



Australian
Competition &
Consumer
Commission

ACCC Draft Decision on the Special Access Undertaking lodged by NBN Co on 18 December 2012

April 2013

Australian Competition and Consumer Commission
23 Marcus Clarke Street, Canberra, Australian Capital Territory, 2601

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Glossary

Access Agreements – An agreement between a carrier (access provider) and an access seeker for the supply of declared services. The requirements for a legally valid Access Agreement are set out in section 152BE of the *Competition and Consumer Act 2010*.

Access Determinations – Written determinations made by the ACCC relating to terms and conditions for access to a declared service.

Access seeker – A content service provider or carriage service provider that makes, or proposes to make, a request to NBN Co for access to its services, as defined in section 152AG of the *Competition and Consumer Act 2010*.

Ancillary Services – NBN Co defines this as the services supplied by NBN Co that facilitate the supply of, and are necessary for the access seeker to acquire, the NBN Access Service, but excludes the Facilities Access Service.

Annual revenue requirements – The amount of revenue that NBN Co would be required to earn to recover its costs in a particular year. Over the SAU term, the annual revenue requirements will provide NBN Co an opportunity to recover all of its costs.

ACCC – Australian Competition and Consumer Commission.

AER – Australian Energy Regulator.

AVC (Access Virtual Circuit) – An Ethernet-based Layer 2 virtual connection that carries traffic to and from an end-user on NBN Co's fibre, wireless, or satellite networks.

Basic Access Offer (BAO) – NBN Co defines this as its entry-level residential service, including an AVC (12/1 Mbps, Traffic Class 4), a UNI-D and an optional UNI-V.

Binding Rules of Conduct – Written rules made by the ACCC specifying any or all terms and conditions for compliance with Standard Access Obligations or requiring compliance with any or all applicable Standard Access Obligations in a manner specified in the rules. These rules are made when there is an urgent need to do so.

Building block model – A methodology used to calculate NBN Co's annual revenue requirements.

Building block period – The period of the SAU term during which NBN Co's prices will be set to recover its annual revenue requirements. This period follows the initial cost recovery period.

Carriage service – This is defined in section 7 of the *Telecommunications Act 1997* as a service for carrying communications by means of guided and/or unguided electromagnetic energy.

CCA – *Competition and Consumer Act 2010*.

CPI – Consumer Price Index.

Customer – NBN Co defines this as a carrier or carriage service provider that has entered into, or is otherwise subject to, an Access Agreement with NBN Co.

CVC (Connectivity Virtual Circuit) – NBN Co defines this as an Ethernet-based Layer 2 virtual capacity for the transport of customer traffic from multiple end-users within a Connectivity

Serving Area on an aggregated basis and presented at the Network-Network Interface at the point of interconnect associated with that Connectivity Serving Area (CSA).

Data rate – The number of binary bits per second of data passing through an interface during a given time.

Eligible service – This is defined in section 152AL of the *Competition and Consumer Act 2010* as a listed carriage service or a service that facilitates the supply of a listed carriage service where the service is supplied or capable of being supplied by a carrier or carriage service provider (whether to itself or to other persons).

Enhanced Access Offer (EAO) – NBN Co defines this as its most commonly acquired access service, including an AVC (25/5 Mbps, Traffic Class 4), a UNI-D and an optional UNI-V.

Facilities Access Service – Described by NBN Co as a service that enables a customer to install, operate and maintain its telecommunications equipment at or near a point of interconnect for the purpose of interconnecting its network with the NBN Co network.

Gigabit passive optical network – An optical-access system based on internet protocol that lets multiple homes or businesses in a neighbourhood share fibre from a service provider's central office.

Initial cost recovery account – NBN Co describes this as the account used to accumulate any initial unrecovered costs.

Initial cost recovery period – The initial period of the SAU term during which NBN Co will accumulate unrecovered costs, and then recover these costs as demand increases. NBN Co will be allowed to earn more revenue than allowed by its annual revenue requirements to recover these accumulated costs.

Initial Product Roadmap – NBN Co describes this as the document titled 'Initial Roadmap July 2012, version 2' published on NBN Co's website.

Layer 1 – NBN Co describes this as the physical layer of the OSI model.

Layer 2 – NBN Co describes this as the data link layer of the OSI model.

Layer 2 bitstream – A point-to-point data stream with defined interface protocol. It is independent of the underlying network technology and the services running over it.

Layer 3 – NBN Co describes this as the network internet protocol layer of the OSI model.

Listed carriage service – A carriage service of the type listed in section 16 of the *Telecommunications Act 1997*.

Long-term revenue constraint methodology (LTRCM) – The methodology for determining the amount of revenue NBN Co would be able to earn via its prices over the SAU term. The key components are annual revenue requirements, a regulatory asset base and the initial cost recovery account.

Multicast service – A service which enables content to be transmitted simultaneously to multiple parties, but is carried as a single stream as far into the network as possible.

Multilateral SFAA forum – A multilateral forum established by NBN Co to consult with access seekers on changes to the terms and conditions of SFAAs.

NBN Access Service – NBN Co describes this as a Layer 2 service supplied on the NBN Co network between and including: a User Network Interface on a network termination device; and the Network-Network Interface at the point of interconnect associated with the relevant network

termination device, for the purpose of enabling an access seeker or another service provider that is a customer of an access seeker to supply carriage or content services.

NBN Co – NBN Co Limited and NBN Tasmania Limited.

Network Design Rules – The document that describes the design of NBN Co's fibre, wireless and satellite networks. This document has a role in determining the amount of capital and operating expenditure that NBN Co may recover via the SAU.

Network Termination Device (NTD) – The device on the customer end of an access network used to send and receive signals sent across the physical access medium.

NNI (Network-Network Interface) – A physical interface between the NBN Co network and the access seeker's network at the point of interconnect.

Non-reference Offer – All of NBN Co's products that are not defined as reference offers or other charges.

Open System Interconnection model (OSI model) – The framework developed by the International Standards Organisation to provide worldwide standards for computer communications.

Other charge – NBN Co defines this as an ancillary charge associated with the supply of a product component, product feature, Ancillary Service or type of Facilities Access Service.

PDF Processes – The provisions of Annexure 1 to Schedule 11 of the SAU. These provisions describe how NBN Co will engage with customers via the Product Development Forum on the development and withdrawal of products.

POI (point of interconnect) – The geographical point where traffic stops being carried on the network of the access seeker and is given to the network owned by NBN Co to carry.

Product components – NBN Co defines these as the UNI, AVC, CVC, NNI, and any new or varied product components introduced by NBN Co pursuant to the product development provisions in the SAU.

Product Development Forum (PDF) – NBN Co describes this as the primary forum through which customers may submit new product ideas, provide input on the development of new and existing products, and obtain information from NBN Co on its current and future product offerings.

Product features – NBN Co defines these as the features of a product component that are made available by NBN Co and which are selectable and configurable by the customer in respect of that product component (for example, data transfer rate or traffic class associated with an Access Virtual Circuit).

RAB (Regulatory Asset Base) – Represents the value of capital investments made by NBN Co that it can recover via prices over the SAU term.

Reference Offer – NBN Co's entry-level residential and business grade offers, designed to include all products reasonably necessary to provide a service to end-users over the NBN.

SAU (Special Access Undertaking) – A voluntary undertaking given to the ACCC by a supplier of a telecommunications service specifying the terms and conditions upon which it agrees to supply a listed carriage service or a service which facilitates the supply of a listed carriage service.

SAU term – Refers to the term of NBN Co's Special Access Undertaking. This term commences when the Special Access Undertaking is accepted by the ACCC and ends on 30 June 2040.

SIO (Service in Operation) – The supply of a single AVC for use in conjunction with a single UNI-D or UNI-V.

Standard Business Offer (SBO) – NBN Co defines this as its entry-level business grade service, including an AVC (25/10 Mbps, Traffic Class 4), a UNI-D and an optional UNI-V.

Standard Form of Access Agreement (SFAA) – A document published on the NBN Co website which sets out terms and conditions on which NBN Co is obliged to enter into in an Access Agreement with an access seeker upon request, and declares the services to which it relates.

Statement of Expectations – A statement released by the Australian Government on 17 December 2010, which sets out the Government's expectations for NBN Co in implementing the NBN policy.

UNI (User-Network Interface) – The physical interface where the end-user's equipment connects to NBN Co's network, either a data port (UNI-D) or a voice port (UNI-V).

WACC (Weighted Average Cost of Capital) – A method for calculating the minimum required cost of capital for a company. This method is calculated by using a weighted average of the costs of the sources of funding for a company.

Wholesale Broadband Agreement (WBA) – The WBA sets out comprehensive price and non-price terms in relation to the supply of NBN Co's services; and the processes for providing NBN Co's customers with operational and technical information in relation to those services. The WBA is a Standard Form of Access Agreement.

Preface

NBN Co Limited and NBN Tasmania Limited ('NBN Co') lodged a Special Access Undertaking ('the SAU') with the Australian Competition and Consumer Commission ('the ACCC') pursuant to section 152CBA in Division 5 of Part XIC of the *Competition and Consumer Act 2010* ('CCA') on 18 December 2012. The SAU specifies matters relating to the supply of what NBN Co terms the 'NBN Access Service' and the 'Ancillary Services'. It also specifies commitments relating to the 'Facilities Access Service'.

The ACCC must accept or reject the SAU based on the criteria for accepting an undertaking set out in section 152CBD of the CCA.¹

This document outlines the ACCC's preliminary views on the SAU, and reflects the ACCC's considerations thus far, having regard to the submissions of interested parties that have been received to date.

In light of the issues that have arisen in the ACCC's consideration of the SAU, the ACCC is proposing to give NBN Co a notice specifying variations to the SAU in order to facilitate NBN Co being able to lodge an amended SAU.² The ACCC has therefore also issued a Consultation Paper about the nature of that Notice to Vary.

The ACCC invites submissions on both the Draft Decision and the Consultation Paper on the Notice to Vary. Submissions on the Draft Decision and Consultation Paper on the Notice to Vary should:

- be provided electronically (in MS Word or PDF format) that is text-searchable to allow a 'copy and paste' function;
- use a text font size no smaller than 12 pt, Times New Roman;
- be singled-spaced; and
- include a copy of any court decision, tribunal decision, consultant's report or other extraneous material that is relied upon in the submission, with the relevant referenced sections clearly marked.

Written submissions from interested parties should be lodged no later than 2 May 2013.

All submissions should be forwarded by email to:

General Manager
NBN Engagement and Group Coordination Branch
Australian Competition and Consumer Commission
GPO Box 520
MELBOURNE VIC 3001
Email: richard.home@acc.gov.au
Fax: 03 9663 3699

Please copy any email correspondence to: analena.gilhome@acc.gov.au

Enquiries may be directed to Analena Gilhome, Director, NBN Co Access Coordination, on 03 9290 1872 or analena.gilhome@acc.gov.au

¹ *Competition and Consumer Act 2010*, s. 152CBC(2). (CCA)

² CCA, s. 152CBDA(2).

All submissions will be considered as public submissions and will be published on the ACCC's website. If parties wish to submit commercial-in-confidence material as part of their submission to the ACCC, parties should submit both a public and confidential version of their submission. The public version should clearly identify the confidential material by replacing the confidential material with an appropriate symbol or 'c-i-c'.

Parties are encouraged to restrict confidentiality claims to a minimum and to establish appropriate confidentiality regimes for the disclosure of any information that is claimed to be confidential.

Consultation on the SAU to date

The ACCC must not accept the SAU unless it has published the SAU, invited submissions on the SAU and considered the submissions received within the time limit specified for the consultation when it published the SAU.³

The ACCC published the SAU on 19 December 2012.

On 12 November 2012, the ACCC published a Consultation Paper on the SAU lodged by NBN Co on 28 September 2012. Subsequent to the withdrawal and re-lodgement by NBN Co of the 28 September 2012 SAU, the ACCC notified parties that they should respond to the 12 November 2012 Consultation Paper in relation to the 18 December 2012 SAU.

Submissions were due by 18 January 2013. Submissions were received from the following parties:

- AAPT, *Submission to the Australian Competition and Consumer Commission: Consultation on the NBN Co 2012 SAU dated 18 December 2012.*
- ACCAN, *NBN Co 2012 SAU Consultation Paper: Submission to the ACCC.*
- Competitive Carriers' Coalition (CCC), *Submission to SAU Discussion Paper.*
- The Department of Broadband, Communications and the Digital Economy (DBCDE), *Policy positions underpinning the NBN initiative.*
- Henry Ergas, *Submission to the ACCC in relation to the revised Special Access Undertaking filed by NBN Co.*
- Herbert Geer (on behalf of iiNet), *NBN Co Limited 2012 Special Access Undertaking Consultation Paper submission.*
- John de Ridder, *A submission to the ACCC Consultation on the NBN Co SAU, (with attachment: John de Ridder, Submission to the Senate Select Committee on the National Broadband Network).*
- Macquarie Telecom, *Submission to the ACCC in relation to the NBN Co Limited 2012 Special Access Undertaking.*
- Nextgen Networks, *Submission to the ACCC Consultation Paper: NBN Co Special Access Undertaking (public and confidential versions).*
- Optus, *Submission to the ACCC Consultation Paper: NBN Co Limited 2012 Special Access Undertaking (public and confidential versions), (with*

³ CCA, s. 152CBD(2)(d).

attachment: NERA Economic Consulting, *Review of the Long Term Revenue Constraint in NBN Co's SAU: A report for Optus*).

- Telstra, *NBN Co 2012 Special Access Undertaking: Telstra's response to the ACCC Consultation Paper, and Supplementary submission to the ACCC Consultation Paper in relation to the NBN Co 2012 Special Access Undertaking — charging for service qualification enquiries*.
- Vodafone Hutchison Australia, *NBN Co Special Access Undertaking for the NBN Access Service: Submission to the Australian Competition & Consumer Commission*.

NBN Co had previously submitted the following material in support of its 28 September 2012 SAU:

- *Supporting Submission: NBN Co Special Access Undertaking*.
- *NBN Co's revised SAU: Overview*.
- *NBN Co Network Design Rules*.
- Analysys Mason, *Review of the efficiency and prudence of NBN Co's fibre, wireless and satellite network design*.
- Janusz A. Ordovery and Allan L. Shampine, *Expert Report*.
- Professor Bob Officer and Dr Steven Bishop, *Report on WACC component of NBN Co's Special Access Undertaking*.
- Synergies Economic Consulting, *Advice on NBN Co Ltd's Special Access Undertaking*.

NBN Co has notified the ACCC that this material is also provided in support of the 18 December 2012 SAU. NBN Co also submitted the following materials in relation to its 18 December 2012 SAU:

- *Covering Letter to NBN Co 18 December 2012 SAU*.
- *Special Access Undertaking — mark-up against 28 September 2012 SAU*.

Further:

- on 26 October 2012 the ACCC wrote to NBN Co seeking clarification of particular matters relating to the 28 September 2012 SAU — NBN Co responded to this request for clarification on 1 November 2012; and
- on 4 December 2012 NBN Co provided a supplementary submission in response to the ACCC's Consultation Paper on the 28 September 2012 SAU.

NBN Co has notified the ACCC that these materials are also relevant to the 18 December 2012 SAU.

On 16 November 2012, the ACCC received a letter from Optus requesting that a confidentiality regime be established between NBN Co and interested parties to enable access to NBN Co's financial data and modelling. On 14 January 2013, the ACCC was copied into a letter sent from NBN Co to Optus that responded to Optus' letter of 16 November 2012.

On 29 January 2013 the ACCC issued an informal request to NBN Co to provide information about its forecast costs, demand, prices and revenues. NBN Co provided this information on 15 February 2013. The information was presented in the form of a cover letter with Attachment A and Attachment B. Attachment A, which is confidential, set out detailed information for the

two pricing scenarios. Attachment B, which is public, described the basis on which NBN Co prepared the detailed information.

On 15 March 2013, the ACCC sought further information from NBN Co to assist it in analysing the information provided by NBN Co on 29 January 2013. On 20 March 2013, NBN Co responded to the ACCC's request for further information from 15 March 2013. The information provided includes an explanation from NBN Co about how it developed its demand forecasts and how it developed its capital expenditure forecasts for the NBN fibre network.

All of the above materials are available on the ACCC website, along with information about how to access confidential information.

Further, on 10 December 2012, the ACCC held a stakeholder forum to discuss the issues raised in the ACCC's Consultation Paper on the 28 September 2012 SAU. The discussion at that forum is confidential to those that attended.

Next steps in the assessment process

The ACCC must make a decision to accept or reject the SAU within six months of the lodgement of the SAU with the ACCC.⁴ If the ACCC does not make a decision within this period, it is deemed to have accepted the SAU.⁵ The current deadline by which the ACCC must have made its final decision on the SAU is 19 July 2013.⁶

The ACCC may however extend, or further extend, the decision-making period by giving written notice to NBN Co.⁷

The deadline is also extended by the duration of any periods during which the ACCC is waiting for NBN Co to respond to an information request,⁸ or a notice to vary.⁹

Following receipt of submissions on the Draft Decision and the Consultation Paper on the Notice to Vary, the ACCC will take into account the views expressed in submissions in finalising the Notice to Vary, prior to formally issuing it to NBN Co. The ACCC is aiming to issue the Notice to Vary to NBN Co in May 2013.

Once the Notice to Vary is given to NBN Co, it will allow NBN Co to make changes to the 18 December 2012 SAU within the time period set by the ACCC.¹⁰ (This would not preclude NBN Co from lodging a varied SAU prior to the specified time.)

If NBN Co then provides a varied SAU to the ACCC, the ACCC is likely to consult on the varied SAU before making its final decision on the varied SAU.¹¹ The duration of that consultation period will depend on the level of compliance by NBN Co with the Notice to Vary.

Under these arrangements, it is not possible to give a definitive date by which the ACCC will make its final decision on the SAU. However, the ACCC intends to make its decision as soon as it is practicable to do so.

⁴ CCA, s. 152CBC(5). Under subsection 152CBC(6) of the CCA, the period for which the ACCC undertook public consultation on the SAU is disregarded from this 6 month period.

⁵ CCA, s. 152CBC(5).

⁶ That is, 6 months, plus the period during which the ACCC undertook public consultation on the SAU. (CCA, s. 152CBC(6))

⁷ CCA, s. 152CBC(7). Each extension must be for less than three months. The ACCC must explain in its notice why it was unable to make a decision on the SAU during the original decision-making period.

⁸ CCA, s. 152CBB(2).

⁹ CCA, s. 152CBDA(2).

¹⁰ CCA, s. 152CBDA(2).

Executive Summary

The ACCC's role in assessing the SAU is defined by Part XIC of the CCA.

In particular (broadly), in order to accept the SAU, the ACCC must be satisfied that the undertaking promotes the long-term interests of end-users and is reasonable. This requires that the ACCC have regard to various matters, including:

- the objective of promoting competition in markets for listed services;¹²
- the objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users;¹³
- the objective of encouraging the economically efficient use of, and economically efficient investment in: the infrastructure by which the listed services are supplied; and any other infrastructure by which the listed services are, or are likely to become, capable of being supplied;¹⁴
- the legitimate business interests of the carrier or carriage service provider concerned (NBN Co), and the carrier or provider's investment in facilities used to supply the declared service concerned;¹⁵
- the interests of persons who have rights to use the declared service concerned;¹⁶
- the direct costs of providing access to the declared service concerned;¹⁷
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility;¹⁸ and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.¹⁹

The ACCC's preliminary view is that the SAU has many features which, when having regard to the above criteria, have merit. For example:

- The 'modular' design of the SAU allows for different matters to be 'locked in' for different periods of time — this allows for a balance to be struck between providing certainty about long-term cost recovery and allowing for flexibility to respond to changing circumstances.
- The initial prices set out in the SAU, in general, are likely to allow for a smooth transition from legacy networks.

¹¹ CCA, ss. 152CBDA(2) and 152CBD(6). The ACCC is not required to consult on the varied SAU unless it is satisfied that the changes specified in the notice to vary are not of a minor nature or are likely to have a material adverse effect on the legitimate commercial interests of any person.

¹² CCA, s. 152AB(2)(c).

¹³ CCA, s. 152AB(2)(d).

¹⁴ CCA, s. 152AB(2)(e).

¹⁵ CCA, s. 152AH(1)(b).

¹⁶ CCA, s. 152AH(1)(c).

¹⁷ CCA, s. 152AH(1)(d).

¹⁸ CCA, s. 152AH(1)(e).

¹⁹ CCA, s. 152AH(1)(f).

- The adoption of the long-term revenue constraint methodology, with an ‘initial cost recovery account’, provides NBN Co with the opportunity to recover its prudent costs over the term of the SAU.
- Long-term commitments not to raise prices above the levels allowed by the CPI-1.5 per cent price control provide certainty to access seekers about what maximum prices will be, and have the potential to create incentives for NBN Co to operate and invest in the National Broadband Network (NBN) efficiently.
- Commitments to provide information to, and consult with, customers on various matters have the potential to reduce information asymmetries between NBN Co and its customers, which could in turn facilitate more efficient use of and investment in the NBN, as well as more efficient use of and investment in downstream infrastructure.

However, despite these features, the ACCC's preliminary view is that it is not satisfied that the SAU lodged by NBN Co meets the criteria specified in Part XIC of the CCA for acceptance of an SAU. The potential for NBN Co's incentives to change significantly over the 27 year SAU term has been a contributing factor in this assessment. In the short to medium term NBN Co is likely to face incentives to take an innovative approach which aligns with the interests of its customers with respect to its products, pricing and investment. However, it is also possible that these incentives will change over the SAU term, particularly once any risks that NBN Co will not be able to recover its costs reduce.

