

NBN Co's revised SAU: Overview

28 September 2012

Background

NBN Co has lodged a revised Special Access Undertaking with the Australian Competition and Consumer Commission (ACCC). The SAU sets out the terms that will govern access to the NBN Access Service until 2040, striking a balance between the interests of End-users, Access Seekers and NBN Co. The NBN Access Service covers all wholesale Layer 2 services provided over NBN Co's fibre, wireless and satellite networks, and provides the framework in which NBN Co delivers uniform national wholesale prices across Australia.

This SAU replaces the SAU lodged with the ACCC in December 2011 and recently withdrawn.

NBN Co published a high level design document on 20 June 2012 which outlined the key features of the new approach it was considering for the SAU at that time. After consulting with industry and the ACCC on this design proposal, NBN Co has refined and developed that design to produce this revised SAU.

This overview paper identifies the key commitments made in the revised SAU, and changes made since the December 2011 SAU. NBN Co has also published a supporting submission that was lodged with the SAU that goes into greater detail on the issues discussed in this overview. The supporting submission, and other material on the SAU is available on NBN Co's website: <http://www.nbnco.com.au/getting-connected/service-providers/sau.html>.

Context for the SAU

NBN Co's objectives, in developing the SAU are to:

- give Access Seekers, End Users and NBN Co certainty about the terms of access to NBN Co's services, including an appropriate regulatory oversight role for the ACCC.
- provide the framework necessary for long term cost recovery and for NBN Co to achieve uniform national wholesale pricing of services.

The SAU works in conjunction with the NBN Co's Standard Form of Access Agreement (SFAA), known as the Wholesale Broadband Agreement (WBA) that was published on November 30, 2011, and which is currently being updated and refined with industry via the Contract Development Process. The SAU will shape price and non-price terms until 2040, while the WBA is the commercial contract between NBN Co and its customers. Any WBA offered by NBN Co will be consistent with the accepted SAU.

The SAU confers powers and functions on the ACCC to create a transparent and efficient mechanism which can be used by Access Seekers to seek regulated terms and conditions where agreement cannot be reached on non-price matters that are not covered by the SAU. Once the network is built, NBN Co will need to update the SAU via variation 'modules'. The ACCC will assess and accept or reject these variation 'modules' and the ACCC can establish its own terms if it does not accept NBN Co's.

Some of the other key features of the SAU include:

- A term that extends to 2040, with discrete 'modules' of commitments that apply for different periods of time;
- Prices of key products remain the same until June 2017;
- Price rises on all products or services limited to 1.5% less than CPI in any one year and cannot be accumulated if not used – prices will thus fall in real terms;
- Coverage of all services and products offered by NBN Co, over all networks, and including ancillary services and facilities access services;
- A mechanism that allows NBN Co to recover only its prudently incurred costs inclusive of an appropriate return on capital, and no more. This includes a regulatory rate of return on its assets of 350 basis points above government bond rates for the first 10 years;
- Adoption of a standard utility model for regulating long term revenues after the network build is completed;
- A commitment to include a set of key non-price terms in the SFAA.

Structure of the SAU

The December 2011 SAU sought to provide detailed commitments for 30 years. The feedback from industry and the ACCC indicated that this approach may not be appropriate over that period of time. The revised SAU contains key cost recovery terms spanning 30 years, with other detailed terms falling away after 10 years. After the initial 10 years, NBN Co will need to submit variations to ACCC every 3-5 years to lock-in detailed SAU terms.

