economics*, Vol. 6, pp. 11-26.

⁴⁸ This was one of the key findings in the paper by Averch, H. and Johnson, L. L., 1962 Behavior of the Firm under Regulatory Constraint, *American Economic Review*, Vol. 52, 5, p. 1052-1069. This issue was also highlighted in Cicchetti, M. A. 1993, Irregular Incentives, *Public Utilities Fortnightly*, June 15

⁴⁹ IPART, 2012, *Strengthening the Foundation for Australia's Energy Future IPART's submission to the Draft Energy White Paper 2011* – Electricity March 2012.

⁵⁰ See: Section 2.1 in *Strengthening the Foundation for Australia's Energy Future IPART's submission to the Draft Energy White Paper 2011* – Electricity March 2012.

4.22 According to NSW IPART, “over the past 5 years, rises in network costs were one of the main drivers in electricity price increases.”⁵¹ These are the costs of paying the network businesses to use the transmission and distribution networks to transport electricity from the power stations to their customers’ properties.⁵² It is difficult to show whether network genuinely requires upgrading over its life time, or whether expenditure is simply an example of gold plating.

4.23 In respect to electricity pricing, it has been identified that a key driver of the ability of firms to excessively invest is the structure of the national electricity rules. In IPART’s view, the cumulative effect of the economic regulatory provisions of the National Electricity Rules (NER) is rapidly increasing network prices, which flow through to retail price and customer bills. In response to this, the NERs have recently been amended (discussed below). The recently replaced regulatory framework:

- (a) constrained the AER’s ability to apply what it considers to be the best estimate of the efficient operating and capital costs (opex and capex);
- (b) provided strong incentives for network business to invest capital in the network potentially beyond efficient levels because the prescriptive requirements of the NEW may lead to excessive returns;
- (c) allowed the business to earn a return on all capital invested regardless of its efficiency and prudence, by requiring the AER to roll all capital expenditure into the assess base. This weak incentive for productivity improvement is exacerbated by inadequate governance arrangements in NSW; and
- (d) Provided opportunities for the businesses to cherry pick particular issues through the appeal process.⁵³

4.24 This theme that the electricity regulatory regime has contributed to the incentives and abilities of firms to invest inefficiently was reiterated by the ACCC Chairman in a recent speech.⁵⁴ In commenting on the regulatory change in 2005 to the ‘propose respond’ model where the regulator was required to accept reasonable proposals, and amend proposals “to the ‘minimum extent necessary’ to enable them to be approved,”⁵⁵ he observed:

I am not aware of any other regulatory model in operation in the world today which makes the proposals of the monopoly businesses so central to the process, or so restricts

⁵¹ IPART, 2012, *Strengthening the Foundation for Australia’s Energy Future IPART’s submission to the Draft Energy White Paper 2011* – Electricity March 2012.

⁵² See: [http://www.ipart.nsw.gov.au/Home/About_Us/FAQs?dIv_FAQ%20List=\(dd_Industries=electricity\)](http://www.ipart.nsw.gov.au/Home/About_Us/FAQs?dIv_FAQ%20List=(dd_Industries=electricity))

⁵³ See Changes in regulated electricity retail prices from 1 July 2011 Electricity — Final Report June 2011, p.95.

⁵⁴ ACCC 2012, “Addressing the key drivers of electricity price increases” – Speech by Mr Rod Sims, Chairman, 24th October 2012.

⁵⁵ ACCC 2012, “Addressing the key drivers of electricity price increases” – Speech by Mr Rod Sims, Chairman, 24th October 2012, p.3.

*the ability of the regulator to set independent forecasts of the allowable rate of return, or of required expenditure.*⁵⁶

- 4.25 Optus submits that the NBN Co SAU adopts a near identical approach. Specifically it provides for a regulatory model where the monopoly business is deemed to have incurred efficient expenditure without any ability of the ACCC to *ex ante* approve, or *ex post* review before inclusion into the RAB and rate of return regulation. Further, there is no ability (module 1) and limited ability (replacement modules) for the ACCC to set independent forecasts of rate of return of expenditure.
- 4.26 The above issues, raised by IPART for the energy sector in NSW and the Chairman of the ACCC, mirror the potential issues with fixed-line services under the LTRCM structure proposed by NBN Co.
- 4.27 The LTRCM's building block approach in the SAU constrains the ACCC's ability to consider (and potentially overrule) any price-related terms and conditions. Indeed, the SAU specifically states that the ACCC has no role in oversight of price-related terms. There is also no provision for the ACCC to review the inclusion of capital expenditure into the RAB, or inclusion of operating expenditure into ABBRR. Finally, the SAU enables NBN Co to earn a return (bond rate) on all capital invested regardless of its efficiency and prudence, based on the premise that the construct of the SAU is inherently efficient due to the need to provide superior service in order to attract sufficient demand to ultimately recover their capital investment.
- 4.28 This is such a weak incentive for efficient production, and it is not backed by any further regulations nor literature/precedent. As noted by the Chairman of the ACCC, such a regulatory model is without precedent around the world.

Government ownership magnifies the risk

- 4.29 Finally, NBN Co is a "wholly government-owned enterprise" that will have a monopoly over the wholesale supply of fixed line broadband internet. This form of ownership may lead to perverse outcomes when subject to regulatory arrangements that were primarily designed to encourage cost-minimisation by profit-maximising firms. The interaction between the national electricity rules (on which the NBN Co SAU is based) and government-owned electricity network business has shown that less than optimal outcomes arise due to government ownership.
- 4.30 The Productivity Commission (PC) in its Draft Report on Electricity Network Regulation⁵⁷ noted that a justification for government ownership — especially in the provision of essential services — is it may be difficult to construct effective regulations.⁵⁸ However, the PC noted that this justification may no longer hold given Australia's well developed set of competition

⁵⁶ ACCC 2012, "Addressing the key drivers of electricity price increases" – Speech by Mr Rod Sims, Chairman, 24th October 2012, p.3.

⁵⁷ Productivity Commission 2012, *Electricity Network Regulatory Frameworks*, Draft Report, Canberra.

⁵⁸ Productivity Commission 2012, *Electricity Network Regulatory Frameworks*, Draft Report, Canberra, p. 254. Optus notes that justification (i) to (iv) would not apply in telecommunications markets which is almost exclusively driven by privately-run firms.

regulations. Optus also notes that the telecommunications industry has been subject to specific competition-related access regulated through Part XIC of the CCA.

4.31 Further, the PC find that incentive-based regulations may not work as intended when dealing with government-owned businesses due to their complex investment incentives due to:

- (a) **Concessional access to finance:** This magnifies the gap between the regulated WACC and the true cost of capital faced by the government-owned firm. The larger the gap, the weaker the penalty for excessive expenditure. A large gap may make it profitable to over-spend. Optus submits this is of particular concern for NBN Co as it is required to make an amount above the long term bond rate, whereas the proposed WACC provides for a 350 basis point mark-up over the bond rate.
- (b) **Limited financial accountability:** Unlike private firms which require funding through several sources, government-owned businesses receive funding through one source. This has the potential to negate the long-term consequences faced by private firms of poor management on the ability to obtain further capital. Thus there is less incentive for effective management.
- (c) **Insolvency is effectively impossible:** The incentive to engage in efficient management and prudent cost expenditure to ensure that the firm remains solvent is a key mechanism to promote effective and efficient operation of the firm.
- (d) **Non-commercial incentives:** Many government-owned businesses face multiple and conflicting objectives, which negate their ability to cost-minimise. For example, firms may engage in excessive advertisements promoting the social benefits of the programme, which cost-minimising private firms would not engage. Evidence from the electricity industry shows that state-owned firms appear to pay higher wages and have higher staff ratios than private firms.⁵⁹ The PC also note that state-owned firms may face political interventions which runs counter to the assumption of independent shareholders leaving the running of the company to the board and management.⁶⁰

4.32 Applying this analysis to NBN Co demonstrates that its government-ownership may negate many, if not all, of the efficiency-promoting incentives provided for by the proposed regulatory structure in the SAU. This implies that government-owned business require greater independent oversight than would a private-owned firm in similar circumstances. Optus notes this is an important implication given the extensive reliance placed upon commercial incentives by NBN Co's expert advisors in justifying provisions of the SAU.⁶¹

⁵⁹ Productivity Commission 2012, *Electricity Network Regulatory Frameworks*, Draft Report, Canberra.

⁶⁰ Optus notes the many provisions in the SAU that enable the Ministers and other government officials to direct NBN Co to engage in behaviour, or incur costs.

⁶¹ See for example Synergies Consulting, September 2012.

Mechanisms to manage the risk of incurring excessive expenditure

- 4.33 This section analyses the provisions in the proposed SAU that aim to mitigate the risk that NBN Co will be able to incur and recover excessive costs. The provisions relate to:
- (a) Prudence of costs;
 - (b) RAB roll-over mechanism; and
 - (c) RAB and use of forecasts in module 2.
- 4.34 It is outlined above that rate of return regulation, government ownership and market position of NBN Co creates a significant risk that excessive costs will be incurred over the 27 years of the SAU. Optus submits that the mechanisms to manage the risk must be sufficiently strong to ensure the LTIE is promoted throughout the full 27 years of the SAU. Where the mechanisms are not, or do not allow enough flexibility to enable efficient change, the ACCC should not accept the SAU.

Prudence

- 4.35 The key role prudence has in ensuring that costs incurred are efficient can be seen through the following extract from NBN Co's SAU Supporting Submission:

*[The] prudence approach in Module 1 does not rely on ex ante regulatory approval of capex forecasts or any ex post reviews of capex. NBN Co believes that compliance with the Prudent Design Condition and the Prudent Cost Condition places appropriate controls on NBN Co's capex.*⁶²

- 4.36 In other words, NBN Co is submitting that ACCC oversight (*ex ante* or *ex post*) is redundant because the prudence conditions will ensure that NBN Co does not incur any inefficient expenditure. A key consideration for the ACCC, therefore, should be whether the prudence conditions are sufficiently rigorous as to provide the same controls of specific *ex ante* regulatory oversight.
- 4.37 Prudence is a key component of the expert submissions supporting the claim that the SAU is appropriate. Synergies Consulting note that under the proposed rate-of-return regulation in the SAU, NBN Co would be subject to incentives to incur excessive costs, i.e. gold-plating.⁶³ Synergies notes that the SAU contains prudence provisions to prevent this from happening, and in its opinion, the provisions "*substantially mitigate the risk of productive inefficiency*".⁶⁴
- 4.38 Notwithstanding the views of NBN Co's experts as to the impact of prudence (in effect they assume prudence provisions result in prudent expenditure), Optus has received advice that the inclusion of clause 1E.4.1(f) effectively makes the prudence provisions unenforceable in the

⁶² NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, pp.209-10.

⁶³ Synergies Consulting, September 2012, p.66.

⁶⁴ Synergies Consulting, September 2012, p.66.

Federal Court, and coupled with no provision for ACCC oversight, is not effective in ensuring only prudent costs are incurred.

- 4.39 The vast bulk of NBN Co's expenditure will be subject to no ACCC oversight;
- (a) First, spend that is simply "deemed" to be prudent can be rolled straight into NBN Co's RAB with no further scrutiny, even though these costs are likely to run into tens of billion dollars;
 - (b) Second, NBN Co's capital expenditure will be deemed to be prudent and subject to no further scrutiny if NBN Co's determines that the expenditure satisfies NBN Co's Network Design Rules and its Prudent Cost conditions; and
 - (c) Third, operating expenditure which will run into billions of dollars a year is considered to be prudent if in NBN Co's opinion such expenditure offers "value for money" and "the lowest total cost of ownership" and is otherwise in line with the "Statement of Expectations" and "any other regulatory requirements applicable to NBN Co."
- 4.40 As will be seen below, these rules, which are self-policed, set a low threshold in terms of meeting the proposed prudency test. In fact, it would be unlikely that any capital or operating expenditure would be deemed impermissible under these rules.
- 4.41 Optus' analysis demonstrates that the prudency provisions are not adequate to manage the risk of inefficiency excess expenditure. Optus has particular concerns with:
- (a) The weak nature of the requirements to which NBN Co must adhere; including the ability of the NBN Co CEO to sign-off expenditure if it is in the best interest of the company;
 - (b) Expenditure is deemed prudent if it is incurred to comply with a requirement from a Shareholder Minister, or a legal, policy, regulatory or administrative requirement; and
 - (c) Prudency requirements are unlikely to be enforceable through Federal Court action; meaning that absent effective ACCC oversight, the application of the provisions is at the discretion of NBN Co.
- 4.42 Optus' detailed reasoning is set out in section 5.

RAB roll forward Review

- 4.43 There is no provision within the SAU to allow for ACCC review of the RAB. If expenditure is deemed prudent, it is included in the RAB and is automatically rolled-over each year. As discussed above, Optus has concerns over the ability of the prudency provisions to prevent inefficient expenditure from being incurred.

- 4.44 The RAB for the NBN Co SAU represents the value of capital investments made by NBN Co that can be recovered via prices over the prescribed 27 year term.⁶⁵ Each year, a portion of this expenditure is recovered through regulatory depreciation (by including it in the annual revenue requirement) and the same amount is deducted from the RAB. New capital expenditure is added to the RAB each year. This RAB roll-forward process means that the value of NBN Co's assets in the RAB will not be recalculated over time by the ACCC. This approach seems reasonable given that the NBN is a new investment for which the costs are unknown. However, the reasonableness of this approach assumes that only efficient costs are included in the RAB — indeed the use of a locked in RAB without any efficiency adjustment of past assets is justifiable on the basis that only efficient costs are included. It has been shown (above and in section 5) that the prudency provisions in the NBN Co SAU are likely unenforceable and therefore not effective at ensuring efficient expenditure.
- 4.45 Optus considers that there are two possible choices: include all costs within the RAB and allow periodic review of the RAB with the ability to optimise the asset base; or review efficiency of expenditure each period prior to costs being rolled into the RAB.
- 4.46 In such a scenario, any optimisation that may be required can occur through yearly adjustments to the allowable increases to the RAB.
- 4.47 However, the SAU does not provide for any ability of the ACCC to review inclusion of costs. In Optus' opinion, the RAB roll-forward mechanism is unlikely to encourage economically efficient investment use, and operation of the NBN. The mechanism proposed in the SAU is materially different from that used in other industries. Optus does not see any justification for this approach.
- 4.48 The RAB roll-forward mechanism was one aspect of the National Energy Regulator (NER) that was subject to a recent review by the Australian Energy Market Commission (AEMC)⁶⁶. The Australian Electricity Regulator (AER) stated that the old NER had problems because it provided for all actual capex incurred within a regulatory control period to be rolled into the regulatory asset base (RAB) regardless of whether or not the capex allowed for in the determination was efficient. This roll forward model, in the AER's view, creates incentives for NSPs to incur more than efficient levels of capex.⁶⁷
- 4.49 In response, the AEMC adopted changes to, and clarified the operation of, the regulatory powers relating to assessment of capex and opex allowances⁶⁸ and the treatment of incentive

⁶⁵ If NBN Co incurs capital expenditure on network assets, this expenditure is added to the RAB when the assets are placed in service and will be recovered by NBN Co over the life of the asset. ACCC, NBN Co Limited 2012 Special Access Undertaking, Consultation Paper, November 2012.

⁶⁶ The revised SAU mechanism has no incentive to minimise cost, partly because it is a government enterprise as discussed earlier, and partly because there is no revenue cap during module 1. The price regulation fully relies on "prudency" arrangements.

⁶⁷ AEMC, 2012, Final Rule Determination, National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012 and National Gas Amendment (Price and Revenue Regulation of Gas Services) Rule 2012 Final Rule Determination, p.2.

⁶⁸ AEMC, 2012, Final Rule Determination, chapter 8.

mechanisms.⁶⁹ Importantly, the proposed rules strengthen the ability of the regulator to review capex and opex on an *ex ante* basis and also undertake *ex post* reviews.

4.50 The AEMC provided guidance on the final rule that:

- (a) There is an obligation to accept reasonable proposal; and
- (b) When assessing a substitute for a proposal, the regulator is not constrained by the capex and opex criteria from choosing the best substitute it can determine from all information before it.⁷⁰

4.51 The rule changes make clear that the capex and opex proposal by the provider is the starting point of the analysis; it should be only one of a number of inputs. The regulator can have reference to other submissions, expert reports, and its own analysis when assessing what a reasonable forecast is. The assessment of reasonable allowances is not restricted by the initial proposal.⁷¹

4.52 The rule changes also dealt with enhancing the ability of the regulator to undertake *ex post* review of allowances. The new rules provide the regulator with a number of tools it can apply, including:

- (a) capex sharing schemes to be designed by the regulator;
- (b) efficiency reviews of past capex, including the ability to preclude inefficient expenditure from going into the RAB up to an amount that is equal to the amount of expenditure above the allowance; and
- (c) deciding whether to depreciate the RAB using actual or forecast expenditure to establish a NSP's opening RAB.⁷²

4.53 Of relevance for the assessment of the NBN Co SAU, the AEMC took the view that *ex post* review of efficiency addresses the information asymmetry inherent when making *ex ante* assessments; and provides firms with an incentive to incur only efficient expenditure if there is a risk of an inability to recover inefficient costs.⁷³

4.54 It is clear from this brief outline of the recent changes to the NERs, that the regulatory response to the threat of excessive expenditure in the electricity industry is to enhance and clarify the role of the regulator to review allowances before and after a regulatory period, including the extent to which costs should be rolled over into the RAB.

4.55 It is not clear why NBN Co should not be subject to the same level of oversight as investments within the electricity industry. Optus notes that the investment associated with the NBN is

⁶⁹ AEMC, 2012, Final Rule Determination, chapter 9.

⁷⁰ AEMC, 2012, Final Rule Determination, p.96.

⁷¹ AEMC, 2012, Final Rule Determination, section 8.5.

⁷² AEMC, 2012, Final Rule Determination, p.166.

⁷³ AEMC, 2012, Final Rule Determination, section 9.

significantly larger than most electricity projects, and the proposed NBN Co SAU will last much longer than SAUs within the electricity industry. Both of these factors indicate that NBN Co would require more oversight not less.

Module 2 RAB processes

- 4.56 Unlike Module 1, Module 2 makes clear that the RAB during Replacement Modules is to be based on NBN Co forecasts. NBN Co states this makes the SAU consistent with the standard practice across utility industries.
- 4.57 However, the standard practice of the utility industries has recently changed following criticisms. In the electricity industry, the AER stated that existing NER restricted its ability to interrogate and amend the capex and opex forecasts of providers. The AER considered that the NER invited upwardly biased forecasts and limit its ability to interrogate and amend forecasts provided by providers.⁷⁴
- 4.58 The AEMC identified that a deficiency of the previous NER was that it allowed firms to recover capital expenditure above the level forecasted, without regulatory scrutiny. Thus allowing inefficient expenditure. The new set of tools granted to the AER was designed to remove this ability (see above).
- 4.59 Optus is concerned how the terms of Module 2, combined with fixed principles, may be applied.⁷⁵ It is not clear how much ability the ACCC will have to conduct a full review of NBN Co forecasts, and where necessary, to insert its own forecast in replacement of a rejected NBN Co forecast. Any restriction on the ability of ACCC to do so risks replicating the flawed elements in the previous electricity regulatory regime: which has now been amended to allow the AER more freedom to review and replace forecasts.
- 4.60 These concerns are magnified by the fact that all terms in Module 2 are fixed principles⁷⁶ — which means that the ACCC cannot reject any replacement module “for a reason that concerns” the fixed principles term.⁷⁷ The ACCC noted in the Supplementary Information Paper that:
- ... if a fixed principles term or condition sets out high-level principles involving judgment and discretion, there is a question as to whether the ACCC may reject a variation for the reason that the variation does not comply with these principles.*⁷⁸
- 4.61 One possible interpretation is that the ACCC cannot reject a Replacement Module for a reason that concerns the relevant consideration under clause 2D.6. If this is so, this would place significant limitations on the ability of the ACCC to review and replace NBN Co’s forecast

⁷⁴ AEMC, 2012, Final Rule Determination, p.1.

⁷⁵ See, for example, concerns raised in Supplementary information paper about the Special Access Undertaking given to the ACCC by NBN Co Limited and NBN Tasmania Limited on 18 December 2012.

⁷⁶ Clause 5.3.

⁷⁷ Section 152CBAA(6) of the CCA.

⁷⁸ ACCC, Supplementary information paper about the Special Access Undertaking given to the ACCC by NBN Co Limited and NBN Tasmania Limited on 18 December 2012, p.3.

capex, opex and revenue. As described below, during the ICRP, NBN Co will face an incentive to manipulate its forecasts to prolong the ICRP (and hence avoid application of revenue cap) while making an actual financial profit. Any limitation on the ACCC to review such behaviour may lead to inefficient outcomes.

- 4.62 Optus recommends that the SAU be amended to clarify how clause 2D.6 will operate with the ability of the ACCC to interrogate and amend forecasts put forward by NBN Co. Further, it should be made clear that clause 2D.6 is not a fixed principle.
- 4.63 Further, Optus recommends that the ACCC reject the SAU on the basis that it proposes fixed principles that should not be fixed principles — this is irrespective of whether the considerations in clause 2D.6 are reasonable.
- 4.64 In addition, the Module 2 LTRCM procedures do not include any efficiency incentive mechanisms, such as sharing schemes. NERA concluded that this feature is unique in regulatory regimes in Australia.⁷⁹ During the recent changes to the NER, the AER recommended the introduction of a requirement in the NER that only 60% of any expenditure incurred by a NSP above its capex allowance would be rolled into the RAB and, therefore, be recoverable. The AER summarised its views on why efficiency incentives should be included:

As in a competitive market, businesses should be exposed to both the risks and rewards of their investment decisions... [where service providers] invest more than is needed to provide the level of service that consumers (or governments / regulators on their behalf) demand, they should not be able to pass through the costs of that investment to consumers – just as in a competitive market, consumers would choose to use a different (more efficient) provider rather than pay the additional costs. Likewise, where investment takes place that is efficient – i.e. at lowest long term cost – service providers should make a profit on that investment.⁸⁰

- 4.65 In response, the AEMC changed the NER to make clear that the AER has the ability to introduce sharing schemes in combination with other powers to adjust recoverable RAB *ex post*. These tools include: capex sharing schemes to be designed by the AER, efficiency reviews of past capex, and deciding whether to depreciate the RAB using actual or forecast expenditure to establish a NSP's opening RAB.⁸¹
- 4.66 Optus notes that none of these tools are available in NBN Co's SAU.
- 4.67 In conclusion, the new NER does not place any restrictions on the analytical techniques that the AER can use to scrutinise and, if necessary, amend or substitute the NSP's capex or opex forecasts. Optus does not see any justification for the NBN Co SAU placing restrictions on the ability of the ACCC to review the efficiency of NBN Co's expenditure and its inclusion within the RAB, restrictions on the ability of the ACCC to introduce a capital sharing scheme.

⁷⁹ NERA, 2013, Appendix B.

⁸⁰ AEMC, Economic regulation of Network Service Providers, and Price and Revenue Regulation of Gas Services, Directions Paper, 2 March 2012, p.8.

⁸¹ AEMC, 2012, Final Rule Determination, p.27.

Mechanisms to manage the risk of recovering excessive costs

- 4.68 The pricing commitments in the SAU, and the flexibility afforded to the ACCC, are vital elements to ensure that the LTIE is promoted, and continues to be promoted, during the lifetime of the SAU. It has been shown that there is a significant risk of excessive expenditure and that the provisions to manage that risk are insufficient and not fit for purpose. There is therefore an incentive and ability for NBN Co to incur excessive expenditure. It is imperative that the SAU contains strong provisions to prevent excessive expenditure being recovered through higher prices.
- 4.69 NBN Co and the Government have a clear and stated objective to deliver enhanced competition in the provision of high speed broadband services and ensure that customers benefit from lower prices. Consistent with this aim, NBN Co's Corporate Plan and the Government have stated that prices will be affordable and will decline over time, in nominal and real terms.⁸²
- 4.70 Optus welcomes such commitments. In saying that, however, these commitments are not reflected in the drafting of the SAU. This may not be a problem in the immediate future. But the ACCC must be satisfied that provisions of the SAU promote efficient pricing and the LTIE over the next 27 years.
- 4.71 It is foreseeable that there may be conflict over the next 27 years between the objectives of NBN Co making a return above the long-term Government bond rate, and the desire to lower prices on a nominal and real term. As outlined above, the monopoly position of NBN Co creates a risk of excessive expenditure during the build phase. As explained in section 5 and section 6, the mechanisms in the SAU to prevent non-prudent expenditure are unlikely to be sufficient to ensure efficient expenditure over the next 27 years; nor to ensure that total revenue reflects an efficient cost recovery profile.
- 4.72 The potential for inefficient pricing also comes from applying one pricing regime to two very different phases of the NBN — the build phase and the cost-recovery phase. These phases have very different pricing objectives:
- (a) During the build phase, the pricing objective is to facilitate take-up, promote usage, and ensure efficient transition from legacy products; and
 - (b) During the cost recovery phase, the pricing objective is to ensure total revenue follows an efficient cost recovery path.
- 4.73 The ACCC must be satisfied that the pricing commitments in the SAU promote the LTIE in both phases. It would appear that this may be difficult to achieve given the differences in the objectives and the long time periods involved. For instance, it is difficult to say now with any certainty as to what pricing rules and levels are required to promote the LTIE during the cost

⁸² NBN Co, Corporate Plan 2011-2013, 17 December 2010, pp.100-4; and DBCDE, "Government release NBN Co Corporate Plan", Joint Media Release with the Hon Julia Gillard MP Prime Minister and Senator the Hon Penny Wong Minister for Finance and Deregulation and Senator the Hon Stephen Conroy Minister for Broadband, Communications and the Digital Economy, 20 December 2010.

recovery phase (a 20 year period not expected to start until after 2021) when the total costs to be recovered are also not known.

- 4.74 Without such certainty, it would be difficult for the ACCC to be satisfied that the proposed inflexible pricing regime, which effectively removes ACCC oversight, promotes the LTIE for the next 27 years. NBN Co submits that reliance on the combination of the CPI-1.5% individual price increase limit, the overall revenue cap, and initial pricing principles will constrain prices to recover no more than prudently incurred costs.⁸³
- 4.75 This section tests this claim. Optus submits that NBN Co will face pricing constraints only from one requirement: the CPI-1.5% individual price increase limit. Using NBN Co's Corporate Plan forecasts, it can be seen that not even the NBN Co is forecasting the overall revenue cap will apply during the 27 year lifetime of the SAU — this result has been confirmed by NBN Co.⁸⁴ In addition, the requirement imposed on NBN Co by the initial pricing are weak and unlikely to limit NBN Co's freedom to introduce new prices in any manner it sees fit. Further, there is no ACCC oversight, and Federal Court enforcement is unlikely to be a viable option.
- 4.76 Optus submits that solely relying on the CPI-1.5% individual price increase limit to control the ability of the monopoly provider of fixed-line services to extract monopoly rents is not sufficient to ensure that the LTIE is promoted. Furthermore, Optus demonstrates that NBN Co has failed to provide sufficient evidence to affirmatively satisfy the ACCC that the actual price increase limit proposed, as a stand-alone pricing rule, promotes the LTIE over the 27 year period of the SAU.
- 4.77 First, the application of the overall revenue cap during the lifetime of the SAU is summarised, with detailed discussion in section 6. Second, the effectiveness and enforceability of the IPP to limit the introduction of excessive new prices is discussed. And third, the appropriateness of relying solely of the individual price increase limit is analysed.

ICRP & Revenue Cap

- 4.78 In addition to individual price controls, the NBN SAU proposes that the NBN Co be subject to an overall revenue cap. This requires that the maximum yearly revenue will equal the ABBRR: that is, the allowable revenue on the RAB. However, the revenue cap only applies in the period after all the initial losses are recovered. During the ICRP the NBN Co is not subject to an overall revenue cap: this has been identified by Synergies as a potential problem.⁸⁵
- 4.79 Optus discusses the operation of the initial cost recovery period (ICRP) in section 6. But in summary, using NBN Co's own forecasts, it is estimated that the level of losses in the ICRP are such that it is unlikely to be extinguished during the lifetime of the SAU. This is notwithstanding the fact that over the same period, NBN Co forecasts a financial return of around 7%.
- 4.80 NBN Co has confirmed this result in a letter to Optus dated 14 January 2013, stating:

⁸³ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.173.

⁸⁴ Lovell, C., Letter to Andrew Sheridan re: NBN Co Special Access Undertaking, 14 January 2013.

⁸⁵ Synergies Consulting, September 2012, section 9.

If the Corporate Plan forecasts and assumptions are applied to the LTRCM as set out in the SAU, the revenue constraint does not come into effect by 2039-40. The information in the Corporate Plan enables access seekers who are so minded to check this outcome.⁸⁶

- 4.81 Optus has used the information in the Corporate Plan to check how NBN Co expects the LTRCM to work during the life time of the SAU. Optus' analysis shows that:
- (a) NBN Co expects to make a positive internal rate of return of 7.1% over the period 2012 to 2040. That is, it will recover all its costs and make an additional amount of revenue. However, using the financial information in the 2012-15 NBN Corporate Plan, Optus estimates the ICRA account will be around \$60 billion in 2040.
 - (b) There is a disconnect between the financial and regulatory accounts which undermines any external pressure for NBN Co to extinguish the ICRA. For example, in 2040 it is forecasted that NBN Co will make an EBITDA margin of 77 per cent, and yet regulatory losses *increases* by around \$4 billion (see section 6).
 - (c) The continuation of the ICRP for the full period of the SAU, the use of forecasts after Module 1, and its disconnect from financial concepts of losses, undermines the expert opinion submitted by NBN Co on the efficiency of the loss capitalisation scheme.
- 4.82 Optus submits that no reliance can be placed upon the overall revenue cap to limit the ability of NBN Co to price in a manner unconstrained by market pressure. The assessment of the SAU therefore relies upon the application of the CPI-1.5% individual price growth limit, and the ability of NBN Co to set prices for new products and charges.

Ability of the IPP to manage introduction of new charges and prices

- 4.83 As noted above, NBN Co relies upon the combination of the three mechanisms — revenue cap, individual price increase limit and IPP — to justify that the SAU constrains NBN Co from setting inefficient prices. Optus' analysis, however, demonstrates that on the information before the ACCC, it is reasonably foreseeable that the overall revenue cap will not apply during the lifetime of the SAU. Therefore, greater weight must be placed upon the IPP and the initial price increase limits when assessing the reasonableness of the SAU.
- 4.84 This section discusses the ability of the IPP to effectively manage the introduction of new charges and prices. Optus anticipates that it will be through this mechanism that NBN Co will be able to introduce new charges in response to any revenue shortfall.⁸⁷ An effective and efficient IPP is vital to ensure that NBN Co can only set prices at a level consistent with the recovery of efficient costs, and consistent with the LTIE.
- 4.85 NBN Co describes the impact of the IPP:

⁸⁶ Lovell, C., Letter to Andrew Sheridan re: NBN Co Special Access Undertaking, 14 January 2013, p.2.

⁸⁷ Either due to lack of demand or due to a cost blow-out.

*Where a price for a Non-Reference Offer or an Other Charge is set at zero or not specified, NBN Co may introduce a new price subject to compliance with the Initial Pricing Principles but unlike in relation to Reference Offers (or Other Charges related to the supply of Reference Offers) there is no regulatory recourse in these circumstances.*⁸⁸
[emphasis added]

- 4.86 The IPP state that initial or new prices will be determined by NBN Co having regard to, among other relevant matters:
- (a) Uniform national wholesale pricing;
 - (b) Statement of expectations;
 - (c) Nature and extent of market demand;
 - (d) The relationship between the new offer, new other charge or zero-priced non-reference offer and other reference offers, non-reference offers and other charges;
 - (e) The importance of affordability to drive take-up rates;
 - (f) NBN Co's long term cost recovery; and
 - (g) The projected timeframe for recovery of initial losses.⁸⁹
- 4.87 NBN Co also commits that prior to introducing the new or initial prices, it will publish a pricing rational statement "*describing, in qualitative terms, how the initial or new price has been determined*".⁹⁰
- 4.88 That is the extent of NBN Co's commitments. The relevant question is whether these provisions are adequate to manage the risk that over the 27 year timeframe of the SAU, the monopoly provider of fixed-line services may introduce new or initial prices that are above the level consistent with the LTIE.
- 4.89 Optus has serious concerns that the IPP provisions in the SAU will provide no effective constraint on NBN Co adopting initial or new prices at whatever level it sees fit. The IPP, as drafted makes:
- (a) No reference to the LTIE;
 - (b) No reference to promoting competition in related markets; and
 - (c) No reference to the legitimate business interests of access seekers.
- 4.90 The IPP plays an even more important role during the initial loss recovery period. During the ICRP, NBN Co is subject to no overall revenue cap and can set new or initial prices at any level

⁸⁸ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.107.

⁸⁹ Clauses 1D.6 & 2C.5.

⁹⁰ Clauses 1D.6(b) & 2C.5(b).

so long as it complies with the IPP. This potential to set 'extreme initial prices' during the ICRP was recognised by Synergies Consulting:

*... the substantial capitalised losses expected to arise under the SAU would allow NBN Co, absent constraints, scope to set quite extreme prices for new Non-Reference Offers.*⁹¹

- 4.91 NBN Co's expert advisor Synergies note that the IPP will play an important role in ensuring efficient new prices during the ICRP. Synergies highlights that the SAU requires NBN Co to reference the IPP in setting new prices. Synergies conclude that the terms of the IPP "circumscribe the factors that would need to be considered in establishing an efficient price."⁹² However, Synergies fail to provide any evidence to support their conclusion.
- 4.92 Optus agrees with Synergies assessment that during the ICRP there is a material risk of NBN Co introducing extreme prices for new services. On available data, it appears that the ICRP will exist throughout the 27 year timeframe of the SAU — a conclusion confirmed by NBN Co which stated that the revenue constraint does not come into effect by 2039-40.⁹³ The ability to price in such an unconstrained manner for products in a market without effective competition is unprecedented within Australian telecommunications markets.
- 4.93 Importantly, the IPP provides for no ACCC oversight, and no requirement to justify the new prices with any rigour. There is no requirement to provide quantitative evidence to support claims prices are consistent with the IPP. The SAU requires that NBN Co provide a qualitative statement describing how the pricing had been determined. Yet, Optus notes there is no requirement that NBN Co justify the price against the IPP criteria.
- 4.94 Notwithstanding the lack of oversight, it may be possible that action could be brought by third parties in the Federal Court for breaches of the SAU. A key question, therefore, is whether the terms of the IPP are drafted to enable effective enforcement through the Federal Court. Optus submits this is a significant concern: without effective enforcement there is no requirement for NBN Co to comply, irrespective of whether the factors contained in the IPP reflect considerations for efficient pricing, as argued by Synergies.
- 4.95 The ACCC, or any persons whose interests are affected by the SAU, is entitled to take enforcement action pursuant to section 152CD of the CCA. If such an application were made in relation to the SAU and the Federal Court was satisfied that NBN Co had breached the SAU, the Federal Court would have the power to:
- (a) direct NBN Co to comply with the SAU;
 - (b) direct NBN Co to compensate any person affected by its breach of the SAU; or
 - (c) make any other order it thinks appropriate.

⁹¹ Synergies Consulting, September 2012, p.41.

⁹² Synergies Consulting, September 2012, p.42.

⁹³ Lovell, C., Letter to Andrew Sheridan re: NBN Co Special Access Undertaking, 14 January 2013.

- 4.96 Any person making an application under section 152CD would need to establish, on the balance of probabilities, that NBN Co had breached its obligations under the SAU.

Are the undertakings in clause 1D.6 enforceable?

- 4.97 While clause 1D.6(a) requires NBN Co to consider the matters set out above, the list is not exhaustive with the consequence that any decision made by NBN Co to set a price in relation to the matters governed by 1D.6 may also be based on factors not listed in this clause.
- 4.98 Accordingly, it would be extremely difficult for the ACCC or any other person to establish that the decision is incorrect/inappropriate. Even where the ACCC or any other person were able to establish NBN Co had failed to consider a particular matter, the outcome of such enforcement action is likely to be limited to NBN Co being forced to reassess its decision giving consideration to that particular matter.
- 4.99 The requirement to publish a pricing rationale statement in clause 1D.6(b) is distinct from the requirement to consider the listed matters. In the absence of detailed statements from NBN Co, it may be difficult to establish whether, and if so to what extent, NBN Co has given due consideration to the matters set out in 1D.6(a). It is likely that the qualitative explanation of new price determinations which forms the pricing rationale statement would include reference to the considerations set out in 1D.6(a). However, from an enforcement perspective it would be difficult for the ACCC or any other person to establish NBN Co has breached the obligations in 1D.6(b) other than where NBN Co failed to publish a pricing rationale statement at all.
- 4.100 It should also be noted that a number of the factors listed in 1D.6(a) are in tension with each other. For example, importance of affordability⁹⁴, may potentially conflict with NBN Co's long term cost recovery⁹⁵ — especially during the ICRP. Accordingly, any decision on setting a price pursuant to clause 1D.6(a) is likely to involve the weighing of a number of competing demands. This again limits the practical ability of the ACCC, or any other party, to apply to the Federal Court on the basis of an objection to the particular pricing decision of NBN Co. NBN Co's likely response to any such claim would be that it considered the matter in question, but that factor was outweighed by competing considerations.
- 4.101 Except in the most extreme circumstances it is difficult to envisage any person successfully taking action under section 152CD in relation to the IPP. If a price were objectionable, it would be necessary to establish that no reasonable person could have reached that price decision if he or she had considered the matters set out in 1D.6(a). The chance of any objection resulting in a change of price is very small. Accordingly, the ability to enforce these provisions is of negligible value.
- 4.102 Given the drafting of the IPP clause, the exclusion of any ACCC oversight, and the resulting lack of enforceability in the Federal Court, it is reasonable to conclude that the IPP will have no ability to prevent NBN Co setting initial or new prices at any level it so wishes.

⁹⁴ Clause 1D.6(a)(viii).

⁹⁵ Clause 1D.6(a)(ix).