The following key issues have contributed to the ACCC's preliminary view that it is not satisfied that the criteria for acceptance of an undertaking have been met:

- The SAU, if accepted, would operate as one part of the overall telecommunications access regime that applies to NBN Co. Regulated terms and conditions can also be set out in determinations made by the ACCC. These determinations have effect provided that they are not inconsistent with commercially negotiated Access Agreements or the SAU. Certain SAU provisions create uncertainty about the extent to which NBN Co must comply with these other regulatory determinations, and in turn about the ACCC's ability to respond effectively to changing circumstances over the SAU term.
- The SAU would allow for current price structures and price relativities to be locked in by NBN Co until 2040. Whilst the ACCC generally has no objections to the proposed price structures and price relativities applying in the short to medium term, it is unable to be satisfied that they will encourage efficient use of the network for the full proposed term of the SAU, absent the prospect of some rebalancing.
- The combination of the proposed product withdrawal provisions (which allow the withdrawal of a broad range of products) and the discretion provided to NBN Co by the SAU to set new prices, diminishes the prospect that the proposed CPI-1.5 per cent price control will incentivise NBN Co to invest and operate efficiently. Further, the additional mechanisms which NBN Co has proposed in the SAU to encourage it to invest and operate efficiently are not likely to be effective in isolation. The ACCC is therefore unable to be satisfied that the SAU will encourage efficient investment in, and operation of, the NBN.
- The SAU drafting creates uncertainty about whether the ACCC could use its existing powers under Part XIC to declare services and set terms and conditions for those services in circumstances where NBN Co does not face incentives to respond to evolving end-user demand — such circumstances could arise during Module 2 of the SAU in particular.
- The proposed non-price terms do not give sufficient weight to the interests of access seekers. Further, in some cases, they may not ensure that risks are

borne by the party able to manage them most effectively. This could have subsequent implications for the prices paid by, and quality of services provided to, consumers.

In light of these issues, the ACCC is proposing to issue a notice to NBN Co suggesting variations to the SAU. The key variations are as follows:

- Specific drafting amendments (including the deletion of particular clauses) aimed at providing certainty about the extent to which NBN Co must comply with regulatory determinations made by the ACCC.
- The inclusion in the SAU of an opportunity for the ACCC to periodically review whether price structures and relative price levels should be re-balanced (for example, every five years) — the outcomes of this re-balancing would be constrained by the principle that any changes to price structures or relative price levels must be revenue neutral in their effect.
- Amendments to acknowledge that there will be a role for the ACCC in the process of withdrawing products, in order for the ACCC to be able to ensure the effectiveness of the CPI-1.5 per cent price control in creating incentives for NBN Co to invest and operate efficiently.
- Amendments to acknowledge that the ACCC could, in circumstances where NBN Co does not face incentives to respond to evolving end-user demand with respect to the development of new products and their prices, declare services and set terms and conditions for new services.
- Amendments to the long-term revenue constraint methodology which would allow for a greater degree of flexibility in the approach that is adopted, to mirror usual regulatory practice and so encourage efficient investment in and operation of the NBN at various points in time throughout the SAU term.
- The removal from the SAU of a number of the proposed non-price terms, including those relating to service levels, in order to facilitate effective commercial negotiation. The removal of these terms from the SAU would mean that they could be the subject of later ACCC regulatory determinations. (In this context, the ACCC also recognises that these non-price terms have been the subject of some disagreement between NBN Co and its customers. The ACCC notes that — in the event further examination of non-price terms was warranted through a separate regulatory process — the ACCC might need to prioritise those issues that most directly affect end-users in migration to the NBN, given that NBN Co is currently in the early stages of its rollout.)

A number of the above proposals are directed towards clarifying that — for matters not currently directly dealt with by the SAU — Part XIC would continue to operate as intended. As stated in the *Explanatory Memorandum to the Telecommunications Legislation (National Broadband Network Measures — Access Arrangements) Bill 2010*, “the policy intention is that at all times NBN corporations are subject to the obligations under Part XIC — specifically the Category B SAOs...[a]s a consequence the supply of services by NBN corporations is always subject to oversight by the ACCC.”

The proposals would nonetheless also preserve the primacy of commercially negotiated Access Agreements in the legislative hierarchy.

Further, the ACCC notes that in using its powers under Part XIC (to declare services and to determine terms and conditions for services) it is required to take into account particular matters specified by Part XIC — such as NBN Co’s legitimate business interests, the interests of access seekers and whether the declaration or determination would promote the long-term interests of end-users.

The variations proposed by the ACCC are intended to allow the SAU to deliver a framework for the regulation of NBN Co's services which:

- ensures consumers and businesses get services of broadly the quality they get today for broadly the price they get today — consumers and businesses would only pay more for services and/or usage beyond what they get today;
- allows for vigorous retail competition;
- provides NBN Co with the opportunity — subject to efficient investment and adequate demand for its services — to earn a reasonable return on its investment (but no more);
- provides NBN Co with incentives to not be wasteful, but to also innovate and invest to offer improved services/capacity over time in response to customer demand;
- ensures that NBN Co and access seekers have incentives to commercially negotiate and agree terms and conditions of access, due to the potential for regulatory determinations in the event that agreement cannot be reached; and
- provides a suitable balance between certainty on key principles and flexibility over detailed terms of access over the SAU's proposed 27 year term.

The ACCC notes that its consideration of the SAU is taking place in a unique set of circumstances, both in terms of the network that it will be regulating and the regime that it will be regulating the network under. The remaining sections of this Executive Summary provide relevant context for the ACCC's consideration of the SAU.

The National Broadband Network

The Australian Government has established NBN Co to design, build and operate the NBN.²⁰ The NBN is intended to deliver high data rate broadband services to all Australians, by building an access network using a combination of optical fibre, wireless and satellite technologies with the following initial specifications:

- fibre-based coverage with data rates of up to 100Mbps to at least 93 per cent of premises, with a minimum fibre coverage obligation of 90 per cent of premises; and
- fixed wireless and satellite coverage with data rates of at least 12 Mbps to the remaining premises.²¹

NBN Co has estimated that the construction and rollout of the NBN will cost \$37.4 billion in capital expenditure and will be completed around 2021.²²

Reflecting on the rapid technological advances in the sector over the past 30 years — at the access network, application and consumer device layers — how technology and consumer preferences will evolve over the life of the NBN investment is highly uncertain. Nonetheless,

²⁰ Explanatory Memorandum to the *National Broadband Network Companies Bill 2010 Telecommunications Legislation Amendment (National Broadband Network Measures – Access Arrangements) Bill 2010*, p. 1. (EM to NBN Companies Bill 2010)

²¹ Letter from the Hon. Penny Wong MP, Minister for Finance and Deregulation and Senator the Hon. Stephen Conroy, Minister for Broadband, Communications and the Digital Economy to NBN Co, *Statement of Expectations*, 17 December 2010, Department of Broadband, Communication and the Digital Economy, Canberra, viewed 27 March 2013, http://www.dbcde.gov.au/_data/assets/pdf_file/0003/132069/Statement_of_Expectations.pdf, p. 4. (*Statement of Expectations*)

²² NBN Co, *Corporate Plan 2012-15*, 6 August 2012, p. 10.

recent rapid increases in data consumption by consumers represent a significant opportunity for the telecommunications sector, and for NBN Co.²³

The structure and function of NBN Co is established by the *National Broadband Network Companies Act 2011*. NBN Co is to operate as a wholesale-only company.²⁴ This will deliver a key structural reform to the telecommunications sector, responding to longstanding competition concerns that have arisen from vertical integration in Australian telecommunications markets.

The Government has also stated that its intention is that NBN Co will be planned as a monopoly national fixed-line network as far as practical from its points of interconnect to the end-user premises.²⁵ Under arrangements considered by the ACCC, Telstra is required to progressively migrate its wholesale and retail customers from its copper and HFC networks to the NBN.²⁶ Furthermore, the second largest HFC network — owned by SingTel Optus — will also be progressively shutdown as end-users are migrated onto the NBN.²⁷

NBN Co is a wholly Commonwealth Government owned entity that has been prescribed as a Government Business Enterprise (GBE).²⁸ The Government has stated its expectation that it will retain full ownership of NBN Co until the rollout of the NBN is complete — privatisation can only occur after the Communications Minister declares the NBN to be built and fully operational, a Productivity Commission report on the NBN has been tabled in Parliament and the Finance Minister has declared conditions suitable to carry out the sale of NBN Co.²⁹ Whilst NBN Co will be initially funded solely with Government equity, NBN Co is expected to operate on a commercial basis — that is, it must recover its costs, including earning a commercial return on its investment.³⁰

Regulation of the National Broadband Network

As a wholesale-only monopoly, the context in which the ACCC regulates the NBN differs in some ways from the context in which it regulates services provided over Telstra's copper customer access network. Whereas it is beneficial for a vertically integrated provider to offer services to wholesale customers at higher prices or of a lower quality of service than it provides to its downstream retail arm, generally, there is unlikely to be a benefit to NBN Co from discriminating between its customers. In any event, NBN Co is subject to statutory prohibitions against it doing so (the 'non-discrimination provisions').

Nonetheless, absent regulation NBN Co could, if it chose to, provide fixed-line services to all retailers at high prices and of a low quality of service — retailers would have no choice but to accept NBN Co's offer, because there will be no fixed-line alternative to the NBN.

It is therefore essential that the right access settings are established for the NBN so that the potential pitfalls of monopolies — high prices, inefficient investment and poor service quality — are minimised. The economic regulation of industries that exhibit natural monopoly characteristics aims to achieve the productive efficiency benefits of a single infrastructure

²³ ACCC, *ACCC Telecommunications reports 2011-12 — Telecommunications competitive safeguards for 2011-12*, Chapter 2.

²⁴ EM to *NBN Companies Bill 2010*, p. 1.

²⁵ *Statement of Expectations*, p. 4.

²⁶ See ACCC, *Assessment of Telstra's Structural Separation Undertaking and draft Migration Plan — Final decision, February 2012*, available at www.accc.gov.au

²⁷ See ACCC, *Applications for authorisation lodged by NBN Co Limited in respect of provisions of the HFC Subscriber Agreement entered into with SingTel Optus Pty Ltd and other Optus entities — Final Determination*, 19 July 2012, available at www.accc.gov.au

²⁸ EM to *NBN Companies Bill 2010*, p. 6.

²⁹ *Statement of Expectations*, p. 12.

³⁰ The *Statement of Expectations* provides that "NBN Co will be funded with Government equity until NBN Co has sufficient cash flows to support private sector debt without explicit Government support" and "[f]ollowing completion of rollout, the Government will consider the optimum capital structure for the Company following which private sector debt should be applied to repaying the Government investment, consistent with that structure." (*Statement of Expectations*, p. 11.)

operator while preventing the allocative inefficiency losses that would result from the monopolist's exercise of its market power.³¹

The ACCC considers that the regulatory framework for the NBN (which includes the SAU) should lead to outcomes such as vigorous retail competition, innovation and efficient investment by NBN Co in improved services and network capacity over time and effective commercial negotiation between NBN Co and its customers. These are similar to the outcomes the ACCC and the Australian Energy Regulator (AER) seek to facilitate across a range of network industries, including gas, electricity, post and transport. However, whilst the outcomes sought are generally similar, the specific circumstances faced by NBN Co are likely to differ somewhat to those faced by other regulated utilities:

- NBN Co is likely to presently face a higher degree of uncertainty about demand — how much data end-users will want to consume, at what data rate and what they will be willing to pay for it — relative to that faced by other regulated utilities; and
- whilst the NBN is being rolled out, NBN Co is likely to face more uncertainty than other regulated utilities about how much it is going to spend in any given year.

These differences in circumstance could potentially in and of themselves provide greater encouragement for NBN Co to both keep costs down and innovate in its approach to products and prices relative to other regulated utilities.

Having said this, it is possible that over time these uncertainties about demand and costs will reduce. In turn, it is possible that over time the incentives faced by NBN Co will come to more closely reflect those faced by other regulated utilities. It is therefore crucial that the regulatory regime can operate in a manner that is responsive to changing circumstances and can effectively resolve issues if and when they arise. The ACCC notes that the legislative arrangements in Part XIC provide that all services supplied by NBN Co will be declared services and hence able to be regulated by the ACCC when necessary.³²

The SAU lodged by NBN Co would be a key part of the framework under which the NBN would be regulated. If accepted, it would set out a framework for the terms and conditions on which retail service providers will be able to access the network, and in turn shape the telecommunications industry for decades to come — NBN Co proposes that aspects of the SAU will operate until 2040.

However, it is important to note that Part XIC establishes a regulatory framework that is broader than an accepted SAU. Under Part XIC, NBN Co must not supply services unless those services are declared services.³³ Part XIC allows for the terms and conditions on which NBN Co supplies declared services to be set out in different documents.³⁴ NBN Co may give the ACCC an SAU that sets out some or all of the terms and conditions relating to the supply of a service.³⁵ If the SAU is accepted by the ACCC, the ACCC may still supplement the SAU terms and conditions by setting out regulated terms and conditions in relation to the services in Access Determinations or in Binding Rules of Conduct.³⁶

Part XIC also provides for terms and conditions to be established by mutual agreement between NBN Co and access seekers in Access Agreements.³⁷

³¹ ACCC, *Submission to Productivity Commission Review of the National Access Regime, February 2013*, section 3.2.2.

³² EM to *NBN Companies Bill 2010*, p. 136.

³³ CCA, ss. 152CJA(1) and 152AXB.

³⁴ CCA, s. 152AY(2).

³⁵ CCA, ss. 152CBA(1)(b) and 152CBA(2).

³⁶ CCA, ss. 152AY(2)(d) and 152AY(2)(c).

³⁷ CCA, s. 152AY(2)(a).

The ACCC has always recognised that commercially agreed terms and conditions of access are desirable where these can occur. However, it is also important that access seekers have the opportunity to seek effective regulatory recourse in the absence of such agreement. The opportunity for a regulated outcome can, in and of itself, enhance the likelihood of commercial agreement being reached.

The ACCC's assessment of the SAU given by NBN Co is taking place in the above context.

It is also the first SAU to be assessed since Part XIC was significantly amended in 2011. Key amendments to the regime since the ACCC's previous assessment of an undertaking include the introduction of:

- **The legislative hierarchy of regulatory instruments:** terms and conditions in Access Agreements will prevail over regulated terms (that is, the terms and conditions contained in an SAU, Access Determination or Binding Rule of Conduct) to the extent of any inconsistency between these instruments.³⁸
- **The ability for NBN Co to formulate and publish a 'Standard Form of Access Agreement' (SFAA):** NBN Co must, at the request of an access seeker, enter into an Access Agreement on the same terms and conditions as set out in any SFAA relating to the service.³⁹
- **The ability for an SAU to confer powers on the ACCC:** an SAU can provide for the ACCC to perform functions or powers in relation to the undertaking — if it does, the ACCC may perform those functions or exercise those powers in accordance with the SAU.⁴⁰
- **The ability to include fixed principles in an SAU:** an SAU may provide that a term or condition specified in the undertaking is a fixed principles term or condition for a certain period of time.⁴¹ If the ACCC has accepted a SAU that contains fixed principles terms or conditions, the ACCC must not reject another undertaking given in relation to the same service for reasons relating to the fixed principles terms or conditions.⁴²
- **The ability for an SAU to include different categories of commitments:** NBN Co can specify different 'categories' of terms and conditions and conduct in an SAU.⁴³ The ACCC must apply different statutory tests to the different categories.
- **The preclusion of the ACCC rejecting an SAU for reasons relating to uniform national pricing:** if the SAU contains price-related terms and conditions that are reasonably necessary to achieve uniform national pricing of NBN Co's services, the ACCC must not reject the SAU for a reason that concerns the price-related terms and conditions.⁴⁴
- **The preclusion of the ACCC rejecting an SAU for reasons relating to authorised refusals:** if certain conduct by NBN Co (relating to interconnection and bundling of access services) is authorised under Part XIB of the CCA, the ACCC must not reject the undertaking for a reason that concerns this conduct.⁴⁵

³⁸ CCA, ss. 152AY, 152CBIA, 152CBIB and 152CBIC.

³⁹ CCA, s. 152CJA(2).

⁴⁰ CCA, s. 152CBA(10A).

⁴¹ CCA, s. 152CBAA(1).

⁴² CCA, s. 152CBAA(5)(h).

⁴³ See subsections 152CBA(3A), 152CBA(3B) and 152CBA(3C) of the CCA.

⁴⁴ CCA, s. 152CBD(5A)(c).

⁴⁵ CCA, s. 152CBD(5C)(a).

- **Non-discrimination obligations:** NBN Co must not discriminate between access seekers.⁴⁶ (The ACCC has published explanatory material on its website relating to these non-discrimination provisions.)

⁴⁶ CCA, ss. 152AXC(1) and 152AXD(1).

1. Background

This section of the Draft Decision provides an overview of:

- the SAU lodged by NBN Co;
- what an SAU is according to section 152CBA of the CCA; and
- the criteria the ACCC must have regard to in making its decision on the SAU.

It concludes by outlining the structure of the rest of the Draft Decision.

1.1. Overview of the Special Access Undertaking

The SAU lodged by NBN Co has a proposed term of approximately 27 years, with an expiry date of 30 June 2040 ('SAU term').⁴⁷ The SAU has a 'modular structure' which means that different matters are locked-in for different periods of time.

Module 0 operates for the full SAU term. It contains:

- functional descriptions of the services to which the SAU relates;⁴⁸
- commitments to publish Standard Forms of Access Agreement ('SFAAs') and align them with the SAU;⁴⁹ and
- commitments relating to the modular structure of the SAU — in particular, the lodgement by NBN Co, and assessment by the ACCC, of 'replacement modules' (outlined below),⁵⁰ and the setting out of fixed principles terms and conditions.⁵¹

Module 1 operates for approximately 10 years until 30 June 2023 unless it is extended in accordance with clause 4.3 of the main body of the SAU.⁵² The extension is for one year only.⁵³ Module 1 contains a set of detailed terms addressing:

- the implementation of the services to which the SAU relates;⁵⁴
- 'regulatory recourse';⁵⁵
- the definition of 'reference offers' and 'non-reference offers';⁵⁶

⁴⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 3.

⁴⁸ Ibid, Main Body, Attachments A and B.

⁴⁹ Ibid, Main Body, clause 6.

⁵⁰ Ibid, Main Body, clause 4.

⁵¹ Ibid, Main Body, clause 5.

⁵² Ibid, Main Body, clause 4.1(b).

⁵³ Ibid, Main Body, clause 4.3(a).

⁵⁴ Ibid, Schedule 1A.

⁵⁵ Ibid, Schedule 1B.

⁵⁶ Ibid, Schedules 1C and 1D.

- price controls and the operation of the long-term revenue constraint methodology ('LTRCM') (including prudence and the provision of information relating to pricing matters);⁵⁷
- non-price terms and conditions (including service level commitments);⁵⁸ and
- product development and withdrawal.⁵⁹

It also addresses the lodgement by NBN Co, and assessment by the ACCC, of proposals to change aspects of Module 1 at around year five of the SAU term (at the 'midpoint review' process).⁶⁰

Module 2 operates from the expiry of Module 1 until the end of the SAU term.⁶¹ It sets out, generally at a higher level than in Module 1:

- the implementation of the services to which the SAU relates;⁶²
- principles for determining the composition of reference offers;⁶³
- price controls and the operation of the LTRCM;⁶⁴
- product development and withdrawal commitments;⁶⁵ and
- principles for the establishment of service levels.⁶⁶

It also establishes 'regulatory cycles' and their relationship to 'replacement modules'.⁶⁷

Replacement modules, if accepted by the ACCC, would operate in turn for three to five year periods commencing at the expiry of Module 1.⁶⁸ NBN Co would submit these modules as variations to the SAU for ACCC assessment prior to the expiry of the preceding module.⁶⁹ The SAU states that replacement module applications must include a proposed term for the replacement module and proposals about:

- which products will be reference offers;
- the revenues allowed to be earned by NBN Co; and
- service levels.⁷⁰

The SAU also states that any other matter may also be addressed in a replacement module.⁷¹ The manner in which matters will be dealt with by NBN Co in a replacement module is constrained by the principles in Module 2.⁷² If a replacement module is accepted by the ACCC, the accepted terms would operate until the expiry of that replacement module.

⁵⁷ Ibid, Schedules 1C, 1D, 1E, 1F and 1G.

⁵⁸ Ibid, Schedules 1H and 1J.

⁵⁹ Ibid, Schedule 1I.

⁶⁰ Ibid, Schedule 1K.

⁶¹ Ibid, Main Body, clause 4.1(c).

⁶² Ibid, Schedule 2A.

⁶³ Ibid, Schedule 2B.

⁶⁴ Ibid, Schedules 2B, 2C and 2D.

⁶⁵ Ibid, Schedule 2E.

⁶⁶ Ibid, Schedule 2F.

⁶⁷ Ibid, Schedule 2A.

⁶⁸ Ibid, Main Body, clauses 4.5-4.6.

⁶⁹ Ibid, Main Body, clause 4.6(a). Under section 152CBG of the CCA, NBN Co can submit variations to an SAU that is in operation.

⁷⁰ Ibid, Main Body, clause 4.6(b)(i)-(iv).