The structure of the revised SAU can be illustrated as follows:

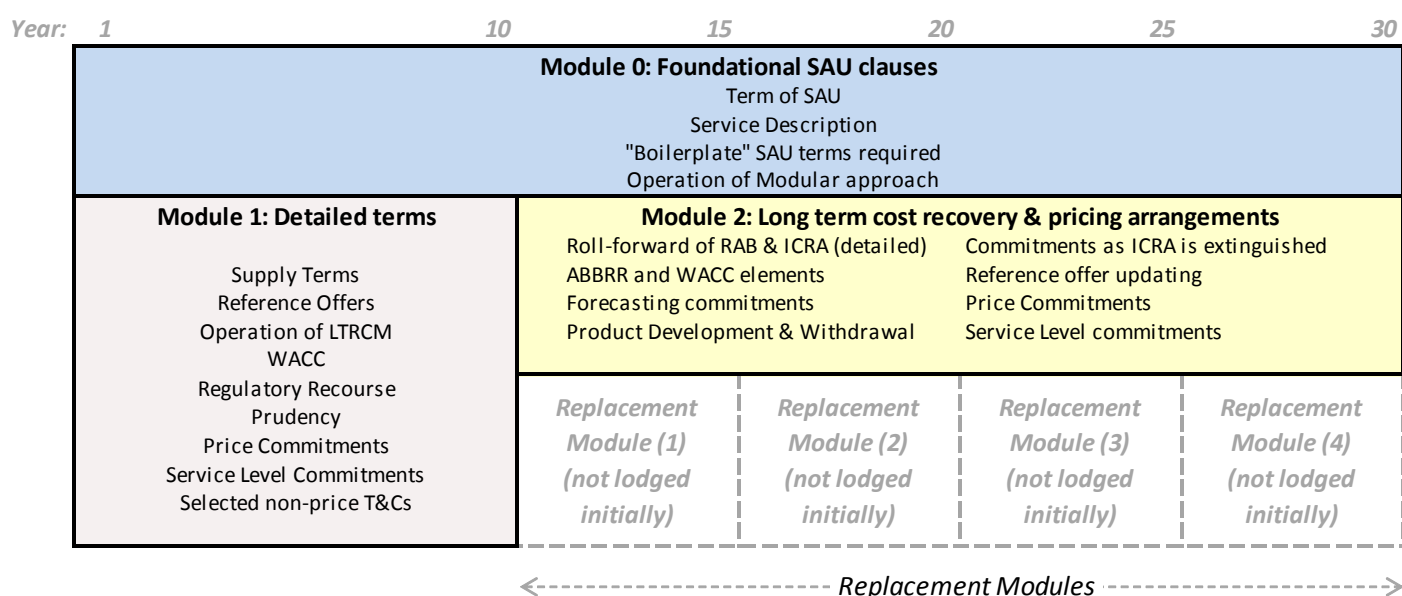


Figure 1: Modular structure of the revised SAU

Modular structure

The revised SAU consists of a modular structure with various modules applying for different timeframes:

- Module 0 would apply for the full 30 years and contains foundational terms and conditions (including the service description, details of the operation of the modular approach and boilerplate legal terms);
- Module 1 contains the more detailed terms relating to prudence of expenditure, key non-price terms, weighted average cost of capital (WACC), operation of the Long Term Revenue Constraint Methodology (LTRCM) and price controls, and will be set to expire on 30 June 2023 (which implies a period of around 10 years from when the SAU may be accepted by the ACCC); and
- Module 2 contains terms up front that are appropriate at this stage of NBN Co's development to support long term cost recovery and provide certainty on key matters to industry. In general these are specified as principles rather than detailed operating terms. A comparison of the treatment of specific issues in Modules 1 and 2 is set out below in Figure 2.
- Modules 3 and beyond (each of which is termed a 'Replacement Module' in the SAU) are SAU variations that NBN Co would need to submit periodically (discussed in further detail below), to be assessed by the ACCC.