- 4.103 In summary, the proposed IPP:
- (a) Imposes no effective restraint on the NBN Co from introducing initial or new prices at any level it so wishes; and
 - (b) Is drafted in such a manner, and imposes such weak obligations, that enforcement through Federal Court action is very doubtful.
- 4.104 Optus submits that the ACCC cannot assume that the IPP will operate in the manner put forward by NBN Co. In addition, NBN Co cannot rely upon the IPP to justify the efficiency of future pricing.
- 4.105 At a minimum, the IPP should mirror the requirements set out in section 152AH of the CCA for the ACCC's assessment of undertakings and regulations. It is widely accepted that these provisions are suitable to assess whether prices are reasonable and in the interest of Australian consumers.
- 4.106 In addition, the IPP should also require NBN Co to justify initial or new prices to access seekers through a proper quantitative analysis: clearly outlining the business case for the price, future growth of demand, how the initial price promotes uptake of the service; and how the initial price relates to the costs of providing the service. The NBN Co should also quantitatively show how the financials of the NBN would be with the initial price, and at different potential price points. The NBN Co's quantitative justification should be subject to a complete review by the ACCC.

Individual price increase limit

- 4.107 It has been proven above that NBN Co will not be constrained by the overall revenue cap or the IPP to ensure that prices remain efficient over the 27 year timeframe of the SAU. Consequently, sole weight must be placed upon the individual price increase limit when assessing whether the SAU is reasonable.
- 4.108 A central consideration for the ACCC is whether the individual price increase limit on its own promotes the LTIE during the 27 year SAU. NBN Co argues that the individual price increase limit will do so because:
- (a) It provides a degree of price stability and predictability; and
 - (b) Certainty of the CPI-1.5% limit will facilitate access seekers to make investments.⁹⁶
- 4.109 No other justification is put forward. Optus notes that there has been no evidence submitted justifying the actual proposed individual price increase limit. Moreover, the justification put forward is that the individual price limit, in combination with the initial pricing principles and the LTRCM promote competition and are in the LTIE.⁹⁷ No evidence is put forward to justify

⁹⁶ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.164.

⁹⁷ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.8. Note that this is the same argument put forward in previous SAU justifying the CPI/2 approach – see NBN Co 2011 SAU Supporting Submission, p.4.

the price increase limit on its own basis. This is important, as analysis of the SAU casts serious doubt as to whether the LTRCM will act as a revenue cap during the lifetime of the SAU (see section 6) — a result confirmed by NBN Co,⁹⁸ and there is serious doubt over the legal enforceability of the IPP (see above).

- 4.110 Opinion on which the NBN Co relies seems indifferent as to the form of the individual price increase limit. No specific analysis, or justification, has been put forward to justify the actual price increase limit.⁹⁹ The analysis could be relied upon to justify any individual price limit. There is no issue of the concept of a price increase limit — the relevant question for the ACCC is whether the specific individual price increase limit (CPI-1.5%) promotes the LTIE.
- 4.111 In fact, the opinion of Synergies on the matter has not changed even though the price control has. In its initial report, Synergies justifies the CPI/2 price increase limit based on price stability and certainty to customers that increase will not be greater than that amount.¹⁰⁰ The justification put forward in Synergies' subsequent paper is that the CPI-1.5% limit allows NBN Co flexibility to change prices¹⁰¹ and provide certainty to customers as to future price trends.¹⁰²
- 4.112 The justification put forward by Synergies is problematic. Synergies states that assuming initial costs are prudent, then its recovery, in whatever form, will also be efficient. Optus is concerned about this line of reasoning, especially given the significant doubts over the effectiveness of the prudency provisions to protect against inefficient expenditure (see section 5). The relevant question is whether the individual price increase limit sufficiently manages the risk of recovering inefficient costs by itself. This question is not addressed by Synergies, and therefore no weight can be placed on the opinion.
- 4.113 The ACCC must be satisfied that the yearly individual price increase allowed under the CPI-1.5% rule is appropriate over the full 27 years of the SAU. Further, the ACCC must be satisfied that the CPI-1.5% rule, on its own, is sufficient to protect against recovery of inefficient costs or introduction of monopoly pricing.
- 4.114 Recent history shows that one cannot assume the benign economic conditions will continue without challenges. Optus notes that while the CPI-1.5% may appear reasonable given the current assumed level of future inflation (2.5%), should Australia experience high inflation over the next 27 years adoption of CPI-1.5% will allow significantly greater price increases than the previous CPI/2 price cap.
- 4.115 The ACCC should also be satisfied that the specific formulation of the individual price limit is preferable to other possible formulations. That is, is CPI-1.5% to be preferred over CPI/2, or CPI-CPI? NBN Co has provided no evidence or reasoning as to why CPI-1.5% is preferable over

⁹⁸ Lovell, C., Letter to Andrew Sheridan re: NBN CO Special Access Undertaking, 14 January 2013.

⁹⁹ Optus notes that the Ordover and Shampine paper do not make any comment on the specific content of the SAU, therefore provide no support to the reasonableness of the CPI-1.5% approach.

¹⁰⁰ Synergies Consulting, Advice on NBN Co Ltd's Special Access Undertaking, January 2012, section 7.

¹⁰¹ Synergies Consulting, September 2012, p.38.

¹⁰² Synergies Consulting, September 2012, p.34.

other formulations; and specifically, why CPI-1.5% better promotes the LTIE than the previous CPI/2 formulation.

- 4.116 Any assessment should also take into account the historical development of broadband pricing and speed. First, the price for internet services has decreased significantly since the ACCC started collecting data in 2006-07. In 2010-11 the internet service index had decreased by a total of 18% — an average compound yearly decline of around 5%.¹⁰³ Over the same time period, average internet speed increased by 117% to around 7Mbps in 2011.¹⁰⁴
- 4.117 Further, average fixed broadband usage per month has increased from 6.8GB in December 2009 to 17.4GB in June 2012.¹⁰⁵ Average usage is forecasted to increase on average by 28% each year to 2016.¹⁰⁶ Given the structure of NBN Co pricing — reliance on per Mbps CVC pricing — total price paid by end-users (AVC+CVC) would increase as total data consumption increases even if per unit pricing remains stable.
- 4.118 That is, over the last five years the average price for internet access has decreased by 18%, and the average access speed and average usage have both more than doubled. Yet NBN Co is suggesting without evidence that a price increase of around 1% per annum for the same speed of access (AVC) and same level of usage (CVC) is reasonable. Furthermore, the application of a 1% per annum increase to CVC per Mbps pricing may actually result in a higher increase in corresponding retail prices given the increasing level of data consumption of around 30% each year.
- 4.119 The combined impact of the individual price increase limit, and the increasing CVC cost per user, is shown in figure 3 below.¹⁰⁷ This figure shows the real price index for internet services for three distinct 5 year periods. The first period (blue line) shows the price index for the last 5 years (2007-2011) as calculated by the ACCC in the annual Telecommunications Report.¹⁰⁸ This line represents the 18% real price decline over the 5 year period.
- 4.120 The second period (red line) represents NBN Co's proposed pricing for the first 5 years of the SAU, under which there is a nominal price freeze for reference offers (in effect a CPI-CPI rule). The price includes the AVC for a BAO connection, and sufficient CVC to take into account average peak usage.¹⁰⁹ Over this period AVC charge remains constant at \$24 and the per Mbps

¹⁰³ ACCC Telecommunications Reports 2010–11, Table 7.1.

¹⁰⁴ ABS, Internet Activity, Australia, Jun 2012, cat.8153.0. Average speed increase is the increase in the weighted average of speed tiers. Assumed speed in each tier: less than 254kbps, 128kbps; 256kbps to less than 1.5Mbps, 512kbps; 1.5Mbps to less than 8Mbps, 2Mbps; 8Mbps to less than 24Mbps, 10Mbps; 24Mbps or greater, 24Mbps.

¹⁰⁵ ABS, Internet Activity, Australia, Jun 2012, cat.8153.0. Total fixed broadband usage divided by sum of DSL, cable & fibre subscribers.

¹⁰⁶ Cisco VNI Forecast, Traffic per user and household forecast 2016. Available at: http://www.cisco.com/web/solutions/sp/vni/vni_forecast_highlights/index.html#~Country.

¹⁰⁷ CVC capacity is calculated by converting monthly GB usage to throughput using the same ratio as used in the NBN Co Wholesale pricing calculator. Available at: <http://wholesalecalculator.nbnco.com.au/>.

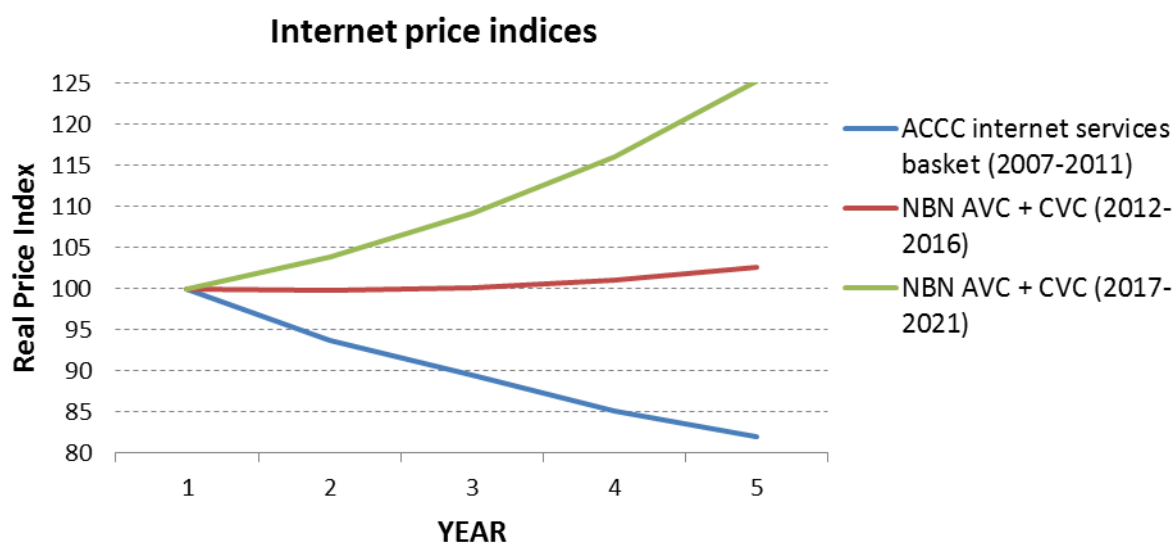
¹⁰⁸ ACCC, Changes in prices paid for telecommunications services in Australia, 2010–11, Table 7.1.

¹⁰⁹ Peak usage is calculated from the ABS average monthly usage per connection. ABS, Internet Activity, Australia, June 2012, cat.8153.0. Monthly is transformed to peak throughput using Optus assumptions required to ensure adequate QoS.

CVC charge remains constant at \$20. However, while per unit prices remain constant, required peak throughput increases, requiring more CVC units over time. Consequently, the nominal price starts at \$25.70 in year 1 and increases to \$28.57 in year 5. Assuming a 2% inflation rate, this results in a real increase of 2.7% over the 5 years.

- 4.121 The third period (green line) represents the second 5 year period of the SAU, under which the CPI-1.5% annual price increase limit applies. Unit pricing increases to \$24.57 for AVC and \$20.47 for CVC in year 5. The per unit price increase combines with the increased amount of CVC required as usage grows to result in a nominal price increase from \$29.99 at the start of the second five year period to \$40.64 at the end of the period. This results in a real price increase of 25.2% over the 5 years.

FIGURE 3



- 4.122 Over the first 10 years of the SAU, the proposed CPI-1.5% price increase limit results in a real price increase of 32.3%.
- 4.123 The reversal of historic price trends is magnified by the fact the NBN Co pricing relates to the *same* access speed, while the 18% decline in the historic internet services basket corresponded to a more than doubling of access speeds. The impact of doubling access speed under the NBN Co price construct (i.e. upgrading AVC) on total internet cost can be seen below:

- (a) Increasing AVC from BAO to EAO¹¹⁰ at the end of the first five year period results in the NBN price increasing to \$31.57 in nominal terms, and represents a 13.5% increase in real terms; and
- (b) Increasing AVC from 25Mbps to 50Mbps at the end of the second five year period¹¹¹ results in the NBN price increasing to \$51.54 in nominal terms, and represents a 58.8% increase in real terms.

¹¹⁰ BAO and EAO are reference offer and subject to the price freeze until 2017 under clause 1C.3.

- 4.124 Optus submits that the CPI-1.5% individual price (including the price freeze for reference offers) is likely to result in a reversal of the historic price trend for internet services. While the individual price increase may not seem significant on a per unit basis, the combination of the necessary product components and increased usage over time results in potentially high internet prices — this impact is magnified if one assumes access speeds increase at the same historic rate.
- 4.125 The key question is whether the specific individual price increase of CPI-1.5% is efficient as a stand-alone proposition given the forecasted level of demand and level of usage. This question has not been answered by NBN Co, or its expert advisors. Optus' analysis shows that reliance on the individual price increase limits would result in significant consumer welfare losses compared to the historic price trend.

Conclusion

- 4.126 This section assesses the mechanism within the SAU to manage the risk of excessive expenditure and pricing. In the absence of adequate provisions, the ACCC should not be satisfied that the risks of excessive expenditure over the 27 year period of the SAU are reduced sufficiently so as to ensure the LTIE is promoted.
- 4.127 To manage the risk of incurring excessive expenditure, the SAU contains provisions dealing with:
- (a) Prudence of costs; and
 - (b) RAB roll-over mechanism.
- 4.128 Optus' analysis shows that the ability of NBN Co to set its own rules and to determine its own compliance without any independent oversight does not adequately manage the risk that the NBN Co will incur excessive expenditure over the 27 year lifetime of the SAU.
- 4.129 The lack of any *ex ante* or *ex post* review of expenditure does not adequately manage the risk that the government-owned monopoly provider of fixed-line services will incur inefficient costs over the next 27 years. Further, it is inconsistent with the recent review of the NER and criticisms raised by the ACCC Chairman.
- 4.130 The SAU contains additional provisions with the purpose of limiting the ability of NBN Co to recover any excessive costs through higher prices. Should these provisions work effectively, it may provide NBN Co with incentives not to incur inefficient expenditure as it will be aware that these costs could not be recovered. These provisions relate to:
- (a) CPI-1.5% individual price increase limit for existing products;
 - (b) Overall revenue cap; and
 - (c) Initial pricing principles for new and initial prices.

¹¹¹ Assumes that the 50Mbps AVC price increase each year at CPI-1.5%. The 50/20 AVC product is a non-reference offer, and is not subject to the 5 year price freeze under clause 1C.3.

- 4.131 NBN Co relies upon the interaction of all three provisions to justify the reasonableness of the SAU. However, an objective analysis demonstrates that the overall revenue cap and the IPP are not likely to apply during the 27 year timeframe of the SAU.
- 4.132 Using NBN Co's Corporate Plan forecasts, it can be seen that NBN will not move out of the ICRP during the lifetime of the 27 year SAU. Indeed, it appears that not even the NBN Co is forecasting the overall revenue cap will apply during the 27 year lifetime of the SAU — a result confirmed by NBN Co. Optus discusses the likely operation of the ICRP in section 6.
- 4.133 In addition, the requirements imposed on NBN Co by the IPP are weak and unlikely to limit NBN Co's freedom to introduce new prices in any manner it sees fit. The provisions are inconsistent with the legislatively criteria under section 152AH and cannot be regarded as ensuring initial and new prices would be reasonable over the 27 year lifetime of the SAU. Further, there is no ACCC oversight, and Federal Court enforcement is unlikely to be a viable option.
- 4.134 The sole factor that will constrain future prices is the CPI-1.5% individual price increase limit. The key question for the ACCC is whether this provision by itself is sufficient to constrain the ability of the monopoly provider of fixed-line services to extract monopoly rents and to ensure that the LTIE is promoted. Optus submits that it is not. There is no evidence before the ACCC that the individual price increase limit of CPI-1.5% promotes the LTIE as a stand-alone proposition. Further, there is no evidence before the ACCC that the CPI-1.5% rate is to be preferred over other rates such as CPI-CPI.
- 4.135 Optus submits that relying on the CPI-1.5% individual price increase limit will likely result in prices that would be substantially greater in five or ten years' time than if the current price trend of the industry continues.
- 4.136 In conclusion, the current provisions in the SAU do not adequately manage the risk of excessive expenditure of the 27 year lifetime of the SAU; nor does the SAU contain sufficient safeguards to ensure that prices are not increased at a level inconsistent with the LTIE.

Section 5. Prudency

KEY POINTS

- *No evidence has been put before the ACCC as to the reasonableness of the Deemed Prudent expenditure, with the exception of the NBN-Optus HFC Authorisation.*
- *Prudency cost and design conditions set a very low hurdle for prudency. For example, clause 1E.4.1(f) effectively makes the prudency provisions unenforceable, and therefore not effective. Furthermore, the Procurement Rules are not yet drafted, so that the ACCC is not able to assess its reasonableness.*
- *NBN Co will have the ability to unilaterally decide on network changes and may be in a position frustrate any regulatory review processes.*
- *The lowest total cost of ownership test does not restrict the ability of NBN Co to incur operating cost at whatever level it sees fit.*
- *Optus finds that the assessment of Synergies Consulting of the prudency provisions is not sufficiently justified, nor has it examined how they are likely to work in practice.*
- *NBN Co has failed to provide sufficient evidence to demonstrate that the prudency provisions are reasonable and promote the LTIE.*

5.1 The concept of prudent expenditure is the key assumption that underpins the reasonableness of the NBN Co's SAU. NBN Co submits that the revised SAU:

... provides commitments in Module 1 of the SAU that ensure that the costs it incurs, and the processes it uses to incur those costs are prudent – that is, the costs and processes are necessary, effective, efficient and aligned with NBN Co's and its Customers' interests. NBN Co has drawn on established approaches to prudency in other regulated industries to develop these commitments and adapted them to reflect the specific objectives set for NBN Co and NBN Co's structure and operating context.¹¹²

5.2 NBN Co highlight that its "prudency approach in Module 1 does not rely on ex ante regulatory approval of capex forecasts or any ex post reviews of capex. NBN Co believes that compliance with the Prudent Design Condition and the Prudent Cost Condition places appropriate controls on NBN Co's capex."¹¹³

5.3 In other words, NBN Co is submitting that ACCC oversight (ex ante or ex post) is redundant because the prudency conditions will ensure that NBN Co does not incur any inefficient expenditure. A key consideration for the ACCC, therefore, should be whether the prudency

¹¹² NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.209.

¹¹³ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, pp.209-10

conditions are of sufficient rigour as to provide the same controls of specific *ex ante* regulatory oversight.

5.4 The December 2011 NBN Co SAU contained the same prudency provisions as the current proposed SAU. Almost all interested parties criticised the prudency provisions and commented that they were inadequate to ensure efficiency of expenditure. Optus recommended that there should be no presumption by NBN Co that it can recover costs unless they have been endorsed by the ACCC. Optus therefore submitted that, as a minimum the ACCC should have clear powers to:

- (a) Review and approve upfront NBN Co's forecast capital and operating expenditure;
- (b) Review and approve NBN Co's actual capital and operating expenditure; and
- (c) To exclude expenditure that the ACCC considers to be inefficient.¹¹⁴

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

5.6 The general approach to prudency appears to have changed little in the December 2012 version of the NBN Co SAU. Capital expenditure will be defined as prudent and included in the LTRCM if NBN Co satisfies either the two conditions (prudent design condition and prudent cost condition) or is deemed to be prudent.

5.7 The remainder of this section addresses the prudency provisions in the December 2012 SAU. It discusses the provisions relating to:

- (a) Deemed prudency;
- (b) The Prudent Cost Condition and Prudent Design Condition;
- (c) Network change and endorsement process; and
- (d) Operating Cost prudency.

Deemed prudency

5.8 The SAU contains a range of expenditure that is deemed to be prudent. That is, upon acceptance of the SAU, these costs are also approved and can be included in the LTRCM.

5.9 Optus submits that the ACCC should also assess the reasonableness of the costs included within the deemed provisions in its assessment of the SAU. It is questionable whether the ACCC has the necessary information to make an informed assessment as to whether these

¹¹⁴ Optus Submission to the ACCC Supplementary Consultation NBN Co's Special Access Undertaking (Public Version) 30 March 2012.

deemed expenditures have been prudently incurred. Without such evidence, the ACCC cannot be satisfied that the deemed prudent expenditures are reasonable.

- 5.10 NBN Co has provided little qualitative assessment, and no quantitative assessment as to the prudence of these expenditures. Further, NBN Co has provided no independent third party assessment as to the prudence of these expenditures. It is instructive to note that the Synergies Consulting expert opinion does not “*opine on the efficiency implications*” of the deemed provisions.¹¹⁵
- 5.11 Optus submits that the ACCC does not have before it sufficient information to make an informed assessment as to whether these deemed expenditures have been prudently incurred. Notwithstanding Optus’ views of the merits of the expenditure, NBN Co has not discharged its affirmative burden to satisfy the ACCC as to the reasonableness of the deemed expenditure. Absent such information, the ACCC cannot be in a position to make a decision as to whether the provisions meet the statutory criteria.

Third party funded extensions

- 5.12 ‘Third Party Funded Changes’ refer to any change to the design and construction of the relevant assets to the extent a third party has agreed to fund, in whole or in part, the capex and opex incurred.¹¹⁶ The total capex related to the third party funded change is deemed to have been prudently incurred and included with NBN Co’s cost recovery model.¹¹⁷ While NBN Co cites a similar arrangement in relation to the ARTC Hunter Valley Access Undertaking¹¹⁸ is in place, Clause 10 (User Funded Options) in that Undertaking in fact does not treat this class of expenditure to be automatically deemed prudent.¹¹⁹
- 5.13 Optus notes that NBN Co has provided no material to support its proposed treatment of third party funded extensions: but for an incorrect reference of the ARTC Undertaking.¹²⁰ Further, it is questionable whether it is consistent with the statutory criteria to include within the RAB costs for which the NBN have been fully, or partly, compensated. That is, NBN is seeking to be compensated by access seekers for costs that NBN Co has not actually incurred.

Expenditure incurred prior to SAU commencement date

- 5.14 NBN Co proposes that all expenditure incurred before the commencement of the SAU be included within the RAB. NBN Co submits this is to ensure the RAB reflects all of NBN Co’s

¹¹⁵ Synergies Consulting, September 2012, p.68.

¹¹⁶ NBN Co SAU, p.46.

¹¹⁷ Clause 1E.3.2.

¹¹⁸ ARTC, Hunter Valley Coal Network Access Undertaking, 23 June 2011 [Commenced on 1 July 2011].

¹¹⁹ In this example onus is on the ‘Contributor’ to elect whether the ‘Project’ should undergo the process to be deemed prudent. For example, Clause 10.1(d) the Undertaking states that “*In negotiating a user funding agreement, a Contributor may elect: (i) to seek to have some or all of the Project costs deemed as Prudent through the Project proceeding through the RCG or seeking ACCC endorsement of the Project costs as Prudent (in which case ARTC will provide reasonable cooperation to the Contributor at the Contributor’s cost); and/or (ii) fund the Project without seeking to have some or all of the Project costs included into the RAB.)*”.

¹²⁰ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.213.

actual prudently incurred costs. NBN Co submits it *“has been subject to significant expenditure efficiency incentives arising out of its commercial context, and the significant transparency and cost control measures”*.¹²¹ No other justification is provided.

- 5.15 By the end of financial year 2013, NBN Co is predicting cumulated capex of over \$4.5 billion.¹²² NBN Co is also proposing that all operating costs incurred prior to the SAU also be deemed prudent.¹²³
- 5.16 In total, the ACCC is being asked to approve \$6.5 billion in costs without any justification or analysis as to how these costs meet the statutory criteria. To put that into perspective, the ARTC Hunter Valley Rail Undertaking had a RAB value of \$800 million in 2009-10.¹²⁴ However that 2011 Undertaking had also been subject to extensive debate and analysis by the ACCC prior to its approval.
- 5.17 The same requirement is not imposed on NBN Co and raises the risk on imprudent costs being incurred. For example, there has been some debate surrounding the efficiency of the contract awarded to Fujitsu for greenfield roll-out. In May 2011 Fujitsu was awarded an exclusive contract to connect new houses in greenfield estates. It was reported to be worth \$100 million in the first twelve months.¹²⁵ It was intended that the deal would enable NBN Co start rapidly deploying fibre into these new developments across the country concurrently.¹²⁶ The contract was for initial build and initial operations of the greenfield network.¹²⁷ It was reported in June 2012, that NBN Co had refused to renew the Fujitsu contract over continued delays to connection of new homes.¹²⁸
- 5.18 In August 2012, NBN Co had passed 100,000 homes in greenfield estates and connected 500 homes.¹²⁹ Criticism was levied that NBN Co had incurred \$100 million of cost to connect only 500 homes.¹³⁰
- 5.19 Optus submits therefore that it would be unreasonable to permit \$6.5 billion in costs to be included into a RAB without *any* review, oversight or justification. It would be inconsistent with, and disproportionate to, the detailed analysis conducted for undertakings in other

¹²¹ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.213.

¹²² NBN Co, Corporate Plan 2012-15.

¹²³ Clause 1F.7.2.

¹²⁴ See, <http://www.artc.com.au/Content.aspx?p=234>. While this RAB value is not under the 2011 ARTC Undertaking, it could be considered a guide as to the likely value.

¹²⁵ <http://www.itwire.com/it-industry-news/deals/47143>.

¹²⁶ Press Release, NBN Co selects Fujitsu Australia as New Developments deployment partner, 13 May 2011. Available at: <http://www.nbnco.com.au/news-and-events/news/nbn-co-selects-fujitsu-australia-as-new-developments-deployment-partner.html>.

¹²⁷ Environment And Communications Legislation Committee, Senate Estimates, Tuesday, 16 October 2012, P.115.

¹²⁸ <http://www.itnews.com.au/News/305636,nbn-co-ditches-fujitsu-for-greenfield-work.aspx>.

¹²⁹ Joint Committee on the National Broadband Network, Rollout of the National Broadband Network, Tuesday, 30 October 2012, p.23.

¹³⁰ <http://www.abc.net.au/7.30/content/2012/s3618047.htm>.

sectors worth less than \$1 billion in total, to allow \$6.5 billion to be incurred without requiring NBN Co to even attempt to justify the expense, or stating how it meets the legislative criteria.

The Prudent Cost Condition and Prudent Design Condition

- 5.20 Under the SAU, NBN Co will be allowed to recover all capital expenditure that satisfies both the Prudent Design and Prudent Cost conditions. Furthermore, in meeting these conditions, the capital expenditure incurred must be ‘materially consistent’ with the Network Design Rules (i.e. the Prudent Design Condition) and compliant with the NBN Co Procurement Rules (i.e. the Prudent Cost Condition).¹³¹ It follows that in assessing the reasonableness of the SAU, the ACCC *must* have regard to both the NBN Co documents setting out its network design and procurement rules.¹³²
- 5.21 Both these Conditions set a very low hurdle regarding the conditions to be satisfied for expenditure to be considered prudent and therefore off-limits to the ACCC. For example, expenditure can be considered prudent simply because it is incurred on an “*arm’s length basis*”, which presupposes that unlike any other regulated monopoly NBN Co has an innate ability to only pay the efficient rate for a good or service. Similarly, the CEO of NBN Co has the ability to determine whether expenditure is prudent, subject to only very loose rules, including the CEO’s sole opinion that “*it is in the best interests of the company to incur*” such expenditure. Neither of these examples provides a rigorous test for prudence.
- 5.22 In addition, Optus notes that NBN Co’s expert advice from Synergies Consulting provides little, if any, justification for their conclusion that these conditions are reasonable. Synergies merely states that in its opinion the terms are reasonable, without inquiring whether the terms would operate as put forward by NBN Co.¹³³
- 5.23 This is discussed in more detail below.

Prudent cost conditions

- 5.24 The SAU proposes that capital expenditure will be prudent if *any one* of the following criteria are met.¹³⁴
- (a) Expenditure follows the Procurement Rules.
 - (b) Incurred following a competitive tendering process.
 - (c) Pursuant to arrangements which are on arm’s length terms.
 - (d) Goods or services in an open and competitive market.

¹³¹ ACCC, NBN Co Limited Special Access Undertaking, Consultation Paper, December 2011, p.43.

¹³² The ACCC notes that NBN Co has not yet submitted its Procurement Rules to the ACCC.

¹³³ Synergies Consulting, September 2012, p.67-8.

¹³⁴ Clause 1E.4.1.

- (e) Incurred to comply with a legal, policy, regulatory or administrative requirement, or a requirement of the Shareholder Ministers.
- (f) If the NBN Chief Executive is satisfied one or more apply:
 - (i) Only one potential supplier
 - (ii) Expenditure incurred on exceptionally advantageous terms' or
 - (iii) Expenditure falls within a comparable range of benchmarks that would be incurred by a prudent operator in the same or similar position to NBN Co; or
 - (iv) Is in the best interest of the company to incur such expenditure.

5.25 Optus submits that these criteria do not guarantee that only prudently incurred costs will be allowed to be recovered through the RAB. In addition, NBN Co has provided little, if any expert analysis supporting the conclusion that the provisions are reasonable.¹³⁵

5.26 It should also be noted that NBN Co need only meet any one of the above criteria. So for example, expenditure could be incurred that is inconsistent with the Procurement Rules but nonetheless was incurred through a competitive tender. This effectively makes the Procurement Rules meaningless. For example, one criterion of the Procurement Rules is that any decision to approve a tender that is not the lower price tender “*must be appropriately justified and documented*”.¹³⁶ But, clause 1E.4.1(b) requires that the capital expenditure be incurred with a third party in a competitive tendering and procurement process. So, it appears that while one clause requires NBN Co to be consistent with Procurement Rules, the very next clause deems the cost to be prudent for the mere fact of there being a competitive tender. There appears no restriction on the ability of NBN Co to choose tenders above the lowest cost.

5.27 Another problematic clause is that expenditure would be deemed prudent if it complies with a policy or regulatory requirement, or follows a requirement of a Stakeholder Minister. Synergies Consulting have indicated that whilst this clause provides scope for Government interference, Parliamentary processes may mitigate any such concerns. However, Optus notes that Synergies does not provide any conclusion as to the efficiency of this clause.¹³⁷ It is also instructive to note the recent conclusions of the Productivity Commission that Government-owned electricity companies are run less efficiently than privately-owned firms.¹³⁸ It appears therefore, that reliance on Parliamentary processes places a low restriction on the ability to incur inefficient costs.

5.28 There are already examples of inefficiently high costs being incurred due to Government directions. For example, NBN Co has committed to using fibre to connect individual units within multi-dwelling units (MDUs). NBN Co has made it clear that it will not consider any

¹³⁵ See Synergies Consulting, September 2012, section 7.3.2.

¹³⁶ Clause 1E.4.2.

¹³⁷ Synergies Consulting, September 2012, p.67.

¹³⁸ Productivity Commission, 2012, *Electricity Network Regulatory Frameworks*, Chapter 7.

alternative to a direct fibre connection to every dwelling within an MDU, even where it is technically not possible, or is not cost effective, or where another lower cost alternative is possible. NBN Co CEO, Mike Quigley, stated that *"We execute on the objective set by the government ... have been directed to provide fibre to the premises, and that is what we are doing."*¹³⁹ The CEO also made it clear that to consider a more cost effective alternative, NBN Co would need *"directions from our shareholder to tell us that is what they want us to do."*¹⁴⁰

- 5.29 In addition, costs will be deemed to be prudent if the CEO believes it is *"in the best interest of the company"* to do so.¹⁴¹ The ability of the NBN Co CEO to effectively allow any expenditure that is, in his opinion, in the best interest of NBN Co is unlikely to prevent inefficient spending. For example, in May 2011 NBN Co entered into a \$100 million one-year contract with Fujitsu to deliver fibre infrastructure to new developments. At the time, the NBN Co CEO stated that:

*NBN Co is pleased to be partnering with Fujitsu as they have the necessary workforce capacity and expertise for rapid deployment to meet the considerable demand for fibre services in new development.*¹⁴²

- 5.30 It would appear at the time, it was the CEO's opinion that the deal was in the best interest of the company to do so.¹⁴³ However, only one year later, the contract was cancelled due to Fujitsu failing to deliver on targets.¹⁴⁴ At the end of the contract criticism was levied that NBN Co had incurred \$100 million of cost to connect only 500 homes.¹⁴⁵
- 5.31 Furthermore, Optus has received advice that suggests that the inclusion of clause 1E.4.1(f) effectively makes the prudency provisions unenforceable, and therefore, not effective in enduring only prudent costs are incurred.¹⁴⁶
- 5.32 Pursuant to 1E.4.1(f), NBN Co can meet the Prudent Cost Condition if NBN Co's CEO is satisfied that one of four broad and relatively vague criteria (such as that *"it is in the best interests of the company to incur such Capital Expenditure..."*) is met. This built-in subjectivity means that the ability to enforce compliance with the Prudent Cost Condition is effectively of no value. Establishing breach of 1E.4.1 is virtually impossible due to the fact that, even where Capital Expenditure is incurred in circumstances which fall short of the remaining subclauses, any

¹³⁹ Joint Committee on the NBN, Fourth Report, Public Hearings, Tuesday, 30 October 2012, Hansard Transcript, p.9.

¹⁴⁰ Joint Committee on the NBN, Fourth Report, Public Hearings, Tuesday, 30 October 2012, Hansard Transcript, p.9.

¹⁴¹ Clause 1E.4.1(f)(iv).

¹⁴² Press Release, NBN Co selects Fujitsu Australia as New Developments deployment partner, 13 May 2011. Available at: <http://www.nbnco.com.au/news-and-events/news/nbn-co-selects-fujitsu-australia-as-new-developments-deployment-partner.html>.

¹⁴³ The deal would also have met the prudency test by being part of an arms' length tendering process.

¹⁴⁴ <http://www.itnews.com.au/News/305636,nbn-co-ditches-fujitsu-for-greenfield-work.aspx>.

¹⁴⁵ <http://www.abc.net.au/7.30/content/2012/s3618047.htm>.

¹⁴⁶ The ACCC Consultation Paper notes that the ACCC may be able to enforce the prudency provisions by seeking enforcement action in the Federal Court for a breach of the SAU. The ACCC notes that its ability to do so may depend on the level of prescription in the prudency provisions in Module 1 of the SAU. See p.71.

Capital Expenditure may be defended by NBN Co on the basis of the satisfaction of its CEO in relation to the listed matters.

- 5.33 In order to establish a breach of the SAU in these circumstances, it would be necessary for the ACCC (or other affected person) to demonstrate not that the decision did not meet the relevant criteria, but rather, that the CEO was not satisfied that they had been met, a virtually impossible task.
- 5.34 Optus is unaware of any undertaking accepted by the ACCC where the owner and management of the monopoly provider can self-assess the prudence of costs. NERA also concludes that the lack of oversight is inconsistent with any other regulatory regime in Australia.¹⁴⁷ The self-policing nature of the prudent cost conditions means that NBN Co will face no restrictions on its ability to act in a manner inconsistent with the long term interest of end-users.
- 5.35 Optus believes therefore, that the prudent cost conditions do not provide a robust constraint on the ability of NBN Co to incur inefficient expenditure.

Procurement rules

- 5.36 One criterion which NBN Co is able to satisfy prudency is compliance with the Procurement Rules. Clause 1E.4.2 outlines the criteria that must be satisfied. However, NBN Co has not submitted any Procurement Rules to the ACCC for assessment.
- 5.37 NBN Co is proposing that the ACCC assess whether its Procurement Rules are consistent with the long-term interest of end-users without submitting the actual Rules to the ACCC. This is yet another example of NBN Co seeking ACCC approval for material that has not been placed before the ACCC. Optus cannot make comments on the Procurement Rules as these have not yet been made public.
- 5.38 Optus submits that without the detailed Procurement Rules, the ACCC is not able to assess whether the SAU meets the legislative criteria. Further, without the detailed Rules, NBN Co has not discharged its affirmative burden to satisfy the ACCC that the terms of the SAU meet the statutory criteria.

Prudent design conditions

- 5.39 NBN Co must also comply with the prudent design conditions. The SAU proposes that capital expenditure will be deemed prudent if it is consistent with or within the scope of:
- (a) Network design rules;
 - (b) A permitted variation; or
 - (c) An endorsed network change.

¹⁴⁷ NERA, 2013, Appendix B.

- 5.40 Optus discusses these below. It is also highlighted that there appears no or little material change from the previous version of the SAU. Therefore, Optus' comments in its previous submission are still relevant.¹⁴⁸

Network Design Rules

- 5.41 The Network Design Rules serve as the basis for establishing the baseline for the operation of the prudence provisions in the SAU. This is notwithstanding the fact that NBN Co itself sets those rules. Notably, it forms the framework from which to assess any changes against the efficiency and prudence of NBN Co initial network design (however this is also based on the presumption that the NBN Co Initial Network Design is, by NBN Co's own admission, prudent and efficient).
- 5.42 Optus previously provided comments on the deemed prudence of the network design rules and use of the Analysys Mason Report on which it is justified.¹⁴⁹ Optus has previously pointed out the important role the ACCC has played with respect to POI locations and numbers as an indication how the preferred NBN Co network design may not be consistent with promotion of competition and the long term interest of end-users.¹⁵⁰
- 5.43 Optus is not aware of any substantial changes to the network design rules or to the Analysys Mason Report. The previous comments are still applicable.

Permitted variations

- 5.44 NBN Co proposes to allow nine types of permitted variations. As per other provisions in the SAU (such as deemed prudence), these conditions require that NBN Co meet only one of the possible nine for the variation to be defined as a permitted variation.
- 5.45 Of greatest concern to Optus is the proposed provision to allow any variation that arises due to a requirement to comply with:
- (a) Statement of expectations;
 - (b) Legal requirements;
 - (c) Policy requirement;
 - (d) Regulatory or administrative requirement; or
 - (e) Any requirement of the Shareholder Ministers.¹⁵¹

¹⁴⁸ Available at: <http://www.accc.gov.au/content/index.phtml/itemId/1028861>

¹⁴⁹ Optus Submission to the ACCC Supplementary Consultation NBN Co's Special Access Undertaking (Public Version) 30 March 2012, p.33.

¹⁵⁰ Optus Submission to the ACCC Supplementary Consultation NBN Co's Special Access Undertaking (Public Version) 30 March 2012, p.33.

¹⁵¹ Clause.1E.6.2(vi).