⁷¹ Ibid, Main Body, clause 4.6(b)(v).

⁷² Ibid, Main Body, clauses 4.6-4.9.

Further, the SAU provides that every term and condition in Module 0 and Module 2 (collectively) is a fixed principles term and condition for the SAU term.⁷³ The ACCC provides its views on the proposed fixed principles in chapter 7 of this Draft Decision.

Modules 0, 1 and 2 are included in the SAU for assessment now, whereas the replacement modules will be submitted for ACCC approval as variations to the SAU prior to the expiry of Module 1 and subsequent replacement modules.⁷⁴

The ACCC provides its views on these 'operational' aspects of the SAU in chapter 2 of this Draft Decision.

Other key components of the SAU are as follows.

For the full SAU term, NBN Co commits to publishing and maintaining SFAAs for the NBN Access Service and Ancillary Services,⁷⁵ and to ensuring the SFAA is consistent with the SAU.⁷⁶ For Module 1, NBN Co also commits to:

- ensuring that new SFAAs are consistent with any Access Determinations and Binding Rules of Conduct ('regulated terms') that are in operation;⁷⁷ and
- offering SFAAs with a two-year, 'co-terminus' term.⁷⁸

The ACCC provides its views on these 'regulatory recourse' commitments in chapter 2 of this Draft Decision.

The SAU describes how NBN Co will supply the services that the SAU is given in relation to. The ACCC provides its views on these matters in chapter 3 of this Draft Decision.

NBN Co also makes commitments relating to the consultative processes it will follow when developing certain new products, enhancing certain products and withdrawing certain products.⁷⁹ The ACCC provides its views on these matters in chapter 4 of this Draft Decision.

The SAU contains a pricing methodology, which includes a constraint on the overall revenues that NBN Co is permitted to recover over the SAU term (that is, the LTRCM).⁸⁰ The SAU also contains a price control mechanism which prevents NBN Co from increasing the maximum regulated prices that it will include in SFAAs for all of its products by more than CPI-1.5 per cent per annum.⁸¹ The SAU allows NBN Co to recover any losses it makes in its early years of operation in later years.⁸²

NBN Co commits to supplying 'reference offers', which are products whose prices remain fixed until 30 June 2017, and which cannot be withdrawn whilst they are defined as reference offers.⁸³ The products that are reference offers can be changed over time, subject to ACCC approval, as consumer demands and preferences change.⁸⁴

⁷³ Ibid, Main Body, clause 5.3.

⁷⁴ Ibid, Main Body, clause 4.6.

⁷⁵ Ibid, Main Body, clause 6.3.

⁷⁶ Ibid, Main Body, clauses 6.1-6.2.

⁷⁷ Ibid, Schedule 1B, clauses 1B.2.2-1B.2.3.

⁷⁸ Ibid, Schedule 1B, clause 1B.1.3.

⁷⁹ Ibid, Schedules 1I and 2E.

⁸⁰ Ibid, Schedule 1F.

⁸¹ Ibid, Schedule 1C, clause 1C.4; Schedule 1D, clause 1D.4.

⁸² Ibid, Schedule 1F, clause 1F.1.3(c).

⁸³ Ibid, Schedule 1C, clause 1C.1.

⁸⁴ Ibid, Schedule 2B, clause 2B.2.

The SAU also contains mechanisms about promoting efficient capital and operating expenditure.⁸⁵

The ACCC provides its views on the price-related aspects of the SAU in chapter 5 of this Draft Decision.

The SAU also contains certain non-price commitments. In particular, NBN Co commits to including in SFAAs particular terms and conditions relating to service levels, dispute management, risk management, confidentiality and intellectual property rights.⁸⁶ NBN Co also makes commitments to provide network and points of interconnect ('POI') rollout information, and commitments relating to the process it will undertake when reviewing and changing the location of POIs.⁸⁷ The ACCC provides its views on these matters in chapter 6 of this Draft Decision.

1.2. What is a Special Access Undertaking?

Section 152CBA of the CCA allows NBN Co to give an SAU to the ACCC in certain circumstances.⁸⁸ NBN Co may give an undertaking if it is, or expects to be, a carrier or carriage service provider, and the undertaking is given in connection with services that are not yet declared under subsection 152AL(8A) and for which no Access Determination is in place.⁸⁹

NBN Co has given the SAU in connection with a listed carriage service — the 'NBN Access Service' — and a service that facilitates the supply of the NBN Access Service — the 'Ancillary Service'. The SAU also sets out commitments in relation to the 'Facilities Access Service', which is stated by NBN Co to be a service in connection with the interconnection obligations under subsection 152AXB(4) of the CCA. There is currently no Access Determination applying in respect of the NBN Access Service, Ancillary Services or Facilities Access Service.

An SAU given by NBN Co must satisfy certain requirements and include certain commitments:

- The undertaking must state that NBN Co agrees to be bound by the Category B Standard Access Obligations ('SAOs') and will comply with the terms and conditions specified in the undertaking in relation to the SAOs⁹⁰ — the ACCC notes that clause 1 of the main body of the SAU refers to the application of SAOs and states that NBN Co will comply with any applicable SAOs.
- The undertaking must specify the expiry time of the undertaking,⁹¹ and may provide for NBN Co to extend the expiry time if the extension is approved by the ACCC in accordance with the criteria as specified in the undertaking⁹² — the ACCC notes that clause 3 of the main body of the SAU specifies the expiry time of the SAU to be 30 June 2040 and clause 7.3 of the main body of the SAU provides for extension of the operation of the SAU.

Further, the undertaking may:

⁸⁵ Ibid, Schedules 1E and 2D.

⁸⁶ Ibid, Schedule 1H, clauses 1H.5, 1H.6 and 1H.7; Schedule 1J, clause 1J.2.

⁸⁷ Ibid, Schedule 1H, clauses 1H.2, 1H.3 and 1H.4.

⁸⁸ CCA, ss. 152CBA(1)(b) and 152CBA(2).

⁸⁹ CCA, s. 152CBA(1)(b).

⁹⁰ CCA, s. 152CBA(3A). The SAOs that apply to NBN Co in respect of declared services are known as Category B SAOs. Section 152AXB provides that these SAOs are: to supply a declared service upon request; to provide interconnection to facilities upon request; and to supply any service using conditional access customer equipment that is necessary in order for a service provider to provide carriage and/or content services by means of the declared service, upon request.

⁹¹ CCA, s. 152CBA(6).

⁹² CCA, s. 152CBA(9).

- state that NBN Co will engage in specified conduct relating to access in the event that NBN Co supplies the service and will do so on terms and conditions as specified in the undertaking;⁹³ and
- state that NBN Co will engage in certain conduct relating to other matters (such as developing new eligible services, enhancing declared services and giving information in relation to those activities).⁹⁴

Essentially therefore, an SAU may contain clauses which reflect terms and conditions in relation to the SAOs and/or any of the above matters. The ability for an SAU to include these different categories of provisions was enabled by the changes to Part XIC introduced in early 2011. The requirement to categorise clauses has added a layer of complexity to the ACCC's assessment of the SAU.

NBN Co states that all the terms and conditions in the SAU are terms and conditions in relation to the SAOs.⁹⁵ However, NBN Co has also indicated that Schedule 1L of the SAU (the product development and withdrawal provisions, including the PDF Processes), may be characterised as conduct relating to developing new eligible services, enhancing declared services and giving information in relation to those activities.⁹⁶

The ACCC has identified, throughout this Draft Decision, which clauses it considers fall into each of the above categories.

The undertaking may also provide for the ACCC to perform ongoing functions in relation to the undertaking;⁹⁷ and provide that a term or condition specified in the undertaking is a fixed principles term or condition for a certain period of time.⁹⁸

The ACCC has identified that the SAU provides for the ACCC to perform ongoing functions in relation to the undertaking, as follows:

- Functions allowing the ACCC to request information — under the 'enhanced information request'; about NBN Co's compliance with the Procurement Rules; about compliance with the pricing aspects of the SAU; about the non-price proposal and engagement proposal lodged by NBN Co at the midpoint review; and about the termination or appointment of 'resolution advisors' under the Dispute Management Rules.
- Functions allowing the ACCC to resolve disputes between NBN Co and its customers about prudence.
- Functions allowing the ACCC to determine terms and conditions — under the Facilities Access Decision process and for new prices for zero-priced facilities access offers and other charges associated with the facilities access reference offers; and under the midpoint review process.
- Functions allowing the ACCC to provide consent for NBN Co to do particular things — including modifying the terms which the SAU specifies will be included in SFAAs; opening, relocating or closing POIs; and appointing and terminating resolution advisors under the Dispute Management Rules.

⁹³ CCA, s. 152CBA(3B).

⁹⁴ CCA, s. 152CBA(3C).

⁹⁵ Letter from NBN Co to ACCC, *Re NBN Co SAU request for clarification*, 1 November 2012, p. 1.

⁹⁶ NBN Co, *Supporting submission: NBN Co Special Access Undertaking*, 28 September 2012, p. 182 (NBN Co Supporting submission); Letter from NBN Co to ACCC, *Re NBN Co SAU request for clarification*, 1 November 2012, p. 1.

⁹⁷ CCA, s. 152CBA(10A).

⁹⁸ CCA, s. 152CBAA(1).

The SAU given by NBN Co also provides that every term and condition in Module 0 and Module 2 of the SAU (collectively) is a fixed principles term and condition for the SAU term.⁹⁹

1.2.1. What are fixed principles?

Section 152CBAA of the CCA provides that if certain pre-conditions are met, the ACCC must not reject any proposed new or varied SAU for a reason that concerns a fixed principles term or condition.

Specifically, if there is an accepted SAU containing a fixed principles term or condition, there will be implications for the ACCC's assessment of a new SAU or variation to the SAU where the new or varied SAU contains:

- an identical fixed principles term or condition;
- a notional fixed period that ends at or before the end of the notional fixed period for the original fixed principles term or condition; and
- any qualifying circumstances that are identical to the original qualifying circumstances.¹⁰⁰

Those implications are that when the ACCC is assessing a new or varied SAU, it does not need to be satisfied that the fixed principles term or condition, its notional fixed period and the qualifying circumstances meet the legislative criteria for accepting an undertaking (these criteria are outlined in section 1.3).

The notional fixed period for a fixed principles term or condition sets out the period of time for which the term or condition is fixed. It begins when the SAU comes into operation and is set to end at a time before, on or after the expiry time of the undertaking.¹⁰¹ The SAU given by NBN Co specifies that the period of time for which the terms in Module 0 and Module 2 will be fixed is until the end of the SAU term.¹⁰²

An SAU may also provide that one or more specified circumstances are 'qualifying circumstances' in relation to the fixed principles term or condition.¹⁰³ If the qualifying circumstances exist, the restriction on the ACCC's assessment of a new SAU or varied SAU will not apply. The SAU given by NBN Co provides that the qualifying circumstances for the fixed principles term and condition are that the ACCC is satisfied that:

- there is not a manifest and material error in the fixed principles term and condition; and
- any information on which the fixed principles term and condition was based was not false and misleading in a material respect.¹⁰⁴

⁹⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 5.

¹⁰⁰ CCA, ss. 152CBAA(5) and 152CBAA(6). Note that there is no requirement that any later SAU must contain the same fixed principles term or condition with the same notional fixed period.

¹⁰¹ CCA, s. 152CBAA(3).

¹⁰² NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 5.

¹⁰³ CCA, s. 152CBAA(2).

¹⁰⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 5.

1.3. Criteria for assessing the Special Access Undertaking

Section 152CBD of the CCA requires that the ACCC must not accept an undertaking unless it is satisfied of certain matters.

Section 152CBD requires that the ACCC be satisfied of different matters depending on the nature of the specific clauses in the SAU — the ACCC must not accept the SAU unless it is satisfied that:

- the terms and conditions specified in the undertaking in relation to compliance with the Category B SAOs (referred to in subsection 152CBA(3A)) are consistent with these obligations and are reasonable;¹⁰⁵
- any conduct specified by the undertaking in relation to access (referred to in subsection 152CBA(3B)) will promote the long-term interests of end-users, and the related terms and conditions are reasonable;¹⁰⁶ and
- any conduct specified by the undertaking in relation to certain matters, such as developing new eligible services or enhancing a declared service (referred to in subsection 152CBA(3C)) will promote the long-term interests of end-users.¹⁰⁷

Section 1.3.1 of this chapter expands on the meaning of the ‘long-term interests of end-users’ and ‘reasonable’.

The ACCC also must not accept the SAU unless it is satisfied that the undertaking is consistent with any Ministerial pricing determination.¹⁰⁸

If an SAU specifies a fixed principles term or condition, subsection 152CBD(4) of the CCA provides that the ACCC must reject the SAU if it considers that:

- the fixed principles term or condition specified in the SAU should not be a fixed principles term or condition;¹⁰⁹
- the notional fixed period for the fixed principles term or condition should not be the notional fixed period;¹¹⁰
- if the SAU provides that one or more specified circumstances are qualifying circumstances in relation to the fixed principles term or condition — any of the qualifying circumstances should not be qualifying circumstances;¹¹¹ or
- if the SAU does not provide that particular circumstances are qualifying circumstances, those circumstances should be qualifying circumstances in relation to the fixed principles term or condition.¹¹²

Finally:

¹⁰⁵ CCA, s. 152CBD(2)(b).
¹⁰⁶ CCA, s. 152CBD(2)(ca).
¹⁰⁷ CCA, s. 152CBD(2)(cb).
¹⁰⁸ CCA, s. 152CBD(2)(c). The ACCC notes that there is no Ministerial pricing determination in force at this time.
¹⁰⁹ CCA, s. 152CBD(4)(a).
¹¹⁰ CCA, s. 152CBD(4)(b).
¹¹¹ CCA, s. 152CBD(4)(c).
¹¹² CCA, s. 152CBD(4)(d).

- the ACCC must not reject the SAU for a reason concerning price-related terms and conditions if those terms and conditions are reasonably necessary to achieve uniform national pricing of eligible NBN services;¹¹³ and
- the ACCC must not reject the SAU for a reason that concerns certain conduct by NBN Co (relating to interconnection and bundling of access services) if that conduct is authorised under Part XIB for the purposes of subsection 51(1) of the CCA.¹¹⁴

1.3.1. 'Long-term interests of end-users' and 'reasonable'

This section expands on the interpretation of the 'long-term interests of end-users' and 'reasonable'.

1.3.1.1. Long-term interests of end-users

In determining whether a particular thing promotes the long-term interests of end-users, subsection 152AB(2) of the CCA requires the ACCC to only have regard to the extent to which the thing is likely to achieve the following objectives:

- promoting competition in markets for listed services;¹¹⁵
- achieving any-to-any connectivity in relation to carriage services that involve communication between end-users;¹¹⁶ and
- encouraging the economically efficient use of and investment in infrastructure by which services are supplied, and any other infrastructure by which listed services are, or are likely to become capable of being supplied.¹¹⁷

These objectives are interrelated — in many cases, the long-term interests of end-users may be promoted through the achievement of two or all three of these matters simultaneously. In other cases, there may be some trade-off between the different aspects and the ACCC will need to weigh up the different effects. The ACCC interprets 'long-term' to mean a balancing of the flow of costs and benefits to end-users over time in relation to the objectives. Thus, it may be in the long-term interests of end-users to receive a benefit for even a short period of time if its effect is not outweighed by any longer term cost.

Promoting competition in markets for listed services

'Competition' is the process of rivalry between firms, where each market participant is constrained in its price and output decisions by the activity of other market participants. In the current context, effective competition requires both that the prices of wholesale 'resale' services and retail services should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-quality packages offered to consumers.

Competition is likely to be in the long-term interests of end-users as it usually brings lower prices for end-users than would otherwise be the case, increased quality of service, increased diversity and scope of product offerings and quicker access to innovations.

To determine the extent to which this objective is likely to be achieved, the ACCC would generally consider firstly its approach to defining the boundaries of the

¹¹³ CCA, s. 152CBD(5A).

¹¹⁴ CCA, s. 152CBD(5C).

¹¹⁵ CCA, s. 152AB(2)(c).

¹¹⁶ CCA, s. 152AB(2)(d).

¹¹⁷ CCA, s. 152AB(2)(e).

markets for listed services. The ACCC's general approach to defining markets is outlined in its *Merger Guidelines*.¹¹⁸ For the purposes of this Draft Decision however, it is not necessary for the ACCC to make precise findings regarding the boundaries of the market definition for relevant markets. The ACCC considers the impact of the provisions in the SAU on the following broad markets for listed services are relevant:

- Retail markets — the relevant retail markets in this context are primarily those which relate to services which will be supplied over the NBN (or which will be capable of being supplied over the NBN). Therefore, at least initially, the greatest impact is likely to be in relation to the retail market(s) for business and consumer grade products based on the wholesale services that will be supplied by NBN Co. This would include fixed-line broadband and voice services. The ACCC considers that it is appropriate to focus its consideration upon the effects upon a national retail market(s) or markets for broadband and voice services.
- Wholesale markets — even though NBN Co will be a provider of wholesale services, these services are expected to be at a sufficiently low enough layer in the supply chain to allow other service providers to offer 'value-added' wholesale services to retail service providers ('RSPs'). These wholesale services could include the supply of services for use or resale by those RSPs, which could range from a small addition to the service which is provided by NBN Co to a complete product which is readily able to be resold with minimal intervention by the RSP. The ACCC considers that it is appropriate to take into account the effects on a broad market or markets for the supply of wholesale 'resale' services. This market could include wholesale services which support the delivery of voice and broadband services. The ACCC considers that vibrant wholesale markets are an important input into ensuring vigorous competition in the downstream retail markets.
- Transmission capability markets — transmission capability refers to links (also referred to as 'backhaul') which are used to connect service providers' core networks with points of service delivery (such as exchanges). These links are usually provided using optical fibre, but can be provided using digital microwave or satellite systems. Service providers can obtain transmission capability by building and installing their own physical infrastructure in order to self supply; acquiring services in an 'unconditioned' state (that is, dark fibre) and providing their own electronics to condition the fibre; or acquiring services in a 'conditioned' state, such as managed transmission services, which includes the declared domestic transmission capacity service (DTCS).

In determining the extent to which the provisions in an SAU are likely to promote competition in markets for listed services, the ACCC must have regard to the extent to which obstacles to end-users gaining access to these services are removed.¹¹⁹ The ACCC would typically also consider:

- whether conditions leading to an improvement in competition would be likely to be established; and
- the extent of the competitive impact and the likelihood of that extent.

In the context of regulating access to Telstra's copper customer access network the effect on competition of various terms and conditions has been a key factor in the ACCC's consideration of whether the long-term interests of end-users are promoted, due to Telstra's previous incentive and ability to discriminate in favour of its downstream retail arm.

¹¹⁸ ACCC, *Merger Guidelines*, November 2008. (Merger Guidelines)

¹¹⁹ CCA, s. 152AB(4).

In the current context however, as a result of NBN Co's wholesale-only structure, it should not have incentives to favour particular customers over others.

In turn, the SAU currently before the ACCC is likely to raise less issues from a competition perspective than previous undertakings lodged by Telstra.

NBN Co is nonetheless subject to the non-discrimination provisions in Part XIC of the CCA — the ACCC's guidelines about the non-discrimination provisions note that it will consider the implications for competition in the event that complaints about possible breaches of the provisions are brought to its attention.

The implications for facilities-based, and quasi-facilities-based, competition at the fixed-line access network layer have also been a relevant consideration in the context of regulating access to Telstra's copper customer access network, due to the existence of alternative fixed-line access networks and the unbundled local loop. However, as noted, the Government has stated that its intention is that NBN Co will be planned as a monopoly national fixed-line network as far as practical from its points of interconnect to the end-user premises,¹²⁰ and Telstra and Optus will be progressively migrating their wholesale and retail customers from existing copper and HFC networks to the NBN.

Hence, the ACCC has not considered the impacts of the SAU on fixed line facilities based competition at the access network layer in this Draft Decision.

Importantly, the promotion of competition will not necessarily always be achieved merely by an increase in (or prevention of a decrease in) the number of participants in a market. That is, the 'level' of competition in a particular market is not assessed as a numerical exercise by tallying the number of firms in the market. Rather, the level of competition is assessed by reference to the vigour of competition between firms, regardless of their number.

In the current context, the ACCC considers that competition in retail markets will not necessarily always be promoted merely by an increase (or prevention of a decrease) in the number of retail service providers connecting directly to the NBN (that is, purchasing services directly from NBN Co). This is because barriers to connecting directly to the NBN will not in and of themselves create barriers to entering retail markets — barriers to entering retail markets can be addressed through the provision of aggregation (and other) services by wholesale providers, rather than through the regulation of terms and conditions of access to NBN Co's network.

Ensuring any-to-any connectivity

Any-to-any connectivity is achieved if and only if each end-user of a carriage service that involves communication between end-users is able to communicate with each other end-user who is supplied with the same or similar service, whether or not the end-users are connected to the same telecommunications network.¹²¹

The any-to-any connectivity requirement is particularly relevant when considering services that involve communications between end-users.¹²²

However, the ACCC considers that this criterion is neither promoted nor hindered in the context of other types of services (such as carriage services that are inputs to an end-to-end service) and it will therefore be less relevant in assessing the SAU lodged by NBN Co.¹²³

¹²⁰ *Statement of Expectations*, p. 4.

¹²¹ CCA, s. 152AB(8).