Issue	Module 1	Module 2
Regulatory Oversight	Regulatory Recourse; Facilities Access Decisions; Multilateral SFAA Forum. Enhanced compliance reporting, changes to zero-priced offers; resolution of prudency disputes; review of operating arrangements of SAU.	Assessment of Replacement Module Applications with ability for ACCC to introduce its own terms; changes to zero-priced offers.
Reference Offers	Detailed description of offers & initial prices; Price commitments	Principles for updating; Price commitments
Non-Reference Offers & Other Charges	Maximum prices when introduced; Price Commitments; Pricing Principles	Price Commitments (e.g. CPI-1.5%); Pricing Principles
Regulatory Asset Base	RAB calculations; Capex Prudency arrangements; Changes to network design rules	Details of roll-forward calculations for RAB; approach to forecasting. Updates to network design rules.
LTRCM	ABBRR & ICRA calculations; Building block revenue constraint; Opex prudency	Details of roll-forward calculations for ICRA. Principles around ABBRR, etc rather than formulae. Approach to forecasting. Revenue constraint in building block period.
WACC	Details of WACC calculation (Rf+350)	General principle for setting WACC. Proposal made in each Replacement Module Application.
Regulatory Information	Forecast & Actual information provided; Expenditure & Price compliance reporting	None. Could be specified in Replacement Module Application.
Non-price Terms & Conditions	Specific terms for identified NPTCs that will be included in SFAAs	None. Could be specified in Replacement Module Application.
Product Development & Withdrawal	Principles; Development via PDF; Withdrawal restrictions (in addition to Reference Offer commitments; PDF Processes	Similar commitments as in Module 1, but PDF processes not specified.
Service Levels	Commitment to include specific service levels in SFAAs.	Principles for service levels. Proposal on service levels made in each Replacement Module Application.
Reviews of operating arrangements in SAU	Review of multilateral processes Review of Non-Price T&Cs	None. Operation of replacement modules would play a similar role.

Figure 2: Comparison of the treatment of issues between Module 1 and 2

Replacement Module Applications

Prior to the expiry of Module 1 and every 3 to 5 years thereafter, NBN Co will develop and lodge a Replacement Module as a variation to the SAU, which will provide for the specific application of the principles set out in Module 2 to apply for the following Regulatory Cycle. Module 0 sets out a number of matters a Replacement Module Application **must** include:

- Forecasts for the Long Term Revenue Constraint Methodology,
- Reference Offer Proposal,
- Service Level Proposal and
- The term of next Regulatory Cycle (3-5 years),

but it may also include other matters e.g. non-price terms and conditions, product development and regulatory recourse.

The Replacement Module Application would be assessed by the ACCC for reasonableness in the context of the other commitments made in the SAU and would either be accepted or rejected. If accepted, the new Replacement Module would then operate in conjunction with Modules 0 and 2 to provide the complete set of SAU commitments for the next regulatory period. Module 0 of the revised SAU also sets out detailed arrangements to apply if the ACCC rejects a Replacement Module Application. This means that the ACCC can establish its own terms for the issues covered by the Replacement Module Application if it does not accept NBN Co's proposal. This provides strong and enduring regulatory oversight of NBN Co over the long-term.

Declared service

The declared service in the December 2011 SAU was limited to the NBN Access Service, reflecting the key service that NBN Co will be offering (a layer 2 wholesale Ethernet bitstream service over all three networks). Industry expressed the view that ancillary services (including facilities access services) should also be incorporated into the SAU and be declared. In taking on this feedback, the revised SAU will now declare Ancillary Services (which allow access seekers to test how they technically connect to NBN Co's network, and to interface with NBN Co's IT platforms). The service descriptions of the NBN Access Service and Ancillary Services are set out in a broad, functional and technology neutral manner. While the Facilities Access Service (which provides the means for access seekers to physically connect to NBN Co's network at points of interconnection) is not declared, the SAU makes enforceable commitments in relation to long term pricing and availability.

ACCC regulatory oversight

In response to feedback about the scope of the ACCC's regulatory oversight role in the December 2011 SAU, the revised SAU provides for the ACCC to have a clear oversight role on any matter not covered by the SAU. This role will not cover prices (except in relation to currently zero-priced services). Any regulatory decision made by the ACCC will be given effect (subject to them not being inconsistent with the SAU or Part XIC of the Competition and Consumer Act 2010 or discriminatory as between access seekers) in the next published Standard Form of Access Agreement (SFAA), which then forms the basis for an access agreement between NBN Co and an access seeker. This will provide for customers to take up regulated terms once their existing access agreements expire. The revised SAU will

commit to having a 2 year co-terminus SFAA that will facilitate the 'flow through' of the ACCC's regulatory decision at regular and appropriate intervals.