- 5.46 These provisions allow NBN Co to introduce any network variation, at any cost, which is directed by potentially any level of Government. The provisions extend beyond directions given by Shareholder Ministers to any policy, regulatory or administrative requirement. One interpretation is that this provision gives free reign for the government at the time, and any Department to require NBN Co to incur a network change at any cost.
- 5.47 Optus cannot see how this provision, in the context of the structure of clause 1E.6.2, provides any restriction on the ability of the government to interfere with the cost effective running of NBN Co. To put this into perspective, this is akin to saying that Telstra, whilst under majority government ownership, could avoid any ACCC oversight or access regulation based purely on a policy or administrative direction from the government. Optus submits such broad power would have been unacceptable in relation to Telstra, and is unacceptable in relation to NBN Co.
- 5.48 Optus submits that the ACCC cannot assess a SAU as being consistent with the legislative criteria if it contains provisions that effectively allow for such broad variations to permitted expenditure.

Minor expenditure limit

- 5.49 Optus raised significant concerns about the content of the permitted variations in relation to NBN Co's previous SAU. These concerns remain as NBN Co has appeared to have made no change to these provisions. In summary, Optus submitted that:¹⁵²
- (a) 'Minor Variations' refer to expenditure that is incurred as part of network changes, in addition to Permitted Variations, and which falls under a Minor Expenditure Limit (MEL) threshold of \$100 million (annually indexed to CPI). This threshold is too high and should be reduced substantially. Further, it is not reasonable for the MEL threshold to be automatically increased by CPI (or any other factor) on an annual basis, but should (at a minimum) be subject to a review that is open to industry and in line with the SAU review periods.
 - (b) 'Urgent and unforeseen variations, changes and enhancements' refer to expenditure that is incurred as part of network changes and which satisfies the following three conditions set out in Clause 1E.6.3(c);
 - (i) it is necessary that the variation, change or enhancement be operational within 6 months;
 - (ii) the event or circumstances causing the variation, change or enhancement was not reasonably foreseeable by, and was beyond the reasonable control of, NBN Co; and
 - (iii) a failure to address the variation, change or enhancement is likely to materially adversely affect the safe and reliable operation of the NBN

¹⁵² Optus Submission to the ACCC Supplementary Consultation NBN Co's Special Access Undertaking (Public Version) 30 March 2012, p.34.

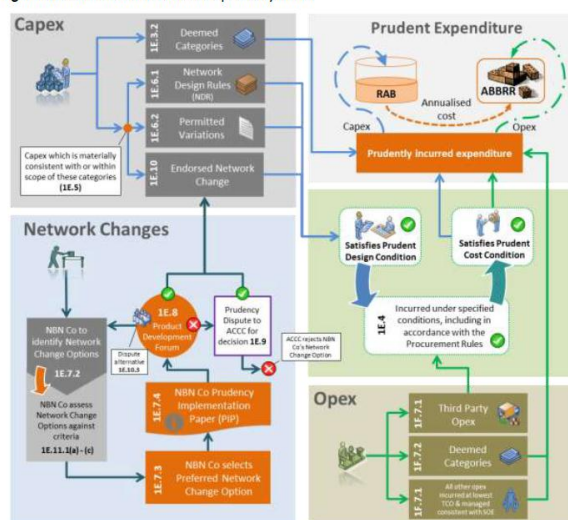
Co Network or the supply of Product Components, associated Product Features or Ancillary Features.

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

Network change and endorsement process

- 5.51 The Network Change process fits into the overall NBN Prudency Model as illustrated below, and represents the key mechanism through which an Endorsed Network Change can be determined.¹⁵³

Figure C.1: Overview of the Module 1 prudency model



- 5.52 Clauses 1E.7 to 1E.11 set out the conditions precedent required to identify, select, consult and endorse future Network Changes.

Network Change: Selection and publication of Preferred Network Change Option

- 5.53 Clause 1E.7 outlines the procedure and selection criteria for NBN Co’s Preferred Network Change Option. Following the identification and assessment of the Network Change Options, NBN Co will then prepare and publish a NBN Prudency Implementation Paper (PIP) in

¹⁵³ NBN Co, Supporting submission – NBN Co Special Access Undertaking, 28 September 2012, p.211.

accordance with 1E.7.4 which essentially only *provides a summary of* NBN Co's assessment of the various Network Change Options considered, as well as the reasons for the selection of the Preferred Network Change Option.

- 5.54 Nonetheless, the detail underlying the various elements to be summarised in the PIP is less than comforting. Ultimately, the entire identification, assessment and selection process up to and including the preparation and publication of the PIP will be initiated and conducted by NBN Co remains at NBN Co's discretion.
- 5.55 Following the identification of alternative Network Change Options, these are then assessed by reference to the Net Economic Benefit criteria, defined in Module 0 as the Market Benefits less the Network Change Costs (associated with a Network Change Option).
- 5.56 However, as drafted in Clause 1E.11, this does not necessarily set a very high bar for consideration. For example,
- (a) While Market Benefit is to be calculated in accordance with 1E.11.1(b)(i), NBN Co has the discretion to bypass this requirement in 1E.11.1(b)(ii) in the event that *"NBN Co can identify why: (A) a particular class of Market Benefit is likely not to materially affect the outcome of the assessment of the Network Change Options; or (B) the estimated cost of undertaking the analysis to quantify the Market Benefit is likely to be disproportionate to the scale, size and potential benefits of each Network Change Options identified by NBN Co."*
 - (b) In contrast, Network Change Cost is to be calculated in accordance with 1E.11.1(b)(iii) however, this is only required to be estimated *"by reference to the net present value of the direct costs of each Network Change Option (and the effect that these costs will have on NBN Co's Prices). In estimating the classes of cost pursuant to this clause, NBN Co is not required to separately quantify each class of cost."*
 - (c) Finally, despite the assurances set out in 1E.11.1(c) with respect to the assessment criteria for Network Change Options, this is effectively countered in 1E.11.1(d) which states *"NBN Co will only be required to apply a level of analysis that is proportionate to the scope and size of the required Network Change."*
- 5.57 It follows that by only requiring the PIP to take the form of a summary report this will limit the ability for Access Seekers to appropriately comment on the alternative Network Change Options. Furthermore, it is only after the publication of the PIP that Customers will be given the opportunity to comment.

Network Change: Customer engagement and endorsement process

- 5.58 Unlike the original SAU, NBN Co has now simply chosen a single Customer endorsement process for proposed Network Changes (instead of the option of either a Customer and/or Regulatory endorsement process) on the basis that:

NBN Co sees considerable benefit in engaging with Customers on Network Changes instead of relying solely on the ACCC to decide on the merits of any such change. NBN Co's Customers are large, sophisticated telecommunications service providers, and are

*well placed to form a view on the prudence of a proposed Network Change. Including a role for customer endorsement in the Network Change process may therefore, appropriately, obviate the need for the ACCC to make decisions about Network Changes in most cases.*¹⁵⁴

- 5.59 However, the current drafting in the revised SAU unnecessarily constrains the ability for effective consultation to take place – e.g. any engagement on the proposed Network Change must abide by the conditions set out under Clause 1E.8, which explicitly recognises that engagement is restricted only to Customers that have become members of the product Development Forum (PDF).
- 5.60 In addition, the consultation process has been outlined in 1E.8.2 which defines the consultation in relation to the Network Change Option to basically be confined within a certain set of parameters – i.e. *“in relation to the NBN Prudency Implementation Paper in accordance with a published timetable which will provide a reasonable period of time for consultations, having regard to the nature of the proposed Network Change (**Consultation Period**).”*
- 5.61 Following the conclusion of the Consultation Period,¹⁵⁵ clause 1E.8.3(c) notes that NBN Co will publish an Updated PIP and *“notify Customers of the period of time (which must be at least 20 Business Days from the date of publication of the updated NBN Prudency Implementation Paper) within which a Customer may notify NBN Co that it objects to the Preferred Network Change Option.”* Only after this notification, and subject to several caveats, will the Network Change: Prudency Dispute resolution mechanism set out in clause 1E.9 be enacted.
- 5.62 Of particular concern are the strict conditions, deemed the Prudency Dispute Conditions, which must be satisfied in order to raise a Prudency Dispute. For example,
- (a) A Prudency Dispute can only be raised within a specified timeframe following the publication of the updated NBN PIP;
 - (b) A Prudency Dispute can only be raised by a Customer who has signed and entered into an Access Agreement; and
 - (c) Any dispute raised must be substantively supported by the Customer, via participation in consultations, be materially affected by the resolution of the matters subject to dispute, and must have a reasonable basis for the objection based on a material error by NBN Co in the application of NBN Co’s own selection criteria set out in clause 1E.11.
- 5.63 Optus notes that this sets a particularly high bar for Access Seekers to raise any such objections to NBN Co’s decision, particularly given that all assessment criteria are determined by NBN Co and will be deemed satisfied given the self-assessment process that has been outlined.

¹⁵⁴ NBN Co, Supporting submission – NBN Co Special Access Undertaking, 28 September 2012, p.221.

¹⁵⁵ There is currently no substantive definition of a Consultation Period. This is despite the term being included in the Dictionary set out in Module 0 which defines *“**Consultation Period** has the meaning given to that term in clause 1E.8.2(a).”* This in fact represents a circular reference given that there is no minimum requirement for consultation, other than the ambiguous reference that it must *“provide a reasonable period of time.”*

- 5.64 Optus further notes that the notification of objection to the Preferred Network Change Option is also non-binding. There is currently no mechanism in which NBN Co must notify Customers of the status or outcome of their dispute notification.
- 5.65 The only requirement outlined is in the event that NBN Co wishes to pursue their Preferred Network Change Option and an objection has been raised, then under 1E.9.2(a)(i) NBN Co has 60 Business Days to notify the ACCC of the objections lodged by the Customer. However, under 1E.9.2(b) the ACCC is only given 5 Business Days to take any remedial action, i.e. during this specified timeframe it must determine (based on the documentation provided by NBN Co in relation to the matter) whether the Prudency Dispute Conditions have been satisfied and where it has been satisfied, only then can a Prudency Dispute come into effect.
- 5.66 This is in contrast to the process whereby if there has been no objection raised within the specified timeframe, then the Preferred Network Change Option will be considered endorsed and as set out in 1E.10(b), “NBN Co will, within 20 Business Days from the date of the Endorsed Network Change, publish the final NBN Prudency Implementation Paper in respect of that Endorsed Network Change on NBN Co’s Website and notify Customers and the ACCC of such publication.” This implies that where a Preferred Network Change Option may be endorsed, this can be finalised and come into effect as early as 40 Business Days from publication of the updated NBN PIP.

Prudency Dispute

- 5.67 A Prudency Dispute may only be raised if the ACCC agrees that the NBN Prudency Dispute Conditions (outlined in 1E.9.1) have been satisfied by the Customer.
- 5.68 As such, the role of the ACCC is only introduced in the event that Customers do not endorse NBN Co’s preferred Network Change option and a Prudency Dispute has been raised – however, the ACCC’s role is also constrained by the fact that it must award its decision by reference to the Net Economic Benefit test where (even after a formal consultation process):

The ACCC must accept NBN Co’s preferred Network Change Option if that option maximises the Net Economic Benefit, unless the ACCC reasonable considers that an alternative Network Change Option (whether considered by NBN Co or not, including no change) would maximise the Net Economic Benefit and those benefits materially exceed the Net Economic Benefit of NBN Co’s preferred option. However, if NBN Co has not chosen the option that maximises the Net Economic Benefit, a different test applies.¹⁵⁶

- 5.69 Once a Prudency Dispute has arisen, a number of specified timeframes come into play within which contain the duration of the Prudency Dispute process:
- (a) Within 5 Business Days, the ACCC will invite other Customers to apply to join the Prudency Dispute, and within 10 Business Day after the date the ACCC invites Customers to apply to join the Prudency Dispute, it will make a decision to either accept or reject each application it has received subject to the application meeting

¹⁵⁶ NBN Co, Supporting submission – NBN Co Special Access Undertaking, 28 September 2012, p.221.

the Prudency Dispute Conditions. By the end of this timeframe, the ACCC will have determined the relevant pool of 'Prudency Dispute Participants'.

(b) The consultation period in respect of a Prudency Dispute is specified under 1E.9.4 to be *"between 30 Business Days to 40 Business Days from the date that a Prudency Dispute has arisen."*

(c) Following the conclusion of this consultation period, the ACCC is required to make a decision within 50 Business Days subject to the 'decision making criteria for Prudency Dispute' as stated under 1E.9.5(a):

The ACCC must make a decision accepting or rejecting the Preferred Network Change Option (and thereby resolving the Prudency Dispute) by reference to the criteria referred to in clauses 1E.9.5(b) and 1E.9.5(c) and must notify NBN Co and the Prudency Dispute Participants of such decision within 50 Business Days after the final date on which submissions are provided to the ACCC under clause 1E.9.4.

(d) The ACCC's decision thereby forms the basis of the subsequent endorsement of the Preferred Network Change Option set out in Clause 1E.10.

5.70 Optus, however, notes that even if the ACCC agrees (or is likely) to reject the Preferred Network Change Option under Clause 1E.9, there is considerable recourse for NBN Co to seek alternative options to resolve Prudency Dispute under as outlined under 1E.10.3.

5.71 For example, NBN Co may at its discretion and at any time after the formation and/or resolution of a Prudency Dispute, choose to undertake an alternative option in respect of the Preferred Network Change Option (via either a recommencement of the process under 1E.7.2 for the Network Change or variation thereof; or ceasing to pursue the Network). Clause 1E.10.3(b) will effectively render a current Prudency Dispute process obsolete.¹⁵⁷

5.72 As a result, this provides NBN Co with the potential to game the regulatory framework and disrupt the traditional course of the ACCC to make a decision.

Operating Cost Conditions

5.73 Operating costs incurred on a prudent basis will also be included in the LTRCM. Operating expenses are assessed as being prudent if the opex:

(a) has been deemed to be prudent; or

(b) relates to third party operating expenditure under 1E.4.1.¹⁵⁸

¹⁵⁷ As set out in Clause 1E.10.3(b) *"If NBN Co undertakes one of the options identified in clause 1E.10.3(a) as an alternative to a Prudency Dispute: (i) NBN Co will notify Customers and the ACCC of that fact; and (ii) **the Prudency Dispute will be withdrawn and the ACCC will cease all activities in relation to such Prudency Dispute from the date that NBN Co gives such notice.**" [emphasis added]*

¹⁵⁸ Clause 1F.7.1.

- 5.74 Operating costs will also be assessed as being prudent if:
- (a) NBN Co ensures that the opex is incurred in a manner that seeks to achieve value for money and the lowest total cost of ownership; and
 - (b) Manages and controls opex in a manner consistent with the Statement of Expectations; any other legal requirement; or any requirement from Stakeholder Ministers.¹⁵⁹
- 5.75 Synergies Consulting concludes that NBN Co will face “strong incentives” to incur efficient opex over the initial regulatory period. This is due to the obligation to achieve the lowest overall cost of ownership; and incentives to minimise losses for as long as it is incurring losses relative to ABBRR such that capitalised losses in the ICRA are accumulating.¹⁶⁰
- 5.76 First, Optus notes that the Synergies description of the “*obligation to achieve the lowest overall cost of ownership*” does not accurately reflect the requirement placed upon NBN Co. The SAU requires that NBN Co “*seeks to achieve*”; there is no requirement to actually achieve the lowest cost of ownership.
- 5.77 Further, Synergies argues that the provisions could be enforced in the Federal Court by affected parties or the ACCC. It is the potential for enforcement that places the incentive upon NBN Co.¹⁶¹ However, the ability of parties to successfully bring an action in the Federal Court is questionable given the need to prove that NBN Co did not “seek to achieve” the lowest cost of ownership. Given that this goes to the mindset of NBN Co at the time of entering into the expenditure, it would appear unlikely that any challenge would face a reasonable chance of success. The threat of a successful legal challenge would appear to be at best a very limited threat.
- 5.78 This problem is magnified by the fact that the consideration of lowest total cost of ownership may involve higher opex now if it may lead to lower costs sometime in the future. NBN Co states that:
- ... a lowest total cost of ownership approach may not, in every given situation, lead to the lowest possible opex outcome, but would still result in value for money when viewed against the totality of capex and opex over the life of the asset.*¹⁶²
- 5.79 It would appear unlikely for a third party, or the ACCC, to be able to assess the claim that high current opex would lead to lower capex at some future point. Given this information asymmetry and the need to inquire into the mindset of NBN Co at the time of the decision, it does not seem reasonable to conclude that the potential for Federal Court action would ensure compliance with prudent opex.

¹⁵⁹ Clause 1F.7.1.

¹⁶⁰ Synergies Consulting, September 2012, p.76.

¹⁶¹ Synergies Consulting, September 2012, p.76.

¹⁶² NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.225.

5.80 NBN Co and Synergies Consulting also rely upon the pressure of NBN Co to operate in an efficient manner, especially during the initial roll-out period. Such reliance, however, appears to be counter to empirical evidence available from other infrastructure industries. That is, government-owned firms operating within a regulatory regime allowing for *ex ante* and *ex post* review have been found to result in higher capital and operating expenditure compared to privately-owned firms.¹⁶³ This implies that government-owned firms may be less able to control costs. This places significant doubt on the assumption of Synergies Consulting that the government-owned NBN Co will face meaningful pressure to incur efficient costs – especially where there is no effective external oversight.¹⁶⁴

Conclusion

5.81 NBN Co relies upon specific prudency requirements in the SAU to manage the risk that excessive expenditure will be incurred during the lifetime of the SAU. NBN Co argues that the requirements are sufficiently strong so as to negate the need for independent oversight (either *ex ante* approval or *ex post* review) which is seen in every other undertaking accepted by the ACCC, and is a feature of regulatory regimes for other industries (see, for example, the recently amended National Electricity Rules).

5.82 Sole reliance on prudency provisions in the SAU implies that the provisions are suitably rigorous to offset the risk imposed by preventing ACCC oversight. Without such rigour, the provisions should not be considered to be reasonable.

5.83 Optus finds that the prudency provisions place weak, if any, restrictions on the ability of NBN Co to incur costs at any level it sees fit. This is because:

- (a) expenditure that is simply “deemed” to be prudent can be rolled straight into NBN Co’s RAB with no further scrutiny, even though these costs are likely to run into tens of billions of dollars;
- (b) capital expenditure will be deemed to be prudent and subject to no further scrutiny if NBN Co determines that the expenditure satisfies NBN Co’s Network Design Rules and its Prudent Cost conditions;
- (c) the Prudent Cost Conditions are unlikely to be enforceable in the Federal Court as it is only necessary for NBN Co to show that in the CEO’s opinion the expenditure was in the best interest of the company;
- (d) the Procurement Rules which would deem expenditure prudent have not yet been written by NBN Co, therefore it cannot be assessed as being reasonable;
- (e) consultation provisions for network changes are unreasonably restrictive, preventing effective discourse among the industry participants; and

¹⁶³ Productivity Commission, 2012, *Electricity Network Regulatory Frameworks*, Chapter 6 & AER, 2011, *State of the Electricity Market*.

¹⁶⁴ Synergies Consulting appears to assume that NBN Co would be subject to substantial pressures from the ‘investment community’. However, NBN Co is fully government owned and therefore would face little if any pressure from investment community given the lack of tradable equity.

- (f) operating expenditure which will run into billions of dollars a year is considered to be prudent if in NBN Co's opinion such expenditure offers "*value for money*" and "*the lowest total cost of ownership*" and is otherwise in line with the "*Statement of Expectations*" and "*any other regulatory requirements applicable to NBN Co.*"

5.84 Finally, upon a detailed analysis of the workings of the SAU provisions, Optus finds the expert opinion of Synergies Consulting that the prudency provisions are sufficient to ensure "*appropriate safeguards against the risk inherent in long-term undertakings*"¹⁶⁵ is not correct, nor is it sufficiently justified. Optus finds that:

- (a) The Prudent Cost Conditions are unenforceable and provide no or little restriction on the ability of NBN Co to incur excessive costs;
- (b) Synergies makes no comment on the efficiency of the deemed expenditures, and therefore no weight can be placed on its conclusion on deemed prudency;
- (c) Synergies makes no comment on the efficiency of the network design rules, and therefore no weight can be placed on its conclusion on deemed prudency;
- (d) Synergies fails to accurately reflect the nature of industry consultation during the engagement process, and fails to note the highly restrictive terms of consultation and ability of the ACCC to review expenditure; and
- (e) Synergies does not accurately portray the requirement of NBN Co to seek to achieve lowest cost of ownership, and overstates the ability of market forces to constrain a government-owned monopoly provider.

¹⁶⁵ Synergies Consulting, September 2012, p.64.

Section 6. LTRCM and the initial cost recovery period

KEY POINTS

- *NBN Co has confirmed that it does not expect the LTRCM to become binding during the lifetime of the SAU and therefore NBN Co will not be subject to an overall revenue cap.*
- *None of the expert reports submitted by NBN Co assess how the LTRCM would work in practice. Thus, NBN Co has put no evidence before the ACCC demonstrating that the LTRCM is reasonable and promotes the LTIE.*
- *Using NBN Co's Corporate Plan and reasonable assumptions, it is estimated that the accumulated regulatory losses will be around \$60 billion in 2040. At the same time, NBN Co forecasts an internal rate of return of 7.1%.*
- *The proposed SAU WACC is significantly above the real cost of financing faced by NBN Co. This creates an incentive to over-invest and gold-plate the RAB.*
- *Without analysis from NBN Co as to how the LTRCM is expected to operate, the ACCC is not able to assess the reasonableness of the provisions.*

6.1 A central element of the NBN SAU is the long term revenue constraint mechanism (LTRCM). The LTRCM provides methods for the determination of:

- (a) regulatory asset base (RAB);
- (b) annual building block revenue requirement (ABBRR);
- (c) initial cost recovery account (ICRA);
- (d) building block revenue period; and
- (e) cost of capital.

6.2 The LTRCM comprises two phases:

- (a) the first phase applies during the initial period of network roll-out and is called the "initial cost recovery period" (ICRP).¹⁶⁶ The ICRP continues until the ICRA is extinguished. During the ICRP, there is no overarching cap on the level of revenue that can be received by NBN in any single year; and
- (b) the second phase starts after recovery of past losses, and is called the "building block revenue period" (BBRP). During the BBRP, total revenue that the NBN can recover each year will be determined by the ABBRR. This is proposed to work so that NBN does not recover more than is required to cover its costs of operation (including return on capital).

¹⁶⁶ Clause 1F.1.

- 6.3 This section discusses the proposed operation of the ICRP and the ICRA; and examines whether NBN Co is likely to be subject to an overall revenue cap during the life of the SAU. Optus notes that the operation of an overall revenue cap is a key factor put forward by NBN Co when justifying efficient prices. The ICRP continues until such time as the ICRA equals zero – that is, until the accumulated regulatory losses are recovered. As such:

*NBN Co anticipates that the ICRA will grow significantly for at least the next 10 years, and it will take a further extended period for these initial costs to be fully recovered.*¹⁶⁷

- 6.4 The principle behind the ICRA – allowing recovery of efficient costs incurred during the initial build period, so that in the long run total cost of the network is recovered, appears reasonable. NBN Co clarify that the “LTRCM is a methodology that constrains NBN Co to recovering no more than its prudently incurred costs of supply (inclusive of an appropriate return on capital).”¹⁶⁸
- 6.5 However, the key concern when assessing whether the ICRA promotes or detracts from the LTIE is how the account works in practice and whether it will actually constrain NBN Co to recovering no more than its prudently incurred costs. That is, does the actual ICRA formula applied to real-world forecasts promote the long term interest of end-users? Does the ICRA/LTRCM differ from standard regulatory practice? And most importantly, do the regulatory accounts differ from the financial accounts?
- 6.6 To that end, Optus has concerns as to the likely operation of the ICRA during the 27 year timeframe of SAU. Specifically, Optus has doubts as to whether the ICRA will ever be extinguished during the lifetime of the SAU, and thereby, negating any benefits that may arise out of the application of an overall revenue cap. Furthermore, the use of forecasts during Module 2 impact upon the claim that the LTRCM constrains NBN Co recovering prudent costs.
- 6.7 As discussed in section 4, the reasonableness of pricing components in the SAU is justified by the combination of the individual price increase limit, the initial pricing principles (IPP), and the overall revenue cap to be applied during the BBRP. It is also shown in section 4 that the IPP are unlikely to be enforceable in the Federal Court, and absent ACCC oversight, there is no effective mechanism through which NBN Co could be compelled to comply. Further, it is shown that the individual price increase limit is likely to result in prices that are counter to the existing pricing trend for internet services. Therefore, claims of efficient pricing over the lifetime of the SAU rests largely on the effectiveness of the overall revenue cap. If it is shown that the ICRP (and hence no revenue cap) exists for substantial period of the SAU, serious questions must be raised as to the efficacy of the pricing protections in the SAU: and therefore the reasonableness of the SAU.
- 6.8 Optus further notes that it has requested a confidentiality arrangement to be established between NBN Co and interested parties so there can be an informed discussion as to how the LTRCM is expected to operate over the lifetime of the SAU. NBN Co has refused to enter into

¹⁶⁷ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.114.

¹⁶⁸ Lovell, C., Letter to Andrew Sheridan Re: NBN Co Special Access Undertaking, 14 January 2013, p.2.

such an arrangement, stating that it “does not see any utility in providing financial data and modelling of the LTRCM as part of the ACCC’s assessment of the SAU”.¹⁶⁹

6.9 NERA confirm that:

*The absence of such supporting detail and associated regulatory model is not consistent with the established practice of the ACCC’s associated body, the Australian Energy Regulator (AER). In sharp contrast to the level of detail set out in the SAU, the associated regulatory and financial model for each application of the building blocks regulatory method in the energy sector is made available as an integral part of the public consultation process adopted by the AER.*¹⁷⁰

6.10 Optus submits that in the absence of a full review of how NBN Co sees the LTRCM working throughout the SAU, no evidence is before the ACCC to assess the LTRCM as being reasonable. In other words, NBN Co has not discharged its affirmative burden to satisfy the ACCC that the LTRCM is reasonable. As such, the SAU is not capable of being accepted.

Concerns with the LTRCM equation

6.11 The LTRCM methodology proposes to calculate the ABBRR using actual tax cost rather than benchmark tax costs using regulatory assumptions on financing and other arrangements. This is inconsistent with other building block regulatory regimes applied in Australia.

6.12 For example, under the AER’s post-tax revenue model taxable profit is estimated by deducting nominal opex, interest expense (derived from regulatory assumption as to gearing ratio, RAB and cost of debt), and nominal tax depreciation. Whereas under the LTRCM, NBN Co’s taxable profit is calculated by deducting from actual nominal revenue, nominal opex, actual interest expenses and nominal tax depreciation.

6.13 NERA conclude that while with the lack of information provided by NBN Co prevents a full investigation of the impact of this departure from standard regulatory practice, its:

*... preliminary assessment is that this departure would have a substantial positive value on NBN Co financial value, as compared with the usual regulatory approach.*¹⁷¹

6.14 In other words, when the tax allowance is applied it would likely to be higher than under the standard approach. As such, the ABBRR would be higher than otherwise would be leading to either: the ICRP being extended for more years than needed; or under the BBRP allowable revenue being higher than otherwise.

6.15 Optus submits that without such adequate information, NBN Co has failed to provide sufficient evidence for the ACCC to assess the impact of the unique approach proposed in the NBN Co SAU. Without such assessment, the ACCC is unable to form a view as to the reasonableness of these provisions.

¹⁶⁹ Lovell, C., Letter to Andrew Sheridan Re: NBN Co Special Access Undertaking, 14 January 2013.

¹⁷⁰ NERA, 2013, Appendix B.

¹⁷¹ NERA, 2013, Appendix B, p.5.

Estimating the LTRCM/ICRA using NBN's Corporate Plan

- 6.16 The SAU is designed to give effect to the NBN Co Corporate Plan. NBN Co states in the Supporting Submission that the SAU covers the 30 years of the Corporate Plan, in order to provide certainty to the long term cost recovery framework for NBN Co.¹⁷² NBN Co further explain:

NBN Co's commercial context (marked by long-lived assets, a long payback period for the initial investment, and long-term commercial arrangements) necessitates that the SAU be specified for a long term, and the specific expiry date of 30 June 2040 was selected because it aligns with the 30 year Corporate Plan published by NBN Co in December 2010 (and in this regard, it should be noted that the same end date is maintained in NBN Co's 2012-15 Corporate Plan).¹⁷³

- 6.17 NBN Co also states that the certainty provided by the SAU over the 27 years is necessary to enable cost recovery of the initial losses incurred during the first 10 years of NBN given the "the expected payback period for the initial investment and ongoing prudently incurred costs".¹⁷⁴
- 6.18 The Government and NBN Co have made clear that NBN Co is expected to make a return greater than the long term bond rate over the lifetime of the network.¹⁷⁵ The two Corporate Plans and recent public statements clarify that NBN Co expects to make around 7 per cent return over its lifetime.¹⁷⁶
- 6.19 Optus therefore considers it pertinent to examine how the LTRCM component of the SAU operates given its assumed purpose: to enable NBN Co to achieve the financial payback outlined in the Corporate Plan. Where the LTRCM enables NBN Co to achieve the stated financial outcomes in the 30 year Corporate Plan, it can be said that the LTRCM and ICRA promote efficient investment decisions. Where the LTRCM varies from the Corporate Plan, either enabling under or over recovery, the efficiency of the regime must be questioned.
- 6.20 Notwithstanding the fact that NBN Co has refused to provide financial data and modelling of the LTRCM, NBN Co confirmed in a letter to Optus that:

*If the Corporate Plan forecasts and assumptions are applied to the LTRCM as set out in the SAU, **the revenue constraint does not come into effect by 2039-40**. The information in the Corporate Plan enables access seekers who are so minded to check this outcome.¹⁷⁷ [emphasis added]*

¹⁷² NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.43.

¹⁷³ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.51.

¹⁷⁴ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.52.

¹⁷⁵ See below for further discussions, para.6.50 to 6.63.

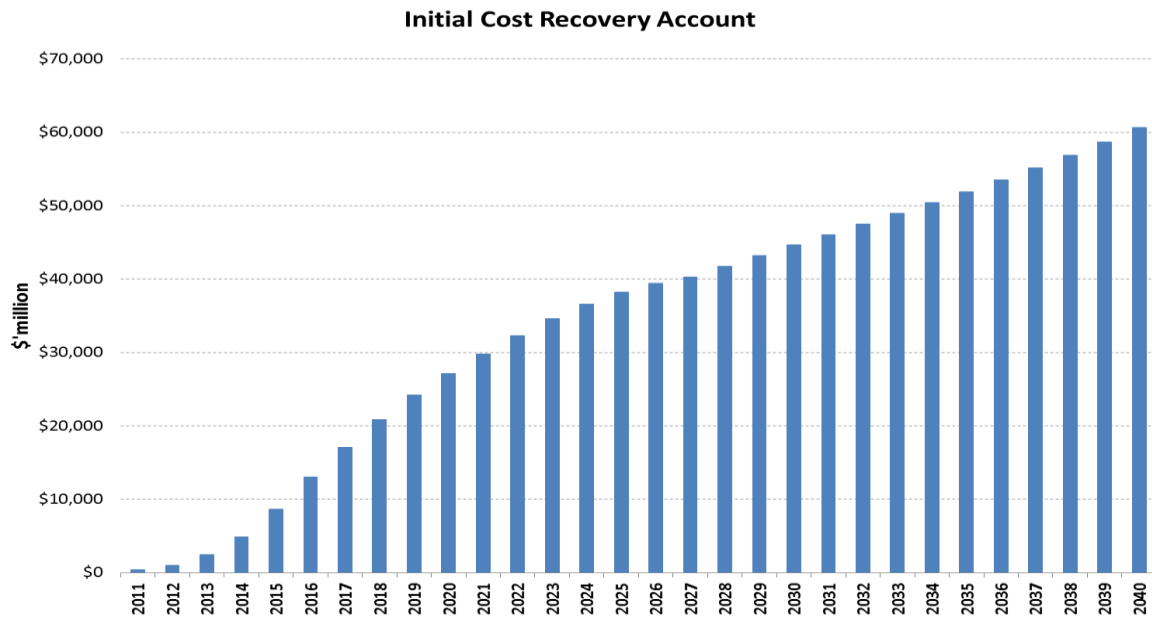
¹⁷⁶ NBN Co, Corporate Plan 2012-15, p.9; NBN Co, Corporate Plan 2011-12, p.23; http://afr.com/p/technology/remove_nbn_speed_limits_ex_telstra_OsikF0bBx8igR7gGvTH1RP.

¹⁷⁷ Lovell, C., Letter to Andrew Sheridan Re: NBN Co Special Access Undertaking, 14 January 2013, p.2.

- 6.21 Optus has requested NERA to estimate how the LTRCM and ICRA, would likely operate over the lifetime of the Corporate Plan and SAU. The expert opinion of NERA is attached at Appendix B. NERA use the Corporate Plan 2012-15 metrics for the years 2011-2021, 2028 and 2040; and using reasonable assumptions to estimate the unobserved years to estimate how the specific LTRCM equations in the SAU would likely operate over the 27 year period to 2040. Missing data for which NERA has to use assumptions include:
- (a) Financial information for the financial years ending 2022 to 2027 and 2029 to 2039;
 - (b) Government 10 year bond rate;
 - (c) Regulatory depreciation over the full period; and
 - (d) Value of construction in progress over the full period.
- 6.22 NERA notes that only NBN Co is in a position to supply interested parties with this information. Failure to do so *“denies interested parties the opportunity to meaningfully examine the implications of the LTRCM”*.¹⁷⁸
- 6.23 As noted above, NBN Co expects to make an internal rate of return of 7.1% over the period 2012 to 2040. That is, it will recover all its costs and make an additional amount of revenue sufficient to satisfy its provider of finance (the Australian Government).
- 6.24 However, using the financial information in the NBN Co Corporate Plan 2012-15, and reasonable assumptions, Optus estimates the ICRA account will be around \$60 billion in 2040. In addition, it is estimated that the ICRA is still increasing rather than being run down (see figure 4 below).

¹⁷⁸ NERA, 2013, Appendix B, p.4.

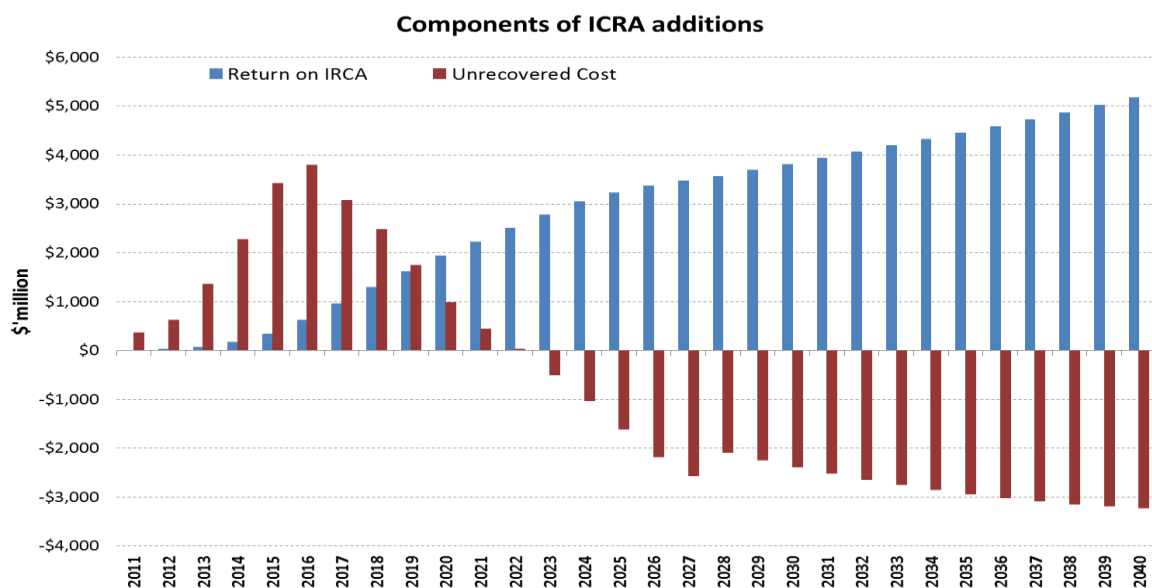
FIGURE 4



6.25 The ICRA is still increasing at the end of the SAU period (2040). This is due to the impact of compounding; over time the main driver of the size of the ICRA is the WACC component (see figure 5). This has the effect of increasing ICRA (i.e. increasing the yearly regulatory loss) even where forecasted revenue is greater than the ABBRR. Forecasted revenue in the NBN Co Corporate Plan is forecasted to exceed ABBRR in 2023. NERA estimates that ICRA will increase by \$2 billion in 2040.

6.26 Optus is concerned that NBN Co is making substantial profit margins in excess of 70% and yet the regulatory losses are *increasing*. To put that into perspective, NBN Co forecasts EBT margins of 73% in 2040 and yet its regulatory accounts will show a loss of \$2 billion. This loss is the combination of yearly WACC adding \$5.2 billion to ICRA and excess revenue reducing ICRA by \$3.2 billion.

FIGURE 5



6.27 NERA conclude that:

- (a) NBN Co will not move out of the ICRP during the lifetime of the SAU. Further, ICRA increases even through by 2040, nominal revenue exceeds regulated allowable revenue by 28%.
- (b) The LTRCM may lead to price instability over time. NERA calculate that nominal revenue needs to be 45.5% higher than allowable revenue (ABBRR) in order for ICRA to reduce year-on-year. In order to pay off the \$60 billion at the end of 2040, NBN Co would most likely need revenue substantially above this amount. This suggests that there would be a significant fall in prices when the overall revenue cap becomes binding (when ICRA is paid down).
- (c) LTRCM contains no incentive to minimise costs over time, as all opex is included in ABBRR and all capex is rolled into the RAB. Further, there is no scope for third party review on either an *ex ante* or *ex post* basis.¹⁷⁹

The likely application of ICRP undermines its justification

6.28 NBN Co submits two expert opinions supporting the use of the ICRA within the SAU. NBN Co relies upon these opinions to support the assertion that the ICRA promotes the LTIE. Optus notes, however, that neither of these expert opinions attempted to estimate how the ICRA would work during the lifetime of the SAU. Given that the concerns on ICRA relate to its practical implementation, little weight should be given to the conclusion of the expert opinions — in addition, NBN Co has provided no evidence to the ACCC as to the likely operation of the LTRCM and ICRA during the lifetime of the SAU. Optus' expert advice from NERA concludes that the LTRCM and ICRA are not likely to promote the LTIE.