¹²² Explanatory Memorandum to the *Trade Practices (Telecommunications) Amendment Act 1996* (Cth), p. 41.

¹²³ *Ibid.*, p. 41; ACCC, *Final decision: Fixed Services Review Declaration Inquiry for the ULLS, LSS, PSTN OA, PSTN TA, LCS and WLR*, July 2009, p. 119.

Encouraging efficient investment in and use of infrastructure

In determining the extent to which the provisions in an SAU are likely to result in the achievement of the objective of encouraging the efficient use of and investment in infrastructure, the ACCC must have regard to the following matters:

- whether it is, or is likely to become, technically feasible for the services to be supplied and charged for (having regard to the technology that is in use, available or likely to become available; whether the costs that would be involved in supplying, and charging for, the services are reasonable or likely to become reasonable; and the effects, or likely effects, that supplying, and charging for, the services would have on the operation or performance of telecommunications networks);¹²⁴
- the legitimate commercial interests of the supplier or suppliers of the services, including the ability of the supplier or suppliers to exploit economies of scale and scope;¹²⁵ and
- the incentives for investment in the infrastructure by which the services are or will become capable of being supplied.¹²⁶

The ACCC is not restricted to considering these matters when determining whether the provisions in an SAU encourage efficient use of and investment in infrastructure.¹²⁷

In assessing the provisions in the SAU lodged by NBN Co, the ACCC considers that the SAU neither promotes nor detracts from the criterion of whether it is, or is likely to become, technically feasible for the services to be supplied and charged for. NBN Co is already supplying and charging for services of the nature that the SAU is given in relation to. This suggests that it is technically feasible to supply and charge for such services and that NBN Co considers that the costs in doing so are reasonable. It also suggests that there are not negative effects resulting from supplying and charging for the services on the operation or performance of the network.¹²⁸

The ACCC considers that a legitimate commercial interest of a supplier of services is the ability of the supplier to recover the efficient or 'prudent' costs of providing the services and to earn a normal commercial return on their investment in the infrastructure used to supply those services. The ACCC considers that allowing for a normal commercial return on an investment will provide an appropriate incentive for NBN Co to maintain, improve and invest in the efficient provision of the service.

In considering the ability for the supplier to exploit economies of scale and scope, the ACCC will typically consider whether the supplier is precluded from exploiting the benefits of production processes in which the average (or per unit) cost of production decreases as the firm's output increases; and the benefits of production processes in which it is less costly in total for one firm to produce two (or more) products than it is for separate firms to produce each of these products.¹²⁹ NBN Co is likely to be the sole supplier of Layer 2 bitstream services used to provide fixed line telecommunications products to the majority of end-users in Australia. The ACCC considers that NBN Co therefore can potentially obtain the benefits of economies of scale or scope, and that the SAU does not detract from its ability to do this.

¹²⁴ CCA, s. 152AB(6)(a).

¹²⁵ CCA, s. 152AB(6)(b).

¹²⁶ CCA, s. 152AB(6)(c).

¹²⁷ CCA, s. 152AB(7).

¹²⁸ CCA, s. 152AB(6)(a)(iii).

¹²⁹ ACCC, *Final decision: Declaration of the wholesale ADSL service under Part XIC of the Competition and Consumer Act 2010*, February 2012, p. 67.

¹²⁹ ACCC, *Draft decision: Assessment of FANOC's Special Access Undertaking in relation to the Broadband Access Service*, December 2007, p. 37. (*FANOC Draft Decision*)

In considering the incentives for investment in the infrastructure by which the listed services are supplied; and any other infrastructure by which the listed services are, or are likely to become capable of being supplied, the ACCC must have regard to the risks involved in making the investment.¹³⁰ The ACCC would also typically consider matters such as:

- whether the supplier has the opportunity to recover the prudent costs of building, operating and maintaining the infrastructure used to supply the declared service under consideration; and
- whether the supplier faces an incentive to invest efficiently in delivering a particular service quality.

In considering whether the economically efficient use of infrastructure is encouraged, the ACCC would typically consider:

- whether access prices allow the access provider to recover its prudently incurred costs, but no more; and
- whether the suppliers of services will make timely changes to technology, products, price structures and price relativities in response to changes in consumer tastes.

Finally, the ACCC considers that the phrase 'economically efficient' consists of three components:

- productive efficiency — this is achieved where individual firms produce the goods and services that they offer at least cost;
- allocative efficiency — this is achieved where resources are allocated to their highest valued uses, that is, resources are allocated to those uses that provide the greatest benefit relative to costs; and
- dynamic efficiency — this is achieved when industries make timely changes to and investments in technology and products in response to changes in consumer tastes and productive opportunities.

1.3.1.2. Reasonableness

In determining whether the terms and conditions in an SAU are reasonable, the ACCC must have regard to the matters set out in subsection 152AH(1) of the CCA. The ACCC is not limited to having regard only to these matters.¹³¹

The first of the matters listed in section 152AH(1) is whether the terms and conditions promote the long-term interests of end-users of carriage services or of services supplied by means of carriage services.¹³²

The other matters set out in section 152AH(1) are as follows.

¹³⁰ CCA, s. 152AB(7A).

¹³¹ CCA, s. 152AH(2).

¹³² CCA, s. 152AH(1)(a).

The legitimate business interests of the carrier or carriage service provider concerned and the carrier's or provider's investment in facilities used to supply the declared service concerned

The phrase 'legitimate business interests' is interpreted in a manner consistent with the concept of 'legitimate commercial interests' described above — that is, a legitimate business interest for a carrier or carriage service provider that is an access provider, is the ability to recover the efficient cost of providing services and to earn a normal commercial return on its investment in the infrastructure used to supply those services.¹³³

This matter also requires consideration of the interests of the carrier or carriage service provider in conducting its business affairs. A carrier or carriage service provider should not be unduly compromised in the conduct of its legitimate business interests simply because it has an obligation to provide access to its services — a carrier or carriage service provider is entitled to have some legitimate control over its relationship with an access seeker to the extent reasonably required to protect its business concerns.

For instance, a carrier or carriage service provider should be able to make appropriate decisions about modifications and upgrades to its networks or set appropriate requirements for the billing and payment of its accounts.

The interests of persons who have rights to use the declared service concerned

'Persons' is interpreted to include all current and potential access seekers of the service. Access seekers will generally use that service as an input to supply carriage services, or a service supplied by means of carriage services, to end-users.¹³⁴

Access seekers have an interest in being able to compete for the custom of end-users on the basis of their relative merits. That is, this criterion reflects a consideration of whether the ability of access seekers to compete in the supply of a service in a dependent market is based on the cost and quality of their services relative to each other, rather than a consideration of whether access seekers are ensured of being able to conduct a profitable business.

The interests of access seekers also include not being subjected to overly onerous commercial terms simply because of their status as access seekers. From a non-price perspective, the ACCC, would, for example, expect an access seeker to have reasonable notification of proposed changes to a facility or service that affects its business interests or to be consulted in relation to billing and credit matters, suspension of services and other facets of a business where its customer relationship may be impacted.

The direct costs of providing access to the declared service concerned

Direct costs are those necessarily incurred (or caused) by the provision of access.

Previous decisions of the ACCC have emphasised that direct costs do not include the recovery of any profits the access provider (or any other party) may lose in a dependent market as a result of the provision of access. This consideration is not relevant to wholesale-only access providers. Wholesale-only access providers, such as NBN corporations, do not sell services in dependent markets.

The operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

An access provider will not be precluded from ensuring the safe and reliable operation of carriage services, telecommunications networks or facilities where it gains sufficient revenue to

¹³³ FANOC Draft Decision, p. 38.

¹³⁴ Ibid, p. 39.

cover the costs of the operational and technical requirements necessary for ensuring the safe and reliable operation of carriage services.¹³⁵

Terms of access also should not require work practices that would be likely to compromise the safety or reliability of the carriage service, network or facility.

However, terms of access aimed at ensuring the safe and reliable operation of a carriage service, a telecommunications network or a facility should not be used as a barrier to access seekers gaining access.¹³⁶

The economically efficient operation of a carriage service, a telecommunications network or a facility

‘Economic efficiency’ in this context has the same meaning as outlined above.

The economically efficient operation of a carriage service, telecommunications network or facility will not be precluded where the carrier or carriage service provider is allowed to recover the efficient operating cost of providing services (and no more).

If it were to recover less than this, it may not be able to fund its operations and aspects of service quality may subsequently decline and/or the safe operation of the business may not be guaranteed. If it were able to recover more than its efficient operating costs, it may not be incentivised to operate in an efficient manner (and higher access prices than otherwise may discourage efficient use of the network).

1.4. Structure of the Draft Decision

The following chapters of the Draft Decision provide the ACCC’s preliminary views about the following matters:

- Chapter 2 — the interaction between the SAU and the telecommunications access regime in Part XIC of the CCA.
- Chapter 3 — the service descriptions proposed in the SAU.
- Chapter 4 — the proposed product development and withdrawal provisions.
- Chapter 5 — the proposed price-related terms.
- Chapter 6 — the proposed non-price terms.
- Chapter 7 — the specification of particular terms as a fixed principles term and condition.

Finally, chapter 8 summarises the ACCC’s preliminary assessment of the SAU against the statutory criteria in section 152CBD of the CCA.

¹³⁵ *Re Telstra Corporation Ltd (No 3)* (2007) 242 ALR 482, 545. Cited in: *FANOC Draft Decision*, p. 40.
¹³⁶ *FANOC Draft Decision*, p. 40.

2. Interaction between the SAU and the telecommunications access regime

The SAU, if accepted, would operate as one part of the overall telecommunications access regime that applies to NBN Co.

NBN Co has chosen to specify certain conduct in the SAU which creates obligations for NBN Co to utilise aspects of Part XIC of the CCA in a certain way, and obligations for NBN Co to respond to ACCC decisions in a certain way.¹³⁷

The aspects of the SAU for which NBN Co has adopted this approach include:

- the 'explicit interaction' between the SAU and the SFAA;
- the 'regulatory recourse' mechanism; and
- when changes to the SAU occur through the 'replacement module' approach and the 'midpoint review'.

The ACCC has categorised the provisions relating to these matters as conduct in relation to access under subsection 152CBA(3B) of the CCA. As noted in section 1.3, the ACCC must be satisfied that any conduct that is specified by the SAU will promote the long-term interests of end-users.¹³⁸

This chapter considers whether the above types of conduct could be interpreted as changing the obligations of NBN Co and the rights of access seekers under Part XIC, and whether this would promote the long-term interests of end-users.

For the reasons set out in this chapter, the ACCC's preliminary view is that it is generally not satisfied that the above types of conduct specified by the SAU will promote the long-term interests of end-users — this is primarily because the specified conduct creates uncertainty about when and how NBN Co must comply with its obligations under the telecommunications access regime.

The ACCC considers that this position is consistent with the legislative intent of Part XIC of the CCA.

The legislative arrangements in Part XIC provide that all services supplied by NBN Co will be declared services and hence able to be regulated by the ACCC when necessary. The *Explanatory Memorandum to the Telecommunications Legislation (National Broadband Network Measures — Access Arrangements) Bill 2010* states that "the policy intention is that at all times NBN corporations are subject to the obligations under Part XIC — specifically the Category B SAOs...[a]s a consequence the supply of services by NBN corporations is always subject to oversight by the ACCC."¹³⁹

¹³⁷ Subsections 152CBA(3B) and 152CBA(3C) of the CCA provide for an NBN corporation to specify conduct about certain matters in a Special Access Undertaking.

¹³⁸ CCA, ss. 152CBD(2)(ca) and 152CBD(2)(cb).

¹³⁹ EM to *NBN Companies Bill 2010*, p. 136.

This reflects that while the interests of a wholesale-only provider differ from those of a vertically integrated provider, they do not necessarily fully align with those of access seekers or end-users.

The ACCC notes that the Department of Broadband, Communications and the Digital Economy (DBCDE) submits that “[t]he SAU provides the opportunity to encourage commercial solutions rather than regulatory ones.”¹⁴⁰

Part XIC provides for terms and conditions to be established by mutual agreement between NBN Co and access seekers in Access Agreements,¹⁴¹ and the ACCC has always recognised that commercially agreed terms and conditions of access are desirable where these can occur.

However, it is also important that access seekers have the opportunity to seek an effective regulatory fallback in the absence of such agreement. The opportunity for a regulated outcome can, in and of itself, enhance the likelihood of commercial agreement being reached.

The ACCC considers that drafting amendments can address its concerns with the conduct specified in the SAU about the above matters, and proposes amendments to this effect in the Consultation Paper on the Notice to Vary. For the avoidance of doubt, these drafting amendments are not aimed at changing the primacy of commercially negotiated Access Agreements in the legislative hierarchy.

2.1. Overview of issues and ACCC approach to assessment

Part XIC establishes a telecommunications access regime for third-party access to specific telecommunications services, known as ‘declared services’. A service can become a declared service in a number of ways,¹⁴² including by the ACCC accepting a Special Access Undertaking that relates to the service.¹⁴³ Suppliers of declared services are subject to SAOs,¹⁴⁴ which include an obligation to supply a declared service to an access seeker upon request.¹⁴⁵

The terms and conditions on which carriers and carriage service providers are required to comply with the SAOs are subject to agreement (as set out in an Access Agreement between the access provider and an access seeker).¹⁴⁶ If agreement cannot be reached or if a particular matter is not dealt with by the Access Agreement between the parties, Part XIC provides for some or all of these terms and conditions to be specified by Special Access Undertakings given by an access provider and accepted by the ACCC,¹⁴⁷ Binding Rules of Conduct made by the ACCC,¹⁴⁸ and Access Determinations made by the ACCC.¹⁴⁹

As the terms and conditions for compliance with the SAOs can be simultaneously derived from different sources, Part XIC establishes a hierarchy of these sources to deal with any inconsistency among these terms and conditions (see Diagram 1 below).¹⁵⁰

¹⁴⁰ Department of Broadband Communications and the Digital Economy, *Policy positions underpinning the NBN initiative*, 22 January 2013, p. 1. (DBCDE submission)

¹⁴¹ CCA, s. 152AY(2)(a).

¹⁴² CCA, s. 152AL.

¹⁴³ CCA, ss. 152AL(7) and 152AL(8E).

¹⁴⁴ CCA, ss. 152AZ and 152BA.

¹⁴⁵ CCA, ss. 152AR(3) and 152AXB(2).

¹⁴⁶ CCA, s. 152AY(2)(a).

¹⁴⁷ CCA, s. 152AY(2)(b).

¹⁴⁸ CCA, s. 152AY(2)(c).

¹⁴⁹ CCA, s. 152AY(2)(d).

¹⁵⁰ CCA, ss. 152AY, 152CBIA, 152CBIB and 152CBIC.

One effect of this hierarchy is that any Access Determinations or Binding Rules of Conduct ('regulatory determinations') that the ACCC may make will have no effect to the extent of inconsistency with the SAU if it is accepted.¹⁵¹

It is important to note that this hierarchical relationship extends beyond terms and conditions for compliance with the SAOs included in an SAU in accordance with subsection 152CBA(3A). For example, regulatory determinations will also have no effect to the extent of inconsistency with any conduct and related terms and conditions specified by the SAU for the purposes of subsection 152CBA(3B).

Part XIC includes some additional NBN-related aspects that apply as follows:

- NBN Co cannot supply a service unless the service is a declared service.¹⁵²
- NBN Co can publish an 'open offer' to supply a service, known as a Standard Form of Access Agreement ('SFAA'), which has the effect of declaring that service.¹⁵³
- NBN Co must, at the request of an access seeker, enter into an Access Agreement on the same terms and conditions as set out in any SFAA relating to the service.¹⁵⁴
- NBN Co must not discriminate between access seekers, or against access seekers in favour of itself, in complying with applicable SAOs, and must not discriminate between access seekers when carrying on certain activities.¹⁵⁵

The relationship that Part XIC establishes between the SAU, Access Agreements and other regulatory determinations, as well as the relationship between these instruments and SFAAs, is depicted in Diagram 1 below.

¹⁵¹ CCA, s. 152AY, 152CBIA and 152CBIB.

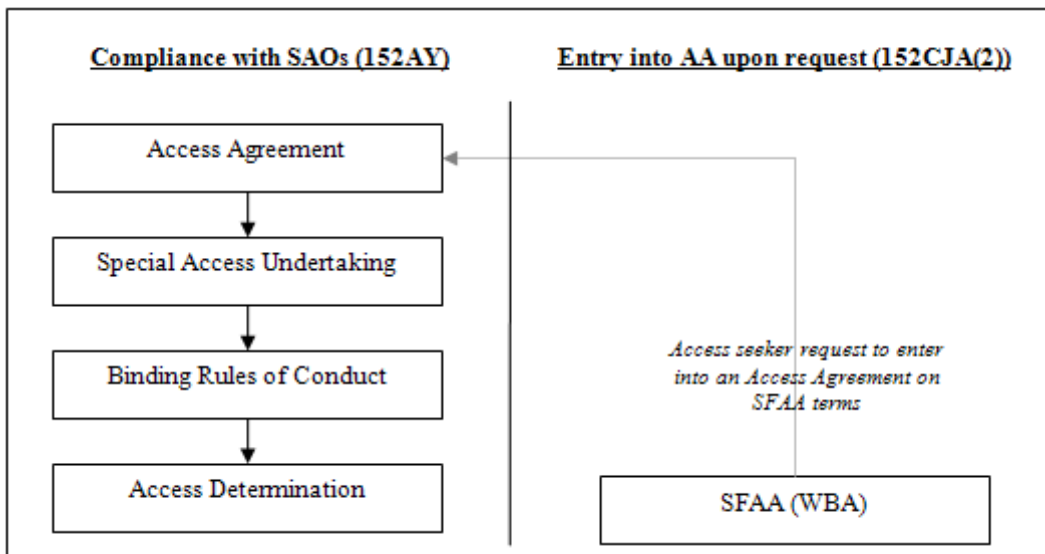
¹⁵² CCA, s. 152CJA(1).

¹⁵³ CCA, s. 152AL(8D).

¹⁵⁴ CCA, s. 152CJA(2).

¹⁵⁵ CCA, ss.152AXC and 152AXD.

Diagram 1: Part XIC hierarchy and its relationship with the SFAA



Sections 2.1.1 and 2.2.2 set out the ACCC’s preliminary reasoning about two general issues that have arisen in the ACCC’s assessment of the SAU — namely that the conduct specified by the SAU causes uncertainty about:

- to what extent and/or when NBN Co must comply with regulatory determinations about matters that are not directly dealt with by the SAU; and
- access seekers’ ability to obtain access on regulated terms by means other than an SFAA-based Access Agreement.

The remaining sections of this chapter then set out the ACCC’s preliminary views about the specific conduct:

- section 2.2 considers the conduct specified in the SAU concerning elements of the telecommunications access regime; and
- section 2.3 considers the conduct specified in the SAU concerning changes to the SAU over time.

Finally, section 2.4 provides the ACCC’s preliminary views on the proposed SAU extension mechanisms.

2.1.1. Interaction between the SAU, Binding Rules of Conduct, and Access Determinations

The SAU does not set out all terms and conditions of access to NBN Co’s services, nor is the SAU required to do so in order for it to be accepted by the ACCC.

Part XIC provides for the ACCC to make Access Determinations and Binding Rules of Conduct that may do a range of things, including specifying terms and conditions for the supply of services by NBN Co.¹⁵⁶ However, as noted, these instruments have no effect to the extent of

¹⁵⁶ CCA, ss. 152BC(3) and 152BD(1).

inconsistency with the SAU if it is accepted (or to the extent of inconsistency with Access Agreements).¹⁵⁷

The SAU includes provisions (or 'conduct') that refer to ACCC regulatory determinations (that is, Access Determinations and Binding Rules of Conduct) for a range of different purposes. These are not provisions that directly regulate substantive matters relating to access to declared services — in particular, the provisions are not about particular price and non-price terms of access to declared services.

The ACCC considers that the drafting of these particular provisions should not create uncertainty about when and how NBN Co must comply with the ACCC's regulatory determinations. Such uncertainty may arise if the drafting of the SAU does not make it clear that NBN Co is also required to comply with the ACCC's regulatory determinations in other circumstances which are not specified by the provisions in the SAU.

Put another way, it could be interpreted that NBN Co's obligations to comply with ACCC regulatory determinations under Part XIC are limited to the circumstances specified by the SAU — even where these instruments specify terms and conditions which are not directly addressed by the SAU (and which are not inconsistent with Access Agreements).

The ACCC acknowledges that under the hierarchy of instruments set out in Part XIC of the CCA, the ACCC's regulatory determinations do not have effect to the extent of inconsistency with the SAU (or Access Agreements). Provisions specified by the SAU will only come into operation if the ACCC is satisfied that they will promote the long-term interest of end-users and are reasonable.¹⁵⁸ Therefore, the fact that terms and conditions specified by regulatory determinations would have no effect to the extent of inconsistency with terms and conditions specified by an accepted SAU is not in itself a reason why the SAU should not be accepted.

However, given that the SAU does not specify all terms and conditions of access to NBN Co's services, it is important that all parties have certainty about when NBN Co must comply with regulatory determinations which specify terms and conditions for matters that are not directly dealt with by the SAU (and which are not inconsistent with Access Agreements). Otherwise, access seekers may face a lack of certainty about their ability to take advantage of the ACCC's regulatory determinations.

In summary, in assessing the SAU, the ACCC will consider whether the provisions of the SAU, as drafted, may result in uncertainty about when NBN Co must comply with ACCC regulatory determinations which specify terms and conditions that are not directly dealt with by the SAU, and which are not inconsistent with Access Agreements.