Regulatory oversight in the revised SAU will also consist of an explicit commitment to keep SFAAs and the SAU aligned, as well as a commitment to regularly convene the Multilateral SFAA forum (similar to the current Contract Development Process (CDP) being utilised to develop the next version of the Wholesale Broadband Agreement).

Price terms and conditions

The revised SAU includes prices for all current products (including Ancillary Services and the Facilities Access Service). It utilises the concepts of Reference and Non-Reference Offers. Reference Offers are key product elements that are required to deliver end-to-end services over the NBN, for example covering the supply of entry-level broadband services, popular mass-market offerings, and basic business services. The SAU ensures that these offers cannot be withdrawn, thus providing certainty to access seekers, and also gives the ACCC an oversight role in how these Reference Offers can evolve over time to remain relevant to the changing needs of the market.

For the first 5 years, maximum prices will be frozen in nominal terms for Reference Offers. Thereafter, an individual price increase limit of CPI-1.5% will apply on all products.

After 10 years, the individual price increase limit will continue to apply, along with a commitment that prices will do no more than recover cost in the long term inclusive of an appropriate return on capital. In response to industry concerns about CVC pricing in the December 2011 SAU, the SAU also includes a statement of intent to annually review CVC prices after the transitional CVC rebate ends, taking into account aggregate demand and published Corporate Plan information.

NBN Co retains the discretion to set initial prices for new products and services, and NBN Co commits to determine such prices having regard to a series of principles including: uniform national wholesale pricing, the nature and extent of market demand, the importance of affordability to drive take-up rates and NBN Co's long term cost recovery and projected timeframe for recovery of initial losses. NBN Co will then publish a pricing rationale statement describing how the initial price has been determined, thus providing transparency to industry and a compliance role for the ACCC in relation to whether NBN Co has actually had regard to the principles.

This approach is appropriate given that NBN Co is precluded by law from having any competing retail interests and faces strong and consistent incentives to price its services efficiently, having particular regard to current and future market demand. These incentives are the result of the long term revenue sufficiency risk associated with the NBN (a point acknowledged by the ACCC in its recent authorisation of NBN Co's agreement with Optus).

NBN Co has to date introduced some ancillary charges at a \$0 price point. If NBN Co wishes to later charge for the relevant service and it is associated with the supply of a Reference Offer, any such charge introduced would be subject to ACCC regulatory recourse.

Cost recovery and prudence

As with the December 2011 SAU, the revised SAU contains a Long Term Revenue Constraint Methodology (LTRCM) to allow NBN Co the opportunity to recover initial losses over the 30 year term, including a return on capital. The significant difference from the December 2011 SAU is that it provided for actual costs to be rolled into the Regulatory Asset Base (RAB) throughout the 30 year term, using a compliance-based approach to prudent expenditure, whereas the revised SAU only provides for this during Module 1 (first 10 years). In Module 2, NBN Co will submit expenditure forecasts for ACCC approval, in a manner similar to other regulated utility businesses. Actual capex will continue to be rolled into the Regulatory Asset Base.

Actual costs incurred by NBN Co in Module 1 must satisfy the SAU prudence requirements (broadly, that NBN Co builds its network consistent with its network design, as set out in the Network Design Rules that will be provided to the ACCC with the SAU, and that it complies with its procurement processes) similar to the December 2011 SAU and the revised SAU provides for the ACCC to have oversight of NBN Co's prudence through the enhanced compliance regime.

Service levels

NBN Co is now in a position to make a more developed offer in relation to service levels and rebates and the revised SAU includes a commitment to include specific minimum service levels in the SFAA. Other, future service levels subsequently included in the SFAA will be subject to ACCC regulatory recourse. The service levels to be included in the SAU are those which are being developed by NBN Co via the contract development process being conducted with industry and include 'roadmap' elements for ongoing development, as NBN Co's processes and systems become more mature.

Product development

The revised SAU sets out a product development process making commitments in relation to how NBN Co will develop new products and vary or withdraw existing products. The approach is similar to the December 2011 SAU, with the utilisation of a Product Development Forum process that provides (again in response to industry feedback) an enhanced arrangement for managing intellectual property rights and confidential information in relation to product development activities.