6.29 The first report by Ordover and Shampine note that they were not asked to opine of the specific provisions of the SAU, but the principle of using a long term commitment to a rate of return, including allowing recovery of losses, is likely to promote efficient levels of investment.¹⁸⁰

6.30 Optus submit that the Ordover and Shampine report offer little, if any, support to the actual approach to loss recovery contained in the SAU. The authors agree that the concept of long term commitment to cost recovery is efficient. This issue is not in doubt; Optus is raising concerns about the implementation of these principles within the SAU.

6.31 The second report by Synergies Consulting does address the specifics of the LTRCM and ICRA in its expert opinion. First, Synergies notes that the ICRA allows NBN Co to set prices unconstrained by a revenue cap:

If NBN Co achieves a position of market power in the provision of any of these new services, then the substantial capitalised losses in the ICRA will confer the NBN Co the

¹⁷⁹ NERA, 2013, Appendix B, pp.6-9.

¹⁸⁰ Ordover & Shampine, p.16.

*ability to set high prices for these new services subject to the constraints imposed by the SAU.*¹⁸¹

- 6.32 Synergies identify the following constraints imposed by the SAU on the ability to set high prices during the ICRP. These are:
- (a) governance arrangement;
 - (b) uniform pricing;
 - (c) prudency requirements;
 - (d) initial pricing; and
 - (e) characteristics of demand.
- 6.33 Optus does not agree that these factors necessarily limit the ability of NBN Co to set excessively high prices during the ICRP; nor will NBN Co likely face commercial pressures to lower the ICRA. Rather, it is more likely that the ICRA will be seen as a 'value-add' by the financial markets as its existence results in NBN Co avoiding revenue cap regulation for period beyond 2040. These are summarised below.
- 6.34 First, it is demonstrated in section 5 that the prudency requirements contained in the SAU are not sufficient to guarantee efficiency expenditure. Most importantly, the prudency requirements do not allow for any third party oversight and review. NERA conclude that the LTRCM provisions in the SAU differ substantially from the accepted approach to building block modelling in other Australian industries. NERA is not aware of any other regulatory arrangements in Australia that provide no incentives for NBN Co to minimise costs, or exclude independent oversight.¹⁸²
- 6.35 Second, it is demonstrated in section 4 that the initial pricing principles are not sufficient to ensure that new pricing is efficient. To summarise, the IPP provides for no ACCC oversight, and no requirement to justify the new prices with any rigour. Further, except in the most extreme circumstances it is difficult to envisage any person successfully taking action under section 152CD in relation to NBN Co breaching the IPP provisions. As such, it is likely that the IPP provisions will be effectively unenforceable.
- 6.36 Third, uniform pricing is unlikely to impose "some constraint" to set prices as it is very unlikely that NBN Co will face any cream-skimming. Specific legislative provisions were inserted into the CCA to remove the potential for cream-skimming. This requires that any new or upgraded superfast network must be built to the same technical specifications as the NBN, be subject to the same access regulations, and must also offer a wholesale, non-discriminatory layer 2 broadband service.¹⁸³ The Explanatory Memorandum makes it quite clear that these provisions

¹⁸¹ Synergies Consulting, September 2012, p.85.

¹⁸² NERA, 2013, Appendix B.

¹⁸³ CCA, s.152ARAA.

were inserted to address the identified risk that competing networks choosing to compete in low cost areas (cherry-picking) would undermine the business case of NBN Co.¹⁸⁴

- 6.37 In addition, NBN Co has entered into agreements with Telstra and Optus to shut down their HFC networks in order to avoid potential cream-skimming. As a result, there does not exist any fixed network that can ‘cream-skim’ or cherry-pick the NBN, nor is it possible to build a network to compete against NBN in profitable areas only.
- 6.38 Fourth, and arguably most importantly, the ICRA in practice is likely to significantly diverge from NBN Co financial losses, and as such, market expectations and incentives imposed on NBN Co by investors is not going to be driven by the level of the ICRA. This is because the financial returns of NBN Co are unlikely to influence the size of ICRA. For example, at the end of 2040 NBN Co is forecasting a 7.1% internal rate of return, while the ICRA will be \$60 billion and increasing.
- 6.39 Optus expects that financial markets will see this divergence and note that the size of the ICRA does not reflect financial returns. It is more likely that the ICRA will be regarded as an ‘asset’ for NBN Co, as when ICRA is greater than zero it will avoid any revenue cap. As a result, it is not reasonable to expect governance and market pressure will provide sufficient constraints on NBN Co pricing behaviour during the ICRP.
- 6.40 In conclusion, the reasons put forward by Synergies —without any analysis of how the ICRA is likely to work during the lifetime of the SAU — are unlikely to hold due to the incentives created by the operation of the ICRA, as per NBN Co’s own expectation of the future. NBN Co has not submitted any evidence as to how it expects the LTRCM to operate over the lifetime of the SAU, and its experts provide no justification as to the reasonableness of the LTRCM. Optus submits, therefore, that NBN Co has failed to discharge its affirmative burden to satisfy the ACCC that the LTRCM terms of the SAU are reasonable and promote the LTIE.

The LTRCM during Module 2

- 6.41 NBN Co claims that “*the LTRCM is a methodology that constrains NBN Co to recovering no more than its prudently incurred costs of supply (inclusive of an appropriate return on capital).*”¹⁸⁵ It has been shown above that such a claim may not be correct as over the 27 year term of the SAU, NBN Co forecasts to make a financial return (IRR) of 7.1%, yet the regulatory accounts show an accumulated loss of \$60 billion. In addition, NBN Co’s claim is further undermined by the use of forecasts to roll-over the ICRA during Module 2.
- 6.42 The incentive created by setting ABBRR on forecasts and rolling actuals into the RAB may lead to inefficient outcomes. As noted above, the interpretation of fixed principles and clause 2D.6 may result in the ACCC being unable to independently assess and replace opex, capex and revenue forecasts where necessary. If this is the case, it would result in almost unfettered ability of NBN Co to manipulate the proposed forecast-based LTRCM regime during Module 2 to maintain the ICRP while at the same time make significant actual financial profits.

¹⁸⁴ *National Broadband Network Companies Bill 2010 Telecommunications Legislation Amendment (National Broadband Network Measures — Access Arrangements) Bill 2010*, Explanatory Memorandum.

¹⁸⁵ Lovell, C., Letter to Andrew Sheridan re: NBN Co Special Access Undertaking, 14 January 2013, p.2.

- 6.43 The ability to do so directly contradicts the claim made by NBN Co that the LTRCM constrains NBN Co to recovering no more than its prudent costs.
- 6.44 Under Module 2 and during the ICRP, NBN Co will put forward a forecast of revenue for the length of the regulatory period.¹⁸⁶ This forecast can be above or below the forecast nominal ABBRR.¹⁸⁷
- 6.45 It can be easily shown that NBN Co could understate revenue, or overstate capex, in its forecasts and this would lead to a higher ICRA than if actuals would be used. Optus has modelled the LTRCM using the NBN Co Corporate Plan 2012-2015. At the end of 2021 (expected date for end Module 1), the ICRA totals \$37.5 billion. Assuming that NBN Co makes forecasts consistent with the Corporate Plan at the end of the first Replacement Module (5 year duration), the ICRA would grow to \$47.2 billion. Under Module 2, this would be the ICRA that rolls forward to the next regulatory period. However, it can easily be seen that if actuals vary from forecasts, the ICRA could be much different. For example, if actual revenue over the 5 years period is 20% higher than forecast, the ICRA would only grow to \$39.1 billion.
- 6.46 This difference is important since any commercial or financial market pressure that NBN Co could face would come from *actual results* not forecasts. NBN Co could under-state revenue for regulatory purposes, and thereby ‘artificially’ increasing the ICRA, yet make sufficient actual revenue to return significant profits and pay off actual debt at an appropriate rate.
- 6.47 Would NBN Co have an incentive to behave in such a manner? It is clear that NBN Co has an incentive to maintain ICRP for as long as possible: as noted by Synergies Consulting, during the ICRP NBN Co is free to price as it sees fit, subject to the individual price increase limit.¹⁸⁸ Synergies also notes that the use of forecasts during the ICRP “*presents incentives that may not result in efficient outcomes*”.¹⁸⁹ Further, Optus notes that acting on these incentives undermines the key justification Synergies put forward for concluding the ICRP is reasonable: namely, that NBN Co has a commercial incentive to minimise losses.
- 6.48 Synergies states that effective ACCC oversight and approval of forecasts for each new Replacement Module is likely to offset this risk.¹⁹⁰ Optus agrees that the ACCC may be able to control this risk overtime, if it had the same level of powers as the AER under the newly amended NER. However, as discussed above there is uncertainty as to the extent of the ACCC’s power to review forecasts given that clause 2D.6 is a fixed principle.
- 6.49 As such, no weight should be placed on Synergies’ conclusion that “*the expected vigilance and expertise of the ACCC*”¹⁹¹ can reasonably be expected to outweigh the potential inefficiencies of relying on forecasts during the ICRP.

¹⁸⁶ Clause 2D.3.1(a).

¹⁸⁷ Clause 2D.3.1(b).

¹⁸⁸ Synergies Consulting, September 2012, p.85.

¹⁸⁹ Synergies Consulting, September 2012, p.50.

¹⁹⁰ Synergies Consulting, September 2012, p.51.

¹⁹¹ Synergies Consulting, September 2012, p.51.

Regulatory WACC and true cost of capital

- 6.50 NBN Co proposes a fixed WACC throughout the lifetime of the SAU of the risk free rate plus 350 basis points. NBN Co refers to an expert report stating that the 350 basis point mark up is reasonable.¹⁹²
- 6.51 Optus notes that no mention is made of how the regulatory WACC compares to the actual cost of capital incurred by NBN Co. Optus considers the WACC proposed by NBN Co is inappropriate. NBN Co should receive compensation for the efficient capital costs it has incurred, and no more. In this regard the key relevant fact is that the NBN is a public project funded by taxpayer funds. At the very most, the WACC should represent the Government's actual borrowing costs, that is, the Government bond rate, not the WACC that would be required for a commercial project.
- 6.52 The Government has recognised that it does not require a commercial rate of return for the project as it stated that:
- ... we have never taken the approach that we need to make the rate of return that the telco sector is used to.*¹⁹³
- 6.53 Notwithstanding this, the Government has also indicated that it expects to receive more than its actual costs of borrowing as the Minister has stated that:
- NBN Co's expected rate of return is 7.04 per cent, which compares favourably with the average 10 year bond rate (July 2009 to November 2010) of 5.39 per cent. The NBN Corporate Plan shows the Government can expect to recover all its funding costs with interest.*¹⁹⁴
- 6.54 NBN Co recently re-stated its intention to meet this 7 per cent requirement: stating that its pricing structure was built to ensure UNWP and to provide "a 7 per cent return to the government on capital costs".¹⁹⁵
- 6.55 Optus questions the appropriateness of the proposed approach to WACC since the expected rate of return represents a cost to consumers above the actual costs of building the network. Setting a lower return is likely to better deliver the Government objectives of providing affordable broadband to all Australians.
- 6.56 Furthermore, having a WACC above the actual cost of finance creates an incentive to increase the size of the RAB above the efficient level. The impact on the efficient operation of the building block approach of having a WACC that differs from the actual cost of funding was

¹⁹² NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, pp.122-3.

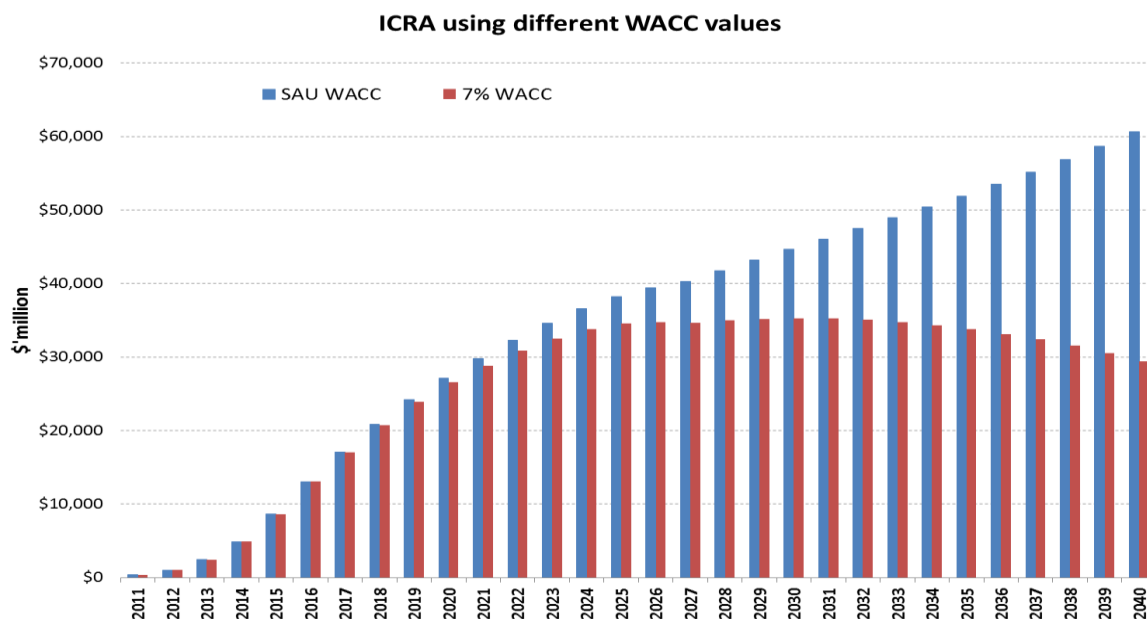
¹⁹³ Computerworld, "Conroy: NBN Co doesn't need regular telco commercial returns", 10 May 2010.

¹⁹⁴ Joint Media Release with the Hon Julia Gillard MP Prime Minister and Senator the Hon Penny Wong Minister for Finance and Deregulation and Senator the Hon Stephen Conroy Minister for Broadband, Communications and the Digital Economy, "Government release NBN Co Corporate Plan", 20 December 2010.

¹⁹⁵ http://afr.com/p/technology/remove_nbn_speed_limits_ex_telstra_OsikF0bBx8igR7gGvTH1RP.

discussed by the Productivity Commission (PC) in its recent Draft Report on Network Electricity Regulation.¹⁹⁶

FIGURE 6



6.57 Where the regulated WACC is set above the actual cost of finance over a long period of time, it results in allocative inefficient transfers from consumers to NBN Co. The PC found that such divergence is not in the long term interest of consumers – or in Part XIC terms, it would not promote the LTIE.¹⁹⁷ Figure 6 above shows the difference in the ICRA using different WACC values. The blue columns represent ICRA using the WACC in the SAU, and the red columns show the ICRA using a WACC of 7%. In 2040, the difference between the two WACCs results in a \$31 billion variation in the ICRA (\$15.4 billion in real terms).

6.58 The PC found that where there is a long run expectation that the regulated WACC is above the actual cost of finance, there are incentives for the regulated firm to over-invest. It was found that a higher WACC led to a higher RAB and if the regulated WACC was sufficiently above the actual cost, over-investment may be profit-maximising.¹⁹⁸ Optus further notes that this incentive may be stronger for NBN Co, where under the proposed LTRCM in Module 1, actual capex determines not only the RAB but also the yearly allowable revenue.¹⁹⁹

6.59 Furthermore, the fact that NBN Co is not required to make a commercial return magnifies the incentive to over-invest due to the high WACC return proposed in the SAU. The capital costs of government-owned businesses will be subsidised by its government owner when:

¹⁹⁶ PC, 2012, *Electricity Network Regulatory Frameworks*, section 5.3.

¹⁹⁷ PC, 2012, *Electricity Network Regulatory Frameworks*, p.195.

¹⁹⁸ PC, 2012, *Electricity Network Regulatory Frameworks*, p.195.

¹⁹⁹ Under the NER, forecasts are used, so that any actual over-spend on capex does not translate into higher allowable revenue during the current regulatory period. But since actual capex flowed into RAB, it resulted in higher allowable revenue in the next regulatory period.

- (a) The government owner does not behave as an arm's length equity investor, demanding a return that is commensurate with the risk of the project; and
- (b) The government lends to the firm at a rate that does not include a properly calculated competitive neutrality fee: so that the borrowing cost of the firm is at a level that it would face if it acquired private debt.

6.60 It is clear from Government and NBN Co statements that these conditions are not met. NBN Co is a government-owned enterprise, with guaranteed government provided equity of \$30.4 billion, up from \$27.5 billion in the previous corporate plan.²⁰⁰ NBN Co and Australian Government entered into a funding arrangement on 22 June 2011 guaranteeing Government funding equity to fund the rollout of the NBN, with such funding being conditional on the annual appropriation process.²⁰¹

6.61 The DBCDE also confirmed that the Government has internalised the market risk faced by a commercial entity:

*The project is being financed by the government because it is best able to mobilise the capital required and manage the risks involved, rather than the private sector which **would require an additional risk premium for risks controlled by government.***²⁰²[emphasis added]

6.62 One policy reason for NBN Co is that the private sector would not be able to achieve Government's broadband objectives because it would not be able to receive an adequate commercial return.

6.63 It is clear that NBN Co faces a subsidised financing rate much below what the market would require to fund the NBN project. It is therefore not appropriate to set the regulated WACC at the market level (as estimated by NBN Co's experts). To do so would create a strong incentive to over-invest. This would result in inefficient transfer from consumers to NBN Co, totalling around \$31 billion in 2040: and therefore would not promote the LTIE.

²⁰⁰ NBN Co, 2012, Corporate Plan 2012-2015, p.73.

²⁰¹ NBN Co, 2012, Corporate Plan 2012-2015, p.78.

²⁰² Quoted by AGCNCO 2011, NBN Co, Investigation No. 14, Canberra, November, p.32.

Section 7. Pricing commitments in the SAU

KEY POINTS

- *There are two distinct pricing periods:*
 - *Initial pricing during build phase, where pricing should ensure smooth transition and take-up of services; and*
 - *Cost recovery after the build phases, enabling recovery of efficient cost incurred during build phase.*
- *The pricing regime is lacking appropriate oversight to ensure prices are, and will be, set at levels that promote the LTIE over the 27 years of the SAU.*
- *Initial pricing in the SAU is not suitable for anchor pricing because:*
 - *Proposed AVC/CVC price structure will result in higher prices over time as usage increases;*
 - *Some existing products will face higher prices for the same functionality than under legacy networks; and*
 - *Some new products are set at a level that prevents RSPs from using the service.*
- *Consultation with industry has been less than satisfactory and there are significant unresolved issues in relation to initial prices in the SAU.*

7.1 The effectiveness of the SAU to ensure future investments and future prices promote the LTIE over the full 27 year timeframe has been addressed in section 4. This section looks at:

- (a) the level of oversight afforded to the ACCC; and
- (b) the initial price structure and levels in the SAU.

7.2 Optus concludes that the pricing arrangements proposed in the SAU do not promote the LTIE because:

- (a) The pricing regime lacks appropriate independent oversight to ensure that prices are set, and continue to be set, at levels that promote the LTIE during the build and post-build phases.
- (b) The initial price structure and levels included in the SAU are not suitable anchors for current or future services. Further, proposed NBN pricing means that some existing products will face significantly higher prices for the same functionality than under legacy networks. This undermines the pricing objective during the initial build phase.
- (c) The individual price limit increase is inconsistent with the stated pricing intention on NBN Co, and may overtime lead to anchor prices that are not appropriate. This

potential problem is magnified by the inability of prices to be “re-set” if it is found to be inconsistent with the LTIE.

- (d) NBN Co has almost unfettered ability to set prices for new products of zero rated non-reference products at any level. This problem is enhanced during the ICRP, where NBN Co will face no revenue cap.
- (e) Little regard has been had to prices in the post-build phase that ensure total revenue reflects an efficient cost recovery profile. During the ICRP NBN Co is free to maximise revenue without regulatory interference. This may also lead to significant price shock during the transition from ICRP to the first year where the revenue cap applies. This may result in total revenue being reduced by around 30% in one year.

7.3 The SAU must be assessed against the criteria contained in the CCA — specifically that the SAU is in the LTIE²⁰³. The ACCC has stated:

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

- Goods and services at **lower prices**
- Goods and services of a high quality, and/or
- A greater diversity of goods and services.²⁰⁴ **[emphasis added]**

7.4 The Australian Competition Tribunal has expressed a similar view on the legislative criteria, having stated that:

*...the **interests of the end-users lie in obtaining lower prices** (than would otherwise be the case), increased quality of service and increased diversity and scope in product offerings...²⁰⁵ **[emphasis added]***

7.5 This has been recognised by the ACCC Chairman in a recent speech where it was highlighted that one of the main challenges the ACCC faces in the communications industry is its role in ensuring that the NBN arrangements work in ways that continue to promote robust competition in the sector:

A key issue will be ensuring there are strong incentives for the NBN to continue meeting customers massively increasing data needs, and at reasonable cost.²⁰⁶

7.6 The ACCC faces some challenges in managing this balance at the current time; and to ensure its approach is appropriate for the next 27 years:

²⁰³ CCA, s.152BCA.

²⁰⁴ ACCC, Telecommunications services – declaration provisions: a guide to the declaration provisions of Part XIC of the Trade Practices Act, July 1999, p.33.

²⁰⁵ *Seven Network Limited (No 4)* [2004] ACompT 11 at [120].

²⁰⁶ ACCC 2012, “Addressing the key drivers of electricity price increases” – Speech by Mr Rod Sims, Chairman, 24th October 2012.

- (a) First, the NBN is new infrastructure of significant scale and uncertain cost. The build phase is predicted to continue until 2021 and it is far from clear the level of efficient costs likely to be incurred, and the extent of any inefficient costs incurred.
 - (b) Second, the NBN will enable new technology and products to be delivered to end-users. It is difficult to predict the structure and level of prices to promote the LTIE. It is also difficult to anticipate the specific product design, and the pricing of each component.
 - (c) Third, the NBN is being deployed at a time of rapidly changing market demand and design of market products. It is difficult to anticipate what the BAO or EAO should be throughout Module 1. While broadband may be the focus of NBN Co now, it may develop that multicast and content delivery becomes the key revenue driver.
- 7.7 These unknowns indicate that the ACCC should be afforded flexibility as to how it can manage the competing interests of lower prices and adequate return to NBN Co. Flexibility is important given the differing pricing objectives that are likely during the build and post-build phases. Initially, efficient pricing may require prices to be anchored to existing services to as to encourage take-up and smooth transition from legacy products. However, after the build phase, prices will need to be set to ensure that total revenue reflects and efficient cost recovery path.
- 7.8 At the current time, there can be no certainty as to what the efficient price structure or level will be over the initial regulatory period, or throughout the full 27 years of the SAU. This is magnified by the fact that no party knows what the efficient cost of building the NBN will be.
- 7.9 The only statement that can be made with any degree of certainty is that a pricing regime that locks in pricing mechanisms for the initial regulatory period; and for the remaining period of the SAU, without adequate flexibility is not sufficient to promote the LTIE over the 27 year lifetime of the SAU.
- 7.10 In saying that, however, the efficiency of the starting price anchors in the SAU will influence whether future prices remain efficient and whether the LTIE is promoted now and overtime.

Appropriate oversight of prices

- 7.11 In developing its overarching pricing strategy, NBN Co states:

The pricing strategy should allow NBN Co to balance, over time, the competing needs of maintaining high rates of take-up of the NBN (through affordable AVC prices) with high rates of usage of the NBN (through affordable CVC prices). Striking an effective balance, and having the flexibility to adjust it dynamically is very important for NBN Co, Access Seekers and their End Users given the extent of the economies of scale and scope associated with the NBN and also the need to account for evolving technology, applications and demand over the 30 year term of the SAU.²⁰⁷

²⁰⁷ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.100.

7.12 Optus agrees that flexibility is required to ensure prices are appropriately set during and between the build phase and cost recovery phase of the NBN. However, flexibility is only afforded to NBN Co to change pricing: there is no flexibility afforded to ACCC. Recent history in the telecommunications industry demonstrates the potential downside to granting too much pricing flexibility to a monopoly supplier of services.

7.13 Optus also expresses serious concern with NBN Co's comment that:

In addition to its modularity, the revised SAU approach provides a greater role for incentive mechanisms than the original SAU. These mechanisms are intended to operate together so that over the 30 years of the SAU it is commercially rational for NBN Co to make prudent and efficient expenditure decisions (subject to meeting service level commitments) and to make economically efficient pricing decisions (subject to meeting a range of short term and long term price commitments).

Consistent with these incentives, NBN Co will have discretion to set initial prices for new products and ongoing prices for existing products (with no conferral powers on the ACCC to determine such prices), subject to compliance with SAU commitments.²⁰⁸

7.14 This essentially confers almost all pricing powers to NBN Co, thereby further entrenching its ability to extract monopoly rents. It is shown in the preceding sections that the provisions in the SAU designed to ensure efficient expenditure are inadequate. This cannot, therefore, be the sole justification for granting NBN Co exclusive discretion over how prices are set for initial and new products.

7.15 Optus' concerns, however, recognise that NBN Co has committed in its Corporate Plan to lower prices in both real and nominal terms.

*The 2012-15 Corporate Plan retains the assumption that **both CVC and AVC prices will fall over time in both real and nominal terms.** [However] NBN Co retains the flexibility to modify the rate at which future prices are decreased in the event that actual data usage and/or speed growth is higher or lower than assumed in the 2012-15 Corporate Plan.²⁰⁹ [emphasis added]*

7.16 While this assumption is welcomed, the SAU governs the operation of NBN Co for the next 27 years, which is well beyond the timeframe that any pricing aspirations in the 2012 Corporate Plan would reasonably be expected to apply. Further, this statement of intent for the reduction of CVC and AVC prices in both real and nominal terms has not been included in the SAU. As such, there is no binding commitment for NBN Co to reduce its wholesale access prices over time.

7.17 Optus submits that the ACCC should ensure that the pricing arrangements for the NBN be consistent with the following objectives:

²⁰⁸ NBN Co, Incentive Based Modular SAU: Design Principles, 20 June 2012, p.2.

²⁰⁹ NBN Co, Corporate Plan 2012-15, 6 August 2012, p.61.

- (a) Encourage efficient expenditure to provide the lowest sustainable cost of service, acknowledging that the overall revenue cap will not apply during Module 1;
- (b) Provide incentives for efficient tariff structures to encourage efficient utilisation of the network, ensuring that CVC pricing does not lead to negative outcomes;
- (c) Promote a sustainable, competitive and innovative retail telecommunications sector by keeping access prices low and encouraging retail innovation;
- (d) Provide sufficient price certainty to NBN Co to enable it to invest and manage its business;
- (e) Provide access seekers with sufficient certainty to invest and manage their respective businesses; and
- (f) Ensure that long-term prices beyond Module 1 are able to ensure that total revenue is set in a manner that promotes efficient recovery of costs incurred during the build phase of the NBN.

7.18 Optus acknowledges that this may not be possible to manage these competing objectives within the current structure of the SAU, given the proposed fixed principles in Module 0 and Module 2. As such, consideration should be given to alternative structures, for example, as discussed in section 2.

7.19 The remainder of this section assesses the structure and level of initial prices contained in the SAU. The proposed individual price increase limit and the initial pricing principles are discussed in section 4.

Concerns over the price structure

7.20 Optus remains concerned with the pricing for certain current access and variable components under the proposed price structure. As such, the views set out in its previous submissions regarding the two-part tariff structure largely remain unchanged.²¹⁰

7.21 A number of these key concerns are reiterated below:

- (a) The two-part tariff structure proposed by NBN Co requires re-examination. While Optus concedes that the AVC and CVC construct may not change, the initial price structures set for these component needs to be justified;
- (b) Competition in downstream markets is already constrained by consumer willingness to pay. As such, the linear pricing approach NBN Co has proposed for its fixed access component will likely stymie any hope of a rapid adoption of higher speed plans and take-up of data rich services and applications; and
- (c) The situation remains that there has been no consultation, or assessment conducted, on the methodology used to determine and set the initial prices. This

²¹⁰ Refer to Optus' March 2012 submission to the ACCC Supplementary Consultation on NBN Co's special access undertaking, Section 3 and Attachment 1.

means there has been insufficient information available to industry to assess the appropriateness of the price structures and initial prices.

7.22 First, Optus considers that the current proposed ratio of fixed to variable components needs to be re-balanced. As noted throughout this submission, the key objective for prices during the build phase of the NBN should be to encourage take-up and efficient use of the NBN. NBN Co should design its tariffs to encourage maximum take-up and usage of the network.

7.23 This is particularly relevant given NBN Co's acknowledgement that:

*Average Revenue Per User (ARPU) will initially be driven mostly by AVC revenue, but over time it will be driven to a greater degree by CVC revenue as usage of the NBN increases.*²¹¹

7.24 The ACCC has also previously acknowledged that different pricing structures can have different impacts on downstream markets.²¹² For example, the ACCC notes that a large fixed cost component may advantage larger access seekers since it can be spread over a larger customer base. Optus does not consider this to be a real risk in the context of the NBN. This is because a substantial proportion of access seekers' costs, regardless of their size, will largely be made up of the NBN access fee and therefore scale advantages may only have a limited impact on end-user prices and downstream competition.

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

7.26 The impact of high variable CVC pricing is shown in figure 3 — where the expected growth in customer usage is likely to result in a real price increase of 32% over the first 10 years of the SAU.

7.27 Irrespective of whether the CVC component of pricing seems reasonable today — given today's typical usage — the ACCC must be satisfied that the proposed pricing structure remains reasonable over the lifetime of the SAU. And specifically, whether reliance on CVC to contribute a larger proportion of ARPU over time is adequate given the lack of enforceable commitments to lower CVC pricing. As demonstrated by the pricing example in paragraphs 4.115 to 4.124, CVC will have a significant impact on total price, especially as data usage is predicted to grow at around 30% on a compound annual average.

²¹¹ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.100.

²¹² ACCC, NBN Co Limited Special Access Undertaking, Supplementary Consultation Paper, February 2012, p.40.

- 7.28 As indicated by industry, it is expected that data usage is likely to more than treble over the next few years. As such, industry expects CVC pricing to materially impact on the affordability of broadband packages within the next 5 years. The ACCC must ensure it has sufficient flexibility to ensure the structure of pricing does not impede on the development of the broadband market.
- 7.29 Second, broadband customers do not generally pay for data usage and certainly not in the linear manner proposed by NBN Co. In fact, intense competition for broadband customers has resulted in internet service providers (ISPs) increasing the data allowances with little or no change to the average prices paid for such services. Market Clarity has recently highlighted this fact when it noted that *“In general, ISPs have focussed on adjusting their plan allowances rather than their price points.”*²¹³ Yet, at the same time, *“NBN Co considers that willingness to pay for its higher speed and functionality services will grow over time (supported by new applications and patterns of use).”*²¹⁴
- 7.30 To this extent, Optus again notes that NBN Co has put forward no evidence to suggest that customers will be willing to pay the levels of premium over current broadband access prices implied in NBN Co’s wholesale access pricing plans. The reality is that broadband will have to compete for share of wallet with many other services. There is no evidence before the ACCC that the proposed price structure will promote the pricing objectives during the build phase: to promote take-up, usage and ensure smooth transition from legacy products. In the absence of such evidence, NBN Co has not discharged its affirmative burden to satisfy the ACCC that the pricing in the SAU is reasonable and promotes the LTIE.
- 7.31 Finally, although there is no cost model to assess the proportion of NBN Co’s variable costs, it would be expected that the additional cost to serve customers on higher speed tiers or for incremental data would be very low.²¹⁵ It is therefore important to strike an appropriate balance between these factors. In the context of pricing during the build phase, it would be in the interest of consumers and NBN Co — and therefore most likely promote the LTIE — if end-users were encouraged to embrace the high-speed potential of the NBN.

Concerns over the initial price levels

- 7.32 NBN Co has included a larger suite of initial prices in Module 1 of the revised SAU, in the form of both reference and non-reference offers.²¹⁶ Optus notes that with the explicit exception of the Basic Access Offer, which is specified in a summary of the NBN Definitive Agreements with

²¹³ Market Clarity, Broadband download behaviour in Australia: The disconnect between allowance and usage, January 2011.

²¹⁴ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.100.

²¹⁵ As a result, a low variable charge may encourage customers to use more (and faster) data with little cost impact on NBN Co. However, a very high fixed component associated with a very low variable component may discourage the take-up and retention of customers.

²¹⁶ The key difference being that reference offers will be subject to continued loose ‘regulatory oversight’ in the context that it cannot be withdrawn over the entire duration of the module and that its prices remain frozen in effect for the first five years of the SAU then similar to non-reference offers will be subject to the designated price controls.

Telstra to be \$24 per month (inclusive of the 12/1Mbps AVC_TC4 and UNI)²¹⁷, all other prices have been determined at NBN Co's discretion.

- 7.33 The prices for the various components of the NBN Access Service have also since been widely published in the NBN Co Corporate Plan, as well as other NBN Co documentation such as its Product and Pricing Papers; however the information in support of the prices starting at those levels remains limited or non-existent. To this extent, NBN Co's justification in support of its initial prices for their entry-level products²¹⁸ are as follows:
- (a) NBN Co has an incentive to promote take-up and competition in downstream markets. Because NBN Co is not vertically operated, it has the incentive to price new products in such a manner as to develop the new market;
 - (b) NBN Co has an incentive to ensure non-disruptive transition from legacy networks to NBN. Given NBN Co's wholesale-only status, it is therefore in its interest to ensure that RSPs are able to price NBN services in a manner consistent with existing services;
 - (c) NBN Co claims that the initial prices have been subject to widespread consultation and it is unaware of any remaining complaints from industry; and
 - (d) NBN Co notes the ACCC's acknowledgement of its initial prices in the form of its LBAS FAD.²¹⁹
- 7.34 The initial prices put forward by NBN Co in the SAU clearly are not cost-based. This is appropriate at this stage of network deployment. It is accepted that during the build phase, the objective of NBN pricing should not be efficient cost recovery but rather promotion of usage and take-up. NBN Co recognises this by stating that it has an incentive to price products in this manner (including ensuring smooth transition from legacy technology).
- 7.35 However, such incentive only holds during the build phase (Module 1). Upon entering the cost recovery phase (which would be covered by Module 2 and Replacement Modules), the priority for setting prices should be to ensure efficient cost recovery profile. There is a risk that establishing one set of pricing principles for a 27 year period to cover both phases could result in inefficient pricing over time. As noted above, there is a lack of flexibility to amend these prices absent NBN Co's express willingness. This inflexibility ensures that the pricing will promote NBN Co's interests and not necessarily the LTIE.
- 7.36 Notwithstanding temporal concerns, Optus highlights that the current pricing proposals do not meet NBN Co's stated objectives. The current prices proposed in the SAU may not encourage new products and revenue streams; may not ensure smooth transition to NBN; and have not been set in a manner consistent with industry feedback.

²¹⁷ Telstra, "Telstra signs NBN Definitive Agreements", Media Release, 23 June 2011.

²¹⁸ For instance, Schedule 1C sets out the full suite of reference offers including the Basic Access Offer (12/1Mbps AVC_TC4), the Enhanced Access Offer (25/5Mbps AVC_TC4) and the Standard Business Offer (25/10Mbps AVC_TC4); while Schedule 1D set outs all other included non-reference offers.

²¹⁹ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, section 6.6.

- 7.37 The justification put forward by NBN Co therefore does not hold. In addition, NBN Co has not provided any evidence that its proposed pricing is consistent with legacy products, or that it will promote the LTIE. Absent such evidence, NBN Co has not affirmatively discharged its burden to satisfy the ACCC that the terms of the SAU are reasonable.
- 7.38 To this end, Optus' outlines its concerns below with regards to:
- (a) Failure of proposed prices to encourage new products and revenue streams; and
 - (b) Failure of proposed prices to ensure a smooth transition from legacy products.

Encouraging new products and revenue streams

- 7.39 First, in relation to setting initial prices based on balancing the incentives faced by stakeholders, Optus considers the price levels proposed by NBN Co fail to meet the objective of meeting the shared incentives of Customers and NBN Co, let alone the individual incentives of any party other than NBN Co itself.
- 7.40 For example, industry and NBN Co have shared incentives to both develop new revenue streams based on NBN products for downstream markets, whilst encouraging take-up and increased utilisation to make use of these new capabilities.²²⁰ In contrast, and in relation to individual incentives, NBN Co considers that *"due to its wholesale only status, NBN Co has no competing retail interest that may distort its incentives in setting wholesale access prices."*²²¹
- 7.41 It follows that in taking both the shared and individual incentives outlined above NBN Co has tended towards using its own incentive to justify the reasonableness of all initial prices proposed. The fact that NBN Co will operate under a wholesale-only status does not provide sufficient justification that it will always set efficient wholesale access prices. Reliance on the willingness of a monopoly provider to set efficient prices is unlikely to promote the LTIE.
- 7.42 Notwithstanding the risks associated with relying solely on a monopoly provider to set efficient prices over time, it is clear that NBN Co is currently proposing pricing for new products that is inconsistent with its stated intentions. For example, in relation to multicast service — a service that should open new revenue for NBN Co and for which it should be interested in promoting — proposed pricing demonstrates that NBN Co is not pricing in a manner that promotes the take-up of the service.

The ability to develop multicast products and market

- 7.43 NBN Co has priced multicast as a premium product. NBN Co has recognised there is a subscriber threshold under which multicasting makes no commercial sense. Before RSPs are able to justify use of NBN Co's multicast product they must have a critical mass of subscribers. The key concern for RSPs is what that critical mass is and what content is needed to achieve it. This equation is further complicated by the wholesale price point at which NBN Co has decided to price its multicast product.

²²⁰ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.110.

²²¹ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.110.