Where the ACCC considers that uncertainty does arise from the drafting of the provisions of the SAU, the ACCC cannot be satisfied that the provisions will promote the long-term interests of end-users.

2.1.2. Interaction between the SAU and SFAAs

As noted, Part XIC provides for NBN Co to formulate a type of 'open offer' to supply services, known as a SFAA.¹⁵⁹ If an access seeker requests NBN Co to enter into an Access Agreement

¹⁵⁷ CCA, ss. 152AY, 152CBIA, 152CBIB and 152CBIC. Where the ACCC has referred to inconsistency between ACCC regulatory determinations and Access Agreements in this chapter, this specifically relates to the circumstance in which an access seeker enters into an Access Agreement with NBN Co, and any Access Determinations or Binding Rules of Conduct subsequently having no effect between that access seeker and NBN Co to the extent of inconsistency with their Access Agreement.

¹⁵⁸ CCA, s. 152CBD(2).

¹⁵⁹ CCA, ss. 152CJA(2) and 152CJF.

that contains the same terms and conditions as those contained in an SFAA, NBN Co must comply with the request.¹⁶⁰

SFAAs are not an Access Agreement, and SFAAs do not form part of the Part XIC hierarchy of terms (see Diagram 1 above). However, if an access seeker enters into an Access Agreement that contains the same terms as an SFAA, these terms will prevail over regulated terms specified by an SAU, Binding Rules of Conduct and Access Determinations.

The SAU refers to SFAAs for a number of different purposes, including:

- **Production and maintenance of SFAAs** — clause 6.3 of the main body states that NBN Co will publish and maintain SFAAs in relation to the supply of the NBN Access Service and Ancillary Services. NBN Co may include terms and conditions in relation to the supply of the Facilities Access Service in SFAAs.
- **Development of SFAAs ('multilateral SFAA forum')** — Schedule 1B, clause 1B.3 states that NBN Co will establish and conduct a multilateral SFAA forum to consult with access seekers on changes to the terms and conditions of SFAAs.
- **Alignment of SFAAs with the SAU** — clauses 6.1 and 6.2 of the main body state that NBN Co will amend published SFAAs to ensure consistency with the terms of the accepted SAU, and will ensure that SFAAs remain consistent with the SAU, including when the SAU is varied over time.
- **Consistency between SFAAs and regulatory determinations ('regulatory recourse')** — Schedule 1B, clause 1B.2 states that NBN Co will ensure that new SFAAs it publishes are consistent with any Access Determinations and Binding Rules of Conduct that apply in respect of the NBN Access Service and Ancillary Services and any 'Facilities Access Decisions' made by the ACCC in relation to the Facilities Access Service under a power conferred on the ACCC by the SAU.
- **Including particular terms and conditions in SFAAs** — Schedule 1H, clauses 1H.5, 1H.6 and 1H.7 and Schedule 1J, clause 1J.2 require NBN Co to include certain terms and conditions in SFAAs for certain non-price matters.
- **Reference offers** — Schedule 1C, clauses 1C.1.4, 1C.1.5 and 1C.1.6 specifies that the price that can be included in SFAAs for reference offers will be no higher than the maximum regulated price in certain circumstances.
- **Non-reference offers and other charges** — Schedule 1D, clauses 1D.1.4, 1D.1.5, 1D.1.6 and 1D.1.7 specifies that the price that can be included in SFAAs for non-reference offers and other charges will be no higher than the maximum regulated price in certain circumstances.

Under Part XIC, entry into an Access Agreement based on an SFAA is not the only way that access seekers can obtain access to services supplied by NBN Co.

Firstly, NBN Co and an access seeker may agree to terms and conditions in an Access Agreement that are different to those included in an SFAA.¹⁶¹

Secondly, NBN Co must comply with terms and conditions that are specified by an SAU, Access Determinations and Binding Rules of Conduct,¹⁶² where these instruments are not

¹⁶⁰ CCA, s. 152CJA(2).

¹⁶¹ CCA, s. 152CJA(3).

inconsistent with an Access Agreement between the parties (or also, for Access Determinations and Binding Rules of Conduct, an SAU that is in operation). Part XIC includes mechanisms for these instruments to be enforced by NBN Co, the access seeker, or the ACCC.¹⁶³ Similarly, NBN Co and an access seeker may agree to incorporate terms and conditions specified in these instruments into an Access Agreement.

It is therefore not essential for NBN Co and an access seeker to enter into an Access Agreement based on an SFAA in order for NBN Co to supply declared services to the access seeker.

However, the ACCC considers that some of the conduct about SFAAs specified in the SAU creates uncertainty about whether the effect of the ACCC's regulatory determinations is limited to NBN Co updating new SFAAs (discussed further in section 2.2.2). Put another way, the ACCC considers that some of the conduct about SFAAs specified in the SAU creates uncertainty about the extent to which NBN Co must comply with regulatory determinations in ways *other* than updating new SFAAs (such as the ways noted above).

This has the potential to alter the choices access seekers can make when choosing whether to enter into an Access Agreement based on an SFAA. If an access seeker could not require NBN Co to comply directly with the terms and conditions set out in the ACCC's regulatory determinations, it may not be able to refuse to enter into an Access Agreement based on the SFAA offered by NBN Co — even if that SFAA contained terms and conditions that did not promote the long-term interests of end-users.

In addition, the relationship between the SAU and SFAAs that is established by the SAU has the potential to alter this choice. If the SAU does not specify terms and conditions in its own right, but instead requires NBN Co to include terms and conditions in an SFAA, this means that access seekers would need to enter into an SFAA-based Access Agreement and accept any other terms that NBN Co formulates in an SFAA in order to obtain access on the SAU terms (discussed further in section 2.2.1). This could in turn exacerbate the potential for NBN Co to decide the terms and conditions upon which it will comply with the SAOs and could prevent the SAU terms from providing an effective regulatory fallback.

Further, under Part XIC, access to declared services is not contingent on entry into any Access Agreement. The ACCC notes that some commitments in the SAU are expressed with respect to 'Customers' rather than with respect to 'Access Seekers'.¹⁶⁴ For example, NBN Co offers to supply product components to customers.¹⁶⁵ Similarly, a CVC is defined to be capacity for the transport of 'Customer traffic', with the product features selected by 'a Customer'.¹⁶⁶ Such references appear to purport to require an access seeker to have entered into, or be subject to, an Access Agreement with NBN Co in order to obtain supply of declared services in accordance with regulated terms in the SAU.

The ACCC recognises that some interested parties have concerns about the viability of supply in accordance with Access Determinations and Binding Rules of Conduct. These concerns appear to reflect the fact that there currently is no Access Determination or Binding Rules of Conduct made in relation to services supplied by NBN Co. The concerns also appear to reflect:

¹⁶² The ACCC has not made an Access Determination or Binding Rules of Conduct in relation to services supplied by NBN Co at this time.

¹⁶³ See, for example, private rights for carriers and access seekers to enforce Access Determinations and Binding Rules of Conduct in the Federal Court under sections 152BCQ and 152BDH, and carrier licence conditions and service provider rules about compliance with Access Determinations in sections 152BCO and 152BCP(2) and Binding Rules of Conduct in sections 152BDF and 152BDG(2). Similarly, under section 152BC(3)(g), an Access Determination may require an access seeker to accept and pay for supply on the terms specified by the ACCC if the access seeker requests NBN Co to supply declared services.

¹⁶⁴ Examples of this include definitions in Attachment C to the Main Body of the SAU; various clauses in Schedule 1A; clause 1E.9.1(b)(i) of Schedule 1E; and clause 11.3.1 of Schedule 1I. This issue does not apply to the drafting of terms and conditions in Annexures 1, 2 and 3 to Schedule 1H and Annexure 1 to Schedule 1J, which would only have effect under an Access Agreement.

¹⁶⁵ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1A, clause 1A.3.1.

¹⁶⁶ *Ibid*, Schedule 1A, clause 1A.2.5.

- the potential for termination and disconnection provisions in Access Agreements to prevent access seekers from transitioning to regulatory determinations without interrupting the supply of services to end-users; and
- the potential for 'change management' provisions in Access Agreements that allow NBN Co to unilaterally change terms and conditions to prevent an access seeker from obtaining the benefits of regulated terms.¹⁶⁷

The ACCC expects that NBN Co and access seekers would ensure that the terms and conditions in Access Agreements cannot be used in these ways.

Further, while the ACCC has not made any Access Determinations or Binding Rules of Conduct that apply to NBN Co at this time, it could do so in the event that commercial agreement between NBN Co and access seekers cannot be reached. In making such regulatory determinations, the ACCC would be required to take into account particular matters specified by Part XIC — such as NBN Co's legitimate business interests, the interests of access seekers and whether the determination would promote the long-term interests of end-users.¹⁶⁸

In summary, in assessing the types of conduct discussed in this section, the ACCC will consider whether the conduct specified by the SAU, as drafted, may mean that access seekers must enter into Access Agreements based on SFAAs in order to obtain supply in accordance with regulated terms set out in the SAU or regulatory determinations. Where the ACCC considers that this occurs, the ACCC cannot be satisfied that the conduct will promote the long-term interests of end-users.

2.2. Assessment of conduct concerning elements of the telecommunications access regime

The following sections apply the above framework to the conduct specified by the SAU concerning elements of the telecommunications access regime, and set out the ACCC's preliminary views on that conduct.

2.2.1. Conduct about including terms and conditions in SFAAs

NBN Co makes certain commitments in the SAU about the terms and conditions it will include in SFAAs, as follows:

- The SAU requires NBN Co to include specific terms and conditions in SFAAs — for example, clauses 1H.5.1, 1H.6, and 1H.7 of Schedule 1H require NBN Co to incorporate the terms set out in Annexures to Schedule 1H into any SFAA.

¹⁶⁷ See, for example, Herbert Geer on behalf of iiNet Ltd, *NBN Co Limited 2012 Special Access Undertaking Consultation Paper submission*, 18 January 2013, pp. 12-13 and p. 19 (iiNet submission); Macquarie Telecom, *Submission to the ACCC in relation to the NBN Co Limited 2012 Special Access Undertaking*, 18 January 2013, p. 3 (Macquarie Telecom submission); Nextgen Networks, *Submission to the ACCC Consultation Paper: NBN Co Special Access Undertaking*, 18 January 2013, p. 7 (Nextgen Networks submission); Telstra, *NBN Co 2012 Special Access Undertaking: Telstra's response to the ACCC Consultation Paper*, 18 January 2013, pp. 18-19 (Telstra submission); Vodafone Hutchison Australia, *NBN Co Special Access Undertaking for the NBN Access Service: Submission to the ACCC*, 18 January 2013, pp. 10-11. (Vodafone Hutchison Australia submission)

¹⁶⁸ CCA, ss. 152BCA(1) and 152BDAA(1).

- The SAU prevents NBN Co from including certain terms and conditions in SFAAs — for example, clause 1C.1.4 of Schedule 1C prevents NBN Co from including a price for a reference offer in an SFAA that is higher than the maximum regulated price for that reference offer, as determined in accordance with the SAU.¹⁶⁹

For convenience, terms and conditions of the kinds mentioned above will be subsequently referred to as **SFAA terms and conditions**.¹⁷⁰

There is a question about what effect these commitments have — that is, whether they are terms and conditions in relation to compliance with the SAOs in accordance with subsection 152CBA(3A), or whether they are conduct that NBN Co will engage in, and the terms and conditions relating to that conduct in accordance with subsection 152CBA(3B). If the SFAA terms and conditions are specified by the SAU in relation to the SAOs, it means that NBN Co would be required to supply to access seekers who choose not to enter into an Access Agreement based on an SFAA.¹⁷¹ On the other hand, if the SFAA terms and conditions are not specified by the SAU in relation to the SAOs, NBN Co would only be required to supply services on those terms and conditions if an access seeker enters into an Access Agreement based on an SFAA.

The question as to whether the SFAA terms and conditions are specified in the SAU in relation to the SAOs arises because, in addition to the commitments that are set out above about including the terms in SFAAs, the SAU includes statements about NBN Co's compliance with the SAOs (which are required to be included in an SAU by subsection 152CBA(3A)) as follows:

1.1 Compliance with category B standard access obligations

In the event that NBN Co supplies, or becomes capable of supplying, the NBN Access Service and the Ancillary Services (whether to itself or to other persons), NBN Co agrees to be bound by the obligations referred to in section 152AXB of the CCA, to the extent that those obligations would apply to NBN Co in relation to the NBN Access Service and Ancillary Services if the NBN Access Service and Ancillary Services were treated as declared services.

1.2 Compliance with this Special Access Undertaking

In the event that NBN Co supplies, or becomes capable of supplying, the NBN Access Service and the Ancillary Services (whether to itself or to other persons), NBN Co undertakes to comply with the terms and conditions specified in this Special Access Undertaking in relation to obligations referred to in section 152AXB of the CCA.

However, the SAU, as drafted, is not clear about the extent to which it specifies terms and conditions about compliance with the SAOs. As noted, another possible categorisation is that the SAU specifies conduct about the SFAA (namely, that NBN Co will include the SFAA terms and conditions in SFAAs), and the SFAA terms and conditions are the terms and conditions to

¹⁶⁹ Clause 1C.1.4 of Schedule 1C applies from acceptance of the SAU until 30 June 2017 — equivalent provisions that apply CPI-1.5 per cent price controls to reference offers after 30 June 2017 are included in clause 1C.1.5 of Schedule 1C and clause 2C.2.1 of Schedule 2C. For further information about the operation of the price controls applying to products supplied by NBN Co, please refer to chapter 5 of this Draft Decision.

¹⁷⁰ It should be noted that this refers to the terms and conditions that the SAU requires NBN Co to include (or not include) in an SFAA, and does not refer to any terms and conditions that are actually included in an SFAA (whether or not in accordance with NBN Co's obligations under the SAU).

¹⁷¹ This is analogous to how the 'regulatory recourse' commitments in the SAU (discussed in section 2.2.2 of this Draft Decision) may impact on how access seekers obtain supply in accordance with regulatory determinations. It should also be noted that NBN Co would not be required to supply to an access seeker in accordance with the SAU if the access seeker had an Access Agreement that was inconsistent with the SAU — see sections 152AY and 152CBIC of the CCA.

be included in the SFAA — they are therefore part of the terms and conditions upon which NBN Co will engage in this conduct.

For the purposes of the SAU assessment, under the first categorisation (that is, the SFAA terms and conditions are specified in relation to the SAOs), the ACCC must be satisfied that the SFAA terms and conditions are reasonable. Under the second categorisation (that is, the SFAA terms and conditions are specified in relation to conduct), the ACCC must also be satisfied that the conduct of including the terms in SFAAs will promote the long-term interests of end-users.

The ACCC sought clarification from NBN Co in October 2012 about the intended effects of the SFAA terms and conditions in the SAU.¹⁷² NBN Co responded that all of the terms and conditions in the SAU are terms and conditions in relation to subsection 152CBA(3A), that is, terms and conditions in relation to compliance with the SAOs.¹⁷³ However, NBN Co also stated that the SFAA terms and conditions will be dealt with as a contractual matter between NBN Co and an access seeker under their Access Agreement, rather than as a breach of the SAU.¹⁷⁴ In addition, NBN Co stated that the ACCC could set out different terms and conditions to the SFAA terms and conditions in a regulatory determination, but that such an instrument will have no effect to the extent to which it is inconsistent with the terms set out in the SAU.¹⁷⁵

The ACCC does not consider that NBN Co's response has clarified whether the SFAA terms and conditions are intended to be specified by the SAU in relation to the SAOs. While it includes a specific reference to subsection 152CBA(3A), other aspects of the response appear to contradict an interpretation whereby the SAU specifies the SFAA terms and conditions in relation to the SAOs.¹⁷⁶ For instance, as noted above, NBN Co considers that it will not breach the SAU if it does not comply with the substance of these terms and conditions that are to be included in the SFAAs.

The ACCC considers that these commitments are not terms and conditions in relation to the SAOs referred to in subsection 152CBA(3A) and proposes to assess these commitments as conduct specified by the SAU as follows:

- conduct that is specified by the SAU in relation to SFAAs in accordance with subsection 152CBA(3B)(a) and assessed by the ACCC in this section of the Draft Decision; and
- terms and conditions that are specified by the SAU in relation to this conduct in accordance with subsection 152CBA(3B)(b) — these terms and conditions are assessed by the ACCC in chapters 5 and 6 of this Draft Decision.

2.2.1.1. Submissions

Interested parties submit that:

¹⁷² Letter from ACCC to NBN Co, *NBN Co SAU request for clarification*, 26 October 2012, pp. 1-2. It should be noted that the September 2012 SAU and the December 2012 SAU are effectively identical in their references to SFAA terms and conditions.

¹⁷³ Letter from NBN Co to ACCC, *Re NBN Co SAU request for clarification*, 1 November 2012, p. 1.

¹⁷⁴ *Ibid*, p. 2.

¹⁷⁵ *Ibid*, pp. 2-3.

¹⁷⁶ For example, if the SAU specifies the SFAA terms and conditions in relation to the SAOs, this means that the SFAA terms and conditions are not necessarily dealt with only as a contractual matter. Further, it is not clear why the ACCC would ever set out terms in a regulatory determination about the particular matters addressed by the SFAA terms and conditions, as suggested by NBN Co — access seekers would already be able to obtain supply on the SFAA terms and conditions by means of the SAU in effectively the same manner as if the ACCC made a regulatory determination. There would therefore seem to be little point to the ACCC specifying different terms that would have no effect due to inconsistency with the SAU.

- The SAU should be clear about whether substantive commitments are to be enforced through commercial arrangements or through the SAU itself.¹⁷⁷
- If non-price terms are included in the SAU, the SAU should require NBN Co to comply with the substance of these terms and conditions. If these terms and conditions are included in the SFAA only, then they should be enforced under the contract between the parties.¹⁷⁸
- In principle, there is nothing wrong with the SAU including commitments affecting the terms that NBN Co will offer access seekers in SFAAs. However, there should be clear commitments relating to the change management provisions that NBN Co will include in SFAAs to prevent these commitments being circumvented.¹⁷⁹

2.2.1.2. Preliminary ACCC view

The ACCC is not satisfied that the conduct that is specified by the SAU in relation to SFAAs will promote the long-term interests of end-users.

This is because the conduct has the effect of requiring that access seekers sign an Access Agreement that is based on an SFAA in order to obtain supply on the SFAA terms and conditions specified in the SAU. In turn, access seekers would need to agree to all other terms and conditions in an SFAA that have been formulated by NBN Co in order to obtain the benefit of the SFAA terms and conditions set out in the SAU — even if those other terms and conditions would distort competition, discourage efficient operation of and investment in infrastructure, or hinder any-to-any connectivity.

The Consultation Paper on the Notice to Vary proposes to address this issue by proposing variations which clarify that the SFAA terms and conditions are specified in the SAU in relation to the SAOs. The effect of this would be to clarify that NBN Co would be required to supply on the SFAA terms and conditions to access seekers who choose not to enter into an Access Agreement based on an SFAA.

The ACCC's conclusion about this conduct does not mean that NBN Co's proposed framework of interaction between the SAU and SFAAs cannot operate. If the terms and conditions that constitute the SFAA terms and conditions are reasonable, the SAU can specify these terms and conditions and clause 6 of the main body of the SAU — which requires NBN Co to ensure that SFAAs are consistent with the SAU — would establish a relationship between the SAU and SFAAs. (The ACCC's assessment of the reasonableness of the SFAA terms and conditions is set out in chapters 5 and 6 of this Draft Decision.)

2.2.2. Conduct about updating SFAAs in response to Access Determinations and Binding Rules of Conduct

Schedule 1B of Module 1 of the SAU contains commitments about how NBN Co will make new SFAAs consistent with regulated terms that are established by the ACCC in Access Determinations and Binding Rules of Conduct.

The 'regulatory recourse' mechanism in the SAU requires NBN Co to "give effect" to regulatory determinations by ensuring that new SFAAs are consistent with:

¹⁷⁷ Telstra submission, p. 10.

¹⁷⁸ Nextgen Networks submission, p. 18.

¹⁷⁹ iiNet submission, p. 13.

- an Access Determination or Binding Rules of Conduct that relate to the NBN Access Service or the Ancillary Services (these are described as a ‘regulatory determination’ in the SAU);¹⁸⁰ and
- a ‘Facilities Access Decision’ (which is a decision made by the ACCC pursuant to a power that is conferred on the ACCC by the SAU, and discussed further in section 2.2.3).¹⁸¹

NBN Co will not be required to “give effect” to any regulatory determination or Facilities Access Decision by amending any existing published SFAA.¹⁸²

When read in conjunction with clause 1B.1.3(a) (which requires any SFAA to include an expiry date that is no later than two years after the date it commences) this conduct provides for access seekers to obtain regulated terms in a new SFAA-based Access Agreement every two years when their current Access Agreements expire.

Through its inclusion in Module 1 of the SAU, this conduct is specified for approximately 10 years (until 30 June 2023, unless Module 1 is extended in accordance with clause 4.3 of the main body of the SAU). However, this conduct will be reviewed at the midpoint review of Module 1.

The SAU states that the ‘regulatory recourse’ mechanism does not apply in relation to pricing matters.¹⁸³ This aspect is discussed in chapter 5 of this Draft Decision.