Non-price terms and conditions

The December 2011 SAU contained high level principles in relation to non-price terms and conditions which were intended to shape the terms offered in the SFAA. The ACCC and industry sought more clarity as to the interaction between the SAU and non-price terms in NBN Co's SFAA.

In taking on board this feedback, the revised SAU takes a different approach to non-price terms and conditions by incorporating the actual drafting of key non-price terms and conditions in the SAU, with a commitment to include the drafting in the SFAAs. The selection and content of terms reflects NBN Co's current state of maturity operationally and

commercially, as well as developments arising out of NBN Co's CDP conducted with the industry. The ACCC could use the regulatory oversight mechanism to make a regulatory decision in relation to the balance of NBN Co's non-price terms and conditions, that NBN Co would flow into the next version of the relevant SFAA.

The included terms and conditions are: intellectual property and confidentiality regimes, ongoing supply activities, risk management and liability, rollout progress, POI rollout progress and location and dispute management.

Reviews

The December 2011 SAU built in a number of reviews (including a 5 yearly review of the customer engagement process and a review on or before 30 June 2027) during the 30 year term. Under the revised SAU, reviews will be conducted at the midpoint of Module 1 with new terms (if required) being proposed to apply for the remainder of Module 1. If the ACCC does not accept the proposed new terms they are able to set new terms (subject to being consistent with the SAU, non-discriminatory as between access seekers and otherwise compliant with the NBN Co specific access regime) to apply until the end of Module 1. Reviews will be conducted of the multilateral processes: customer engagement process, Product Development Forum processes, Dispute Management Rules; and Multilateral SFAA Forum. Reviews will also be conducted of non-price terms and conditions, regulatory recourse mechanism, service levels and regulatory reporting.

Enhanced compliance regime

The revised SAU will require NBN Co to provide the ACCC with regular information on NBN Co's forecast and actual cost information, including reasons for variances. NBN Co will also provide reports signed by NBN Co's CFO certifying that capex and opex have been incurred prudently and price controls have been adhered to.

Summary of ACCC roles under the revised SAU

The revised SAU provides for the ACCC to have a number of key roles in determining the appropriateness of NBN Co's access arrangements over the next 30 years. The roles provided to the ACCC under the revised SAU are set out in Figure 3.

Area	ACCC role
Replacement Modules	Assessment and approval of variation proposals under s152CBG of the CCA. If ACCC rejects, it can propose its own terms for reference offers, LTRCM forecasts (incl WACC), and service levels, which NBN Co will adopt to the extent they are not inconsistent with the SAU.
Regulatory Recourse/ Oversight	ADs and BROCs made on matters not covered by the SAU will be flowed through to SFAAs, with the exception of prices (but decisions on "zero priced" offers will be). These changes will be flowed through on a co-terminus basis. Similar arrangements developed in relation to facilities access.
Module 1 Reviews (by mid-2018)	Assessment and approval of NBN Co proposals for updated arrangements in relation to customer engagement, PDF processes, dispute management rules, Multilateral SFAA Forum, non-price terms and conditions, service levels, regulatory recourse and reporting. If the ACCC rejects, it may make its own decision in relation to these arrangements.
Changes to "zero priced" offers	Any reference offers or ancillary charges associated with reference offers that are initially taken to market at \$0 will be subject to regulatory recourse.
Prudency Disputes	If there is disagreement about a network change that NBN Co proposes to introduce, that is outside the design rules or not otherwise permitted by the terms of the SAU, the ACCC is able to make a decision as to whether the network change should be endorsed (and hence able to be included in the RAB)
Compliance	General compliance role for the ACCC, enhanced by provision of specific information to them in relation to expenditure and pricing compliance, on which the ACCC can request additional information. Specific transparency on setting prices for new products via pricing principles and statement of pricing rationale.
POIs	ACCC approval required to open, close, relocate POIs.

Figure 3: Key roles provided to the ACCC under the SAU