- 7.44 [CiC]
- 7.45 [CiC]
- 7.46 [CiC]
- 7.47 The multicast product will only grow in the short to medium term if NBN Co adopts a pricing construct that is consistent with the low retail ARPU that non-premium content can attract in the Australian market.
- 7.48 In addition to the price, the non-price conditions make it more difficult to successfully supply the NBN multicast product. NBN Co has required that multicast and broadband be provided by the same RSP. That is, there can be no over-the-top multicasting through the NBN. NBN Co states that this is not solely due to technical reasons:
- It will not be possible for an End User to acquire a Multicast product from one Service Provider that is supported by a Fibre Access Service by another Service provider. While this limitation exists primarily due to technical constraints, it also enables Service Providers to retain full control over the operation and reliability of the Multicast product, as well as facilitating a simplified fault management process.²²²*
- 7.49 This restriction on the retail market is likely to have a substantial reduction in competition in the downstream bundled market. Importantly, NBN Co's self-imposed restriction on competition locks in the monopoly supplier of premium content (FOXTEL) to just one internet provider (RSP). Or at best, RSPs with which the monopoly premium content supplier decides to negotiate.
- 7.50 Importantly, this self-imposed rule removes end-users choice for access premium content. If end-users want access to key premium live sports (AFL, NRL, cricket, EPL, A-League) end-users must have a subscription with FOXTEL. If end-users also want an internet connection, they must choose an RSP to which FOXTEL provides wholesale services.
- 7.51 It appears that NBN Co has *voluntarily chosen* to restrict competition in the downstream retail market by requiring bitstream AVC and MAVC be provided by the same provider. The development of the multicast service in this manner is evidence that the claim NBN Co has the same interest as end-users is not correct.
- 7.52 It should be in NBN Co's interest to promote uptake of multicasting by as many RSPs as possible so as to maximise multicasting wholesale revenue through NBN. In the future world of triple-play bundles, availability of premium content will be a key to RSP profitability. Thus, it is foreseeable that the demand for provision of IPTV (either OTT via bitstream service, or through dedicated multicast product) by RSPs will grow — so long as access to content and the cost of multicasting is reasonable.

²²² NBN Co, 2012, *NBN Co Fibre Access Service Multicast*, p.5.

Smooth transition from legacy products

- 7.53 Second, the access prices levied by NBN Co will be a critical factor influencing consumer take-up and demand for services on the NBN. Crucially, the initial price structures are likely to have a longstanding influence on future prices and price structures. It is therefore imperative that careful consideration is given to initial prices and price structures to ensure a non-disruptive transition from legacy networks to the NBN.
- 7.54 Optus submits that a key objective during the build phase is to promote efficient and smooth transition from legacy products to NBN products. The ACCC takes a similar view:

The initial prices for NBN Co's entry-level products have been set with reference to legacy wholesale prices.²²³

- 7.55 However, that the same issues outlined above (and the lack of evidentiary proof that such claims are or will hold true) continue to counter the relevance of NBN Co's entry level prices in the context of a dynamic market environment. Specifically, the current reference offers in the SAU are unsuitable for businesses; and would significantly increase the cost for small businesses.
- 7.56 [CIC]

Standard Business Offer

- 7.57 A range of business products have recently been announced by NBN Co. This section summarises the key findings in regards to:
- (a) Relationship between NBN prices and retail business case;
 - (b) Response of NBN Co to the reaction of industry; and
- 7.58 An assessment of the features of the standard business product, NBN Co's reaction to customer feedback, and likely impact on the development of downstream markets, shows that NBN Co's claim that it is naturally incentivised to set wholesale prices and conditions at a level to promote downstream markets is not correct.
- 7.59 This can be seen by comparing the cost to supply a standard business internet connection with committed information rate of 2Mbps.
- 7.60 The standard business offer (SBO) in the SAU includes the following components:
- (a) AVC with 25Mbps TC-4 downlink and 10Mbps TC-4 uplink; and
 - (b) Symmetric 500kbps TC-1 CIR link.
- 7.61 The SBO is a reference offer and is costed at \$53 per month, and will remain at that level until 2017. The SBO contains sufficient TC-1 bandwidth to allow 4 lines.²²⁴ Thus, it is possible to combine basic internet access with a basic number of phone lines.

²²³ ACCC, NBN Co Limited 2012 Special Access Undertaking, Consultation Paper, November 2012, p.46.

- 7.62 Optus notes however, that the provision of best-efforts bitstream (TC-4 AVC) is not sufficient to supply business grade services. Current business services contain a committed minimum bitstream rate. In order for this to occur, Optus would need to acquire additional symmetric AVCs with CIR. The options under the SAU are to purchase an additional:
- (a) TC-1 AVC with symmetrical 2Mbps CIR for \$132 per SIO per month; or
 - (b) TC-2 AVC with symmetrical 5Mbps CIR for \$32 per SIO per month.
- 7.63 These products are non-reference offers and subject to the CPI-1.5% individual price increase limit. The TC-2 product is not planned to be introduced until the second half of 2013, therefore to replicate the service requires the use of the TC-1 product.
- 7.64 In addition, Optus would need to acquire upgraded standard service levels in order to provide the same level of service provided under existing business products. Optus would need to acquire the enhanced 12 SLA pack for an additional \$15 a month per SIO.²²⁵ This fee is also subject to the yearly price increase limit of CPI-1.5%.
- 7.65 Finally, Optus would need to acquire sufficient CVC capacity to ensure a continuous level of throughput consistent with the level of CIR. So, for a 5Mbps CIR, a CVC of 5Mbps at business grade contention is required. In addition sufficient CVC is required to ensure the TC-1 voice service, without contention.
- 7.66 The combination of these product elements are shown below. There are two distinct prices: prices before the TC-2 AVC product is introduced (flagged to be second half 2013 in the Initial Product Roadmap); and prices after TC-2 is introduced.

TABLE 1 STANDARD BUSINESS PRODUCT

Product Component (now)	Price	Product Component (H2 2013)	Price
AVC 25/10 TC-4		AVC 25/10 TC-4	
500kbps TC-1 CIR	\$ 53	500kbps TC-1 CIR	\$ 53
AVC 2/2 TC-1 CIR	\$ 132	AVC 5/5 TC-2 CIR	\$ 32
CVC 2Mbps @ 4:1 contention	\$ 10	CVC 2Mbps @ 4:1 contention	\$ 10
CVC 500kbps @ 1:1 contention	\$ 10	CVC 500kbps @ 1:1 contention	\$ 10
Enhanced-12 SLA	\$ 15	Enhanced-12 SLA	\$ 15
Total per SIO per month	\$ 220	Total per SIO per month	\$ 120

- 7.67 The total cost of providing a business-grade internet connection with a 2Mbps CIR using Optus Ethernet over Business grade DSL (EoBDSL) and using NBN (cost outlined above) end-to-end is compared below. This includes all additional costs required to provide the service. The EoBDSL

²²⁴ SBO includes 500Kbps of TC-1, with each line requiring 110Kbps, as per ITU standard G.711.

²²⁵ Clause 1D.3.2 Other Charges.

product will be directly replaced with the NBN service. It is therefore, a relevant service to compare the claim that the proposed NBN service promotes smooth transition from legacy products.

7.68 [CiC]

7.69 [CiC]

7.70 It is clear from this that the current product components needed to replicate existing business-grade services will result in higher prices for internet access. This is inconsistent with the claim made by NBN Co that it is pricing existing services to promote smooth transition from legacy products.

Multiple business phone line solutions

7.71 In addition to the SBO, there are a range of other business products currently in the market which appear inconsistent with the pricing put forward by NBN Co. The most common is the multiple phone line solution — the traditional PABX-type business product. [CiC]

7.72 Optus notes that the SBO product in the SAU contains sufficient TC-1 bandwidth to allow 4 lines.²²⁶ Thus, it is possible to combine basic internet access with a basic number of phone lines.²²⁷ However, many businesses require more than 4 lines. No other reference or non-reference offer contains sufficient included TC-1 capacity to allow for greater than 4 phone lines. As such, the analysis below is on top of the business-grade internet service adopted. For consistency, the NBN prices are compared to the Optus Evolve Voice service, which provides for a multiple phone line solution. This NBN price does not include internet access (i.e. the AVC needed for bitstream access).

7.73 [CiC]

7.74 [CiC]

7.75 In conclusion, a business would incur significantly greater costs under NBN Co to maintain multiple phone lines, at the same level of service that is available in the market now. Optus submits that the claim by NBN Co that its pricing is consistent with existing products in the market is not correct. There is direct evidence to counter the assumption by the ACCC that *“The initial prices for NBN Co’s entry-level products have been set with reference to legacy wholesale prices.”*²²⁸

7.76 Consequently, serious doubts exist whether the pricing structure and levels proposed in the SAU are consistent with the LTIE. Furthermore, NBN Co has not provided any additional evidence to support the claim that proposed pricing in the SAU is reasonable and meets the statutory criteria.

²²⁶ SBO includes 500Kbps of TC-1, with each line requiring 110Kbps, as per ITU standard G.711.

²²⁷ Noting the above discussion that the SBO is not sufficient for business-grade internet service.

²²⁸ ACCC, NBN Co Limited 2012 Special Access Undertaking, Consultation Paper, November 2012, p.46.

Consultation with industry has not been adequate

- 7.77 Third, NBN Co has claimed that that the proposed prices have been subject to comprehensive consultation with industry stakeholders, and as such was well informed that the initial prices it has published were set at an appropriate level.²²⁹
- 7.78 In the Supporting Submission, NBN Co justify the level of initial prices based on extensive consultation with its customers and that NBN Co has remained open to considering changes. NBN Co, in effect, argue that effective consultation with industry has resulted in it pricing in a manner consistent with market needs.
- 7.79 NBN Co submits that:
- (a) The initial prices set out in the revised SAU are the result of an extended process of consultation with Customers.
 - (b) A number of issues have been raised by Access Seekers, and NBN Co has been responsive in working to resolve these, for example by:
 - (i) Introducing the CVC transitional rebate to address concerns about CVC affordability while the NBN is still being built out in respect of a particular CSA; and
 - (ii) Developing a new entry-level Multicast AVC speed tier, to smooth the transition of IPTV services from legacy networks to the NBN.
 - (c) At the current time, from NBN Co's perspective there are no significant unresolved issues in relation to the initial prices in the SAU.²³⁰
- 7.80 Optus submits, however, that despite some consultation on proposed prices having had taken place, this process was neither adequate nor robust in the industry's recollection of the consultation experience.
- 7.81 For example, NBN Co's consultation held in relation to its initial Product and Pricing Paper (version 1, published December 2010) essentially led to an outcome that reflected almost no change, let alone any substantial change, in the final Product and Pricing Paper (version 2, published December 2011). This is despite numerous industry submissions on the pricing matters set out in the Product and Pricing Paper that identified consistent sentiments and concerns with the pricing structures and arrangements being proposed (e.g. the two part tariff structure and initial prices being set too high).
- 7.82 Although an opportunity and forum was provided to raise concerns, the consultation process remained one-sided because there was no feedback provided in the form of a final decision or supporting document outlining how NBN Co even took into account the comments provided by industry. This lack of transparency therefore entrenches industry scepticism and lack of comfort in the pricing policies being pursued by NBN Co.

²²⁹ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.110.

²³⁰ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.110.

- 7.83 In addition, Optus has raised several concerns regarding the approach taken by NBN Co to business pricing. It was highlighted that NBN Co's linear approach to bandwidth was inconsistent with current pricing and results in pricing that is significantly out of line with current market rates. NBN Co did not respond to these claims, and there has been no change to the prices.
- 7.84 The claim made that prices set in the SAU are such that "*there are no significant unresolved issues in relation to the initial prices in the SAU*"²³¹ is false, and no weight should be placed upon such claims.

Reference to LBAS FAD

- 7.85 Finally, NBN Co also goes on to cite that:

*... in addition to apparent Customer acceptance of NBN Co's initial pricing, the ACCC has also seen fit to use the price of NBN Co's 25/5 Mbps AVC (TC-4) service to set the ceiling price for the Local Bitstream Access Service in its July 2012 Interim Access Determination, and that the ACCC intends to base the Final Access Determination for that service on NBN Co's prices once NBN Co has an approved SAU in place.*²³²

- 7.86 However, Optus considers the above observation to be a loose comment, with the intent underpinning the perception attributable to 'Customer acceptance of NBN Co's initial pricing' and ACCC intention to set LBAS prices based on NBN Co's prices to be overstated. Further, NBN Co fail to reference that the ACCC reserves the right to alter the LBAS rate should it differ from the NBN Co product:

*The ACCC continues to consider NBN Co regulated pricing. The ACCC is able to vary the LBAS FAD at a later stage if further consultation is needed in light of NBN Co regulated pricing.*²³³

- 7.87 It would appear to be a rather circular argument to say that ACCC has provided any implicit approval of NBN pricing given that the LBAS FAD states that should the ACCC set different regulated pricing for NBN, the LBAS rate may also change. The ACCC has decided to 'peg' the LBAS rate to NBN Co's equivalent charge because of market dynamics. It does not provide any support to the notion that NBN Co's charge meets the LTIE.
- 7.88 In addition, it is unclear to what extent 'Customer acceptance' can be substantiated, given that the only mechanism through which this may be inferred is the signing of the interim WBA, and this in itself represents a highly sensitive issue. Despite numerous iterations and various amendments to the draft WBA, since the release of the initial WBA consultation in May 2011, the interim WBA was ultimately signed by most ISPs in early 2012.

²³¹ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.110 and p.111.

²³² NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.111.

²³³ ACCC, Local bitstream access service, Final access determination, Explanatory statement, October 2012, p.4.

- 7.89 As at 30 June 2012, NBN Co noted that *“41 retail service providers, representing about 94% of the retail market, had signed a WBA with NBN Co, providing a positive sign for the future of retail-based competition.”*²³⁴
- 7.90 Nevertheless, this form of ‘Customer acceptance’ should not be readily received as unanimous acceptance of all price and non-price terms set out in the WBA, particularly given that the counterfactual or consequence of not signing the WBA would have meant an inability to access NBN services altogether.
- 7.91 Therefore despite general discontent with the pricing structure and initial prices for the NBN product components, the threat of being effectively ‘locked-out’ and unable to access this future technology was viewed to be of greater consequence.

²³⁴ NBN Co 2012 Annual Report, p.19.

Section 8. Product development and withdrawal

KEY POINTS

- *The efficacy and efficiency of the PDF processes are undermined by explicit carve out of any regulatory recourse or dispute resolution mechanism for access seekers in the likely event of a Product Idea being rejected with little or no feedback, or where confidentiality or IP provisions have been breached.*
- *The effect of clause 113.3 is that any decision by NBN Co regarding consideration of Product Ideas is virtually impossible to challenge given the breadth of the discretion allowed to NBN Co.*
- *The exclusion of all the products on the initial product roadmap from the PDF process is insufficient to ensure access seeker certainty that the product will be developed or released.*
- *The Initial Product Roadmap and Integrated Industry Roadmap also fail to dispel concerns surrounding the lack of detail for each of the key product attributes, allowing discretion for NBN Co to specify a sub-standard service (i.e. lower SLA) that will subsequently be supplied.*
- Any product that has not been fully developed at the SAU Commencement should be subject to all other product development commitments, including regulatory oversight over all price and non-price provisions before introduction into the market.
- *The Minor Product Variation threshold is too high, largely given that NBN Co is not in a position to determine the ‘material impact on Customers’. As such, any change however minor should be consulted upon and receive consent from Customers from which it may directly impact.*

- 8.1 The SAU establishes a framework for NBN Co to engage with its customers to develop new products, as well as vary or withdraw existing products. As such, Schedules 1I and 2E set out the general principles framework underpinning NBN Co’s product development and withdrawal processes.
- 8.2 The operation of Schedule 1I and 2E, however, differ in a number of ways.
- 8.3 First, the SAU commitments in Module 1 regarding product development and withdrawal will be subject to the midpoint review. The adequacy of the midpoint review is discussed in more detail in section 3.
- 8.4 Second, the PDF Processes are detailed in Module 1 and any ACCC decision following the midpoint review will only be considered ‘binding’ for the remainder of the initial regulatory period. This means that even though the Module 2 commitments are inferred to largely ‘mirror’ the commitments set out in Module 1, there is no mechanism that allows the pull-through of any ACCC decision on the PDF Processes into subsequent regulatory periods. As NBN Co notes, the SAU will set out:

*The requirement to have a PDF, although in contrast to Module 1, no detailed commitments are made in relation to PDF Processes. NBN Co considers that details pertaining to product development processes may appropriately be dealt by a Replacement Module taking into account the effectiveness of the processes during Module 1.*²³⁵

8.5 It follows that the lack of opportunity to review the commitments set out in Module 2 further entrenches access seeker concerns. This is magnified given that the Replacement Module process does not require a PDF Process Proposal to be submitted and given that this is outlined in Module 0, this is also outside the scope of any review process.

8.6 Third, while it is NBN Co's position that *all* terms and conditions in the SAU are terms and conditions in relation to section 152CBA(3A) of the CCA therefore should be assessed by the ACCC pursuant to the criteria set out in section 152CBD(2)(b) of the CCA. It also concedes that:

... it is possible that the ACCC may adopt an alternative view that some or all of the conduct specified in Schedule 1I (Product Development and Withdrawal) may only fall within 'specified conduct' under section 152CBA(3C) of the CCA.

*If the ACCC were to adopt such a view of any part of Schedule 1I of the SAU, NBN Co considers that in accordance with section 152CBD(2)(cb) of the CCA the specified conduct in Schedule 1I will promote the long-term interests of end-users (LTIE) for the reasons set out in section 10.3 of the Supporting Submission.*²³⁶

8.7 While in principle NBN Co commits to establishing a commitment to engage in consultation with its customers to develop new products, and vary or withdraw its existing products, this is essentially contravened by virtue of the fact that the entire consultation process is only available to customers, and not access seekers²³⁷, and is subject to further process limitations at NBN Co's discretion.²³⁸ For instance:

- (a) Transparent access to information needs to be strengthened. For example, while the PDF will provide the relevant forum through which Product Ideas are developed, refined and disseminated, there is nothing in the SAU that requires NBN Co to publish the outcome of any Assessment of Product Ideas (irrespective of whether the Product Ideas develop through to the PDF Processes or not).
- (b) The PDF process is a closed forum, such that all participants must agree to the terms and conditions underpinning the membership of the PDF. Notably, this entrenches the Schedule 1I, Annexure 1, clause 12 commitments that Dispute resolution procedures do not apply to the PDF.

²³⁵ NBN Co, Supporting submission – NBN Co Special Access Undertaking, 28 September 2012, p.95.

²³⁶ NBN Co, Letter to the ACCC on NBN Co Special Access Undertaking (SAU) – request for clarification, 1 November 2012, p.1.

²³⁷ Access seekers may be allowed to participate in the PDF Process subject to NBN Co's discretion, as such remains clouded with the air of uncertainty.

²³⁸ NBN Co, Supporting submission – NBN Co Special Access Undertaking, 28 September 2012, pp.182-3.

- (c) Even if a new product is introduced, there remains no regulatory oversight over the introduction of the associated price that is applied, other than the unenforceable IPP commitments set out in the SAU.
- 8.8 Finally, the SAU explicitly carves out a number of exceptions to the product development and withdrawal commitments. These include any development, variation or withdrawal of products which the required change:
- (a) Has been covered by, or contemplated within, the Initial Product Roadmap;
 - (b) That NBN Co is obliged to introduce and/or offer as a result of a licence condition imposed under section 41(1) of the NBN Companies Act;
 - (c) Is in relation to a minor variation or enhancement (which NBN Co itself determines will have 'no material adverse impact on Customers'); or
 - (d) That NBN Co is required to withdraw as required by law or directed by Shareholder Ministers.
- 8.9 Optus submits, however, that none of these exceptions should be allowed. This becomes a concern where it has been only been allowed under the discretion of NBN Co with no external input from industry or access seekers to whom these commitment may directly or indirectly impact.
- 8.10 The remainder of this section discusses each of the issues underpinning the product development principles, including role of the PDF Process; the product withdrawal principles; and the products exempted from any of the aforementioned product development and withdrawal commitments, including the role of the Initial Product Roadmap.

Product development requirements

- 8.11 NBN Co sets out its product development principles at clauses 1I.1.2 and 2E.1.2. In summary, the general principles stipulated by NBN Co include:
- (a) A commitment to *“developing Products that Customers want, that have sufficient demand to be commercially viable and from which Customers have value”*;
 - (b) An obligation to meet the ‘permitted scope of its activities’ as communicated under Australian Government policy, the CCA and the NBN Companies Act; and
 - (c) An encouragement to *“Customer participation in the design of Products, and facilitate Customer engagement and participation in relation to Product Ideas”* to fulfil the commitments outlined above.
- 8.12 Underpinning these principles is a key commitment which requires that *“NBN Co must implement a PDF to engage with customers on the development or withdrawal of products. The PDF must identify and record all product ideas from customers, be the primary forum for the development of product ideas, facilitate discussion and allow feedback from customers.”*²³⁹

²³⁹ ACCC, NBN Co Limited 2012 Special Access Undertaking, Consultation Paper, November 2012, p.41.

As such, the SAU sets out at Schedule 1I: Annexure 1 the framework for the aforementioned PDF Processes.

PDF processes

- 8.13 The PDF Processes govern the framework within which the PDF will operate. It sets principles for participation; submission of a Product Idea; treatment of confidential information and IPR; NBN Co's assessment of a Product Idea; and communication with customers. However, an important area of concern is the explicit carve out of any regulatory recourse or dispute resolution mechanism for access seekers to employ in the likely event of a Product Idea being rejected with little or no feedback, or where confidentiality or IP provisions have been breached (either unintentionally or otherwise).
- 8.14 For example, the overarching PDF principles may in time prove problematic. For instance, clause 1I.3.2 essentially entrenches the PDF Processes described in Annexure 1 as a fixed principle for the duration of Module 1. However, these same prescriptive PDF Processes may not necessarily be applied to the same extent in subsequent Regulatory Periods (i.e. though not a core criterion, it is possible that the PDF Processes may be modified as part of any Replacement Module Application²⁴⁰).
- 8.15 Optus similarly expresses a number of concerns with the proposed framework including:
- (a) NBN Co has the ability to suspend or change the priority of the assessment and development of a Product Idea. There needs to be an ability to review this prioritisation to encourage Customers to participate in the PDF. This requires NBN Co to be transparent in its decision making process;
 - (b) Ceasing assessment and/or rejection of Product Idea needs to be justified based on LTIE and not in NBN Co's absolute discretion. ACCC needs to have the right to have any decision reviewed when a Customer raises an appeal to a Rejection Notice; and
 - (c) Clause 6.6 should be deleted as a failure to identify Customer IPRs should not result in a Customer granting an unconditional and irrevocable waiver of all rights to bring any claim against NBN Co or any related entity to infringement of the rights adhering in Customer IPRs.
- 8.16 Many of Optus' concerns arise from NBN Co's absolute discretion over the operation, facilitation and assessment of Product Ideas in the PDF, which places NBN Co in a significant position of power to gather confidential information, as well as explore and assess Customer Product Ideas.
- 8.17 First, despite the onerous requirements placed on access seekers to even provide a Product Idea for consideration²⁴¹ the same level of feedback is not required of NBN Co in its feedback of the Product Idea to the Submitting Customer. For example, NBN Co alone maintains the discretion to determine the progression of any Product Idea (with no consultation with

²⁴⁰ Refer to Main Body, clause 4.6(b)(v).

²⁴¹ Schedule 1I, Annexure 1, clause 4.1.

industry or other PDF members, where appropriate), thus failing to facilitate the open transparent dialogue that the PDF seeks to achieve.²⁴²

8.18 This lack of transparency appears contrary to NBN Co's submission which notes that:

*NBN Co must communicate with Customers on a non-discriminatory and transparent basis about NBN Co's activities and decisions at each key point of product development and variation. **This transparency empowers Customers to ensure that each Product Idea is judged on its merits and is accorded development resources that are commensurate with the potential value of the Product Idea to NBN Co and to Customers.***²⁴³ [emphasis added]

8.19 Optus emphasises that the efficient operation of terms and conditions within the SAU should not be dependent on the level of good will between NBN Co and industry. It is foreseeable that over the 27 year lifetime of the SAU, such good will cannot be guaranteed.

8.20 Second, while the PDF Processes criteria for assessment confers that NBN Co will assess Product Ideas in accordance with Schedule 11, nothing in that Schedule 11 (in either clauses 11.1.2 or 11.3.3) requires NBN Co to provide feedback (endorsement or otherwise) on the Product Idea with respect to each of the general principles it has set as part of its assessment criteria, nor is it required to be justified based on the LTIE criteria.

8.21 That said, the only requirement of NBN Co in the form of feedback set out in the SAU is in relation to the Rejection of a Product Idea whereby *"if NBN Co decides in its absolute discretion not to develop the Product Idea, it will publish a notice to that effect to the Product Development Forum (a **Rejection Notice**) giving specific reasons for NBN Co deciding not to develop the Product Idea."*²⁴⁴

8.22 Following the publication of this Rejection Notice, it is therefore assumed that the Product Idea will cease to exist and given the explicit carve out of the 'dispute resolution mechanism' in the PDF Processes, there is no right of appeal provided to access seekers to seek a review of the decision made under NBN Co's absolute discretion. This is not reasonable, particularly given that many of the assessment criteria are in fact 'subjective' and may be outside the scope of NBN Co's ability to make a reasonable assessment, e.g. where it may relate to the potential value for a Product Idea over a longer time horizon.

8.23 Finally, Optus notes that there should be greater alignment between the confidentiality and IPR provisions set out in both the PDF Processes and non-price terms and conditions.

8.24 Optus also acknowledges that the confidentiality terms set out in the PDF Processes should also be tighter than the general confidentiality terms set out in the WBA, and is justified given the more sensitive nature of the information being provided. In this context, while clause 5.1

²⁴² This is highlighted by the fact that *"NBN Co may at any time suspend or change the priority of the assessment and development of a Product Idea"* (Schedule 11, Annexure 1, clause 4.2(b)). Consequently, there may be a significant delay in the proposed timing for consideration of a Product Idea.

²⁴³ NBN Co, Supporting submission – NBN Co Special Access Undertaking, 28 September 2012, p.91.

²⁴⁴ Schedule 11, Annexure 1, clause 7.6.

in the PDF Processes places the onus on the access seeker to specifically identify all ‘information’ to be treated as confidential in the PDF Process, the consequence is such that if any ‘confidential information’ is not defined in this way (i.e. in writing at the time the information is initially disclosed), then that information will not fall within the definition of “Customer Confidential Information”.

- 8.25 Secondary to this, Optus has also previously queried whether all of NBN Co’s rights to disclosure in this context are necessary and appropriate (e.g. query why NBN Co would or should need to disclose PDF-related confidential information to its financial advisors or even to government ministers, department and their delegates). That aside, given the potential commercial sensitivity of the information being disclosed, access seekers should also be afforded the opportunity to request that NBN Co should be required to notify the particular Customer of any disclosure of its PDF-related confidential information under clauses 5.5 and 5.4 in the PDF Processes.
- 8.26 Similarly, failure to identify Customer IPR should not immediately confer the conclusion of a Customer granting an unconditional and irrevocable waiver of all rights to bring any claim against NBN Co or any related entity to infringement of the rights adhering in Customer IPRs.
- 8.27 More specifically, with respect to IPR in the PDF Processes:
- (a) Optus is concerned by the inclusion of clauses 6.2 and 6.6. Clause 6.2 requires a customer to identify “exactly” the Materials provided to NBN in which it claims intellectual property rights. If the customer does not identify material in this way, the customer cannot restrict how NBN may use that material, and loses its rights to bring any claim against NBN in relation to NBN’s use of the material. Optus notes that these provisions were previously included in the main intellectual property provisions in a draft of the WBA, and NBN Co deleted those provisions (and replaced them with a more practical and Customer-friendly regime), following customer feedback.
 - (b) The same comment applies to clauses 6.5(c) and (d) in relation to third party intellectual property rights. NBN again removed equivalent provisions from a previous draft of the WBA following customer feedback. Optus therefore requests that these provisions also be removed from these PDF provisions.

Product withdrawal requirements

- 8.28 NBN Co sets out its product withdrawal principles at clauses 11.5 and 2E.6.
- 8.29 In principle, it is well stated that by virtue of being a Reference Offer, NBN Co will be unable to withdraw that product or its associated product components and features during any period in which it maintains this status (Clauses 1C.1.2(a) and 2B.1.2(b)).
- 8.30 This prohibition commitment is also explicitly stated at 2E.6.1, where:
- NBN Co will not withdraw the Reference Offers, during their relevant terms.*
- 8.31 Optus is concerned however over the caveat imposed at 1C.1.2(b) and 2B.1.2(e) which negates the Reference Offer commitment by stating that it “does not apply to the withdrawal of a

Reference Offer that NBN Co is required by law or a Shareholder Minister to withdraw or which NBN Co is prohibited from providing under section 41(3) of the NBN Companies Act." As such, it should be a requirement that in the event that the above is exercised, this should be accompanied by a detailed justification and reasonable notification period before such time that the product can be withdrawn.

8.32 It therefore follows that the product withdrawal requirements at 11.5 and 2E.6, primarily in the form of notification period requirements will only apply to Non-Reference Offers. These notification periods are summarised below:

- (a) The notification or intent to withdraw a Product, Product Component, Ancillary Service or type of Facilities Access Service is 24-months (however an exception of 6-month notice if the withdrawal is in relation to the Tasmania Tri-Area Service or Interim Satellite Service);
- (b) For Product Features this is 12-months, unless it will have a 'material adverse effect' in which a 24-month period will be required; and
- (c) In any case, no notification period is required should the withdrawal be required by law or under direction by Shareholder Ministers.

8.33 NBN Co also notes that *"and in each case will also provide written notice of the transitional arrangements that NBN Co may put in place (if any) to migrate its Customers from the relevant Product, Product Feature, Ancillary Service or type of Facilities Access Service to an alternative Product, Product Component, Product Feature, Ancillary Service or type of Facilities Access Service."*²⁴⁵ However, Optus considers that this should be restated as a firm commitment by NBN rather than be optional as the drafting suggests.

Products exempt from the product development and withdrawal commitments

8.34 As previously noted, the SAU explicitly carves out a number of exceptions to the product development and withdrawal commitments, which include any Product, Product Component or Product Feature that have been covered or contemplated:

- (a) Within the Initial Product Roadmap;
- (b) Arises from an obligation as a result of a carrier licence condition;
- (c) Is a 'minor variation or enhancement'; or
- (d) Relates to a requirement of law or direction by Shareholder Minister.

8.35 The implications of each of these exemptions are discussed below.

²⁴⁵ Clause 11.5 and 2E.6

Role of the Initial Product Roadmap

8.36 The Initial Product Roadmap currently contemplates six major product releases, with the following potential applications summarised in the table below.²⁴⁶

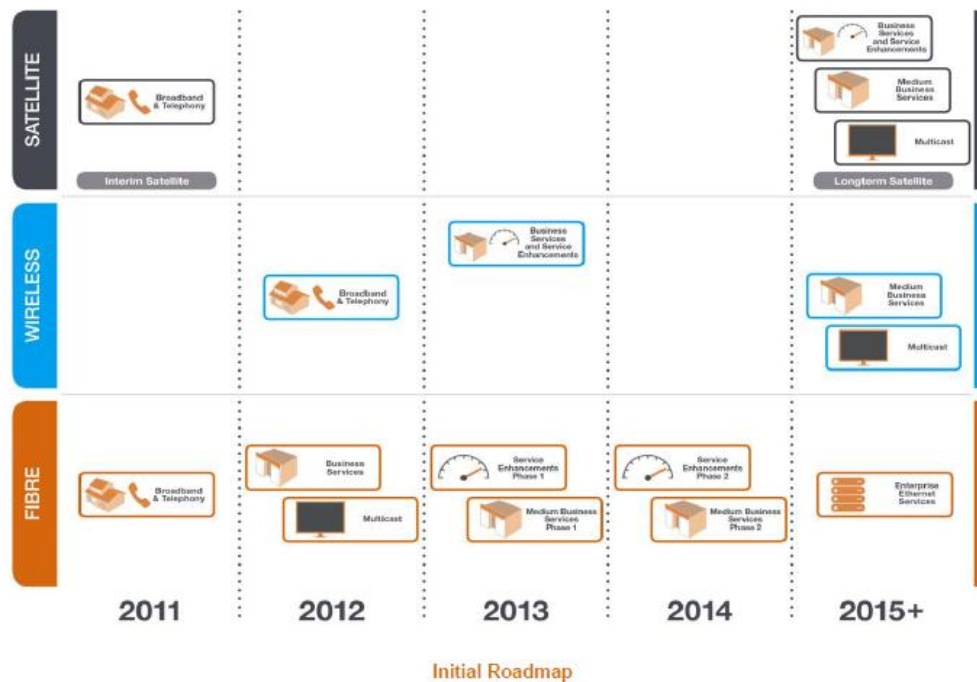
TABLE 2

<i>Product Release</i>	<i>Potential Applications</i>
Broadband & Telephony	High Speed Broadband; High quality Voice over Internet Protocol Telephony; Broadband and Telephony bundles; Facilitate migration of Plain Old Telephony Services to NBN Voice Telephony services (Fibre only)
Multicast	Scalable Internet Television; Triple Play Bundles (Telephony, Data and Video); e-learning and health applications; Software as a Service
Business Services	E-learning and health applications; Small Business Broadband, Telephony bundles; Video conferencing, video collaboration services; Multi-line telephony/small Private Automatic Branch Exchange (PABX); Enhanced Service Levels
Service Enhancements	Enhanced Service Levels; Customer Reporting
Medium Business Services	Video conferencing, video collaboration services; Virtual Private networks; e-learning and health applications; Enhanced Service Levels
Enterprise Ethernet Services	Very high capacity links; Virtual Private Networks; High availability services

8.37 In terms of targeted timing (as illustrated below²⁴⁷), the most recent version of the Initial Product Roadmap published in October 2012 highlights, a significant number of these product releases (and their various components) currently have not commenced or will only commence from second half of 2013.

²⁴⁶ NBN Co, Initial Roadmap, Updated October 2012.

²⁴⁷ NBN Co, Initial Roadmap, Updated October 2012, p.3.



8.38 Optus notes that the inclusion of a product or type of product under the Initial Product Roadmap is insufficient to ensure access seeker certainty that the product will be developed or released. This is particularly so given the continued disclaimer made by NBN Co that “*The Initial Roadmap is a non-binding indicative product roadmap and may change*”²⁴⁸ and as such, the targeted timelines may in fact be delayed or even fail to eventuate.

8.39 Notwithstanding the comment above, the Initial Product Roadmap and Integrated Industry Roadmap²⁴⁹ also fail to dispel concerns surrounding the lack of detail for each of the key product attributes. For instance, in many cases prices have been set irrespective of any firm details being set in relation to technical specifications, yet the Initial Roadmap indicate that consultation and documentation on those product attributes have been completed. This effectively entrenches NBN Co’s initial pricing, while giving it the discretion to specify a sub-standard service (i.e. lower service level commitment) that will subsequently be supplied. This is counterintuitive to the way in which product pricing should operate. Acceptance of the initial pricing set by NBN Co for a product that is yet to be specified, developed or not even available in the short term, would imply that all pricing is based on a backwards engineered construct.

8.40 This would be akin to a person buying a house for a fixed price with significant information asymmetry issues. For example, buying a house off-the-plan with no plan other than the information that the buyer is purchasing a house at a fixed cost, with full discretion provided to the builder to make decisions on all aspects of the house design, including the ability to charge additional costs. The result is such that the buyer will get their house built in a given area, however decisions on all aspects of the house design (i.e. the building materials used, quality of the workmanship, etc.) is made by the builder, notwithstanding any decisions on

additional features (e.g. water fountain) or ‘gold-plating’ (e.g. installation of a chandelier) that may not have been initially discussed and will incur additional costs.

- 8.41 It follows that in accepting the role of the Initial Roadmap with its low threshold and lack of detail as the basis of the exemption from product development commitments, this affords too much discretion on NBN Co to make decision on the Product, Product Components and Product Features that it so choose to pursue (and according to its own timeframes).
- 8.42 Optus therefore submits it is not acceptable for any exemption to be granted on the basis that it is contemplated within the Initial Product Roadmap. Where a Product, Product Component or Product Feature has already been developed, this should be included within the initial suite of products (and Reference or Non-Reference Offer price list) included in the SAU. Any product that has not been developed to fruition at SAU Commencement date should be subject to all other product development commitments, including regulatory oversight over all price and non-price provisions before introduction into the market.

Minor Product Changes

- 8.43 NBN Co has defined minor product changes at clauses 11.4 and 2E.5.2.
- 8.44 In particular, a Minor Product Variation is too loosely defined with discretion at 11.4(a) and 2E.5.2(a) that: *“NBN Co may carry out minor product variations or enhancements which update or improve the functionality or performance of a Product, Product Component or Product Feature and which, acting reasonably, NBN Co determines will have no material adverse impact on Customers.”*
- 8.45 Optus considers that this threshold is too high, largely given that NBN Co is not in a position to determine the ‘material impact on Customers’. As such, any change however minor should be consulted on and receive consent from Customers from which it may directly impact.
- 8.46 Additionally, if a Minor Product Variation requires a Network Change then it must abide by the network change commitments set out in clauses 1E.7 to 1E.11 (in relation to the identification, selection, consultation and endorsement of the network change).
- 8.47 Concurrent to this, Clause 1E.7.1(c) also makes a circular exemption whereby:

Nothing in clauses 1E.7 to 1E.11 prevents NBN Co from:

- (i) *Introducing, varying or enhancing Products, Product Components or Product Features that do not require a Network Change, or which fall within the scope of, are identified within, or are contemplated by, the Network Design Rules or a Permitted Variation; or*
 - (ii) *Terminating the process specified in clauses 1E.7 to 1E.11 where NBN Co decides not to proceed with a Network Change (including where the product development process is terminated under Schedule 11 (Product Development and Withdrawal)).*
- 8.48 As such, this implies that the Network Design Rules have overarching reach over what can be considered a Minor Product Variation where a Network Change is required. In addition, this

gives NBN Co the discretion at 1E.6.2 in relation to Permitted Variations from the Network Design Rules, to simply “vary, change, augment or enhance the design, engineering or construction of the relevant Assets from that specified in the Network Design Rules where such variation, change, augmentation or enhancement” meets any of the ten broadly specified Permitted Variations. Examples include:

- (a) At 1E.6.2(a)(iv), if the variation “is reasonably necessary to establish and maintain the quality, reliability and security of the relevant Assets or the supply of the Product Component”;
- (b) At 1E.6.2(vii), if the variation “relates to the maintenance, replacement or re-routing of assets that comprise the NBN Co Network that has a substantial primary purpose other than the augmentation or extension to such network (e.g. straight swap out of assets for assets as part or routine maintenance)”; and
- (c) At 1E.6.2.(vii), if the variation the estimated Capex required (at the time it is considered) “is likely to be less than the Minor Expenditure Limit.”