2.2.2.1. Submissions

NBN Co submits that:

- It has adopted an “integrated approach to regulatory oversight” that recognises the Government’s policy intent of promoting commercially agreed outcomes, provides the parties with contractual certainty, and allows it to respond to changes as necessary by incorporating certain ACCC decisions into SFAAs.¹⁸⁴
- Its commitment to offer SFAAs with two-year “co-terminus” terms allows access seekers to “take advantage of ACCC decisions in a timely manner [and] also enables NBN Co to comply with its non-discrimination obligations”.¹⁸⁵
- As Access Agreements based on the two-year SFAA will expire at the same time, regardless of when executed, all access seekers will have the ability to obtain regulated terms that it includes in SFAAs at the same time.¹⁸⁶
- Given “the bespoke nature of the regulatory oversight arrangements”, they should only be contained in Module 1. The effectiveness of the operation of these arrangements will inform any mechanism that may be required in the latter 20 years of the SAU term (which could be included as part of a replacement module application).¹⁸⁷

Ordovery and Shampine note that:

¹⁸⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.2.2(b).
¹⁸¹ Ibid, Schedule 1B, clause 1B.2.3(e).
¹⁸² Ibid, Schedule 1B, clauses 1B.2.2(c) and 1B.2.3(f).
¹⁸³ Ibid, Schedule 1B, clause 1B.1.2.
¹⁸⁴ NBN Co Supporting submission, p. 145.
¹⁸⁵ Ibid, p. 145.
¹⁸⁶ Ibid, p. 147.
¹⁸⁷ Ibid, p. 150.

- The existing SFAA will not be modified to reflect ACCC regulatory determinations as the parties require contractual certainty for business planning purposes.¹⁸⁸

The Department of Broadband, Communications and the Digital Economy (DBCDE) submits that:

- NBN Co's approach means that the parties can enter into new agreements knowing that it is for a two-year period. If issues arise during this time that cannot be resolved using the processes under the Access Agreements, they "can be pursued as part of the next cycle".¹⁸⁹
- It is more appropriate to consider whether the regulatory recourse arrangements should apply beyond Module 1 after there is experience of the proposed approach.¹⁹⁰

Interested parties submit that:

- The inclusion of an effective "regulatory oversight mechanism" will facilitate the parties reaching commercial outcomes.¹⁹¹
- The regulatory recourse mechanism in the SAU will not be effective, given the limitations on the availability of regulatory determinations. For example:
 - Access seekers should not be required to transition from their existing Access Agreements to a new SFAA-based Access Agreement every two years if they wished to obtain the benefit of regulated terms, as they may be required to accept any other changes that NBN Co includes in the updated SFAA.¹⁹²
 - It would be inappropriate to wait up to two years to implement Binding Rules of Conduct, which only have a duration of 12 months, and are intended to allow the ACCC to respond where there is an urgent need to do so.¹⁹³
 - There should be the ability to "backdate" regulatory determinations, for example, in relation to NBN Co's implementation of an earlier regulatory determination, to ensure that NBN Co has incentives to implement regulatory determinations in a manner that is consistent with the ACCC's intent.¹⁹⁴
 - The ACCC should have the ability to direct that regulatory determinations be immediately included in SFAAs and/or Access Agreements (rather than giving access seekers the option not to include it in their subsequent Access Agreements).¹⁹⁵

¹⁸⁸ Janusz A. Ordovery and Allan L. Shampine, *Expert Report*, 24 September 2012, p. 28. (Ordovery and Shampine report)

¹⁸⁹ DBCDE submission, p. 2.

¹⁹⁰ *Ibid.*, p. 2.

¹⁹¹ AAPT, *Submission to the ACCC: Consultation on the NBN Co 2012 SAU dated 18 December 2012*, 18 January 2013, p. 15 (AAPT submission); Telstra submission, p. 28.

¹⁹² AAPT submission, pp. 12-13; Competitive Carriers' Coalition, *Submission to the SAU Discussion Paper*, 18 January 2013, p. 8 (CCC submission); iiNet submission, pp. 17-19; Telstra submission, pp. 28-29.

¹⁹³ AAPT submission, p. 12; CCC submission, pp. 8-9; Macquarie Telecom submission, p. 3; Nextgen Networks submission, p. 6; Optus, *Submission to the ACCC Consultation Paper: NBN Co Limited 2012 Special Access Undertaking*, 18 January 2013, pp. 23-24 (Optus submission); Vodafone Hutchison Australia submission, p. 10.

¹⁹⁴ AAPT submission, p. 13; Optus submission (Public version), pp. 23-24; Telstra submission, p. 29.

¹⁹⁵ AAPT submission, p. 12; CCC submission, p. 8; Macquarie Telecom submission, pp. 3-4; iiNet submission, p. 21; Vodafone Hutchison Australia submission, p. 11.

- The scope of the issues that the regulatory recourse mechanism can address is limited, for example, price matters should not be excluded.¹⁹⁶
- The ‘regulatory recourse’ commitments should not be limited to Module 1, that is, they should apply for the term of the SAU.¹⁹⁷

2.2.2.2. Preliminary ACCC view

As stated in section 2.1.1, the ACCC acknowledges that under the hierarchy of instruments set out in Part XIC of the CCA, the ACCC’s Access Determinations and Binding Rules of Conduct do not have effect to the extent of inconsistency with the SAU (and Access Agreements). However, it is important that the ACCC can through these regulatory determinations specify terms and conditions for matters that are not directly dealt with by the SAU.

The ‘regulatory recourse’ provision in the SAU states that NBN Co will “give effect” to the ACCC’s regulatory determinations by ensuring that new SFAAs will be consistent with the ACCC’s regulatory determinations.

In the ACCC’s Consultation Paper on the SAU, the ACCC noted that this provision could be viewed as NBN Co making commitments that are additional to its obligations to comply with regulatory determinations under Part XIC, and that define how NBN Co will, in the circumstances that are set out in the SAU, make regulated terms available to access seekers who sign a new Access Agreement that is based on an SFAA. That is, the commitments could provide a means of obtaining access on regulated terms that is in addition to NBN Co’s obligations under Part XIC.

However, following further consideration of the regulatory recourse provision, the ACCC now considers that it has two features which mean that the ACCC is not satisfied that the provision as drafted will promote the long-term interests of end-users.

Firstly, under the SAU, NBN Co is not required to update an existing SFAA. Its obligation is to make a *new* SFAA consistent with the ACCC’s regulatory determinations.

By stating that NBN Co will not be required to amend any existing published SFAA to make it consistent with the ACCC’s regulatory determinations,¹⁹⁸ the ACCC’s regulatory determinations may not have any impact upon the terms and conditions contained in an SFAA until the SFAA expires. This is despite the fact that the terms and conditions in an SFAA are formulated by NBN Co, have not been agreed by access seekers, and may contain other terms and conditions to which it is not reasonable to expect access seekers to agree.

The ACCC considers that by placing limitations on *when* NBN Co must take account of regulatory determinations in SFAAs, the SAU creates means by which NBN Co could avoid the intended application of regulated terms. For example, the ACCC notes NBN Co’s submission that it has an incentive to ensure that the practical implementation of a regulatory determination is acceptable to access seekers and consistent with the intent of the ACCC decision because the ACCC would be able to make further regulatory determinations specifying implementation of the initial determination.¹⁹⁹ However, it is not clear to the ACCC that NBN Co would in all circumstances have this incentive because that later determination would not be implemented until publication of the next SFAA.

¹⁹⁶ AAPT submission, p. 7 and p. 11; CCC submission, pp. 5-6; Macquarie Telecom submission, p. 4; Nextgen Networks submission, p. 7; Optus submission (Public version), pp. 24-25; Telstra submission, p. 30; Vodafone Hutchison Australia submission, p. 18.

¹⁹⁷ Macquarie Telecom submission, p. 3; Nextgen Networks submission, p. 8; Optus submission (Public version), pp. 23-24; Telstra submission, pp. 30-31.

¹⁹⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.2.2(c).

¹⁹⁹ NBN Co Supporting submission, p. 145.

Secondly, the drafting of the regulatory recourse provision in the SAU creates uncertainty about whether the effect of the ACCC's regulatory determinations is limited to NBN Co updating new SFAAs or whether NBN Co is also required to directly comply with the ACCC's regulatory determinations.

Clause 1B.2.2(b) of Schedule 1B states that NBN Co will "give effect" to 'Regulatory Determinations' as follows:

NBN Co will give effect to any Regulatory Determination by ensuring that the new SFAA, published to be available upon expiry of the term of the current SFAA in accordance with clause 1B.1.3(a), will be consistent with such Regulatory Determination.

The ACCC considers that by stating that NBN Co will "give effect" to the ACCC's regulatory determinations by updating new SFAAs, the 'regulatory recourse' provision could potentially be interpreted as intending that updating new SFAAs is the *only* obligation that NBN Co has in respect of ACCC regulatory determinations. This interpretation could lead to uncertainty about whether, by operation of the hierarchy in Part XIC of the CCA, an obligation to comply directly with the ACCC's regulatory determinations would be inconsistent with the SAU, and in turn whether NBN Co is released from such an obligation.

As noted in sections 2.1.1 and 2.1.2, this uncertainty could mean that an access seeker could not require NBN Co to comply directly with the terms and conditions set out in the ACCC's regulatory determinations and has the potential to alter the choices access seekers can make when choosing whether to enter into an Access Agreement based on an SFAA. If the effect of the ACCC's regulatory determinations were limited to NBN Co updating new SFAAs, before the next SFAA comes into operation, an access seeker would not be able to benefit from the ACCC's regulatory determinations. It would not be able to require NBN Co to directly comply with the ACCC's regulatory determinations, even if the existing SFAA that is available contained terms and conditions that are unreasonable and inconsistent with the ACCC's regulatory determinations. In these circumstances, access seekers may have no alternative but to agree to enter into an SFAA-based Access Agreement on unreasonable terms and conditions.

For these two reasons, the ACCC is not satisfied that the 'regulatory recourse' provision will promote the long-term interests of end-users.

The ACCC recognises that NBN Co has sought to develop a mechanism that is able to provide certainty for all parties about how access will occur on regulated terms made by the ACCC.²⁰⁰ However, the ACCC considers that greater certainty would be achieved if the issues discussed above are addressed, as it would then be clear that when and how NBN Co must comply with regulatory determinations is not limited to the circumstances specified by the conduct in the SAU.

The ACCC also recognises that the mechanism has been developed to take into account NBN Co's non-discrimination obligations under Part XIC.²⁰¹ The ACCC notes that it must not make an Access Determination that has the effect (direct or indirect) of discriminating between access seekers.²⁰² The ACCC considers that an inquiry about a proposal to make an Access Determination would provide a suitable opportunity to consider how to take account of NBN Co's non-discrimination obligations, given the circumstances which exist at that time.

In light of the above considerations, the Consultation Paper on the Notice to Vary proposes that the SAU be amended to remove the qualifications around when and how NBN Co will "give effect" to regulated terms in SFAAs.

²⁰⁰ Ibid, p. 145.

²⁰¹ Ibid, p. 145.

²⁰² CCA, s. 152BCB(4A).

2.2.3. Conduct about updating SFAAs in response to Facilities Access Decisions

Clause 1B.2.3 of Schedule 1B confers a power on the ACCC to make 'Facilities Access Decisions' about terms and conditions for the 'Facilities Access Service'. The SAU describes the process that must be followed by the ACCC.²⁰³ NBN Co commits to making new SFAAs consistent with the terms established by the ACCC under this power.²⁰⁴ The process for implementation of ACCC decisions in SFAAs is similar to NBN Co's commitments to implement Access Determinations and Binding Rules of Conduct in SFAAs (that is, the 'regulatory recourse' mechanism discussed in section 2.2.2).²⁰⁵

The conferral of power on the ACCC to make Facilities Access Decisions will be reviewed at the midpoint review of Module 1.

2.2.3.1. Submissions

NBN Co submits that the Facilities Access Decision power "will provide an appropriate regulatory recourse role for the ACCC in relation to the Facilities Access Service, as provided in the SAU".²⁰⁶

Interested parties submit that:

- The ACCC's powers to decide terms and conditions in relation to the Facilities Access Decision are limited, and the mechanism does not provide for the ACCC to determine all the terms and conditions necessary for the Facilities Access Service.²⁰⁷
- As NBN Co does not consider that the Facilities Access Service is a declared service, it is unclear the extent to which the SAU commitments will or will not apply to this service.²⁰⁸

2.2.3.2. Preliminary ACCC view

The ACCC considers that the Facilities Access Decision mechanism is comprised of two key elements:

- a function or power that is conferred on the ACCC in accordance with subsection 152CBA(10A) to decide certain terms and conditions in relation to the Facilities Access Decision; and
- conduct specified in accordance with subsection 152CBA(3B), whereby NBN Co commits to engage in specified conduct in response to the ACCC's exercise of the function or power — that is, NBN Co will ensure that new SFAAs it publishes will be consistent with ACCC decisions.

The SAU is the first Part XIC undertaking that confers functions and powers on the ACCC since amendments to the CCA provided for an undertaking to do so.

²⁰³ Under clause 1B.2.3 of Schedule 1B, the ACCC must undertake consultation and may consider submissions in making its decision. Each Facilities Access Decision, and the reasons for the decision, must be published within 20 business days after making the decision.

²⁰⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.2.3(e).

²⁰⁵ Ibid, Schedule 1B, clause 1B.2.3(e)-(g).

²⁰⁶ NBN Co Supporting submission, pp. 147-148.

²⁰⁷ Macquarie Telecom submission, p. 4.

²⁰⁸ Nextgen Networks submission, p. 17.

Section 152CBD does not set out criteria against which a conferral of a function or power is to be assessed.

As the Facilities Access Decision mechanism proposes to confer an additional power on the ACCC beyond its regulatory powers under Part XIC, the ACCC considers that it is important that the SAU clearly defines how this power will operate to ensure that the outcomes of the power will promote the long-term interests of end-users, consistent with the object of Part XIC.

Further, the ACCC considers that the ability for it to exercise this power in accordance with the processes set out in the SAU will impact on whether NBN Co will subsequently engage in conduct that promotes the long-term interests of end-users.

Therefore, the ACCC proposes to assess the Facilities Access Decision mechanism as follows:

- firstly, the ACCC will consider whether the power that is conferred on it can be exercised in a manner that will result in NBN Co supplying the Facilities Access Service on reasonable terms and conditions; and
- secondly, the ACCC will consider whether the conduct that NBN Co commits to in response to ACCC decisions, that is, to “give effect” to ACCC decisions by making new SFAAs consistent with such decisions, will effectively implement such decisions.

Overall, the ACCC’s preliminary view is that it is not satisfied that the conduct that NBN Co will engage will promote the long-term interests of end-users. The key reasons for this view are set out below.

Processes associated with the power

The ACCC notes that it is already able to make terms and conditions in relation to the Facilities Access Service under Part XIC. The ACCC has no objection in principle to the SAU conferring an additional, albeit similar, power on it. However, this power should not inhibit its ability to exercise its existing powers.

The ACCC considers that the Facilities Access Decision mechanism does not appear to impact upon the ACCC’s ability to exercise its existing powers.

However, the ACCC notes that it appears that the Facilities Access Decision power has limited operation in comparison to any regulatory determination that the ACCC could make in relation to the Facilities Access Service under its existing regulatory powers. For example, the SAU states that the expiry date of a Facilities Access Decision must be no more than five years after the date on which the decision comes into effect,²⁰⁹ whereas there is no such limitation on an Access Determination.

The ACCC considers that this limitation on the availability of its decisions under the Facilities Access Decision power may not result in NBN Co supplying services on reasonable terms and conditions in all circumstances.

Implementation of outcomes resulting from the ACCC’s decision

As noted, NBN Co commits to undertake certain conduct in respect of the function or power it has conferred on the ACCC. Specifically, NBN Co will ensure that new SFAAs will be consistent with the terms established by the ACCC under the Facilities Access Decision power.

NBN Co’s commitments to implement Facilities Access Decisions are similar to NBN Co’s commitments to implement the regulated terms established by the ACCC in regulatory

²⁰⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.2.3(c).

determinations in new SFAAs, as discussed in section 2.2.2. For the reasons outlined in that section, the ACCC considers that this conduct will not promote the long-term interests of end-users.

In particular, access seekers can only obtain access on the terms made by the ACCC under the Facilities Access Decision mechanism by signing an Access Agreement based on the SFAA terms. This may mean that access seekers would need to accept all the other terms formulated by NBN Co in an SFAA in order to obtain access on the terms and conditions set out in a Facilities Access Decision.

On the other hand, if the ACCC were to make regulated terms in relation to the Facilities Access Service under its existing regulatory powers, access seekers would be able to obtain those terms without the need to enter into an SFAA-based Access Agreement (subject to the ACCC's views on the implications of the current SAU commitments for the effectiveness of regulated terms, outlined in section 2.2.2).

In summary, the ACCC is not satisfied that the conduct that NBN Co will engage in to implement Facilities Access Decisions in SFAAs will promote the long-term interests of end-users. In light of the above considerations, the Consultation Paper on the Notice to Vary proposes that the SAU be amended to remove the Facilities Access Decision mechanism.

2.2.4. Conduct about production and maintenance of SFAAs

NBN Co makes certain commitments in the SAU about producing and maintaining SFAAs.

Under clause 6.3 of the main body, NBN Co commits to publishing and maintaining SFAAs in relation to the supply of the NBN Access Service and the Ancillary Services for the term of the SAU. Clause 6.3 also states that NBN Co *may* include terms and conditions in relation to the supply of the Facilities Access Service in SFAAs.

Clause 1B.1.3 of Schedule 1B provides that NBN Co will ensure that the SFAAs it publishes during Module 1 will have an expiry date of no later than two years after the date on which the SFAA commences. Clause 1B.1.3 also states that these SFAAs may include the option to extend the term of the SFAA. That is, if NBN Co and access seekers executed an Access Agreement based on such SFAAs, they can agree to extend the term of these Access Agreements beyond the specified expiry date. NBN Co also commits to updating SFAAs in accordance with the 'regulatory recourse' mechanism discussed in section 2.2.2.

2.2.4.1. Submissions

NBN Co submits that:

- It intends for the terms and conditions of access to be set out in both an SAU (if accepted) and SFAAs (Access Agreements once signed by access seekers).²¹⁰
- It will offer “co-terminus” SFAAs with maximum term of two years “to ensure that all access seekers are able to avail themselves of regulated terms set by the ACCC at the same time, and within a reasonable timeframe”.²¹¹

Interested parties submit that:

- In principle, the proposal to update the SFAA and make it available on a two-yearly basis is welcome.²¹²

²¹⁰ NBN Co Supporting submission, p. 48.

²¹¹ Ibid, p. 45.

- The “co-terminus” approach would mean that ACCC oversight would be limited during the two-year term of the SFAA.²¹³

2.2.4.2. Preliminary ACCC view

The commitment to publish and maintain SFAAs for the supply of the NBN Access Service and the Ancillary Services (the first part of clause 6.3 of the main body),²¹⁴ has the effect of ensuring that access seekers will have the option of obtaining supply of these services via Access Agreements based on an SFAA for the SAU term.²¹⁵ When read in conjunction with clauses 6.1 and 6.2 of the main body (which require NBN Co to ensure consistency between the SAU and SFAAs), this conduct provides for access seekers to have the option of obtaining access to services on the SAU terms and conditions over the term of the SAU by entering into an SFAA-based Access Agreement.

The ACCC is therefore of the view that the conduct that NBN Co will engage in under the first part of clause 6.3 of the main body will promote the long-term interests of end-users.

However, the ACCC considers that it is unclear how the second part of NBN Co’s commitment in clause 6.3 of the main body, that is, that NBN Co *may* include terms and conditions about the Facilities Access Service in its SFAAs, will operate. In particular, the scope of the terms that NBN Co is permitted to include is unclear. There is therefore uncertainty about whether ACCC regulatory determinations about the Facilities Access Service would be inconsistent with the SAU and therefore of no effect. That is, it is possible that the only terms and conditions about the Facilities Access Service that would be available to access seekers would be those included in SFAAs by NBN Co (as discussed in sections 2.2.1 and 2.2.2).

Given this, the ACCC cannot be satisfied that the conduct that NBN Co will engage in under the second aspect of clause 6.3 of the main body will promote the long-term interests of end-users. Therefore, the Consultation Paper on the Notice to Vary proposes that this aspect of NBN Co’s commitment in clause 6.3 of the main body be amended.

In relation to the commitment to publish SFAAs with a maximum two-year term,²¹⁶ the ACCC considers that the effect of this commitment is that SFAA-based Access Agreements will have a two-year term during the first 10 years of the SAU term, and will be ‘co-terminus’. That is, all Access Agreements based on these SFAAs will expire at the same time (however, NBN Co and access seekers are free to agree to Access Agreements with a different term).

Some interested parties have raised concerns that access seekers may have to wait up to two years to obtain the benefit of regulated terms. Issues with the ‘regulatory recourse’ mechanism in the SAU are discussed in section 2.2.2. However, the ACCC considers that there should be both the ability for terms and conditions of access to NBN Co’s services to continue to develop and be open to negotiation, and certainty that a SFAA with a fixed maximum term will be available.

At this time, the ACCC is of the preliminary view that a two-year SFAA term is an appropriate length of time.

²¹² Telstra submission, pp. 8-9.

²¹³ Optus submission (Public version), pp. 23-24; Telstra submission, p. 29; Vodafone Hutchison Australia submission, p. 9.