8.49 These highlight key examples in which NBN Co has the discretion to simply make a change without significant scrutiny, while in the process incur additional costs²⁵⁰ that under the conditions established elsewhere in the SAU they will be allowed to be fully recovered through the LTCRM.

8.50 Further, there is no level of certainty provided in Module 2, with the only loose commitment provided at 2E.5.2(b) which states that “NBN Co must comply with any applicable requirements in relation to the identification, selection, consultation and endorsement of the network change.” That is, there is no defined commitment to include or even improve on the Module 1 commitments for network change.

²⁵⁰ One such example of this is the inability of the Minor Expenditure Limit (MEL) criteria to constrain unnecessary costs being incurred under the guise of a Minor Product Variation. In addition to the initial MEL being set too high (i.e. the initial MEL defined at the SAU Commencement Date is \$100 million), it will also automatically increase by CPI each year.

Section 9. Non-price terms and conditions

KEY POINTS

- *The SAU must ensure adequate controls over NBN Co's ability to unilaterally vary access terms and conditions — reliance on voluntary consultation with industry (particularly where there is no regulatory oversight) is not appropriate.*
- *The direct replication of WBA/SFAA provisions in the form of Annexures in the revised SAU is not appropriate and risks locking-in set of conditions for the length of SAU — in some cases, these continue to be the subject of significant disagreement between industry and NBN Co.*
- *Service levels proposed in the SAU do not always reflect current industry standards. Moreover, given NBN Co has no legacy systems there is no reason why it cannot adopt world best practice.*
- *Service levels for existing NBN Co services are not subject to ACCC oversight.*
- *Service levels should align to Customer Service Guarantee arrangements.*
- *Optus recommends that the SAU adopt a principle-based approach in relation to non-price terms, given the current drafting of the non-price terms in the SAU; the restricted ability of access seekers or ACCC to initiate change; and the inflexible nature of the terms that are likely to become out-dated very quickly.*

- 9.1 Recent experience in the telecommunications sector has demonstrated that where there is a monopoly supplier of wholesale services, the non-price terms and conditions are as likely to raise competition concerns as price related terms of access. The non-price terms of access can raise barriers of entry and competition by imposing unnecessary costs on access seekers; and/or processes that are unaligned with customer expectations making it harder for access seekers to develop the services that meet end-user demand.
- 9.2 More importantly, non-price terms impact directly on the end-users experience of services: the benefits of new services or lower prices would be negated by having to wait several days for connections or fault repairs.
- 9.3 The fact that NBN Co will operate as a wholesale-only entity will likely address a number of problems this sector has historically faced – namely, since NBN Co will not operate in retail markets it should have no incentive to discriminate in setting access terms for its wholesale services. Moreover, there are legislative obligations to prevent NBN Co from discriminating in the provision of services between access seekers.
- 9.4 However, while NBN Co should have no incentive or ability to set non-price terms of access that are discriminatory, it does not follow that its interests in setting non-price terms of access will fully align with those of access seekers or end customers. A key objective of NBN Co is to make a return on investment first and foremost, and where non-price terms (while

maintaining full discretion to introduce associated charges) can be designed to reduce costs for NBN Co, it is likely it will do so.

9.5 As such, some key risks related to the non-price terms and conditions of supply, include:

- (a) That NBN Co will seek to push risks (and consequently costs) in the provision of services onto access seekers even when NBN Co is in the best position to control those risks;
- (b) That NBN Co will seek to set access terms that meet the lowest threshold in terms of the quality of services offered; and
- (c) That NBN Co is unresponsive to customer requirements.

9.6 Optus anticipates that many of these risks can be mitigated if there is an appropriate degree of balance in the way access terms and conditions are agreed — RSPs have a material interest to provide good customer experience and may request NBN Co to adopt stricter non-price terms. However, with NBN Co being the monopoly supplier of services, it is in a position to unilaterally decide upon such requests: and NBN Co may deem it not in the best interests of NBN Co to do so, or may be slow to implement changes without significant pressure.

9.7 Therefore, in addition to the correct application of regulatory oversight (see section 3), it is also important to ensure that there are adequate controls over NBN Co's ability to unilaterally vary access terms and conditions. Reliance on consultation with industry (particularly where there is no regulatory oversight throughout the entire process) is not enough.

9.8 While NBN Co has provided for some regulatory oversight provisions over a number of non-price matters, the sticking point remains that it is subject to the key caveat that, while it remains subject to NBN Co's interpretation, any such instrument will have no effect to the extent that it is inconsistent with the SAU.

Part XIC of the CCA operates so that the ACCC is able to make, vary or withdraw an Access Determination (AD) or Binding Rule of Conduct (BROC) relating to access to declared services provided by NBN Co. This could include setting out different terms and conditions to those specified in the Annexures to the SAU. However such an instrument will have no effect to the extent to which it is inconsistent with the terms set out in the SAU (including Annexures) as a result of the operation of sections 152CBIA and 152CBIB of the CCA.²⁵¹

9.9 Optus submits that the assessment of reasonableness of the SAU must take into account the reasonableness of the non-price terms. Once set, there is very little future ability for access seekers or the ACCC to initiate change.

9.10 The remainder of this section examines

- (a) Optus' preferred approach to non-price terms in the SAU and in the SFAA;

²⁵¹ Letter from NBN Co to ACCC, Response to request for clarification on NBN Co Special Access Undertaking, 1 November 2012, pp.2-3.

- (b) The overall approach to regulating non-price terms through the SAU; and
- (c) Specific comments on non-price provisions in the December 2012 SAU.

Interaction between non-price terms in SAU and SFAA

9.11 There have been a number of key changes in relation to non-price commitments since the release of the initial SAU on 5 December 2011, including:

- (a) The revised SAU sets out a number of non-price commitments to include terms and conditions in SFAAs in Module 1.
- (b) These key non-price commitments also represent the subset of non-price matters subject to regulatory oversight provisions and include:
 - (i) Service levels (Schedule 1J and Schedule 1J: Annexure 1);
 - (ii) Risk management (Schedule 1H and Schedule 1H: Annexure 3);
 - (iii) Confidentiality and intellectual property rights for ‘business as usual’ activities (Schedule 1H and Schedule 1H: Annexure 2); and
 - (iv) Dispute management rules (Schedule 1H and Schedule 1H: Annexure 1).
- (c) The revised SAU also sets out a number of standalone non-price commitments relating to Changes to Points of Interconnect (POIs); and Information on network and POI rollout.
- (d) For all other non-price terms and conditions (e.g. financial management terms) not referred to in the SAU but included in the SFAA, it is intended that the ACCC maintains oversight via the regulatory recourse provisions set out in Schedule 1B.²⁵² NBN Co notes that *“This approach provides a clear demarcation between the terms of the SAU and terms that are set out only in the SFAA.”*²⁵³

9.12 Optus remains of the view that while the inclusion of a comprehensive set of terms and conditions for a number of non-price matters is required in the SAU, it considers that the direct replication of WBA/SFAA provisions in the form of Annexures in the revised SAU is not appropriate.

9.13 Optus acknowledges that comments were made during the 2011 SAU consultations requesting that the SAU contain more information on the non-price terms.²⁵⁴ However, this was during a period *before* industry had signed a long term WBA, or before the SFAA development process

²⁵² However, the treatment of non-price terms following the expiry of a Regulatory Determination under clause 1B may be problematic. For example, Facilities Access Agreements are generally set for terms of less than 5 years (clause 1B.2.3(c)), hence have to the potential to ‘expire’ mid-term of an existing AA.

²⁵³ Letter from NBN Co to ACCC, Response to request for clarification on NBN Co Special Access Undertaking, 1 November 2012, p.3.

²⁵⁴ Optus Submission to the ACCC Supplementary Consultation NBN Co’s Special Access Undertaking, 30 March 2012.

was in place. It meant that non-price matters were placed outside the scope of the ACCC's jurisdiction. Further, it was not anticipated that the request for more detail to be contained within the SAU would result in the relevant sections of the WBA/SFAA being directly copied into the SAU. The replication of detailed terms into the SAU results in the same problems that existed when excluding all terms from the SAU.

- 9.14 Specifically, in the 2011 SAU Optus was concerned that relying solely on WBA/SFAA for non-price terms and conditions would result in total discretion being afforded to NBN Co, with an ability to unilaterally alter provisions without any regulatory oversight. Further, the ACCC had commented that it had no legislative role over assessing the WBA terms.²⁵⁵
- 9.15 These concerns have not been addressed by the replication of the detailed WBA/SFAA terms into the SAU. In taking its current approach, NBN Co has created another problem since it will effectively lock in the current provisions for the duration of Module 1, and at the same time entrenching disincentives to improve the relevant provisions for access seekers in a timely manner. Only NBN Co can initiate changes to the SAU, and ultimately any change to the SAU terms is at the behest of NBN Co. For example, the terms and conditions currently being proposed for Service Levels are unlikely to remain fit-for-purpose for the entire duration of Module 1 given the dynamic nature of the industry and customer demands.
- 9.16 Furthermore, Optus remains sceptical of the insistence to include the detailed terms and conditions in the SAU, knowing full well that the current provisions are yet to be finalised²⁵⁶ and that there is significant industry concern with the 'finalised' draft of the WBA: and therefore the non-price terms incorporated into the December version of the SAU.
- 9.17 Optus' concerns are supported by the view put forward by NBN Co in a letter to the industry that consensus may not be possible and in fact are not an objective for NBN Co.²⁵⁷ NBN Co decided that the current draft of the WBA was suitable for its purposes; represented an appropriate balance between the interests of NBN Co and its customers; and it was sufficient to go forward without industry agreement. Significantly, it was NBN Co that made the decision that the current WBA drafting best balanced interest of NBN Co and customers and it was NBN Co that declared the consultation period complete. It is the ability to take such unilateral action that concerns Optus, especially since a number of access seekers disagree with NBN Co's position.
- 9.18 This raises a number of concerns for the ACCC given that there is no mechanism within which access seekers can seek to commence a consultation on any relevant non-price matters within the SAU. For example, even though a multilateral SFAA forum will be established under Clause 1B.3, there is no assurance regarding the rights of an access seeker to convene a multilateral SFAA forum outside any timeframe proposed by NBN Co itself, and any suggested change to

²⁵⁵ Optus Submission to the ACCC Supplementary Consultation NBN Co's Special Access Undertaking, 30 March 2012, section 5.

²⁵⁶ Optus notes that RSPs are yet to sign the version of the SFAA that has been copied into the SAU. In addition, there is significant industry discontent with the version of the SFAA currently being considered.

²⁵⁷ Hassell, J., Letter Re: NBN Co's Draft Wholesale Broadband Agreement (WBA), 7 December 2012.

which NBN Co does not agree need not be notified to the ACCC for up to four months after NBN Co has convened a multilateral SFAA forum to discuss that issue.

9.19 Finally, Optus notes recent clarifications by the ACCC regarding its role and the interaction between the SFAA, regulatory determinations and access agreements. Specifically, Optus notes the ACCC view that terms within regulatory determinations can “over-ride” SFAA provisions, and access seekers can request that regulated terms are included in any access agreement with NBN Co.²⁵⁸ This clarification provides assurances that the ACCC has the ability to intervene in disputes relating to detailed terms in the SFAA.

9.20 Optus therefore sees that two approaches are viable:

- (a) **Adopt a principles-based approach for non-price terms in the SAU.** This would require that any SFAA must contain provisions relating to specific topics. For example, a number of these principles for inclusion in any SFAA should include (but not be limited to):
- Billing and Notification;
 - Creditworthiness and Security;
 - Confidentiality provisions;
 - Communication with end-users;
 - Maintenance and Upgrade provisions;
 - Suspension and Termination provisions;
 - Changes to technical/operational manuals;
 - Ordering and Provisioning terms;
 - Service Assurance terms;
 - Fair Use Policies;
 - Changes to Platform Interface B2B;
 - Migration terms;
 - POI rollout, forecasting, and GNAF address information;
 - Dispute Resolution for billing and non-billing issues;
 - Liability
- (b) **Adopt a detailed approach,** as per current SAU, but appropriately amended to allow for access seeker or ACCC initiated reviews using the full powers of Part XIC of

²⁵⁸ Subject to the condition that the AD terms are not inconsistent with the SAU.

the CCA. It is vital that the unilateral power of NBN Co to reject any change to the detailed provisions be removed.

- 9.21 Ultimately, the unilateral extent of NBN Co's discretion to change all terms with even in 'consultation' needs to be fettered by ACCC oversight, particularly in the event that Customers believe the outcome does not meet the LTIE criteria.
- 9.22 Given the current drafting of the non-price terms in the SAU; the restricted ability of access seekers or ACCC to initiate change; and the fact that the terms contained in the SAU are likely to become out-dated very quickly. Optus prefers that the SAU adopt a principle-based approach in relation to non-price terms.
- 9.23 Should the ACCC take the view that a detailed approach is reasonable (assuming there are appropriate changes to the extent of oversight), Optus' comments on the detailed provisions are contained below.

Drafting of the standalone non-price commitments

- 9.24 The standalone non-price commitments in the SAU are in relation to processes associated with making any changes to POIs and the information requirements around network and POI rollouts.
- 9.25 In particular, NBN Co has set out the rollout and POI information requirements at clauses 1H.2, 1H.3 and 1H.4. While Optus considers the inclusion of this information to be a positive step, there are still a number of improvements that need to be made.
- 9.26 First, the 3-year and 1-year construction rollout plan should include information across all NBN Co Platforms (i.e. Fibre, Wireless and Satellite). Optus notes that information regarding the Wireless Network rollout is currently lacking in 1H.2.1 and 1H.2.2, with information on the Satellite Network also omitted in its entirety.
- 9.27 Further, Optus submits that the 3-year construction rollout plan should provide geospatial and boundary information for the geographic regions as part of clause 1H.2.1.
- 9.28 Second, the Monthly ready for service rollout plan only commits to providing detail for that 'geographic area' in 1H.2.3. To this extent, a 'geographic area' is currently not defined however the current application of this has been to provide information for each Fibre Serving Area Module (FSAM) in Brownfield areas on the following:
 - (a) Fibre Serving Area (FSA) name, state and designation;
 - (b) Locality name;
 - (c) Connectivity Serving Area (CSA) name;
 - (d) POI name;
 - (e) Construction region name;
 - (f) Approximate premises count for both Rollout Region and FSA;

- (g) Number of FSAMs for the FSA;
 - (h) Expected date of Construction commencement; and
 - (i) Expected date of Ready For Service.
- 9.29 In addition, this FSAM information is only made available once it has been identified in the construction rollout plan; and as noted at 1H.2.3, the boundaries of the ‘geographic areas’ of the Fibre Network and Wireless Network once it has entered the design and construction phase.
- 9.30 Optus agrees that the ‘geographic area’ should be granular to a FSAM, but notes that the POI Ready For Service date may be different to the FSAM expected Ready For Service date. For example, unlike the Monthly Ready For Service rollout information provided for Greenfield areas, there is no information on the Permanent POI relative to the Interim POI for each FSAM identified. This raises concerns given the lack of certainty surrounding the POI Plan information committed to in 1H.3.1 that “... *NBN Co will publish updates to the status of the Established POIs.*” As such, the POI plan commitment is only applicable to Established POIs (as defined in the POI list and which explicitly excludes Temporary POIs).
- 9.31 Similarly, as NBN Co is planning and building fibre in a rollout region, it is reasonable to expect more information than a proposed footprint list. At a minimum, NBN Co should provide GNAF files for at least 90% of the premises in the footprint at least 12 months prior to the Ready for Service Date.
- 9.32 Third, the commitment at 1H.2.4 details the Historical footprint list that NBN Co will publish. However, there is no obligation to provide accurate or useable data to allow Customers to identify serviceable addresses within a rollout region that has become serviceable. Failing this, a premise should not be considered serviceable until the actual GNAF is provided by NBN Co. As such, Optus submits that at the Ready For Service Date in a rollout region, a precondition should be established to ensure that NBN Co must provide 100% of all GNAF information for all serviceable premises.
- 9.33 Optus also notes that NBN Co intends to conduct Public Information and Migration (PIM) campaigns as part of a rollout region becoming Ready For Service and therefore this activity should not and cannot occur unless full information is provided to Customers to enable it to meet the expectations of End Users. It is therefore imperative that access seekers can seek access to this information in order for them to appropriately plan and make informed decisions regarding any required connection and migration activities.
- 9.34 Finally, Optus has a number of concerns on the commitments sets out in 1H.4 in relation to the timeframes for closure, relocation and new POIs, including:
- (a) Optus submits that a 12-months notification period for the closure or relocation of an Established POI may be insufficient time for access seekers to undertake migration activities. For example, establishing presence in Telstra TEBA space may require infrastructure build (both internal and external to the exchange) and this can take a significant amount of time due to queuing and approval processes. Once the POI is established, only then can the access seeker undertake migration

activities. As such, Optus considers a minimum of 18-months notification should be put in place to cover this set of activities.

- (b) Optus notes that while it is appropriate that ACCC approval is required for the closure or relocation of an Established POI and opening a new POI, this same requirement should be extended to require the ACCC to approve the closure of a Temporary POI.²⁵⁹
- (c) Likewise, Optus submits that a 6-months notification period for the closure of a Temporary POI should be extended to meet the same notification period required for the closure or relocation of an Established POI.

9.35 As highlighted above, Optus has therefore provided a number of improvements that should be addressed in order to strengthen the standalone commitments currently set out in 1H.2, 1H.3 and 1H.4.

Detailed comments on non-price terms subject to oversight

9.36 NBN Co has made a number of key non-price commitments that are subject to regulatory oversight provisions, including:

- (a) Service levels (Schedule 1J and Schedule 1J: Annexure 1);
- (b) Risk management (Schedule 1H and Schedule 1H: Annexure 3);
- (c) Confidentiality and intellectual property rights for ‘business as usual’ activities (Schedule 1H and Schedule 1H: Annexure 2); and
- (d) Dispute management rules (Schedule 1H and Schedule 1H: Annexure 1).

9.37 This section sets out Optus’ detailed concerns on the key non-price commitments proposed to be subject to some degree of regulatory oversight. Optus’ concerns arise from NBN Co proposing non-price commitments that are inconsistent with those currently seen in the market for wholesale services.

9.38 Optus is concerned that NBN Co is attempting to just match existing industry standards, and for many metrics is proposing terms well below what is offered in the market now. There appears little, if any, reason why NBN Co cannot better the standards currently seen. This is because NBN Co is a new build with no legacy systems — and it is the presence of legacy systems that often limit what non-price terms are achievable (especially service levels).

9.39 Without the deadweight of legacy systems, NBN Co should aim to provide world best non-price terms and conditions, so as to ensure end-users receive the best possible product. To this end, Optus recommends that the non-price terms be benchmarked against world-best practice. Where NBN Co proposes terms that are less than this benchmark, the terms should not be considered to be reasonable nor consistent with the LTIE.

²⁵⁹ The closure of a Temporary POI requires the same planning and migration activities as a Permanent POI.

Service Levels

- 9.40 Optus' comments below on service levels highlights areas of concerns where the proposed service levels do not reflect the standards that are currently being met by legacy networks in the market now. NBN Co has no legacy systems; therefore, there appears little reason why NBN Co could not adopt world best practice. Further, NBN Co has provided no evidence to the ACCC as to how the service levels proposed are reasonable. No evidence has been provided explaining why NBN Co cannot meet or exceed existing service levels.
- 9.41 NBN Co sets out its service level commitments in Schedule 1J, including the incorporation of *"the terms set out in Annexure 1 (Service Levels Schedule) to this Schedule 1J into any SFAA and maintain such terms that are the same or better (having regard to all the circumstances) in any SFAA"*²⁶⁰ and that any Metric set out in Annexure 1 will only apply until the end of 2014. After this period, NBN Co will have the discretion to maintain Metrics *"on terms that are the same or better (having regard to all the circumstances) in any SFAA to the terms that applied to the Metrics in 2014."*²⁶¹
- 9.42 Optus is concerned by the ability set out in 1J.2(c) which essentially provides NBN Co with the discretion to bypass even the limited commitments currently set out in the Annexure – i.e. that both *"Clauses 1J.2(a) and 1J.2(b) are subject to any changes permitted in the circumstances described in clause 1B.3.1(e) or 1K.3."*
- 9.43 For example, at 1B.3.1(e) there is an explicit carve out that NBN Co may bypass the ACCC's prior approval to make any changes to an SFAA in relation to the provisions on Service Levels (and other key non-price commitments) which arise *"other than in relation to the supply of new Products, Product Components, Product Features, Ancillary Services and types of Facilities Access Service introduced during the Initial Regulatory Period."* As such, Service Levels for Products introduced during the Initial Regulatory Period are done at NBN Co's discretion.
- 9.44 Similarly, the SAU review commitments in relation to service levels set out in 1K.3 only represents a commitment for NBN Co to submit information on the current operation of the Service Levels regime and propose any changes to which the ACCC can either accept or reject. In the event that the ACCC rejects NBN Co's New Non-Price Proposal, only then can the ACCC make its own decision in relation to the parts of the New Non-Price Proposal rejected by it to apply from 1 July 2018. However the effect of any ACCC decision in replacement for the operation of the Service Levels regime is only valid for the period 1 July 2018 to the end of the Initial Regulatory Period, with no commitment that this will be improved in any Service Level Proposal applicable in any subsequent regulatory periods.
- 9.45 Of particular concern is the loose commitment on NBN Co to only maintain Service Levels terms that are either "the same or better" in any SFAA that applied in the immediately preceding SFAA. This represents a weak commitment as it does not sufficiently provide incentives for NBN Co to make any improvements. Existing networks are built around legacy provisioning and maintenance systems. NBN Co is not hamstrung like other access providers

²⁶⁰ Schedule 1J, Annexure 1, Clause 1J.2(a).

²⁶¹ Schedule 1J, Annexure 1, Clause 1J.2(b).

therefore service levels should be ‘best in class’ across international benchmarks. The NFAS and NWAS are provided on networks which are meant to be at the ‘cutting edge’.

- 9.46 Optus therefore submits that greater certainty should be provided to access seekers to ensure that Service Levels are appropriately addressed at regular intervals. It is insufficient for these terms to only be reviewed, initially at the SAU review period, then again as part of each subsequent Replacement Module Application process – particularly given that Service Levels represent an important term of supply for access seekers and will directly influence end-user experience on the NBN. It is also a very dynamic element, as it can significantly require changes from one year to the next and will have significant implications on an access seeker’s ability to serve end-users. As such, Optus recommends that the provisions in relation to Service Levels should be subject to regular review, i.e. on an annual basis, during the Initial Regulatory Period and then in line with any consultation prior to the execution of a new SFAA.
- 9.47 At a minimum, NBN Co should be required to annually publish a rationale statement justifying its decision to maintain Service Levels that are either the same or better (having regard to all circumstances) before it can be incorporated into any SFAA.
- 9.48 Notwithstanding the concerns highlighted above, Optus also has significant concerns with the commitments set out in the Annexure 1 to this Schedule 1J in which NBN Co currently proposes a number of commitments in relation to the types of Metrics that apply in relation to the activities that are associated with the supply of NBN services. The following sets out Optus’ comments with respect to the Service Level terms set out in the SAU.

Service Levels – Metrics and Remedies

- 9.49 NBN Co has proposed a number of metrics for Service Levels which include:
- (a) Service Levels which apply to Activities associated with the supply of an Ordered Product to Customer;
 - (b) Service Level Targets which apply to the availability of the NBN Co Fibre Network, the NBN Co Wireless Network and the NBN Co Platform Interfacing Service;
 - (c) Performance Objectives which apply to the performance of the Service Levels; and
 - (d) Operational Targets which also apply to the performance of Service Levels but to which NBN Co is not obliged to perform corrective action (i.e. it is non-binding).
- 9.50 It follows that if NBN Co does not achieve a Metric, the Customer may seek a Remedy (e.g. requiring NBN Co to perform Corrective Action; claim a Commercial Rebate; and/or claim CSG Compensation). On this basis, it is therefore of great importance that the proposed metrics are closely aligned with the remedies. That is, if NBN Co only commits to lax Service Level commitments, then this must be matched with the appropriate remedies to provide incentives for NBN Co to improve on its commitments (and vice versa). This is currently not the case given NBN Co’s statement that the sole consequence of failing to meet a service or

performance objective are the consequences listed in the schedule and a failure to achieve a service or performance level “will not be regarded as a breach of this Agreement.”²⁶²

9.51 Optus’ makes a number of general comments on the proposed service level metrics.

- (a) First, separate metrics should be made available for both the NBN Co Fibre Access Service (NFAS) and the NBN Co Wireless Access Service (NWAS). Similarly, the metrics for the Interim Satellite Service (while outside the scope of the WBA) are completely absent but, for completeness, should be provided in the SAU.
- (b) Second, any obligation on NBN Co to perform Corrective Action when Performance Levels and Service Level Targets are not met should be done within defined periods of time. NBN Co currently does not commit to any timeframes for Corrective Action.²⁶³ As such, Optus considers that a commitment for timeliness should be included as part of the remedy commitment – i.e. this Corrective Action should generally take place within a 3 month period unless IT changes are required. In addition, there should be no condition allowing NBN Co the discretion to not respond or provide information in relation to a Customer request for Corrective Action,²⁶⁴ even if the Corrective Action is in relation to an earlier event with a similar root cause.²⁶⁵
- (c) Third, the remedies that are available to Customers should provide appropriate incentives for NBN Co not to miss its obligations. For example, the remedies that are restricted to a commercial rebate for end-user connections and relevant to NFAS standard connections only, appear to be tempered by a Customer’s ability to forecast accurately.²⁶⁶ This is not appropriate since failure to meet a forecast is likely to be as much to with factors outside of an access seekers control, such as NBN Co workforce and workload management matters.

9.52 In addition, Customers should have the right to request a Data Enquiry if they have reasonable belief that the Metrics are inaccurate and not be restricted to a 6-month time period. This is particularly given that NBN Co will, in some cases, only produce quarterly reporting up to 20 business days after the end of the Quarter.²⁶⁷ At a minimum, this Data Enquiry period should be extended to 12 months.

9.53 Finally, in relation to whether the metrics allow Customers to meet their regulatory obligations, Optus notes that under the CSG, carriage service providers (i.e. “Customers”) are required to meet performance standards and provide users with financial compensation when these standards are not met.

²⁶² Schedule 1J, Annexure 1, Clause 18.

²⁶³ Schedule 1J, Annexure 1, Clause 13.

²⁶⁴ Schedule 1J, Annexure 1, Clause 13.

²⁶⁵ Schedule 1J, Annexure 1, Clause 13.2.

²⁶⁶ Schedule 1J, Annexure 1, Clause 1.4.

²⁶⁷ Schedule 1J, Annexure 1, Clause 12.

- 9.54 As such, Optus submits that the CSG obligations are applicable to both the NFAS and the NNAS as they will both be used in providing a Standard Telephone Service. Contrary to this, NBN Co has stated that the commitment for Accelerated Connections will only be provided for NFAS,²⁶⁸ and therefore services provided via NNAS will not meet CSG timeframes and NBN Co will not credit any CSG compensation in relation to any product supplied using NNAS²⁶⁹. This should not be the case and NNAS services should also be subject to accelerated timeframes and CSG compensation where necessary.
- 9.55 Optus similarly submits that the clause in relation to the mitigation of damages²⁷⁰ should be removed in its entirety. It is not appropriate for NBN Co to impose an obligation on the Customer simply to protect NBN Co from being liable to pay CSG compensation for its failure to meet known service levels. Customers are aware of their obligations under s118A of the TCPSS Act and therefore the inclusion of this clause (when read in conjunction with the terms set out in relation to CSG Compensation²⁷¹) is not required.

Service Levels – Connections and Modifications

- 9.56 Optus submits that the Service Levels set out in the SAU should exceed existing legacy service levels as the NBN is a state-of-the-art network without the restraints of legacy systems. At a minimum, they should meet existing industry service levels.
- 9.57 However while NBN Co has generally sought to replicate similar industry standards, NBN Co still have a number of areas where standards need to be improved or where standards are currently missing and need to be provided.

End-User Connections

- 9.58 Optus submits that the proposed Connection Service Levels for 2014 should apply immediately and that there should be an ongoing obligation to improve these service levels to align with, or improve on, CSG obligations regardless of whether the end user is migrating from an existing service or connecting to new service. In addition, the Service Levels for Accelerated Connections²⁷² of 4/9/14 business days for urban/major rural/remote customers should similarly be applied for Service Class 1, Service Class 2 and Service Class 5 services.
- 9.59 Optus is concerned that although CSG obligations may not apply for services that are migrating from an existing service, the service levels proposed by NBN Co will result in an unsatisfactory end user experience. Given the CSG obligations were based on a legacy copper network, Optus submits that the longer term obligations of NBN Co should improve SLA's with a fibre network. As such, the Service Levels of 1 Business Day for all customers applied for Service Class 3 (where the NTD is in place) are appropriate.

²⁶⁸ Schedule 1J, Annexure 1, Clause 1.1(c).

²⁶⁹ Schedule 1J, Annexure 1, Clause 14.2(b).

²⁷⁰ Schedule 1J, Annexure 1, Clause 15.

²⁷¹ Schedule 1J, Annexure 1, Clause 14.

²⁷² Schedule 1J, Annexure 1, Clause 1.1(c).

- 9.60 For the avoidance of doubt, this would infer that the Service Levels for End User Connections would be consolidated into a single table as set out in table 3.

TABLE 3

Location of Premises	NFAS (Business Days)				NWS (Business Days)		
	Service Class 0	Service Class 1	Service Class 2	Service Class 3	Service Class 4	Service Class 5	Service Class 6
Urban Area	n/a	4	4	1	n/a	9	1
Major Rural or Minor Rural Area	n/a	9	9	1	n/a	14	1
Remote Area	n/a	14	14	1	n/a	19	1

- 9.61 Further while this will only represent a minor improvement on the current proposed Service Levels, a stronger commitment to improve on these Service Levels should be put in place that is subject to an annual review. It follows that any decision not to improve the Service Level from one period to the next should be substantiated and the decision made public.
- 9.62 Similarly, in all Service Classes, NBN Co should be required to set a minimum commitment in lieu of any references to “n/a” and in the event that NBN Co is unable to meet the commitment set (i.e. for Service Class 0 and Service Class 4 in table 3) then it must notify Customers of its proposed Service Level (which Optus accepts may vary on a case-by-case basis). Optus submits that a Service Level of one calendar month should apply in these cases.
- 9.63 This would be in line with the approach taken by NBN Co, in which it has combined the End User Connection Service Level with the concept of Accelerated Connection Service Levels which is to be used in instances where the premises is NBN Serviceable and is an Inactive Premise (i.e. it is a new service). While this concept may be acceptable, the obligation for NBN Co to provide Accelerated Connection for CSG applicable services should apply regardless of any cap NBN Co has imposed.²⁷³ This is particularly given the lack of justification for the imposition of the 10% cap; and in fact, there should be no differentiation between the Service Levels for Standard Connections and Accelerated Connections.
- 9.64 NBN Co has defined Total Connections to mean *“the total number of Standard Connections (excluding Accelerated Connections and Priority Assistance Connections) in Service Class 1, Service Class 2 and Service Class 5 supplied by NBN Co to Customer in the relevant month.”*²⁷⁴ Optus submits that the rebate should be based on the connections for each individual Customer in each individual CSA. This aligns with the fact that each Customer is subjected to a

²⁷³ Schedule 1J, Annexure 1, Clause 1.3(a).

²⁷⁴ Schedule 1J, Annexure 1, Clause 1.4(b).

forecast accuracy factor based on forecasts in each individual CSA²⁷⁵ to determine the level of the rebate, but subject to the caveat that *“If the accuracy of the applicable forecast data in the Rollout Plan is <90% or >110%, the Forecast Factor will be 1”*²⁷⁶ for purposes of calculating the Customer Forecast Accuracy.

- 9.65 In general, Optus maintains that the calculation for any applicable Connections Rebate should not be linked to Customer Forecast Accuracy for information to be provided by the Customer in relation to the ability (or lack thereof) of NBN Co to meet the Service Levels for End User Connections. Furthermore, End User Connection forecasts should not be considered on an aggregate basis given the potential and high-risk that this may misrepresent the actual end-user experience, e.g. this has the potential to mask any incidence in which NBN Co significantly fails to meet the Service Levels in an individual CSA. Put simply, in aggregate terms, NBN Co may meet its Service Levels overall but this can still result in a scenario in which the Service Levels for End User Connections in one or more individual CSAs failing to be met.
- 9.66 Optus also notes that in calculating the Connection Rebate, the ‘Reference Performance’ should be aligned, and based on a 90% Reference Performance for both 2013 and 2014²⁷⁷, as end-users should not experience a different performance level from NBN.
- 9.67 NBN Co provides no Service Levels or Performance Objectives for Service Class 0 and Service Class 4 connections.²⁷⁸ This is problematic because Service Class 0 and Service Class 4 premises may represent new estates or multi-dwelling units which are currently not serviceable by NBN. While some installations may be dependent on third party approvals (e.g. body corporate approvals), there are many circumstances under which NBN Co will have control of the resources that are required to provide a service (e.g. where a developer has submitted a request for NBN services with sufficient notice). Optus therefore submits that a Service Level of one calendar month should apply in these cases.
- 9.68 Optus notes that Priority Assistance Service Levels do not apply to NWAS services (only NFAS)²⁷⁹ and maintains that Priority Assistance service level commitment needs to be included. Priority Assistance Customers are ambivalent to the technology that delivers their service and therefore service levels should apply to NWAS.
- 9.69 Finally, although NBN Co has defined Business Services in both Reference and Non-Reference Offers, there is no concept of expedited installations for business end users. Optus submits that the current service levels offered for residential customers are not appropriate for business customers and NBN Co therefore needs to commit to expedited connection timeframes for business services.

²⁷⁵ Schedule 1J, Annexure 1, Clause 1.4(b).

²⁷⁶ Schedule 1J, Annexure 1, Clause 1.4(b).

²⁷⁷ Schedule 1J, Annexure 1, Clause 1.4(b).

²⁷⁸ Schedule 1J, Annexure 1, Clause 1.1.

²⁷⁹ Schedule 1J, Annexure 1, Clause 1.1(c).

Modifications

- 9.70 NBN Co has provided Services Levels for Access Component Modifications. This provides a Service Level of 1 business day for modification of access components where no attendance is required at the Premises, however if attendance at the Premises is required the same Service Levels for Standard Connections will apply.²⁸⁰
- 9.71 Optus submits that the Service Level of 1 Business Day is appropriate, but considers the previously stated commitment to improve the Operational Targets over time should continue to be applied. For example, there was previously a commitment to improve this Service Level from 1 Business Day to 8 Operational Hours then to 6 Operational Hours over time should be reinstated.²⁸¹ In contrast, where attendance at the Premises is required, Optus reiterates that the same changes as discussed for Service Levels for End User Connections should be applied.

Network Connections

- 9.72 NBN Co has provided Service Levels for CVC and Multicast Domain Modifications.²⁸² Optus submits that modifications to these network elements should be achieved within 1 Business Day where NBN Co only undertakes a change in NBN Co systems in order to effect such modification. Optus notes that where attendance at the site is required, a Service Level of up to 5 Business Days may be reasonable.
- 9.73 In addition, while the Service Level for a Service Impacting Multicast Domain Modification is 5 Business Days,²⁸³ Optus submits that this timeframe is excessive for a service impacting situation and should be reduced to 2 Business Days.

Service Levels – Service Assurance and Network Performance

- 9.74 This sub-section looks at the service levels in relation to service assurance and network performance. Specifically, it looks at:
- (a) Business services assurance;
 - (b) Traffic class operations;
 - (c) NBN Co platform interfacing availability target; and
 - (d) Network performance and availability

Business Services Assurance

- 9.75 Optus submits that there are a number of service assurance aspects absent for business services.

²⁸⁰ Schedule 1J, Annexure 1, Clause 7.1.

²⁸¹ Schedule 1J, Annexure 1, Clause 9.3.

²⁸² Schedule 1J, Annexure 1, Clauses 7.2 and 7.3.

²⁸³ Schedule 1J, Annexure 1, Clause 7.3.

- 9.76 For example, NBN Co has offered Enhanced-12 Fault Rectification commitments.²⁸⁴ However, these commitments have explicitly omitted 2 hour, 4 hour and 8 hour fault rectification services which are currently available for legacy networks and which business customers have come to expect as part of their service.
- 9.77 In addition, there is no justification for a Performance Objective for Enhanced-12 Fault Rectification to be lower in 2013 (80%) to that of 2014 (95%). Business Customers pay a premium for the enhanced service assurance and therefore do not expect this to metric to be “phased in” – especially when the Enhanced-12 is charged at an extra \$15 per SIO per month. Similarly, the Performance Objective is currently based on all NBN Co Customers but should be based on each individual Customer’s Enhanced 12 Fault rectifications each month.

Traffic Class Operations

- 9.78 NBN Co provides traffic class Performance Objectives for TC-1 on an individual traffic class basis.²⁸⁵ In contrast, Optus notes that no Performance Objectives are defined for the TC-2, TC-3 and Multicast services. These products are expected to be introduced within the timeframe before the objectives in the SAU are to be reviewed. For instance, TC-2 is expected to be introduced by second half of 2013.
- 9.79 As NBN Co has set prices for these services, it is reasonable to expect key attributes of the services to be specified. For example, the minimum acceptable metrics for each individual service would need to include latency, jitter and packet loss and based on the Communications Alliance Guideline, G632:2012 Quality of Service parameters for networks using the Internet Protocol.
- 9.80 Optus proposes – consistent with current industry standard – that the following binding minimal metrics should apply.

TABLE 4

NBN service Commitment			
NBN Classes	Frame Delay (Latency)	Frame Delay variation (Jitter)	Frame Loss (Packet Loss)
TC-1	≤ 6msec	≤ 3msec	≤ 0.001%
TC-2	≤ 6msec	≤ 10msec	≤ 0.001%
TC-3	≤ 14msec	≤ 20msec	≤ 0.001%
Multicast	≤ 100msec	≤ 50msec @ 0.001%	≤ 10 ⁻⁵ %

²⁸⁴ Schedule 1J, Annexure 1, Clause 5.

²⁸⁵ Schedule 1J, Annexure 1, Clause 11.5.

NBN Co Platform Interfacing Availability Target

- 9.81 Optus submits that there is no justification to offering an availability Target lower than 99% from inception particularly as NBN Co has afforded itself a Planned Maintenance Window of 7 hours (11pm-6am) when it is necessary to upgrade or maintain the platform.
- 9.82 Optus submits that the NBN Co Platform Interface Availability Target should be set at 99% for 2013 and 2014 and be measured on a calendar month basis.
- 9.83 Additionally, NBN Co Platform Interface Availability should be defined by the Platform performing substantively to known specifications which include transaction response times. NBN Co has defined non-binding B2B response times for B2B Access business transaction response times.²⁸⁶ Optus submits that if NBN Co does not meet these response times then the Platform should be treated as unavailable.

Network Performance and Availability

- 9.84 NBN Co provides Service Levels for Network Fault Response and rectification.²⁸⁷ Optus submits that the Performance Objective for 2013 should be set at 95% and not 80%. There is no justification for a lower Performance Objective for 2013.
- 9.85 The Service Level for Network Availability for the NFAS and NWS is 99.9% availability and while, in itself, may be within the ballpark of other fibre networks; this is countered by the fact that NBN Co affords itself many exclusions, where: *"The measurement of Network Availability includes only the time when the NBN Co Fibre Network and NBN Co Wireless Network are in active operation and excludes any time when modifications, activations or installations are occurring."*²⁸⁸ Optus notes that these exclusions simply serve to significantly lower the stated network availability figure.
- 9.86 Further, the Measurement Period already excludes periods of time that NBN Co is performing Planned Outages.²⁸⁹ Planned Outages include operations such as POI relocations, POI Closures, Upgrades, any maintenance, repair, rationalisation or remediation of the NBN Co Network. Optus considers however, that the only exclusion to the Networks Availability measurement should be Mass Service Disruption events and as such all other references in relation to all other outages²⁹⁰ should be deleted in its entirety.
- 9.87 Optus submits that the availability service levels should be higher (up to 99.95%) when purchasing Enhanced Service Levels. Enhanced service levels are typically used by business end users who are offered availability of 99.95% under the legacy copper networks. As service

²⁸⁶ Schedule 1J, Annexure 1, Clause 16.5.

²⁸⁷ Schedule 1J, Annexure 1, Clause 4.4.

²⁸⁸ Schedule 1J, Annexure 1, Clause 11.2.

²⁸⁹ Schedule 1J, Annexure 1, Clause 11.1(b).

²⁹⁰ Schedule 1J, Annexure 1, Clause 11.2.

availability is a function of network availability and time to restore the service, Optus submits that any Enhanced Service Levels offered by NBN Co should significantly reduce the restoration times (reducing the average downtime per service) and hence increasing service availability to 99.95%.

- 9.88 Effectively, NBN Co should offer Enhanced Service Levels (12 hour, 8 hour, 4 hour, 2 hour restore) that will result in 99.95% service availability. Such offerings are consistent with the standards seen in the industry currently.

Service Levels – Proposed Exclusions

- 9.89 In the calculation of all service level metrics, NBN Co has set out a number of exclusions that apply in each of these metrics. These exclusions are comprehensive and include items such as Planned Outages and Emergency Outages, which are both broad in scope and application. Some of these exclusions are already included in the terms of the Operations Manual and NBN Co refers to the Operations Manual throughout the Service Levels Schedule. For example, failure by the Customer to provide mains power at an NTD may exclude these from the End User Connection Service Level; similarly, a Non-NBN Fault is also excluded from the End User Fault Service Level.
- 9.90 As such, the exclusions that apply to specific metrics are already broad and, in some cases, not appropriate. Optus therefore submits that any clause in relation to proposed exclusions should be removed in its entirety.²⁹¹ Failing to do so will add another layer of exclusions to metrics which are already individually subject to broad exclusions.
- 9.91 Optus submits the only overarching exclusion should relate to Mass Service Disruption circumstances.

Confidentiality and IPR

- 9.92 NBN Co sets out its terms and conditions for Confidentiality and Information Property Rights (IPR) commitments at Schedule 1H, which effectively seeks to incorporate the terms detailed in Annexure 2 of Schedule 1H.
- 9.93 The following sets out Optus' comments with respect to the non-price confidentiality and IPR terms set out in both the SAU and draft Final CDP version.

Confidentiality

- 9.94 Optus considers that any confidentiality regime should, at a minimum, incorporate the following key principles:
- (a) Obligations on each party to keep the other party's confidential information confidential;
 - (b) Restrictions on a party's use of the other party's confidential information, i.e. each party may only use the other party's confidential information for very limited

²⁹¹ Schedule 1J, Annexure 1, Clause 18(c).

purposes, to exercise rights or perform obligations under the Agreement, or to the extent necessary to develop and supply products that rely on NBN products;

- (c) Limited rights to disclose the other party's confidential information (such as to personnel, related companies, professional advisors where necessary and to regulators) – any disclosure rights need to be tightly confined, carefully defined and justifiable; and
- (d) Restrictions on NBN's ability to use Network Information.

9.95 Optus notes that NBN Co has sought to address confidentiality commitments between the parties in relation to maintaining confidentiality, restrictions on use and disclosure, and consent for NBN Co to use the information provided for the permitted activities²⁹² but considers a number of minor amendments are still required.

9.96 The right to disclose Confidential Information to Related Bodies Corporate, Personnel and Downstream Customers (who are not End Users) should be amended to be consistent with the scope of the right to use that information. In other words, a party (in particular, a Customer) should be able to disclose Confidential Information to these persons to the extent necessary for the supply of Customer Products, in addition to its right to do so to perform obligations and exercise rights under the Agreement (or the SAU).²⁹³ Further, clause 1.2(b)(x) should either be deleted or, alternatively, amended so that it only applies to disclosure under clause 1.2(b)(iv) -- disclosure where required by law, government or to protect health and safety). The Recipient of Confidential Information should at minimum be required to ensure the person to whom the disclosure is made is subject an obligation to keep the information confidential.

9.97 Optus is also concerned that the reference to "purposes connected with"²⁹⁴ unnecessarily broadens the scope of NBN Co's disclosure right under the relevant clause. At minimum this language should be replaced with the words "for the purposes of", although the preferred outcome would be to redraft this as two separate clauses as follows:

"(iii) for the disconnection of premises from the network of a third party (including for calculating any payments from NBN Co to a third party); or

(iv) for the provision by a third party to NBN Co of access to or ownership of parts of a network of a third party;" .

Downstream Customer details

9.98 When the Customer needs to disclose any details of a Customer's downstream customer to NBN Co to enable NBN Co to supply its products to the Customer under the Agreement, then NBN Co must only use those details for that limited purpose.

²⁹² Schedule 1H, Annexure 2, Clause 1.

²⁹³ For example, in clause 1.2(b)(i) this should be amended to also allow disclosure for the purpose referred to in clause 1.2(a)(ii) (to ensure consistency with the rights to use that information).

²⁹⁴ Schedule 1H, Annexure 2, Clause 1.3(b)(iii).

9.99 To this end, Optus notes that recent amendments by NBN in the December SAU amendments²⁹⁵ have in fact broadened (rather than restricted) the manner in which, and the purposes for which, NBN Co may use Downstream Customer Details. This is a concern given the significant sensitivity, both within the community generally and for Customers, with personal data. As such, the word “including” (between “Downstream Customer Details” and “to supply any Ordered Product”)²⁹⁶ should be deleted so that this clause spells out exhaustively the purposes for which NBN Co is permitted to use Downstream Customer Details.

Rollout and migration communications

9.100 Optus submits that there should be an obligation on NBN Co to provide Customers with accurate and up-to-date information about its rollout and migration activities on a timely basis, including forecasts of the details and locations of network ready for service areas.

9.101 This is currently not the case, with all responsibility on communications placed on Customers. Optus notes that NBN Co should not be entitled to simply dictate what Customers must include in its communications with third parties. In addition, NBN Co has deleted its previously stated commitment that: *“NBN Co will publish on NBN Co’s Website a forecast of the dates and locations of the network from time to time.”*²⁹⁷

9.102 As such, there are no constraints or controls around how or what NBN Co may specify for inclusion by Customers in communications with Downstream Customers, End Users and other third parties; nor does it even require NBN Co to act reasonably.

Intellectual Property Rights (IPR)

9.103 Optus submits that the SAU should contain commitments and general principles in relation to the assignment and use of IPR by and for all relevant parties.

9.104 The key principle is a licence granted by NBN Co to Customers for Customers to use the IPR in NBN products, to the extent needed for Customers to:

- (a) Use NBN products;
- (b) Develop, market, and supply Customers’ products which rely on NBN products; and
- (c) Otherwise to perform their obligations and exercise their rights under the Agreement,
- (d) including appropriate rights to sub-licence to personnel, related bodies corporate and downstream customers.

²⁹⁵ Schedule 1H, Annexure 2, Clause 3.2(a).

²⁹⁶ Schedule 1H, Annexure 2, Clause 3.2(a). Alternatively, in the same clause, the words “in accordance with this Agreement” should be reinstated (between “Downstream Customer Details” and “including to supply any Ordered Product”).

²⁹⁷ Schedule 1H, Annexure 2, Clause 4.

9.105 These terms are currently set out in the context of Ordered Product licences;²⁹⁸ however Optus submits a number of amendments are still required, including:

- (a) The scope of the IPR licence which NBN Co grants to Customers needs to be broadened to allow Customers to develop, market and supply its products which use or incorporate the NBN Products. To this extent, Optus therefore recommends the inclusion of the words *“and to develop, market and supply Customer Products”* be added;²⁹⁹
- (b) The current licence from NBN Co to Customers in relation to the Ordered Products only covers NBN-owned IPR. However, Optus notes that this licence should also expressly cover any third party-owned IPR which may subsist, or be embodied in, an Ordered Product;
- (c) In the context of the IPR warranty which NBN provides in respect of its products, Optus submits that NBN Co’s warranty should not be qualified by reference to NBN Co’s ‘level of knowledge’. This is a standard warranty provided by suppliers and NBN Co should be prepared to stand behind its products from an IPR perspective. To this extent, Optus considers the clause be redrafted as follows: *“NBN Co represents and warrants to Customer that, as at the date of supply of an Ordered Product, the supply and use in accordance with the terms of this Agreement of an Ordered Product will not infringe Third Party IPR.”*³⁰⁰

Risk management

9.106 NBN Co sets out its terms and conditions for Risk Management commitments at Schedule 1H, which effectively seeks to incorporate the terms detailed in Annexure 3 of this Schedule 1H.

9.107 The following sets out Optus’ comments with respect to the non-price risk management terms set out in both the November 2012 SAU.

Liability

9.108 NBN Co has set out commitments in relation to the liabilities (including exclusions and limitations) of each party to the other arising from or in connection with the Agreement.³⁰¹ However, Optus considers a number of issues remain outstanding and further amendments to these commitments should be addressed.

9.109 First, NBN Co has made explicit mention in relation to its liability for failure to meet Service Levels. Optus considers that the payment of any applicable Service Level Rebates should not limit any other rights or remedies which the Customer may have, or any liability which NBN Co

²⁹⁸ Schedule 1H, Annexure 2, Clause 5.2.

²⁹⁹ Schedule 1H, Annexure 2, Clause 5.2(a) – the suggested wording is to be added at the end of this clause.

³⁰⁰ Schedule 1H, Annexure 2, Clause 5.2(d).

³⁰¹ Schedule 1H, Annexure 3, Clause 2.

may have, in respect of any other cause of action arising out of the same event or circumstance that gave rise to the Service Level failure.

- 9.110 This issue has only partially been addressed³⁰² by capturing some but not all potential areas of liability for which a Customer should be entitled to recover from NBN Co. To this end, Optus suggests the following amendment to clause 2.2(b)(iii), where:

Clause 2.2(a) does not limit NBN Co's liability, or the Customer's rights or remedies:

for any other cause of action arising out of the event or circumstance that gave rise to the failure to meet the Service Level, including a claim under an indemnity or for negligence or for breach of another applicable provision of this Agreement; and

without limiting paragraph (a), to the extent that a matter described in clause 2.3(d)(i), (ii) or (iii) applies in respect of a failure to achieve a Service Level.³⁰³

- 9.111 The need for the above clarification has been increased as a result of the insertion of an additional clause³⁰⁴ by NBN Co, under which NBN Co excludes all liability for loss to the extent caused or contributed by a failure to achieve a Service Level (other than an obligation to pay any applicable Commercial Rebate).

- 9.112 Second, Optus considers that there should be no difference between the monetary cap on each party's aggregate liability to the other party under the Agreement, and those areas of liability which are not subject to the cap (for example, death or personal injury or damage to tangible property caused by a party's negligent or wilful acts or omissions). Rather, these provisions should apply equally to both parties.

- 9.113 Similarly, the aggregate cap proposed at clause 2.3(b)³⁰⁵ does not provide adequate coverage for Customers in light of potential exposures. In doing so, Optus considers the following changes would be appropriate:

- (a) Amend the annual cap to reflect a yearly (rather than monthly) billing amount. This could be calculated by simply multiplying the Average Monthly Billing Amount by 12; and
- (b) At a minimum, replacing the references to "\$5 million" with "\$10 million".

Limitation of liability

- 9.114 Optus notes that in the context of limitations of liability, the following principles should be considered:

- (a) Mutual exclusion of liability for consequential or indirect losses;

³⁰² Schedule 1H, Annexure 3, Clause 2.2.

³⁰³ Schedule 1H, Annexure 3, Clause 2.2(b)(iii).

³⁰⁴ Schedule 1H, Annexure 3, Clause 2.7(b)(iv).

³⁰⁵ Schedule 1H, Annexure 3, Clause 2.3(b).

- (b) Mutual indemnities for breach of confidentiality, third party intellectual property claims, death and personal injury and property damage;
- (c) Mutual requirements for each party to procure and maintain certain specified insurances; and
- (d) Provisions dealing with the occurrence of force majeure events which affect a party's performance of its obligations under the Agreement.

9.115 In general, Optus considers that there should be no exception to the general position that neither party is liable for Indirect Loss). As such, the exemption at clause 2.5(c) should be removed in its entirety.³⁰⁶

9.116 Perhaps more importantly, the general exclusion of liability at clause 2.7³⁰⁷ should be removed in its entirety on the basis that they result in an unreasonable transfer of risk and liability from NBN Co to the Customer. This is not acceptable in its current form for two main reasons.

9.117 First, Clause 2.7(a)(i) incentivises Customers to exclude as much liability as legally possible in agreements with their downstream customers, and transfer as much risk as legally possible, to those customers. This outcome can hardly be seen to be in the long term interests of end users. Further, this clause applies a test based on what liability the Customer could *in theory* lawfully exclude, when, particularly in relation to those customer agreements which are negotiated, this is simply not a realistic test in the context of 'real life' customer contracting.

9.118 Second, in light of the other contractual protections which NBN Co has under these terms, clause 2.7(a)(ii) is neither justified nor required. If Downstream Customer Losses are actually caused by a breach or other failure by NBN Co under or in connection with this Agreement and the Customer suffers loss or damage as a result, then NBN Co should be liable for those losses, assuming the Customer has a cause of action against NBN Co. Further, NBN Co already excludes Losses caused or contributed by:

- (a) any act or omission of the Customer, any Downstream Customer or any End User in breach of this Agreement or that is otherwise unlawful (clause 2.7(b)(i) and definition of Customer Event); or
- (b) any event or circumstance to the extent caused or contributed to by a Customer Network, Customer Platform, any Customer Equipment, or the network, systems, equipment or facilities of any of Downstream Customers or any End Users; and
- (c) NBN Co also has the protection of the indemnity relating to claims by Downstream Customers and other third parties in clause 3.5.³⁰⁸

³⁰⁶ Schedule 1H, Annexure 3, Clause 2.5(c).

³⁰⁷ In particular, Schedule 1H, Annexure 3, Clause 2.7(a)(i).

³⁰⁸ Schedule 1H, Annexure 3, Clause 3.5.

Definitions and interpretation

9.119 Optus notes that a number of clauses in the SAU³⁰⁹ refer to paragraph (d) in the definition of Excluded Event.³¹⁰ To this extent, Optus considers that the current drafting of this paragraph is unclear and could be interpreted in a way which is inconsistent with our understanding of the intent behind this paragraph. Paragraph (d) of this definition should therefore be amended to read as follows:

A failure or delay by a third party to supply products, services, facilities or infrastructure to NBN (or a failure in the facilities provided by a third party to NBN) but only where the failure or delay is caused by a Force Majeure Event.³¹¹

9.120 Similarly, the term Downstream Customer Loss is used in a number of provisions this Annexure 3 to Schedule 1H. Optus submits that the current definition is unreasonably and unnecessarily broad (and complicated). As such, it considers that this term should use, and be limited to, the key concepts of Downstream Customer and End User.

9.121 Further, a loss should not be captured simply because it happens to arise on a network which the Customer uses. For example, the current definition would capture (among other losses):

- (a) a loss suffered by another NBN Co Customer who happens to obtain a product or service from the contracting Customer (even though it has no connection with this agreement), where the loss suffered arises not from that product or service, but as a result of the NBN network or a service provided by NBN Co (that arises because of the reference to “*any telecommunications network... which Customer uses*”); and
- (b) loss suffered by NBN Co in connection with a service supplied by a Customer to NBN, which has absolutely no nexus with this agreement or its subject matter. This agreement should not undermine or interact with other separate agreements which NBN may have negotiated with individual customers.

9.122 Optus therefore proposes the following revised definition of Downstream Customer Loss:

“Downstream Customer Loss” means:

any Loss suffered by a Downstream Customer or an End User in connection with a Customer Product or a Downstream Product; and

any Loss suffered by the Customer as a result of any Loss referred to in paragraph (a) of this definition.

Dispute Management

9.123 The dispute management rules set out in Annexure 1 of this Schedule 1H largely exclude the involvement of the courts in favour of arbitration and expert determination.

³⁰⁹ Schedule 1H, Annexure 3, Clause 8.1.

³¹⁰ For example, Schedule 1H, Annexure 3, Clauses 2.7(b)(ii) and 4(c)(i).

³¹¹ Schedule 1H, Annexure 3, Clause 8.1.

- 9.124 A key principle of any contractual dispute regime which prevents a party from having recourse to the courts is that the process must be independent, and be seen to be independent, of any potential participant in the dispute process. The parties to the agreement should not have a role (or, if they do, only an extremely limited role) in the administration and adjudication of disputes.
- 9.125 While NBN Co has made significant improvements to the dispute management regime in the course of consultation on the WBA, there remain concerns about the extent of NBN Co's role in a regime which must be, and above all be seen to be, entirely objective, impartial and independent of the parties.
- 9.126 For example:
- (a) NBN Co nominates the Resolution Advisers and Pool Members.
 - (b) NBN Co negotiates and agrees the terms of appointment with each of the above adjudicators.
- 9.127 If a Customer reasonably believes that any of the above adjudicators has failed to comply with the Dispute Management Rules or their terms of appointment in a material way, it is still entirely at NBN Co's absolute discretion whether to take any action at all or even to consider or investigate the matter.
- 9.128 NBN Co has the sole ability to terminate the appointment of a Resolution Advisor or Pool Member (although there is at least a process under which the ACCC may object to a proposed termination). While a Customer has a right to notify NBN Co if it reasonably believes an event has occurred that gives rise to a right for NBN Co to terminate an appointment, it is entirely at NBN's discretion whether to act on the Customer's notice.
- 9.129 The above concerns are magnified by the fact that NBN Co excludes all liability for losses caused or contributed to by "Dispute Outcome Related Events" (even though NBN has obligations under the dispute management rules).³¹²
- 9.130 One specific concern is that the Dispute Management Rules (which prevent recourse to the courts except in very limited circumstances) could have the effect of limiting an access seeker's ability to seek orders from the Federal Court in relation to certain breaches of the SAU where that access seeker is party to an Access Agreement based on a SFAA. Pursuant to section 152CD of the Act, the ACCC and any person whose interests are affected by the undertaking is entitled to apply to the Federal Court in relation to a breach of a special access undertaking.
- 9.131 It should therefore be made expressly clear (such as by adding an additional paragraph in clause 9.1(b) of Annexure 1) that nothing in these rules prevents an access seeker from taking action under section 152CD of the Act.

³¹² Schedule 1H, Annexure 3, Clause 2.7(b)(iii).

Multilateral SFAA Forum

- 9.132 As set out in Clause 1B.3.1, the Multilateral SFAA Forum will be established as a multilateral consultation forum to engage with Access Seekers on possible changes to the terms of a SFAA. It will operate on a voluntary basis and is open *“to all Access Seekers irrespective of whether they have an Access Agreement with NBN Co.”*
- 9.133 Optus notes, however, that there are several contradictions to the objectives of the SFAA Forum currently touted by NBN Co.
- 9.134 For example, Clauses 1B.3.1(c) and 1B.3.1(d) establish that the purpose of the Multilateral SFAA Forum *“will include identifying and prioritising issues associated with any SFAA...”* and *“allow Access Seekers and NBN Co to suggest changes to any SFAA.”*
- 9.135 However, in Clause 1B.3.1(j) it notes that *“NBN Co may, but is not obliged to, discuss changes to any SFAA arising from a Regulatory Determination within the Multilateral SFAA Forum.”* It follows that given this is the identified forum in which any changes to the SFAA is to be discussed, it is unclear to what extent NBN Co will introduce the variation to the SFAA as result of a Regulatory Determination – i.e. this potentially removes the scope for Access Seekers to comment on NBN Co’s interpretation (and *timely* implementation) of the Regulatory Determination made in response to Access Seeker concerns.
- 9.136 Similarly, NBN Co maintains the discretion in Clause 1B.2.2(d) that *“When a Regulatory Determination expires, NBN Co may amend any SFAA to remove the effect of that Regulatory Determination on the SFAA.”* It should therefore be required that, at a minimum, a similar implementation review be applied for any roll-back of terms in the SFAA.
- 9.137 Another key example in which NBN Co affords itself the right to exercise discretion is through Clause 1B.3.1(e), which essentially notes *“NBN Co may make such changes to any SFAA as NBN Co considers appropriate, including any changes arising from the Multilateral SFAA Forum.”*
- 9.138 Finally, Clause 1B.3.1(f) entrenches the fact that the incorporation of such changes will only be made available in a *“new version of the relevant SFAA ... upon expiry of the term of the current SFAA.”* This same condition would apply to any changes not requiring ACCC approval to be applied in the SFAA and in effect trumps any requirement set out in Clause 6 for the alignment of the SAU with SFAA, particularly given the primacy of the SAU and the constraining requirement that NBN Co imposes on the ACCC that any Regulatory Determination must not be inconsistent with the SAU.
- 9.139 Optus considers that the removal of this constraint on the ACCC’s decision making process, and the ability for the ACCC to in effect set the timeframe within which to impose the implementation of the AD/BROC to flow through directly into a SFAA or executed WBA, so long as the AD/BROC meets the LTIE criteria, would at least mitigate some Access Seeker concerns on this issue.

Section 10. Does the SAU meet the legislative criteria?

- 10.1 This section addresses whether NBN Co's SAU meet the relevant legislative criteria. This section analyses whether:
- (a) The SAU meets the reasonableness criteria under s.152AH;
 - (b) The SAU contains provisions necessary for UNWP; and
 - (c) The SAU contains fixed principles that should not be fixed principles.

Reasonableness under s.152AH

- 10.2 The ACCC must not accept the SAU unless it is satisfied that the terms of the SAU are reasonable. The criteria to assess reasonableness are set out in section 152AH of the CCA. This section looks at the claims made by NBN Co in the Supporting Submission with respect to how the SAU meets the criteria set out in section 152AH.
- 10.3 Importantly, the access provider bears the burden to affirmatively satisfy the ACCC of the reasonableness of the SAU.³¹³ That is, NBN Co must satisfy the ACCC — the ACCC does not need to satisfy itself; nor does it need to prove that NBN Co has failed to do so.
- 10.4 Optus believes the arguments put forward in the NBN Co SAU Supporting Submission are inconsistent with the likely manner in which the SAU will operate over the next 27 years, and inconsistent with previous decisions made by the ACCC.
- 10.5 Notwithstanding any assessment of NBN Co's arguments, NBN Co has not provided sufficient evidence to enable the ACCC to make a proper assessment of the reasonableness of the SAU. Without such evidence, the ACCC is left without the means to accept the SAU. For example, no evidence has been put forward by NBN Co as to how the LTRCM is expected to operate over the 27 years of the SAU. Nor has NBN Co provided evidence as to the reasonableness of the individual price increase limit as a stand-alone price control.
- 10.6 Without such information, it is not possible for the ACCC to be satisfied that the LTRCM is reasonable.

Long term interest of end-users

- 10.7 NBN Co conclude in the Supporting Submission that the LTIE is promoted because:

The counterfactual scenario of having terms and conditions determined via SFAAs and ADs is likely to promote the LTIE to a lesser extent because it is unable to provide as much certainty up front, nor in so definite a manner, as is provided under the SAU and SFAAs. This lack of certainty inherent in the counterfactual implies adverse consequences

³¹³ See: Re Telstra Corporation Limited [2006] ACompT 4 (2 June 2006); Re Optus Mobile Pty Limited & Optus Networks Pty Limited [2006] ACompT 8 (22 November 2006).

*for the objectives of promotion of competition and encouraging efficient use of and investment in infrastructure when compared to the likely outcomes under the SAU.*³¹⁴

- 10.8 However, the definition of this counterfactual is contestable. Therefore it is not appropriate to define promoting the LTIE almost entirely on the concept of certainty. There is little doubt that the SAU will promote certainty over the 27 year timeframe. It does so, however, by locking in inefficient price structures, insufficient protections against inefficient investment and insufficient protection against the risk that this will lead to inefficient prices over the life time of the SAU.
- 10.9 Investment certainty is the key justification for the SAU put forward by NBN Co. But this argument is highly debatable – see Appendix A. Significant certainty can be provided through the use of ADs and fixed principles. It is possible for the ACCC to set fixed principles relating to cost methodologies and recovery of prudently incurred costs for a 27 year period, while relying on ADs to set detailed terms of access.
- 10.10 There is little evidence to demonstrate the SAU promotes the LTIE once certainty is removed as the principle justification for the SAU. Moreover, NBN Co has provided no evidence to satisfy the ACCC that absent certainty, the SAU promotes the LTIE.
- 10.11 In addition to certainty, NBN Co argues that the SAU promotes the LTIE as it meets the criteria under section 152AB that the ACCC must have regard to:
- (a) Promoting competition in markets for listed services;
 - (b) Achieving any-to-any connectivity; and
 - (c) Encouraging efficient use or, and investment in, infrastructure for listed services
- 10.12 Each of these elements is discussed in more detail below.

Promoting competition

- 10.13 The assessment of whether the SAU promotes competition, the ACCC needs to be satisfied that the following terms promote competition:
- (a) Declared services and supply-related terms;
 - (b) Price-related terms and conditions;
 - (c) Non-Price terms and conditions.
- 10.14 These three elements are discussed below.

³¹⁴ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.171.

Declared services and supply-related terms

- 10.15 Optus agrees that the wholesale-only structure of NBN Co, and its non-discrimination requirements, address several concerns that would arise from monopoly provision of wholesale fixed-line services.
- 10.16 In saying that, however, the structural separation and non-discriminatory pricing of NBN Co is not due to the SAU. The Supporting Submission implies that a benefit of the SAU is that it allows for such arrangements. NBN Co quotes the ACCC Draft Decision in relation to FANOC. There is a clear distinction between the two: the FANOC SAU was required to ensure a structural separation and non-discriminatory pricing.³¹⁵ Whereas these features of NBN Co come from legislation, and apply in both the factual and counter-factual worlds.
- 10.17 Therefore, the ACCC cannot regard these features as a benefit flowing from the SAU: Irrespective of the counter-factual adopted by the ACCC, without the SAU these features would still be present as they are set down in legislation.
- 10.18 Another benefit put forward by NBN Co is that the design of NBN products allows for multiple access seekers to provide retail and wholesale services to the same end-user location.³¹⁶ Again, this is not dependent on the SAU. Further, as discussed in section 7, the features of the multicast product developed by NBN specifically prevent multicast and bitstream access to be provided by separate access seekers. This means that there are NBN products containing features that are specifically designed to (or at the minimum have the likely effect of) limit competition in downstream markets.
- 10.19 Optus submits that the ACCC cannot rely upon the claim that a benefit of the service description in the SAU is that it guarantees that multiple access seekers are permitted to provide services to the same end-user location. More importantly, it appears that the SAU will not constrain NBN Co from being able to introduce products that do not permit multiple access seekers to provide services to the same end-user location.
- 10.20 Optus concludes that many of the 'benefits' of the SAU put forward with respect to declared services and supply-related terms are not benefits flowing from the SAU (i.e., without the SAU the benefits would still exist), nor do they accurately represent the nature of products actually offered by NBN Co, or limit the ability of NBN Co to design products in an inconsistent manner over the 27 year term of the SAU.

Price-related terms and conditions

- 10.21 NBN Co states that the ACCC has accepted that price certainty is likely to promote competition.³¹⁷ As explained in Appendix A, without the SAU it is possible that the same level of certainty can be provided through fixed principles in access determinations. The SAU provides no incremental certainty above fixed principles. Certainty is no doubt a benefit, but

³¹⁵ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.162.

³¹⁶ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.162.

³¹⁷ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.163.

certainty of inefficient prices does not negate the detriment of inefficient pricing. Optus submits that the focus should be on the appropriateness of the current pricing, and possible future pricing allowed under the SAU. If current and future pricing is not efficient, then the level of additional certainty provided by the SAU is irrelevant.

- 10.22 NBN Co claims that its charges “*have been designed, amongst other things, to allow Customers to provider a smooth transition for End Users to the NBN.*”³¹⁸ Section 4 and section 7 show that this claim is not correct. NBN Co’s initial pricing with respect to business products and CVC clearly demonstrate that there will not a smooth transition to the NBN.
- 10.23 NBN Co also claims that since it is not vertically integrated it has an interest to develop downstream markets.³¹⁹ Section 4 shows that the current intention of NBN Co for its multicast service demonstrates this claim is open to dispute. More importantly, there appears nothing in the SAU to prevent NBN Co from introducing new services that are inconsistent with developing downstream markets. Under the SAU, there is no role for the ACCC to review price trends of current products, or the initial price of new products. Furthermore, ACCC has no role with regards to any product within the Initial Product Roadmap. Optus submits that the ACCC cannot be satisfied that NBN Co will price in manner to develop downstream markets throughout the lifetime of the 27 years SAU.
- 10.24 NBN Co further claims that the LTRCM will ensure that the prices will, over time, recover no more than its prudently incurred costs.³²⁰ Section 5 and section 6 demonstrate that the prudency provisions in the SAU are not sufficient to ensure that NBN Co, the monopoly provider of fixed-line services, incurs only prudent costs; and show that the ICRA is unlikely to be extinguished during the lifetime of the 27 year SAU thus avoiding the implementation of the overall revenue price cap. Optus submits that the ACCC cannot be satisfies that the LTRCM is sufficient to ensure that prices will, over the 27 year timeframe of the SAU, recover only prudent costs. Importantly, the SAU specifically excludes any ACCC oversight on prices during the 27 years: and excludes ACCC oversight over costs incurred during the build period.
- 10.25 Furthermore, NBN Co has provided no evidence to support its claims as to how the LTRCM will work over time. Optus demonstrates in section 6 that, using NBN Co’s Corporate Plan and reasonable assumptions, the LTRCM will result in significantly greater cost recovery than required to meet the required 7% IRR. Further, the LTRCM will operate so as to ensure that no overall revenue cap is placed on NBN Co. This result has been confirmed by NBN Co in a letter to Optus.³²¹ In other words, using available evidence, the LTRCM will not operate as NBN Co claim in the Supporting Submission. Importantly, NBN Co has provided no other evidence to demonstrate that the LTRCM is in the LTIE. The ACCC cannot, therefore, be satisfied that it does so.

³¹⁸ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.164.

³¹⁹ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.165.

³²⁰ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.165.

³²¹ Lovell, C., Letter to Andrew Sheridan re: NBN Co Special Access Undertaking, 14 January 2013.

- 10.26 The lack of ACCC oversight is not addressed by NBN Co when submitting that the price terms and conditions proposed in the SAU promote competition. Throughout this submission, Optus has argued that there are two key considerations the ACCC should take into account:
- (a) Do the provisions in the SAU promote competition in the current market given the observed behaviour of NBN Co?
 - (b) Do the provisions in the SAU sufficiently manage the risk of detrimental outcomes over the time frame so that the ACCC can be confident the LTIE will be promoted over the next 27 years?
- 10.27 A key question that the ACCC must ask is: whether NBN Co has provided sufficient evidence for the ACCC to make a decision on the above issues.
- 10.28 In addition to the claims made by NBN Co as to how the SAU price terms promote competition, it is instructive to compare the price terms against factors that the ACCC has previously stated are required to promote competition. The ACCC has provided guidance that access prices or pricing methodology are likely to promote competition where:
- (a) Prices are cost-based;
 - (b) Prices do not discriminate in any way that reduces efficient competition;
 - (c) Prices are not inflated to reduce competition in related markets; and
 - (d) Prices are not predatory.³²²
- 10.29 As described above, NBN Co has justified initial prices in the SAU based on a reference to anchor prices and claims that access seekers are happy with the prices. These claims have been addressed and proven not to be accurate – see section 7. NBN Co has provided no evidence as to whether prices are cost-based, or will be cost-based over the 27 year period of the SAU. NBN Co has not provided the ACCC, or interested parties with any model or evidence as to how the initial prices and their forecasted change over time relate to the efficient costs of providing the service. In the context of a five year SAU, the ACCC has previously stated that it required more evidence above extensive modelling (TSLRIC+) before it can be confident prices are appropriate.³²³
- 10.30 Optus recognises that some of the initial prices in the SAU may be in within an appropriate range. It is also clear from section 7 that there are some initial prices that are outside an appropriate range. The ACCC has previously commented that notwithstanding initial prices, it must be satisfied that future prices will also be appropriate. The ACCC previously rejected a 15 year SAU because the future “*price path may lead to substantial price shocks over the lifetime*

³²² ACCC, Assessment of FANOC’s Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.138.

³²³ ACCC, Assessment of FANOC’s Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.138.

of the SAU".³²⁴ In order for the ACCC to have confidence of the future price path over a 27 year SAU, it must have before it detailed modelling outlining expectations of future price paths. No such evidence has been presented by NBN Co. Section 4 demonstrates that the price structure and the CPI-1.5% individual price increase limit will result in prices that are significantly greater than the historical price trend for internet services. Further, there appear no legally enforceable provisions to prevent NBN Co from introducing prices for new services at any level it sees fit. And NBN Co has conceded that it does not expect the overall revenue cap to apply by 2039-40.

- 10.31 The ACCC further stated that effective oversight is vital to ensure that access prices are appropriate.³²⁵ Optus reiterates that the SAU: specifically excludes the ACCC from reviewing prices set during the 27 year term of the SAU; and excludes ACCC oversight over costs incurred during the build period of the SAU (first 10 years).
- 10.32 Optus submits that on the evidence before it, the ACCC cannot be satisfied that the proposed initial prices, and the potential future price trends, would promote competition.

Non-price terms and conditions

- 10.33 The ACCC has previously stated that while commercially negotiated non-price terms is expected to be the more usual outcome, it would be preferable if key terms and conditions:

*... are not determined unilaterally by the access provider or solely through bilateral negotiations in circumstances where one negotiating party has little countervailing bargaining power.*³²⁶

- 10.34 However, the non-price terms and conditions in the SAU provide NBN Co with the unilateral ability to decide the terms, when to amend the terms, and to assess any changes. There is no ability of the ACCC or access seekers to seek, or to demand, any change to the non-price terms and conditions outlined in the SAU. Optus' concerns are outlined in section 9.
- 10.35 Optus submits that the inclusion of detailed provisions within the SAU will lock in a set of terms and conditions that are inflexible and are likely to become out of date quickly. Such terms will not promote the LTIE over the next 5, 10 or 27 years. The terms of the SAU also in effect lock out any ACCC oversight on non-price terms and conditions. Moreover, the midterm review allowed within Module 1 contains rules which enable NBN Co to control the process and to have final say as to any amendments to the SAU.
- 10.36 Furthermore, the actual provisions are not sufficient to ensure that the LTIE will be promoted during the lifetime of the SAU. This is reflected by the fact that industry and NBN Co have failed to fully agree on the detailed terms of the WBA after almost two years of consultation. It

³²⁴ ACCC, Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.138.

³²⁵ ACCC, Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.139.

³²⁶ ACCC, Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.139.

is instructive to note that NBN Co does not believe that industry agreement can ever be achieved, and that in its opinion the terms it has proposed in the final WBA provide a balance between the interests of NBN Co and its customers – notwithstanding the fact that its customers do not agree with this position.³²⁷

10.37 Optus submits that only a provider with significant market power is able to unilaterally declare terms in an agreement finalised without agreement from its customers. With such powers, the ACCC cannot be satisfied that the non-price terms, and NBN Co's ability to unilaterally set and vary terms, promotes the LTIE.

10.38 Optus believes that the only way forward to ensure that non-price terms and conditions promote the LTIE, is to make certain the SAU reflects a principles-based approach; with the ability of ACCC to set appropriate regulatory determinations should the need arise. In the absence of such an explicit role for the ACCC, it would be preferable for the key non-price terms and conditions to be contained within the WBA/SFAA so as to enable the ACCC to make regulatory determinations that access seekers can rely upon when seeking access agreements with NBN Co.

Any-to-any connectivity

10.39 Optus has no comments.

Efficient use and investment

10.40 The ACCC has previously commented that its focus, and that of the Tribunal, has traditionally been on the efficiency of the proposed pricing.³²⁸ The ACCC must be satisfied that there are sufficient safeguards in the SAU for it to be satisfied that efficient prices will be set over the lifetime of the SAU.

10.41 Further, the ACCC must be satisfied that the provisions of the SAU ensure that only efficiently incurred costs are recovered. It is shown in section 4 that the NBN will be susceptible to strong incentives to incur inefficient expenditure.

Allocative efficiency

10.42 NBN Co claim that the proposed pricing balances the need of high take up and high rates of usage through:

- (a) Affordable AVC prices; and
- (b) Affordable CVC prices.³²⁹

³²⁷ Hassell, J., Letter Re: NBN Co's Draft Wholesale Broadband Agreement (WBA), 7 December 2012.