²¹⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 6.3.

²¹⁵ As discussed in section 2.2.6 of this Draft Decision, NBN Co also commits to ensuring that SFAAs remain consistent with the SAU. Also, as noted, under Part XIC NBN Co and access seekers can commercially negotiate different terms in their Access Agreements, and access seekers can also obtain supply via any Access Determinations or Binding Rules of Conduct.

²¹⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.1.3.

2.2.5. Conduct about development of SFAAs

Clause 1B.3 of Schedule 1B provides that NBN Co will establish and conduct a multilateral SFAA forum to identify issues industry has with the SFAA and to develop possible solutions.

The SAU sets out processes for conducting the forum.

The purpose of the forum includes “identifying and prioritising issues associated with any SFAA and working to develop multilateral resolutions to changes to any SFAA.”²¹⁷ Both NBN Co and access seekers can suggest changes to any SFAA.²¹⁸

The first forum will be convened no later than 18 months after the SAU commences,²¹⁹ and subsequent forums will be held six months prior to the expiry of each version of the SFAA.²²⁰

The forum will be available to all access seekers, regardless of whether they have an Access Agreement with NBN Co (however, access seeker participation is voluntary).²²¹

The SAU also sets out how NBN Co may make changes to SFAAs arising out of the forum. Specifically, NBN Co may make changes to any SFAA “as NBN Co considers appropriate.”²²² However, any changes to the non-price terms and conditions specified in Annexures to Schedule 1H (dispute management rules, information & rights management and risk management) and Schedule 1J (service levels) of the SAU (which NBN Co commits to include in SFAAs as discussed in section 2.2.1) as well as the provisions in the Annexure to Schedule 1I (Product development and withdrawal), require the ACCC’s prior approval.²²³ NBN Co will incorporate such changes in new versions of the SFAA upon the expiry of the term of the current SFAA (discussed in section 2.2.4 above).²²⁴

The operation of the multilateral SFAA forum will be reviewed at the midpoint review of Module 1.

2.2.5.1. Submissions

NBN Co submits that:

- The multilateral SFAA forum will ensure open and effective engagement with industry in accordance with NBN Co’s non-discrimination obligations.²²⁵
- It will assist the ACCC to identify terms and conditions for which it may be necessary to make an Access Determination, Binding Rules of Conduct or Facilities Access Decision.²²⁶
- The ability for access seekers to seek, and for the ACCC to make regulated terms provides NBN Co with an incentive to engage productively with access seekers to reach mutually agreeable terms and conditions.²²⁷

Interested parties submit that:

²¹⁷ Ibid, Schedule 1B, clause 1B.3.1(c).
²¹⁸ Ibid, Schedule 1B, clause 1B.3.1(d).
²¹⁹ Ibid, Schedule 1B, clause 1B.3.1(b).
²²⁰ Ibid, Schedule 1B, clause 1B.3.1(h).
²²¹ Ibid, Schedule 1B, clause 1B.3.1(i).
²²² Ibid, Schedule 1B, clause 1B.3.1(e).
²²³ Ibid, Schedule 1B, clause 1B.3.1(e).
²²⁴ Ibid, Schedule 1B, clause 1B.3.1(f).
²²⁵ NBN Co Supporting submission, p. 150.
²²⁶ Ibid, p. 150.
²²⁷ Ibid, p. 150.

- NBN Co is not required to consult with access seekers in relation to its interpretation and implementation of Access Determinations and Binding Rules of Conduct in SFAAs (that is, via the 'regulatory recourse' commitments).²²⁸
- Access seekers do not have the right to convene a multilateral SFAA forum outside of the timeframes proposed by NBN Co, and if NBN Co does not agree with suggested changes, it does not need to notify the ACCC for up to 4 months.²²⁹
- There is no active role for the ACCC in connection with the forum, and if NBN Co rejects suggested changes, the only recourse for access seekers is to seek Access Determinations and Binding Rules of Conduct for incorporation into the next published iteration of the SFAA (that is, via the 'regulatory recourse' commitments).²³⁰

2.2.5.2. Preliminary ACCC view

The ACCC considers that the multilateral SFAA forum provisions specify conduct to be undertaken by NBN Co in accordance with subsection 152CBA(3B) of the CCA. Specifically, NBN Co will implement the outcomes of the multilateral SFAA forum by making changes to the SFAA. Consequently, the ACCC considers that the effectiveness of the multilateral SFAA forum processes set out in the SAU will impact on whether NBN Co will subsequently engage in conduct that will promote the long-term interests of end-users.

Therefore, the ACCC proposes to assess the multilateral SFAA forum provisions as follows:

- firstly, the ACCC will consider whether the multilateral SFAA forum can be conducted in a manner that will allow the parties to propose solutions for incorporation into SFAAs; and
- secondly, the ACCC will consider whether the conduct that NBN Co commits to following the outcomes of the multilateral SFAA forum, that is, to "give effect" to those outcomes in SFAAs, will effectively implement such outcomes.

Overall, the ACCC's preliminary view is that the conduct that NBN Co will engage in will not promote the long-term interests of end-users. The key reasons for this view are set out below.

Processes associated with the multilateral SFAA forum

As noted, the SAU sets out the procedures (including timeframes) that NBN Co will follow during the multilateral SFAA forum. The ACCC considers that the specified processes may not allow for the effective development and timely implementation of outcomes.

Firstly, NBN Co is not obliged to discuss changes to SFAAs arising from a regulatory determination (that is, changes via the 'regulatory recourse' mechanism, as discussed in sections 2.2.2 and 2.2.3) within the multilateral SFAA forum.²³¹ The ACCC considers that there should be no restrictions on the topics that are discussed to enable open engagement and input into the development of mutually agreeable terms for SFAAs.

Secondly, the SAU specifies that the multilateral SFAA forum will be convened 6 months prior to the expiry of each version of the SFAA.²³² Similar to the 'regulatory recourse' commitments, NBN Co only commits to incorporating the outcomes of the forum in new SFAAs (discussed

²²⁸ AAPT submission, p. 12; iiNet submission, p. 16; Optus submission (Public version), p. 26; Telstra submission, p. 29.

²²⁹ Optus submission (Public version), pp. 119-120.

²³⁰ Optus submission (Public version), p. 26.

²³¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.3.1(j).

²³² Ibid, Schedule 1B, clause 1B.3.1(h).

further below). If the outcomes are not settled at the time of publication of a new SFAA, they may not be implemented until publication of the next SFAA another two years later.

As a result, the ACCC is of the view that these procedures are unlikely to enable the parties to identify issues with the SFAA and propose solutions for incorporation into new SFAAs in a timely manner.

Implementation of outcomes

The ACCC considers that the conduct that NBN Co commits to undertake to implement the outcomes of the multilateral SFAA forum will not promote the long-term interests of end-users.

As noted, the SAU states that “NBN Co may make such changes to any SFAA as NBN Co considers appropriate”, subject to:

- clause 6, that is, the commitment to ensure consistency between SFAAs and the SAU; and
- clause 1B.2, that is, the 'regulatory recourse' mechanism.²³³

As the conduct that NBN Co will engage in following the outcomes of the multilateral SFAA forum is subject to *other* conduct specified by the SAU that the ACCC considers is not in the long-term interests of end-users (specifically, the 'regulatory recourse' mechanism discussed in section 2.2.2), the ACCC cannot be not satisfied that this conduct will promote the long-term interests of end-users.

In light of the above considerations, the Consultation Paper on the Notice to Vary proposes that the SAU be amended to remove the commitments about the procedural requirements for conducting the multilateral SFAA forum, and the commitments about how NBN Co will implement the outcomes of the forum in SFAAs. Provided that these variations are made, and in conjunction with the ACCC's proposal to remove the midpoint review mechanism, the remaining provisions about the multilateral SFAA forum would operate for the duration of Module 1. The ACCC's preliminary view is that the remaining provisions about the multilateral SFAA forum would promote the long-term interests of end-users for the duration of Module 1; however, it is a decision for NBN Co whether it wishes for these provisions to operate for five years instead.

2.2.6. Conduct about inconsistency between SFAAs and the SAU

NBN Co makes certain commitments in the SAU to ensure consistency between the SAU and SFAAs it publishes throughout the SAU term as follows:

- initial SFAA alignment obligation — clause 6.1 of the main body provides that NBN Co will amend the terms of published SFAAs to ensure consistency with the terms of the accepted SAU; and
- ongoing SFAA consistency obligation — clause 6.2 of the main body provides that NBN Co will amend the terms of SFAAs to ensure that the SFAAs remain consistent with the SAU, including when the SAU is varied, over time.²³⁴

²³³ Ibid, Schedule 1B, clause 1B.3.1(e).

²³⁴ Under clause 6 of the Main Body of the SAU, NBN Co will amend SFAAs within 20 business days of the commencement of the SAU (or a variation to the SAU). NBN Co will also make amendments within 20 business days after it becomes aware of any inconsistency between the SAU and any SFAA. Further, clauses 4.5 to 4.11 of the Main Body of the SAU provide that following the expiry of Module 1, NBN Co will periodically submit variations to the SAU by the replacement module submission and assessment process

2.2.6.1. Submissions

NBN Co submits that:

- It intends for the SAU and SFAAs “to operate as complementary and consistent documents and they have been drafted to be so” and the alignment clause will ensure ongoing consistency.²³⁵
- The SAU contemplates that the terms and conditions relating to supply may be set out in a combination of the SAU, SFAAs and Access Determinations, Binding Rules of Conduct and Facilities Access Decisions, with Access Agreements being the instrument under which NBN Co will provide supply.²³⁶
- The commitment to amend SFAAs to ensure consistency with the SAU is important given the modular nature of the SAU “which means that the operative terms and conditions are likely to vary over time”.²³⁷

Interested parties submit that:

- The commitment to maintain consistency between the SAU and SFAAs is welcome. However it is unclear how alignment will occur for access seekers on an existing Access Agreement, or for those who choose to extend their Access Agreement.²³⁸

2.2.6.2. Preliminary ACCC view

The ACCC’s preliminary view is that the conduct that NBN Co will engage in will promote the long-term interests of end-users, provided that the variations noted above are made (about clarifying that the SFAA terms and conditions are specified in the SAU in relation to the SAOs and about removing the qualifications around when and how NBN Co will “give effect” to regulated terms).

As noted in section 1.3, the terms and conditions specified in an SAU must be reasonable and any specified conduct must promote the long-term interests of end-users in order for the SAU to be accepted.

Under Part XIC, access seekers can obtain access on the terms and conditions specified by the SAU without signing an Access Agreement based on an SFAA or otherwise commercially agreed to. The ACCC therefore considers that NBN Co’s commitment to align SFAAs with the SAU will give access seekers the *option* to access the terms and conditions specified by the SAU by entering into an SFAA-based Access Agreement, as well as by the SAU as a standalone set of terms.²³⁹

Having said this, whilst the ACCC considers that clauses 6.1 and 6.2 of the main body (that provide for NBN Co to undertake conduct to ensure consistency between SFAAs and the SAU) will promote the long-term interests of end-users, for the reasons outlined in the sections above, the ACCC generally considers that all the other aspects of conduct specified in the SAU concerning SFAAs will not promote the long-term interests of end-users.

discussed in section 2.3.1 of this Draft Decision. Under Part XIC, NBN Co may also submit variation proposals at any other time.

²³⁵ NBN Co Supporting submission, p. 48.

²³⁶ Ibid, p. 48.

²³⁷ Ibid, pp. 48-49.

²³⁸ Telstra submission, p. 27.

²³⁹ NBN Co’s conduct about including terms and conditions specified in the SAU in its SFAAs is discussed in section 2.2.1 of this Draft Decision.

2.3. Assessment of conduct concerning changes to the SAU over time

The following sections sets out the ACCC's preliminary views on two mechanisms proposed by NBN Co to support the 'modular structure' of the SAU:

- the 'replacement module' approach; and
- the midpoint review of Module 1.

2.3.1. Conduct about submitting variations to the SAU

Clauses 4.5 to 4.11 of the main body of the SAU set out processes for the submission and assessment of SAU variation applications following the expiry of Module 1.

NBN Co will submit 'Replacement Module Applications', which must include proposals about reference offers, long-term revenue constraint methodology elements and service levels for a 'regulatory cycle' (a period of 3, 4 or 5 years specified by NBN Co in its application).

If these variations are accepted by the ACCC in accordance with section 152CBG of the CCA, the SAU is varied to include the terms of the replacement module application. Those terms would then operate in combination with Module 0 and Module 2.

Clauses 4.10(b), (d) and (e) provide that an SAU variation application will "apply" if that application has not been accepted by the ACCC, and that Access Determinations or Binding Rules of Conduct will "apply" if these instruments are made either before, or up to one year after, the commencement date for the replacement module specified in the SAU variation application. The implication of these clauses is that Access Determinations or Binding Rules of Conduct will only "apply" for the matters for which NBN Co must submit SAU variation applications if these instruments are made by these specified times, and then only from those specified times.

2.3.1.1. Submissions

NBN Co submits that:

- The modular structure of the SAU "strike[s] a better balance between providing certainty on long-term cost recovery arrangements and some flexibility for the other regulatory terms and conditions to evolve as required over time".²⁴⁰
- Each replacement module "would be assessed by the ACCC for reasonableness in the context of the other commitments made in the SAU and subject to the fixed principles term and condition".²⁴¹
- If the proposed replacement module is rejected and the existing detailed terms have expired, the SAU provides for:
 - certainty about what arrangements will apply to ensure that there are always reference offers and service levels available, and that the long-term revenue constraint methodology operates continuously over time (and on a full financial year basis); and

²⁴⁰ NBN Co Supporting submission, p. 44.

²⁴¹ Ibid, p. 44.

- the ACCC to make effective Access Determinations on some or all of the matters that would have been covered by a replacement module.²⁴²

NBN Co further submits that:

- It acknowledges that it will be subject to the commitments in the 'deemed parts' of the replacement module (that is, reference offers, the long-term revenue constraint methodology and service levels), but except to the extent that an Access Determination or Binding Rules of Conduct applies.²⁴³
- It considers that the structure of the SAU should be considered in its entirety without dealing with the terms in isolation as to whether they would become 'terms of the SAU' for the purposes of the Part XIC hierarchy.²⁴⁴

The Department of Broadband, Communications and the Digital Economy (DBCDE) submits that:

- The proposed 30-year duration of the SAU term is commensurate with the requirement for the recovery of the Government's investment in the NBN.²⁴⁵

Interested parties submit that:

- In principle, the modular structure is welcome, but some changes should be made. For example, Module 1 should be shortened to 6-8 years with the midpoint review occurring after year 3-4, and there should be regular reviews following the midpoint review until the end of the SAU term (for example, every 4 years).²⁴⁶
- The replacement module process has the potential to limit the scope for ACCC oversight of replacement terms, for example:
 - The deemed application of parts of NBN Co's proposals (that is, reference offers, the long-term revenue constraint methodology and service levels) if the ACCC rejects the replacement module application is unreasonable.²⁴⁷
 - The constraints on the availability of regulated terms is unreasonable. For example, Access Determinations and Binding Rules of Conduct made in the first 12 months following expiry of the previous module will not be available for up to 12 months while the deemed parts of NBN Co's proposals continue to apply.²⁴⁸
 - The specified processes are unreasonable. For example, replacement modules should not have effect unless approved by the ACCC in accordance with the SAU variation processes in Part XIC.²⁴⁹

²⁴² Ibid, p. 44.

²⁴³ NBN Co, *Submission to the ACCC's Consultation Paper on NBN Co's SAU*, 4 December 2012, p. 2.

²⁴⁴ Ibid, p. 2.

²⁴⁵ DBCDE submission, p. 2.

²⁴⁶ AAPT submission, pp. 5-10; CCC submission, pp. 3-5; Nextgen Networks submission, p. 5; Optus submission (Public version), pp. 12-13; Telstra submission, pp. 24-25; Vodafone Hutchison Australia submission, p. 2.

²⁴⁷ AAPT submission, p. 10; iiNet submission, pp. 27-28; Macquarie Telecom submission, p. 8; Nextgen Networks submission, pp. 9-10; Telstra submission, pp. 32-33.

²⁴⁸ AAPT submission, p. 10; iiNet submission, pp. 27-28; Optus submission (Public version), p. 27; Nextgen Networks submission, pp. 9-10; Telstra submission, p. 33.

²⁴⁹ AAPT submission, p. 10; CCC submission, p. 8; Macquarie Telecom submission, p. 7; Nextgen Networks submission, pp. 9-10; Telstra submission, pp. 33-34.

2.3.1.2. Preliminary ACCC view

The ACCC's preliminary view is that it is not satisfied that the replacement module submission and assessment process will operate in a manner that will promote the long-term interests of end-users. The key reasons for this view are set out below.

Firstly, the deemed application of SAU variation applications that have not been accepted by the ACCC, including where an updated SAU variation application is made as late as 20 days before it is deemed to apply,²⁵⁰ could result in the SAU specifying terms and conditions that are not reasonable and conduct that does not promote the long-term interests of end-users.

Secondly, the SAU provisions, as drafted, create uncertainty about whether Access Determinations and Binding Rules of Conduct about matters that must be addressed in these SAU variation applications would be inconsistent with the SAU.

The SAU states that an Access Determination or Binding Rules of Conduct which contain terms relating to the matters that NBN Co must include in the SAU replacement module applications will "apply" in certain circumstances (described above).²⁵¹ This suggests that such an Access Determination or Binding Rules of Conduct will not "apply" outside of those circumstances (for instance, if the ACCC's regulatory determinations have not been made in the specified timeframes) even where these regulatory determinations would not be inconsistent with the SAU. This creates uncertainty about the extent to which NBN Co must comply with the ACCC's regulatory determinations in these circumstances. The potential for this outcome means that the ACCC is not satisfied that the replacement module submission and assessment process will operate in a manner that will promote the long-term interests of end-users.

In light of these considerations, the Consultation Paper on the Notice to Vary proposes that the SAU be amended to remove the commitments about the submission and assessment of replacement module applications.

The ACCC has no objection in principle to the SAU specifying SAU variation applications that NBN Co proposes to make, but, for the above reasons, the ACCC is not satisfied that the currently proposed process will promote the long-term interests of end-users.

The ACCC does not consider that its finding that the proposed replacement module process would not promote the long-term interests of end-users means that a modular structure cannot be implemented in the SAU. That is, the 'modular structure', that provides for the SAU to specify terms and conditions, and conduct, for different periods of time, is able to be implemented in the absence of the 'replacement module' mechanism:

- Any aspects of the SAU that are accepted for a long-term (for example, matters that may be related to NBN Co's long-term cost recovery) will operate for the period of time specified at the time of acceptance, unless varied with the ACCC's approval under section 152CBG, or unless the SAU is withdrawn by NBN Co. This means that NBN Co is able to achieve certainty about long-term cost recovery without the replacement module mechanism that would be established by clause 4 of the main body of the SAU.
- Any aspects of the SAU that are accepted for a shorter term (for example, specific terms and conditions of access that the ACCC is satisfied are reasonable for a particular period of time) will also operate for the period of time specified at the time of acceptance, and it is a matter for NBN Co as to whether it wishes to seek a variation to extend this period around the time the period ends. If the SAU is not varied to extend the period during which these aspects operate (or to insert new commitments), these aspects could be addressed through the normal operation of Part XIC. That is, these matters

²⁵⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 4.10(c).

²⁵¹ Ibid, Main Body, clauses 4.10(b), (d) and (e).

may be addressed by NBN Co and access seekers by means of commercial negotiation and, if these matters are unable to be agreed, by means of an ACCC regulatory determination, if appropriate.

2.3.2. Conduct about the midpoint review of Module 1

The SAU sets out a process in Schedule 1K of Module 1 for the ACCC to review various multilateral processes and non-price terms that are contained in Module 1. This process sets out:

- procedures that must be followed by the ACCC when exercising the review role conferred on it by the SAU (including timeframes and the matters the ACCC must consider when making its decisions);²⁵² and
- commitments about how NBN Co will implement ACCC decisions for the remainder of Module 1.²⁵³

NBN Co will submit proposed amendments to the following matters:

- multilateral processes — the customer engagement processes associated with the approach to prudency, the Product Development Forum processes, the Dispute Management Rules and the multilateral SFAA forum;²⁵⁴ and
- non-price terms — non-price terms and conditions (except dispute management), service levels, aspects of regulatory recourse (specifically, the commitment to ensure that new SFAAs are consistent with regulated terms, and the conferral on the ACCC of the power to make Facilities Access Decisions), and the regulatory reporting arrangements (specifically, the commitments to provide information to the ACCC for monitoring NBN Co's compliance with the cost recovery and pricing commitments in Module 1).²⁵⁵

The SAU confers a power on the ACCC to approve NBN Co's proposals or to reject NBN Co's proposals and make its own decisions for the operation of these multilateral processes and non-price terms for the remainder of Module 1.²⁵⁶

Unlike the replacement module submission and assessment process discussed in section 2.3.1, the midpoint review process does not result in the SAU being formally varied in accordance with section 152CBG of the CCA. Rather, NBN Co undertakes to comply with ACCC decisions for the remainder of Module 1 in substitution for the multilateral processes and non-price terms that are set out in the SAU.²⁵⁷

2.3.2.1. Submissions

NBN Co submits that:

- It is appropriate for the ACCC to have a “key oversight role in shaping the ongoing terms and conditions offered for the duration of Module 1”.²⁵⁸
- For the review of multilateral processes, the ability for the ACCC to make substitute terms “will provide NBN Co with incentives to carry out a thorough

²⁵² Ibid, Schedule 1K, clauses 1K.2.2-1K.2.4 and 1K.3.2-1K.3.4.