³²⁸ ACCC, Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.140.

³²⁹ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, pp.167-8.

- 10.43 However, such claims have been shown to be false in section 4, where it is demonstrated that the current price structure will lead to significant increases in the cost of internet access over the next 10 years. Over the last 5 years real internet prices have fallen by 18% and access speeds have more than doubled. To repeat this trend over the first 5 years of the SAU results in a real price increase of at least 13.5%.³³⁰ If the same trend was again repeated for the second 5 year period of the SAU, end-users would face a 58.8% real price increase.³³¹
- 10.44 Stakeholders have repeatedly informed NBN Co that the AVC component of several proposed products is not fit for purpose, and is inconsistent with current industry pricing. Further, NBN Co has been informed by stakeholders that the level of CVC pricing is inconsistent with industry pricing and will likely discourage efficient usage of the NBN overtime. **[CIC]**
- 10.45 Furthermore, industry has raised concerns with NBN Co that the pricing structure is inconsistent with the cost drivers of a FTTP network. The fundamental cost structure of the FTTP network is high access costs and low usage costs: NBN Co has priced its products opposite to this.
- 10.46 NBN Co has failed to address these points either in industry consultation, or in the current SAU process. In addition, the ACCC does not have before it sufficient evidence on which it can be confident that the price level and structure proposed in the SAU will ensure allocative efficiency over the 27 year timeframe of the SAU. NBN Co relies upon its good will to lower prices over time: however, there are no commitments to do so within the SAU.
- 10.47 Optus submits that relying on the good will of a monopoly provider to ensure the LTIE is promoted is not reasonable.
- 10.48 NBN Co also relies on the efficiency of the LTRCM.³³² As shown in section 4, section 5, and section 6, the proposed mechanisms in the LTRCM are not sufficient to address the concerns about excessive expenditure and pricing that arise from NBN Co's legislatively protected monopoly position in wholesale fixed-line services and government ownership.
- 10.49 Importantly, NBN Co has conceded that it does not expect the overall revenue cap to come into force by the end of 2039-40.³³³ This admission counters claims made within the Supporting Submission that the revenue cap will help ensure the reasonableness of the SAU.

Productive efficiency

- 10.50 The Supporting Submission justifies the productive efficiency of the SAU by reference to:
- (a) Prudency commitment in the SAU;
 - (b) Analysys Mason Report;

³³⁰ Access speeds increasing from BAO to EAO.

³³¹ Access speeds doubling from 25Mbps to 50Mbps.

³³² NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.168.

³³³ Lovell, C., Letter to Andrew Sheridan re: NBN Co Special Access Undertaking, 14 January 2013.

- (c) Ordover and Shampine and Synergies reports; and
- (d) Commercial incentives to keep costs low.

10.51 It has been shown in section 5 that the prudency provisions in the SAU will not guarantee that NBN Co will incur only efficient costs. Importantly, the drafting is such that the terms contain built-in subjectivity which means that the ability to enforce compliance with the Prudent Cost Condition is effectively of no value.

10.52 Optus previously provided comments on the deemed prudency of the network design rules and use of the Analysys Mason Report on which it is justified.³³⁴ Optus has previously pointed out the important role the ACCC has played with respect to POI locations and numbers as an indication how the preferred NBN Co network design may not be consistent with promotion of competition and the long term interest of end-users.³³⁵

10.53 The Ordover and Shampine report, while agreeing that the principles of the SAU are efficient, specifically state that they have not looked at the specific provisions within the SAU.³³⁶ Optus submits little weight can be placed on this report. Optus too, agrees with many of the principles of the SAU. However, the provisions of the SAU will operate in a manner significantly different from the principles. Ordover and Shampine provide no opinion on the actual provisions contained within the SAU — the authors explicitly state they do not opine of the specific provisions.³³⁷ For example, Optus agrees that prudent costs should be recovered. However, the prudency provisions in the SAU will not ensure that this occurs.

10.54 The Synergies Report also fails in a similar manner: the experts assume that the provisions would operate as advocated by NBN Co. There appears to be no independent analysis as to how the provisions would likely work in reality. Specifically:

- (a) Synergies conclude that initial pricing is set at levels consistent with legacy products.³³⁸ However, Optus analysis demonstrates that many prices put forward by NBN Co are not consistent with legacy products (see section 7). **[CIC]**
- (b) Synergies conclude that the CPI-1.5% increase limit is likely to result in prices that would be considered efficient.³³⁹ However, Optus' analysis shows that the CPI-1.5% limit is likely to result in future prices inconsistent with the historic price trend for internet access prices (see section 4). Such divergence questions whether future prices would be considered efficient.

³³⁴ Optus Submission to the ACCC Supplementary Consultation NBN Co's Special Access Undertaking (Public Version) 30 March 2012, p.33.

³³⁵ Optus Submission to the ACCC Supplementary Consultation NBN Co's Special Access Undertaking (Public Version) 30 March 2012, p.33.

³³⁶ Ordover and Shampine, p.16.

³³⁷ See footnote 1 of Ordover and Shampine.

³³⁸ Synergies Consulting, September 2012, p.5.

³³⁹ Synergies Consulting, September 2012, p.5 and section 4.3.

- (c) Synergies conclude that use of forecasts in subsequent revenue period is consistent with accepted regulatory practices.³⁴⁰ However, Optus' analysis shows that use of forecasts during the ICRP leads to the ability of NBN Co to maintain the regulatory loss making period while at the same achieving financial profits — thus undermining the claim that the LTRCM constrains NBN Co from recovering more than its efficient costs.³⁴¹ In addition recent changes to the NER demonstrate that reliance on forecasts without full regulatory oversight is not consistent with regulatory practices in other industries (see section 4).
- (d) Synergies conclude that while alternative approaches to the RAB (i.e. replacement and optimised asset valuation) could foster more efficient investment, there are adequate provisions within the SAU to obviate this advantage.³⁴² However, Optus' analysis shows that the prudency provisions are inadequate (see below and section 5).
- (e) Synergies conclude that the prudency provisions in the SAU are adequate and can be expected to deliver efficient outcomes.³⁴³ However, a review of the actual provisions and its expected operation shows that:
- (i) The Prudent Cost Conditions are unenforceable and provide no or little restriction on the ability of NBN Co to incur excessive costs;
 - (ii) Synergies makes no comment on the efficiency of the deemed expenditures, and therefore no weight can be placed on its conclusion on deemed prudency;
 - (iii) Synergies makes no comment on the efficiency of the network design rules, and therefore no weight can be placed on its conclusion on deemed prudency;
 - (iv) Synergies fails to accurately reflect the nature of industry consultation during the engagement process, and fails to note the highly restrictive terms of consultation and ability of ACCC to review; and
 - (v) Synergies does not accurately portray the requirement of NBN Co to seek to achieve lowest cost of ownership, and overstates the ability of market forces to constrain a government-owned monopoly provider.
- (f) Synergies conclude that the loss capitalisation scheme (ICRA) in the SAU can reasonably be expected to result in efficient outcomes due to internal incentives of NBN Co to prevent capitalised losses; prudency requirements; and likely prices

³⁴⁰ Synergies Consulting, September 2012, section 4.

³⁴¹ This claim was repeated in the recent letter to Optus re: NBN Co Special Access Undertaking, 14 January 2013.

³⁴² Synergies Consulting, September 2012, pp.8, 60, 79.

³⁴³ Synergies Consulting, September 2012, pp.9-10.

during the initial regulatory period.³⁴⁴ Importantly, Synergies did not seek to examine how the ICRA would operate over the lifetime of the SAU. Optus' analysis raises serious doubts over these conclusions, specifically:

- (i) Governance arrangements prevent losses accumulating to where investors will not make a return. Optus notes, however, that such incentives do not hold when the regulated WACC is set above the actual cost of financing. When the WACC is greater than the actual cost, it is profit-maximising to over-invest and increase the RAB (see section 6).
- (ii) The NBN Co Corporate Plan shows that the financial return expected over the next 27 years diverges significantly from the ICRA (see section 6). This further weakens any internal or market incentive to limit regulatory losses incurred.
- (iii) ICRA incurs significant losses even while NBN Co is making positive profit and EBITDA margins. For example, in 2040 it is forecasted that NBN Co will make an EBITDA margin of 77 per cent, and yet the ICRA *increases* by around \$4 billion (see section 6). There is a clear disconnect between financial performance and regulatory accounting.
- (iv) Synergies overstates the likely incentives provided by the market and investors – in effect Synergies assumes NBN Co faces the same incentives as a privately-owned firm. However, NBN Co is fully government-owned and is not expected to make a commercial return.³⁴⁵ In addition, government-ownership provides NBN Co with many advantages not seen by private firms: including easier access to finance and lack of insolvency risk. This combined with non-commercial incentives demonstrate that NBN Co will face fewer incentives than private firms to operate efficiently (see section 4).
- (v) Prudency provisions are unlikely to provide any restrictions on NBN Co to incur costs it sees fit. Combined with the absence of any regulatory oversight on costs incurred, the SAU does not adequately protect against the risk of excessive costs (see section 5).

10.55 Finally, it would appear that NBN Co and its experts effectively rely upon the commercial incentives faced by NBN Co to ensure that absent any regulatory oversight, or effective provisions within the SAU, productively efficient outcomes are achieved during the 27 year term of the SAU. Optus believes this significantly overstates the actual commercial incentives likely to be faced by NBN Co. First, it is clear that NBN Co is not required to make a commercial return: indeed this is a key reason for its existence. Second, empirical evidence from the electricity market shows that government-owned business incur higher capex, opex and have

³⁴⁴ Synergies Consulting, September 2012, pp.10-1.

³⁴⁵ See Section 6, and AGCNCO, 2011, *NBN Co*, Investigation No. 14, November, Canberra.

higher staff ratios than private firms. Third, NBN Co is receiving subsidised funding below the proposed market-based WACC, thereby creating an incentive to over-spend on capex.

- 10.56 Moreover, even if NBN Co were to operate in a manner consistent with private ownership, and within a market with some level of competition, the ACCC has consistently found that relying solely on such outcomes is not sufficient to manage the risks of inefficient outcomes.³⁴⁶

Dynamic efficiency

- 10.57 NBN Co submits that the SAU promotes dynamic efficiency due to:

- (a) LTRCM encouraging efficient investment;
- (b) Specific pricing commitments provide certainty for investment; and
- (c) Customer engagement via PDF.

- 10.58 It has been discussed above how the detailed provisions in the LTRCM will not work as intended; and will likely not prevent inefficient expenditure or inefficient pricing during the ICRP. Moreover, NBN Co has conceded that it does not expect the LTRCM to become binding during the lifetime of the SAU.³⁴⁷

- 10.59 While pricing commitments are useful for access seekers, it is ultimately the level of the pricing commitments that impact on efficiency: not merely the presence of commitments. It has been shown above that:

- (a) The level of initial prices are not efficient for a variety of products (including business offers and multicast), and the structure of the AVC/CVC charges are inconsistent with cost causation principles;
- (b) The overall revenue cap is unlikely to be in effect during the lifetime of the SAU, thus placing sole reliance on the individual price increase limit;
- (c) There appears little effective restraint upon the introduction of inefficient prices for initial and new prices; and
- (d) The individual price increase limit is inconsistent with industry trends, and over time, does not address the risk of inefficiently high pricing by a monopoly provider of fixed-line services.

- 10.60 Finally, NBN Co's reliance upon the PDF process to ensure dynamic efficiency is promoted is questionable. As discussed in section 8, industry consultation to date has not been without its difficulties. Many concerns raised by industry have failed to be taken on board by NBN Co. Given this observed behaviour, little confidence can be placed upon NBN Co's reliance on the PDF process to promote dynamic efficiency of the 27 year life time of the SAU.

³⁴⁶ See, for example, FANOC Draft Decision, and recent comments by AER on the need for changes to the NER.

³⁴⁷ Lovell, C., Letter to Andrew Sheridan re: NBN Co's Special Access Undertaking, 14 January 2013.

Legitimate business interests of access provider

- 10.61 Optus agrees that the proposed SAU should result in NBN Co being able to recover its cost of provisions, and thus would be consistent with its business interest. However, there remain significant doubts as to whether it is in the “legitimate” interests of NBN Co to be allowed such flexibility and market power over the price and non-price terms.
- 10.62 The legitimate business interests of NBN Co would also be promoted through the adoption of fixed principles and ADs. Effective regulatory oversight and auditing has been recognised as being important aspect of ensuring the legitimate business interest is promoted.³⁴⁸ The proposed SAU does not contain such provisions.

Interests of persons who have a right to use the declared service

- 10.63 The non-discriminatory and wholesale-only nature of the NBN does promote the interests of persons who have a right to use the declared service. However, these elements are not sufficient to offset the potential damage cause by inefficient price and non-price terms. Appropriate and efficient price and non-price terms are the relevant concerns.³⁴⁹
- 10.64 As described above, it is clear that the proposed SAU does not contain sufficient provisions to ensure efficient and appropriate price and non-price terms over the 27 year life time of the SAU. In addition, NBN Co has not submitted adequate evidence demonstrating that the SAU would promote adequate and efficient terms over its lifetime.

Direct costs of providing the declared service

- 10.65 The provisions of the SAU, including the LTRCM and ICRA mechanism, are sufficient to ensure that NBN Co is able to recover the direct costs of providing declared services – subject to the requirement that the costs included in the LTRCM reflect the actual efficient costs incurred by NBN Co.

Operational and technical requirements

- 10.66 Optus has no comments.

Economically efficient operation of network

- 10.67 Optus has no comments.

³⁴⁸ ACCC, Assessment of FANOC’s Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.171.

³⁴⁹ ACCC, Assessment of FANOC’s Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.141.

Uniform National Wholesale Pricing

- 10.68 NBN Co justifies several price terms and conditions on the basis that they are reasonably needed to achieve uniform national wholesale pricing (UNWP). The ACCC cannot reject an SAU on the basis of terms that are needed for UNWP under provisions in the CCA.³⁵⁰
- 10.69 Section 6.10 of the SAU Supporting Submission states that the following price related terms are necessary for UNWP:
- (a) Prices that do not vary by location or the network over which services are delivered;
 - (b) ICRA mechanism, allowing unrecovered costs to be recovered in later years; and
 - (c) Once ICRA is extinguished, a single overall revenue cap applies across all services and networks.
- 10.70 Optus notes that the principle of UNWP, and the requirement to set prices that do not vary by location of network, are a feature of the CCA and not subject to change in the current process. Given this base case, the principle of an overall revenue cap applied across all services would appear reasonable.
- 10.71 In addition, the *principle* that losses in early years can be recovered in later years is also consistent with the LTIE. However, while the principle is consistent, Optus submits that the operation of the ICRA mechanism is not consistent with the LTIE. Nor is the ICRA mechanism reasonably required to ensure UNWP. This is discussed in more detail in section 6. Moreover, NBN Co has failed to provide sufficient evidence to support that claim that the LTRCM, as drafted in the SAU, will operate over the lifetime of the SAU in a manner consistent with the claim it is needed to ensure UNWP. Optus reiterates that the *only* evidence before the ACCC is that the LTRCM does not operate in a manner needed to ensure UNWP.

Assessment of Fixed Principles

- 10.72 The SAU states that all of Module 0 and Module 2 are fixed principles. Under clause 152CBAA, if a SAU contains a fixed principle and the original SAU was accepted by the ACCC, then during the term of the fixed principle, the ACCC cannot reject a subsequent SAU for a reason that concerns the fixed principle.
- 10.73 The ACCC noted in the Supplementary Information Paper that:
- ... if a fixed principles term or condition sets out high-level principles involving judgment and discretion, there is a question as to whether the ACCC may reject a variation for the reason that the variation does not comply with these principles.*³⁵¹
- 10.74 Optus is concerned that the terms of clause 2D could have the effect of preventing the ACCC from reviewing the revenue, capex or opex forecasts proposed in any Replacement Module.

³⁵⁰ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, section 6.10.

³⁵¹ ACCC, Supplementary information paper about the Special Access Undertaking given to the ACCC by NBN Co Limited and NBN Tasmania Limited on 18 December 2012, p.3.

For example, clause 2D.3 states that forecasted revenue is the expected value of the amount of revenue that NBN Co is expected to earn. However, ACCC may be prevented from rejecting a Replacement Module for a reason that concerns clause 2D.3 — for example, ACCC disagrees with the forecast.

- 10.75 Such concerns are magnified by the high-level principles in clause 2D.6, which outlines the relevant consideration for forecasts. These terms necessarily involve judgment and discretion, and as such, ACCC may be prevented from rejected a Replacement Module for a reason that concerns the operation of judgement from NBN Co.
- 10.76 It is not clear how much ability the ACCC will have to conduct a full review of NBN Co forecasts, and where necessary, to insert its own forecast in replacement of a rejected NBN Co forecast. Any restriction on the ability of ACCC to do so risks replicating the flawed elements in the previous electricity regulatory regime: which has now been amended to allow the AER more freedom to review and replace forecasts. Optus reiterates that any proposal which prevents the ACCC from having full *ex ante* and *ex post* review powers is inconsistent with existing regulatory regimes applied in Australia.
- 10.77 The existence of the Fixed Principles should form an important consideration as to whether the ACCC can approve a SAU. The ACCC “*must refuse to accept the undertaking*” if the ACCC thinks the fixed principles should not be a fixed principle.³⁵² This is independent of whether the ACCC assesses the clause as reasonable, or considers that the SAU in total is reasonable. The fixed principles in Module 2 raise serious doubts whether the Replacement Module scheme will operate as put forward by NBN Co in the Supporting Submission. There is a real risk that accepting the SAU will exclude the ACCC from having any role in amending, reviewing or rejecting a Replacement Module based on unreasonable forecasts.
- 10.78 If the ACCC cannot intervene to prevent excessive expenditure during Module 2, the SAU should not be accepted. Further, Optus recommends that the ACCC reject the SAU on the basis that it proposed fixed principles that should not be fixed principles — this is irrespective of whether the considerations in clause 2D.6 are reasonable.

³⁵² CCA, s.152CBD(4).

Appendix A. Investment certainty and NBN

- A.1 A central justification for the approach adopted by NBN Co is that the approach provides it with the long-term certainty necessary to promote long run investment in long lived infrastructure.
- A.2 Optus accepts that NBN Co has a legitimate claim for regulatory certainty sufficient to ensure that it can recover its efficiently incurred costs. However, it is not the case that NBN Co necessarily needs a SAU in the form prescribed to achieve this aim.
- A.3 In this section, Optus identifies that;
- (a) By the nature of its governance arrangements NBN Co already enjoys a significant degree of certainty in its operating environment compared to commercial entity operating in a competitive market; and
 - (b) That any additional certainty NBN Co requires can be delivered through alternate mechanism to an SAU.

Investment certainty is key reason for the SAU

- A.4 In the Supporting Submission,³⁵³ NBN Co states that the purpose of the SAU is “to provide an appropriate degree of certainty to Access Seekers, their End Users and NBN Co” about the products, prices and non-price terms and conditions of access. In addition, the SAU provides the long term framework “reasonably necessary” for NBN Co to deliver on the goal of uniform national wholesale pricing (UNWP).³⁵⁴
- A.5 NBN Co argues that the SAU (in combination with wholesale agreements³⁵⁵) is the preferred regulatory mechanism over the alternative of the ACCC relying on its legislative powers because it can provide long term certainty and be more procedurally efficient.
- A.6 NBN Co continues to argue that the 27 year time frame of the SAU is required to ensure that the costs of the NBN can be recovered in the long term.³⁵⁶ NBN Co state:

To allow NBN Co to recover these losses at a later date, it is important for NBN Co to have certainty that the ‘rules of the game’ (the applicable regulatory model) will not change before NBN Co has had the opportunity to unwind these losses, and that NBN Co is not prevented from recovering accumulated losses as a consequence of the transition from one regulatory control period to the other.³⁵⁷

³⁵³ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012.

³⁵⁴ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.2

³⁵⁵ Wholesale agreements are available with or without acceptance of the NBN SAU.

³⁵⁶ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.3.

³⁵⁷ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.52.

- A.7 In effect, NBN Co's fundamental justification for the SAU is that it is necessary to over-ride and limit the legislative powers of the ACCC in order to provide certainty and procedural efficiency.
- A.8 In the assessment of the SAU against the legislative requirements under Part XIC, NBN assert that the SAU can be *reasonably assumed* to provide greater regulatory certainty than the proposed counterfactual of relying on access determinations made by ACCC. This is solely based on the fact that the nature, extent and timing of any access determinations are not currently known.³⁵⁸
- A.9 The NBN provide expert support for its submission that the SAU is required to provide sufficient certainty required for its investment. Ordover and Shampine identified that an economic issue of concern is investment uncertainty. Their argument can be summarised as follows: the NBN is a significant investment, most of which will be sunk. Firms that invest in large sunk assets do so with the expectation that it will earn sufficient returns on that investment (taking into account the inherent market risks). However, once assets are sunk there is a risk that the regulator may wish to lower revenues below that needed to ensure recovery of prudently incurred costs. NBN Co would be aware of this risk, and its willingness to invest would in part be influenced by the level of risk regulatory intervention possess.³⁵⁹
- A.10 The Ordover and Shampine analysis focuses on the need for certainty with regards to long term cost recovery in order to ensure efficient investment incentives. The benefits of the SAU, according to Ordover and Shampine, is that it provides a long term commitment allowing an appropriate rate of return (the long term revenue constraint methodology), thus providing the NBN with sufficient certainty to encourage investment.³⁶⁰
- A.11 The expert opinion, quite appropriately, raises concerns about the level of uncertainty created by the potential for regulatory intervention in sunk assets. Ordover and Shampine conclude that they support the general approach of using a credible long-term commitment to a rate of return to promote investment in sunk assets. Ordover and Shampine conclude that:
- .. we have **not been asked to opine on the individual components** of the formulae in the SAU. However, based on our knowledge and experience, we can conclude that the **general approach of using a credible long-term commitment** to a rate of return acceptable to the investors is commonly used and a reasonable and effective means of encouraging durable sunk investment.*³⁶¹
- A.12 However, this does not lead to the conclusion that the proposed SAU is the only or best mechanism through which this uncertainty can be addressed — or specifically that the SAU

³⁵⁸ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.161.

³⁵⁹ Ordover and Shampine, p.14-5.

³⁶⁰ Ordover and Shampine, p.16.

³⁶¹ Ordover and Shampine, p.16.

meets the legislative test and is in the LTIE. The experts have not been requested to provide comments on the details of the SAU, rather only the general approach adopted.³⁶²

Investment certainty and specifics of the NBN

- A.13 The incentive to invest in durable sunk assets will be increased in the presence of a long credible commitment to a regulated rate of return. The relevant policy question, however, is what level of additional long term commitment is required by the NBN to invest in the efficient level of assets.
- A.14 The NBN rely upon the expert opinion of Ordover and Shampine that a long-term commitment to rate of return regulation would encourage investment in sunk assets. As noted above, the experts make no opinion on the specifics of the SAU, and make no opinion on whether the content of the SAU is appropriate.
- A.15 However, on the general point regarding the need for long-term commitments, NBN Co fail to adequately note key qualifications of their experts, which materially impact on the applicability of their conclusions to the specific facts in Australia. For example, Ordover and Shampine state that:

*At the same time, a legal monopolist subject to regulatory oversight is to a significant extent protected from the rigors of market competition which should reduce the risk from investment. Such reduction in risk can, all else being equal, encourage investment.*³⁶³

- A.16 This view is qualified further by the fact that NBN Co is a wholly-owned government enterprise:

*We understand that, at the present, NBN Co is entirely government owned. If NBN Co were to operate strictly as a government funded entity, then return on investment would not necessarily impact its investment decisions (i.e., if the Government wished to run NBN Co at a loss it could do so).*³⁶⁴

- A.17 NBN Co note that the ACCC has previously accepted the principle that a longer term SAU can be justified by providing greater regulatory certainty for investors of new services³⁶⁵ and that this regulatory certainty is likely to promote competition. NBN Co specifically refers to the FANOC Decision.³⁶⁶ The NBN, however, does not refer to the full quote:

This approach would provide a high degree of regulatory certainty for access providers making significant new investments. This is because the pricing methodology would be

³⁶² Ordover and Shampine state: “We have not been asked to opine on the specifics of the methodologies, such as the precise calculation of the Regulatory Asset Base or the price levels of the Offers, but rather on the economics of the overall approach.” See footnote 1.

³⁶³ Ordover and Shampine, p.14, footnote 18.

³⁶⁴ Ordover and Shampine, p.15, footnote 20.

³⁶⁵ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.52.

³⁶⁶ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.163.

*set up-front, with the access provider only required to enter key inputs from time to time, such as its ongoing actual costs, depreciation and demand forecasts. With a fixed pricing methodology, the access provider has certainty as to how access pricing will be approached and the **ACCC need only audit the key inputs for robustness, efficiency and prudence.***³⁶⁷ [emphasis added]

A.18 That is, in the ACCC's view even with locked in long term certainty on the pricing methodology it still needs the ability to audit the key inputs. The ACCC continued to note that notwithstanding the efficient pricing structure contained in the FANOC SAU, its long term timeframe (15 years) required the ACCC to have confidence that the discretion of adequate oversight of its operations:

*This confidence could be achieved **through providing the ACCC with a power to audit or review the key inputs in the pricing methodology (such as demand forecasts and forecast capital and operating expenditure) at appropriate intervals during the SAU period.***³⁶⁸ [emphasis added]

A.19 As outlined in section 3, such review is specifically not permitted under the proposed SAU. The ACCC has no ability to assess the level of expenditure included in the RAB. Moreover, the ACCC is specifically excluded from being able to review pricing principles.³⁶⁹

A.20 Optus submits, however, that the benefits flowing from increased certainty in the NBN SAU would be significantly less than the certainty benefits from the FANOC SAU. This is because the level of uncertainty faced by NBN is significantly less due to:

- (a) Government ownership and requirement to make sub-commercial returns;
- (b) NBN is not subject to competition, and is in effect, a legislatively protected monopoly; and
- (c) Part XIC provides NBN Co with some specific protection against ACCC intervention.

A.21 These are discussed below.

NBN Co is not subject to commercial returns

A.22 A key concern for certainty is the level of return required by businesses, and the impact of variations in future demand and costs. Where a company is required to make a commercial return in order to attract capital investment, long term certainty would be beneficial as it provide providers of capital with a level of confidence.

A.23 However, such concerns would appear to be reduced in the context of NBN. First, NBN Co is a government-owned enterprise, with guaranteed government provided equity of \$30.4 billion,

³⁶⁷ ACCC, Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.13.

³⁶⁸ ACCC, Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service, Draft Decision, December 2007, p.14.

³⁶⁹ Clause 1B.1.2.

up from \$27.5 billion in the previous corporate plan.³⁷⁰ NBN Co and the Commonwealth Government entered into a funding arrangement on 22 June 2011 guaranteeing Government funding equity to fund the rollout of the NBN, with such funding being conditional on the annual appropriation process.³⁷¹

- A.24 The DBCDE also confirmed that the Government has internalised the market risk faced by a commercial entity:

*The project is being financed by the government because it is best able to mobilise the capital required and manage the risks involved, rather than the private sector which would require an additional risk premium for risks controlled by government.*³⁷²

- A.25 This makes it clear that one of the reasons why NBN Co was established was because the private sector would not be able to achieve Government's broadband objectives because it would not be able to receive an adequate commercial return.
- A.26 Optus submits that the guaranteed funding by Government to NBN Co removes significant level of uncertainty for NBN Co. Optus submits that the corporate structure and funding of NBN Co addresses concerns regarding the need for long term certainty and investment.

NBN Co is not subject to competition

- A.27 NBN Co will be subject to little, or no, competition from alternative superfast broadband networks. This arises from the suite of legislative changes brought in during the establishment of NBN Co to ensure that no competing network could "cherry-pick" revenue and undercut NBN Co.
- A.28 Legislative amendments introduced by the *Telecommunications Legislation Amendment (National Broadband Network Measures—Access Arrangements) Act 2011* provided that:
- (a) Competing superfast networks cannot supply carriage services directly to consumers or small business. It must be a wholesale layer 2 bitstream service.³⁷³
 - (b) Any Layer 2 bitstream service delivered over a competing superfast network must be mandated a declared service by the ACCC.³⁷⁴
 - (c) Any Layer 2 bitstream service delivered over a competing superfast network must be supplied on a non-discriminatory basis.³⁷⁵

³⁷⁰ NBN Co, 2012, Corporate Plan 2012-2015, p.73.

³⁷¹ NBN Co, 2012, Corporate Plan 2012-2015, p.78.

³⁷² Quoted by Australian Government Competitive Neutrality Complaints Office 2011, NBN Co, Investigation No. 14, Canberra, November, p.32.

³⁷³ *Telecommunications Act 1997*, s.141 & s.143.

³⁷⁴ CCA, s.152AL.

³⁷⁵ CCA, s.152ARA.

- A.29 In addition, should the above requirements not prevent ‘cherry-picking’, the Government has indicated that it will consider the introduction of a levy, if necessary, to prevent opportunistic ‘cherry-picking’.³⁷⁶
- A.30 In other words, any superfast broadband network that could compete with the NBN, is subject to the same level of regulation requiring a structurally separated wholesale-only network providing declared Layer 2 services on a non-discriminatory basis. It is difficult to see the private sector being willing to invest in an alternate wholesale-only network, given the low rate of return it is likely to generate, the likely lack of scale for an alternate network and the potential for imposition of a levy.
- A.31 It is reasonable, therefore, to expect that NBN Co will not be subject to effective competition from alternative superfast broadband networks. Such protection removes the risk of future competitive entry and any inability to recover sunk costs. This removes a key driver of future uncertainty for NBN Co.

Part XIC has protection against risk of regulatory expropriation

- A.32 In addition, amendments to the access regime under the CCA provide NBN Co protection against ACCC regulatory intervention over key matters. These include:
- (a) ACCC cannot make an access determination that relates to any or all of the category standard access obligations applicable to NBN Co, or has the effect of discriminating between access seekers.³⁷⁷
 - (b) ACCC cannot make an access determination that would have the effect or preventing NBN Co from engaging in conduct reasonable necessary to achieve uniform national pricing of services.³⁷⁸ In other words, ACCC cannot remove the cross-subsidy between provided to rural and regional households due to national uniform pricing.
 - (c) ACCC cannot make an access determination affecting the ability of NBN Co to supply bundled services and to refuse to unbundle such services to access seekers.³⁷⁹
- A.33 These provisions in the CCA protect NBN Co against risks of regulatory expropriation (as discussed by Ordovery and Champagne) for key provisions. In other words, an SAU is not required to ensure uniform national pricing, or to protect bundling of designated services.
- A.34 In summary, NBN Co is subject to significant legislatively-protected certainty regarding its ability to supply services into the future, and receive adequate compensation. NBN Co is protected against market competition — including the possibility of future efficient entry denying its ability to recover its incurred and sunk costs — and has a protected cross-subsidy — where under uniform national pricing low-cost urban households pay above cost so that high-cost regional consumers pay below cost.

³⁷⁶ Shareholder Ministers’ *Statement of Expectations*. Available at: http://www.dbcde.gov.au/__data/assets/pdf_file/0003/132069/Statement_of_Expectations.pdf.

³⁷⁷ CCA, s.152BCB(4A).

³⁷⁸ CCA, s.152BCB(3C).

³⁷⁹ CCA, s.151DA.

- A.35 Optus submits that it is against this legislative certainty that the incremental benefits of the SAU be assessed. That is, what incremental benefits of certainty does NBN Co receive under the SAU?

Alternatives under Part XIC for long term certainty absent the SAU

- A.36 The unique characteristics of NBN Co suggest that additional regulatory certainty under a SAU may not be necessary for an efficient level of investment in durable sunk assets. Moreover, there have been substantial changes to Part XIC since the rejection of the FANOC SAU³⁸⁰ that enables the ACCC to regulate in a manner that provides for long-term commitments through fixed principles.
- A.37 In this context NBN Co's proposed SAU must be seen as being unreasonable. As discussed in the previous section the SAU seeks to provide NBN Co with high degree of certainty by effectively sidelining the ACCC from all material decisions in respect of setting access terms. This creates a significant risk about the ability of the SAU to operate in manner that is consistent with the LTIE over its term. This risk is clearly out of proportion to the incremental benefit the SAU will deliver to NBN Co regarding certainty that it can recover its investment.
- A.38 Optus submits that long-term regulatory commitments, as required by the NBN experts Ordoover and Shampine, can be achieved through existing Part XIC processes. Optus submits that the benefits of the SAU can be delivered without the negatives through the ACCC issuing access determinations with appropriately drafted fixed principles that apply for a sufficiently long period.

Fixed principles in access determinations

- A.39 The 2010 amendments to Part XIC of the CCA introduced powers for the ACCC to determine fixed principles to apply for a stated period which may extend beyond the duration of the access determination (e.g. how depreciation is treated).³⁸¹ This has the effect of 'locking-in' the matters dealt with until a particular termination date, which can be after the expiry date of the access determination in which the fixed principles appear.
- A.40 Any access determination that replaces the original access determination must include a fixed principles same as the fixed principles in the original access determination. And the nominal expiry date of the fixed principles must be the same or later than the date in the original access determination.³⁸²

³⁸⁰ At which time the ACCC was not of the view that the benefits of regulatory certainty outweighed the cost of removing sufficient regulatory oversight.

³⁸¹ CCA, s.152BCD.

³⁸² CCA, s.152BCD(3).

A.41 Section 152BDE of the CCA makes clear that BROCC cannot over rule fixed principles contained within an access determination. The intent of this provision is to ensure preserve the regulatory certainty provided by the inclusion of fixed principles in an access determination.³⁸³

A.42 The explanatory memorandum for the Bill that introduced fixed principles into Part XIC of the CCA states:

*By enabling the ACCC to lock in provisions contained in an access determination for a specified period (which may be longer than the duration of the access determination in which the provisions are contained), proposed section 152BCD will **enable the ACCC to provide greater regulatory certainty in certain circumstances**. For example, where the ACCC adopts a utility pricing model for setting the access price for a declared service – with **all price determinations during the economic life of the relevant facility based on a regulated asset base** – the ACCC will be able to lock in a regulated asset base for the requisite period.³⁸⁴ [emphasis added]*

A.43 Fixed principles within access determination work in a similar fashion to the fixed principles contained in an SAU. The difference between fixed principles in a SAU and in an access determination, is that there is no requirement that a later SAU given to the ACCC contain the same fixed principles. It is up to the provider of the SAU to decide whether to include the principles. However, should NBN Co issue a later SAU that contains the fixed principles, the ACCC cannot reject the SAU based on the presence of the fixed principles.³⁸⁵

A.44 The effect of fixed principles in access determinations is the same as fixed principles within an SAU — that is, to provide long term regulatory certainty as to the treatment of key provisions that go beyond the length of relevant AD or SAU.

Will fixed principles in AD given same effect as in SAU?

A.45 NBN Co submits that the inclusion of fixed principles in the SAU is “*intended to preclude rejection of variations for a reason that concerns conditions already approved by the ACCC*”.³⁸⁶ NBN Co states that this is needed to provide certainty that the ACCC will not re-assess approval of provisions in the SAU.

A.46 In other words, the sole reason for fixed principles in the SAU is to provide certainty that the ACCC will not re-assess the approval of the terms in later revisions to the SAU. NBN Co argues that the SAU (in combination with wholesale agreements³⁸⁷) is the preferred regulatory

³⁸³ *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, Explanatory Memorandum, p.197.

³⁸⁴ *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, Explanatory Memorandum, p.182.

³⁸⁵ See section 152CBAA and *Telecommunications Legislation Amendment (Competition and Consumer Safeguards) Bill 2010*, Explanatory Memorandum, p.206.

³⁸⁶ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.36. See also section 10.4, p.183.

³⁸⁷ Wholesale agreements are available with or without acceptance of the NBN SAU.

mechanism over the alternative of the ACCC relying on its legislative powers because it can provide long term certainty and be more procedurally efficient.

- A.47 In the assessment of the SAU against the legislative requirements under Part XIC, NBN Co asserts that the SAU can be *reasonably assumed* to provide greater regulatory certainty than the proposed counterfactual of relying on access determinations made by the ACCC.³⁸⁸
- A.48 However, Optus submits that the same certainty can be obtained through the use of fixed principles in access determinations. As outlined above, this was the objective for the introduction of fixed principles in access determinations: to provide certainty over the economic life of the asset, which may be longer than the timeframe of the determination. As such, there can be no reasonable assumption made that a SAU will provide greater regulatory certainty than relying on access determinations with appropriate fixed principles.
- A.49 It would be open for the ACCC to establish fixed principles through an Access Determination that provides for the method to calculate the:
- (a) Regulatory Asset Base;
 - (b) Annual Building Block Revenue Requirement; and
 - (c) Profile for recovery of losses incurred during initial cost recovery period.
- A.50 Adoption of such fixed principles will provide the necessary certainty for NBN Co as to how the recovery of efficient costs will occur during the economic life of the network (27 years). Importantly, it will protect against regulatory expropriation which is a key justification put forward by Ordovery and Shampine supporting the SAU.³⁸⁹
- A.51 Whilst the point might be somewhat academic, Optus notes that the ACCC has adopted an approach which provides far less certainty for any future alternate providers of the Layer 2 Bitstream Access Service (LBAS). The ACCC has recently issued an access determination for the LBAS service which specifies price for the LBAS. Optus notes that providing certainty to privately-owned commercial entities was a prime consideration for the ACCC:

The ACCC has now decided to make the FAD before the finalisation of the SAU to provide certainty to the industry regarding the regulation of the LBAS prior to the conclusion of the current public inquiry period on 24 February 2013 ...

... The ACCC therefore considers that the appropriate approach is to provide certainty to stakeholders and adopt the specified benchmark product used in the LBAS IAD.³⁹⁰

³⁸⁸ NBN Co, Supporting Submission – NBN Co Special Access Undertaking, 28 September 2012, p.161.

³⁸⁹ Specifically, that a long-term commitment to rate of return regulation would encourage investment in sunk assets.

³⁹⁰ ACCC, Local bitstream access service, Final access determination Explanatory statement, October 2012, p.16.

A.52 The implication of this is that the only certainty a private alternate investor in LBAS, who will face significantly greater risk than NBN Co, can obtain is through the operation of an access determination. Such an investor would be precluded from lodging an SAU.

Appendix B. NERA, Review of the LTRCM element of NBN Co's SAU