²⁵³ Ibid, Schedule 1K, clauses 1K.2.5-1K.2.7 and 1K.3.5-1K.3.7.

²⁵⁴ Ibid, Schedule 1K, clause 1K.2.1.

²⁵⁵ Ibid, Schedule 1K, clause 1K.3.1.

²⁵⁶ Ibid, Schedule 1K, clauses 1K.2.3-1K.2.7 and 1K.3.3-1K.3.7.

²⁵⁷ Ibid, Schedule 1K, clauses 1K.2.5 and 1K.2.7; clauses 1K.3.5 and 1K.3.7.

²⁵⁸ NBN Co Supporting submission, p. 151.

review...and submit a proposal that will ensure the continued effective engagement between NBN Co and Access Seekers” and the review mechanism “will provide for a timely and well considered update to multilateral processes in the SAU”.²⁵⁹

- For the review of non-price terms, the specified review criteria are “appropriate” and will provide for a “meaningful review”.²⁶⁰

Interested parties submit that:

- The scope of the review is too limited. Other matters that should also be reviewed include NBN Co’s products, service quality, prices and price structures (for example, the CPI-1.5 per cent price control and price structures).²⁶¹
- The specified timeframes for ACCC decisions (60-business days without the possibility of extension) is unreasonable as NBN Co’s proposals will be deemed to be accepted if the ACCC does not meet this timeframe.²⁶²
- The review criteria that the ACCC has to have regard to in its decision-making should specifically reference the ‘long-term interests of end-users’ and ‘reasonableness’ for all matters under review.²⁶³
- The SAU should be clear on how the review outcomes will apply for the remainder of Module 1 and in the next SFAA.²⁶⁴ The absence of commitments to make changes to the SAU, or Access Agreements, or to pass-through the outcomes to SFAAs, is unreasonable.²⁶⁵

2.3.2.2. Preliminary ACCC view

The ACCC considers that the midpoint review process is comprised of two key elements:

- a function or power that is conferred on the ACCC in accordance with subsection 152CBA(10A) of the CCA to review aspects of the SAU; and
- conduct specified in accordance with subsection 152CBA(3B), whereby NBN Co commits to engage in specified conduct in response to the ACCC’s exercise of the function or power — that is, NBN Co will adopt an ACCC decision in replacement for the operation of the aspects of the SAU that have been reviewed.

The ACCC proposes to assess the midpoint review mechanism as follows:

- firstly, the ACCC will consider whether the review role that is conferred on it can be exercised in a manner that will enable it to specify terms and conditions that are reasonable and conduct that will promote the long-term interests of end-users; and
- secondly, the ACCC will consider whether the conduct that NBN Co commits to in response to ACCC decisions will effectively implement such decisions.

²⁵⁹ Ibid, p. 153.

²⁶⁰ Ibid, pp. 155-156.

²⁶¹ AAPT submission, pp. 9-10; Macquarie Telecom submission, p. 7 and p. 8; Nextgen Networks submission, p. 10; Telstra submission, p. 26; Optus submission (Public version), p. 26 and p. 32; CCC submission, pp. 4-5.

²⁶² iiNet submission, p. 25; Macquarie Telecom submission, p. 8; Nextgen Networks submission, p. 10; Optus submission (Public version), pp. 26-27; Telstra submission, p. 26.

²⁶³ Nextgen Networks submission, p. 10; Optus submission (Public version), p. 13.

²⁶⁴ Nextgen Networks submission, p. 10.

²⁶⁵ Macquarie Telecom submission, p. 5.

Taking into account these matters, the ACCC will consider whether the conduct that NBN Co commits to in response to ACCC decisions promotes the long-term interests of end-users.

Overall, the ACCC's preliminary view is that the conduct NBN Co will engage in will not promote the long-term interests of end-users. The key reasons for this view are set out below.

Process associated with the reviews

The SAU sets out procedures that NBN Co and the ACCC will follow during the review processes. The SAU requires NBN Co to provide certain information to the ACCC, including any proposed amendments to the multilateral processes and the non-price terms,²⁶⁶ and specifies timeframes to be followed by the parties and the matters to which the ACCC must have regard when making its decisions.

The ACCC considers that these procedural requirements may not enable it to effectively carry out its review role.

Firstly, the SAU prescribes strict review timeframes. In particular, the ACCC must make its decision within 60 business days, with no possibility of extension.²⁶⁷ As there is no ability to extend the decision-making timeframe (such as when the ACCC is waiting for NBN Co to respond to a request for further information, or while the ACCC is conducting consultation on NBN Co's proposals), NBN Co's incentives to submit reasonable proposals for ACCC consideration may be reduced. Further, as NBN Co's proposals are deemed to be accepted if the ACCC does not make a decision within the specified timeframe,²⁶⁸ there is the risk that outcomes that are not reasonable or do not promote the long-term interests of end-users will apply for the remainder of Module 1, or that the ACCC is forced to make a decision with insufficient information in order to avoid deeming of a proposal. These issues do not arise under the existing Part XIC processes in section 152CBG for the variation of an SAU.

Secondly, the SAU specifies different matters that the ACCC must consider when conducting each review (referred to as 'review criteria' by NBN Co in its supporting submission). The ACCC has no objection in principle to the SAU specifying matters that it must have regard to in making its decisions, provided that those matters do not prevent it from making decisions that result in NBN Co supplying services on reasonable terms and conditions and engaging in conduct that will promote the long-term interests of end-users. For the review of non-price terms, the ACCC is required to consider NBN Co's proposed amendments having regard to the 'reasonableness' criteria in section 152AH of the CCA and additional specific matters for each non-price matter.²⁶⁹ For the decision that the ACCC makes when reviewing the multilateral processes, the SAU does not appear to specify the matters the ACCC must have regard to when considering the amendments proposed by NBN Co. However, the SAU appears to specify the matters the ACCC must have regard to for making a separate decision about the extent to which the combined operation of the multilateral processes is resulting in effective engagement between NBN Co and access seekers.²⁷⁰ NBN Co has made a further submission that even though the SAU does not use the terminology 'criteria' for the ACCC's decision about NBN Co's proposed amendments, this decision would be informed by the ACCC's separate consideration of the existing multilateral processes.²⁷¹

The ACCC considers that the SAU, as drafted, creates uncertainty about how it will consider the matters to which it is required to have regard when conducting the midpoint review

²⁶⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1K, clauses 1K.2.1(a) and 1K.3.1(a). The SAU also states that NBN Co may propose that no amendments are required.

²⁶⁷ Ibid, Schedule 1K, clauses 1K.2.3(a) and 1K.3.3(a).

²⁶⁸ Ibid, Schedule 1K, clauses 1K.2.6 and 1K.3.6.

²⁶⁹ Ibid, Schedule 1K, clause 1K.3.2.

²⁷⁰ Ibid, Schedule 1K, clause 1K.2.2(b). The 'criteria' that the ACCC will have regard to in making this decision includes: the level of access seeker understanding of the processes, whether the parties are devoting sufficient resources to participate in the processes and the level of consensus or disputation.

²⁷¹ NBN Co, *Submission regarding NBN Co's Special Access Undertaking*, 4 December 2012, pp. 2-3.

(particularly for the review of the multilateral processes). The SAU does not specifically refer to the legislative criteria for assessing a SAU variation (that is the 'long-term interests of end-users' and 'reasonableness') for all matters under review, even though the conferral of power is made under Part XIC and the outcomes of the midpoint review are intended to change the SAU commitments. As the ACCC will be exercising a power conferred under the SAU, the ACCC will need to have regard to the legislative criteria in making its decisions, and it is uncertain how the specified matters in the SAU are intended to impact on the ACCC's ability to make its decisions in a manner that is consistent with the existing Part XIC processes. For instance, these matters may not always be relevant to the ACCC's consideration of NBN Co's proposals against the legislative criteria, and the ACCC should not be bound to have regard to them in all circumstances. That is, the application of these specified matters could result in the ACCC being unable to make decisions that are reasonable and in the long-term interests of end-users in all circumstances.

As a result of the procedural requirements specified for the midpoint review, the ACCC considers that it may not be able to exercise its review and decision-making role in a manner that will lead to outcomes that are reasonable and will promote the long-term interests of end-users.

Implementation of review outcomes

As noted, NBN Co has committed to undertake certain conduct in respect of the function or power it has conferred on the ACCC. Specifically, NBN Co has committed to comply with the review outcomes instead of the existing SAU terms for the remainder of Module 1. The SAU describes how the review outcomes will be implemented depending on whether the ACCC accepts NBN Co's proposed amendments or rejects NBN Co's proposed amendments and makes substitute terms.²⁷²

For the reasons set out below, the ACCC is not satisfied that this conduct will promote the long-term interests of end-users.

Firstly, the SAU provides that if the ACCC makes substitute terms, such a decision has no effect to the extent that it is "inconsistent with the SAU".²⁷³ Given that the SAU specifies the terms that are being reviewed when the decision is made, and that the existing terms are not amended or removed from the SAU to reflect the review outcomes, the ACCC's substitute terms may not have effect. For example, if NBN Co proposes that no amendments to the existing commitments are required, but the ACCC makes substitute terms, the ACCC's terms may be inconsistent with the existing commitments, which remain in the SAU. Therefore, it appears that the ACCC's terms may be ineffective and the existing commitments would continue to apply for the remainder of Module 1.

Secondly, it is possible that, despite the reviews continuing in accordance with the specified process, the review outcomes will not be settled prior to 1 July 2018 (when they are intended to take effect).²⁷⁴ In these circumstances, the SAU does not state whether the ACCC can still carry out its review and decision-making role, and whether the existing SAU terms will continue to operate until the outcomes are finalised.

Thirdly, as noted above, NBN Co undertakes to comply with ACCC decisions for the remainder of Module 1 in substitution for the multilateral processes and non-price terms that are set out in the SAU rather than amending the SAU to reflect the outcomes of the midpoint review. The ACCC considers that this creates uncertainty about whether the outcomes will be specified as

²⁷² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1K, clauses 1K.2.5-1K.2.7 and clauses 1K.3.5-1K.3.7.

²⁷³ *Ibid*, Schedule 1K, clauses 1K.2.7(c)(i) and 1K.3.7(c)(i).

²⁷⁴ Schedule 1K of the SAU provides that NBN Co will submit its proposals for ACCC consideration no later than 6 months prior to 1 July 2018 (that is, no later than 1 January 2018). The ACCC has 60 business days to consider the proposal. If the ACCC rejects it, NBN Co then has 60 business days to submit a new proposal. Hence the ACCC may not receive the new proposal until approximately 1 July 2018.

terms and conditions of the SAU (discussed further in section 2.2.1). Consequently, it is unclear if NBN Co's commitment to align SFAAs with the SAU (as discussed in section 2.2.6) would also apply to the ACCC's decisions. It is also unclear whether any subsequent ACCC Access Determination or Binding Rules of Conduct addressing the same matters as an ACCC decision made under the review mechanism would be inconsistent with the SAU and consequently of no effect.

In light of the above considerations, the ACCC is of the preliminary view that there is considerable uncertainty about whether ACCC decisions made in the midpoint review process will be able to be implemented effectively.

In summary, the ACCC is not satisfied that the review and decision-making role conferred on it will allow it to make decisions that are reasonable and promote the long-term interests of end-users, nor that the conduct that NBN Co will subsequently engage in to implement these decisions will promote the long-term interests of end-users.

Consequently, the ACCC is not satisfied that the midpoint review will promote the long-term interests of end-users.

Therefore, the Consultation Paper on the Notice to Vary proposes that the SAU be amended to remove the midpoint review mechanism.

In the absence of the midpoint review, aspects of Module 1 that are accepted (for example, specific terms and conditions of access that the ACCC is satisfied are reasonable for a particular period of time) will operate for the period of time specified at the time of acceptance. It is then a matter for NBN Co as to whether it wishes to seek a variation to extend this period around the time the period ends. If the SAU is not varied to extend the period during which these aspects operate (or to insert new commitments), these aspects could be addressed through the normal operation of Part XIC. That is, these matters may be addressed by NBN Co and access seekers by means of commercial negotiation and, if these matters are unable to be agreed, by means of an ACCC regulatory determination, if appropriate.

2.4. Assessment of SAU extension mechanisms

The following sections sets out the ACCC's preliminary views on two extension mechanisms contained in the SAU:

- the extension of the initial regulatory period (Module 1); and
- the extension of the SAU term.

2.4.1. Extension of the Initial Regulatory Period (Module 1)

Clause 4.3 of the main body of the SAU provides that there will be an automatic 12 month extension of Module 1 (the 'extended initial regulatory period') if:

- NBN Co has lodged a replacement module application (that is, submission of proposed Module 3) no later than 9 months prior to the end of Module 1; or
- NBN Co has lodged a new SAU no later than 9 months prior to the end of Module 1 and the ACCC has not made an Access Determination prior to 30 June 2023, that covers subject matter that is "substantially similar" to the subject matter of the new SAU.

The extended initial regulatory period will not take effect if the ACCC accepts the replacement module application or new SAU before the expiry of Module 1.

2.4.1.1. Submissions

NBN Co submits that the mechanism for automatically extending Module 1 will support the implementation of the replacement module approach.²⁷⁵

Interested parties submit that:

- The automatic 12 month extension of the operation of Module 1 without justification of the need for an extension is of concern.²⁷⁶
- While it is appropriate for the terms in Module 1 to continue to apply while an ACCC decision is pending, where the ACCC has rejected a replacement module and made alternative terms, those terms should apply without delay.²⁷⁷

2.4.1.2. Preliminary ACCC view

The ACCC considers that it should not be required to make a regulatory determination to prevent the continuation of the terms in Module 1 if it is not in the long-term interests of end-users for those terms to be in operation for the extended period.

If the ACCC accepts the SAU with a 10-year term for Module 1 (that is, it is satisfied that the specified terms and conditions are reasonable for that time period), it should be a matter for NBN Co as to whether it wishes to seek ACCC approval for a variation (in accordance with section 152CBG) to extend the operation of these terms and conditions around the time Module 1 ends.

The Consultation Paper on the Notice to Vary therefore proposes that the SAU be amended to remove the mechanism for the extension of the initial regulatory period.

2.4.2. Extension of the SAU term

Subsection 152CBA(9) of the CCA states that an SAU given by NBN Co may provide for NBN Co to extend the expiry time of the undertaking if:

- the extension is approved by the ACCC; and
- the undertaking sets out the criteria to be applied by the ACCC in deciding whether to approve the extension.

Section 152CBE states that the application for extension must be made in the 12 month period ending at the expiry time of the undertaking. If the ACCC is satisfied that the specified criteria have been met, it must approve the extension.²⁷⁸

Clause 7.3 of the main body of the SAU concerns extension of the operation of the SAU. It states that:

- NBN Co may request to extend the SAU term at any time within the 12 month period ending at the date of the SAU term; and
- the ACCC must approve the extension if it is satisfied of the matters in:

²⁷⁵ NBN Co Supporting submission, pp. 54-55.

²⁷⁶ Macquarie Telecom submission, p. 7.

²⁷⁷ iiNet submission, p. 26.

²⁷⁸ CCA, ss. 152CBE(1)(d) and 152CBE(5).

- subsection 152CBD(2)(b) – that is, the terms and conditions for compliance with the SAOs are consistent with those obligations and are reasonable; and
- subsection 152CBD(2)(ca) – that is, any specified conduct will promote the long-term interests of end-users and the associated terms and conditions are reasonable.

This is subject to the matters in subsection 152CBD(5A) — that is, the ACCC is not required to be satisfied that price-related terms and conditions are consistent with the SAOs or are reasonable if these price-related terms and conditions are reasonably necessary to achieve uniform national pricing of eligible NBN services.

2.4.2.1. Submissions

Submissions did not provide views on this issue.

2.4.2.2. Preliminary ACCC view

The ACCC notes that if it is satisfied of the specified criteria, it would be required to approve an extension of the SAU. The provisions in Module 0 and Module 2, as well as any variation to the SAU that is in operation at the time of the extension application, would continue to operate for the term of the extension. This would include the fixed principles term and condition.

The specified criteria for approval of an extension to the SAU are consistent with some of the assessment criteria that the ACCC must consider when assessing an undertaking or a variation to an undertaking.²⁷⁹ However, the criteria do not reflect the specific (and different) criteria for the assessment of fixed principles terms or conditions. Therefore, if the ACCC were satisfied of the criteria above, it would be required to approve an extension of the SAU, which would have the effect of also extending the operation of the fixed principles term and condition, even though the ACCC had not considered the fixed principle against the relevant statutory criteria.

It appears that NBN Co intends for these criteria to be consistent with section 152CBD. Therefore, the Consultation Paper on the Notice to Vary proposes that the SAU be amended to provide that the criteria to be applied by the ACCC in deciding whether to approve the extension will be the same as section 152CBD of the CCA.

²⁷⁹ As discussed in section 1.3 of this Draft Decision, the statutory criteria for assessment of an SAU, including variations to the SAU, is set out in section 152CBD of the CCA.

3. Services to which the SAU relates

Part XIC provides for a person to give a Special Access Undertaking to the ACCC in connection with the provision of access to a service.²⁸⁰ The SAU states that it is given in connection with the provision of access to the 'NBN Access Service' and the 'Ancillary Services'.²⁸¹ The SAU also states that it sets out commitments in relation to supply of the Facilities Access Service in connection with the satisfaction of NBN Co's interconnection obligations under section 152AXB(4) of the CCA in relation to the NBN Access Service and the Ancillary Services.²⁸²

In Module 0, the SAU states that NBN Co will be bound by the SAOs in respect of the NBN Access Service and Ancillary Services, and will supply the Facilities Access Service to comply with its interconnection obligations in respect of these services.²⁸³

In Module 1, NBN Co has included detailed commitments in connection with the supply of these services and "offers to supply" each of the services.²⁸⁴ These commitments specify that NBN Co will "offer to supply" specified components, which are "the means by which" NBN Co will implement and fulfil its obligations under the SAU and the SAOs in connection with the NBN Access Service and Ancillary Services.²⁸⁵ An overview of the commitments in Module 1 is set out below.

Module 2 includes high level commitments that apply in connection with the provision of access to the NBN Access Service, Ancillary Services and the Facilities Access Service.²⁸⁶ These specify that NBN Co will "offer to supply" each service or components of a service in Module 2 as "the means by which" NBN Co will implement and fulfil its obligations under the SAU and the SAOs.²⁸⁷

3.1. NBN Access Service

The NBN Access Service is defined in Attachment A of Module 0 as a Layer 2 service supplied on the NBN Co network between the User Network Interface (UNI) and the Network to Network Interface (NNI).²⁸⁸

In Module 1, the SAU states that:²⁸⁹

The Product Components and associated Product Features provide the means by which:

²⁸⁰ CCA, s. 152CBA(2).

²⁸¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 2.1.

²⁸² Ibid, Main Body, clause 2.2.

²⁸³ Ibid, Main Body, clauses 1 and 2.2.

²⁸⁴ Ibid, Schedule 1A. NBN Access Service: clause 1A.1.2; Ancillary Services: clause 1A.4.1; Facilities Access Service: clause 1A.6.

²⁸⁵ Ibid, Schedule 1A. For the NBN Access Service, NBN Co offers to supply 'Product Components' and 'Product Features', clause 1A.1. For Ancillary Services, NBN Co offers to supply the 'Platform Interfacing Service' and the 'Sandpit Service': clause 1A.4. In the case of the Facilities Access Service, NBN Co will "implement" the service by "offering to supply" specified types of facilities access: clause 1A.6.

²⁸⁶ Ibid, Main Body, clause 4.4(a).

²⁸⁷ Ibid, Schedule 2A. NBN Access Service: clauses 2A.1.2-2A.1.3. Ancillary Services: clauses 2A.1.4-2A.1.5. Facilities Access Service: clause 2A.1.6.

²⁸⁸ Ibid, Main Body, Attachment A, clause 2.

²⁸⁹ Ibid, Schedule 1A, clause 1A.1.3.

(a) NBN Co will fulfil its obligations under this Special Access Undertaking regarding the NBN Access Service; and

(b) NBN Co will fulfil any category B standard access obligations that apply to NBN Co under the CCA regarding the NBN Access Service

'Product Components' are defined as the UNI, Access Virtual Circuit (AVC), Connectivity Virtual Circuit (CVC), NNI or any new or varied product components introduced by NBN Co via the product development and withdrawal provisions in the SAU (these provisions are discussed in chapter 4).²⁹⁰ 'Product Features' are specific attributes of product components that determine particular characteristics of the specific product component such as data rates, or other dimensions of quality of service such as data traffic priority.²⁹¹

Module 1 also specifies certain terms and conditions relating to the supply of product components (including those relating to when NBN Co will offer to supply the product components and points of interconnect).²⁹²

In Module 2, the SAU states that "NBN Co will offer to supply the Product Components and Product Features on each NBN Co Network as the means of implementing its obligations under this Special Access Undertaking in connection with the NBN Access Service".²⁹³ The product components and product features are 'the means by which' NBN Co will fulfil its obligations under the SAU and the SAOs.²⁹⁴

3.2. Ancillary Services

Ancillary Services are defined in Module 0 as services supplied by NBN Co that facilitate the supply of, and are necessary for access seekers to acquire, the NBN Access Service, including.²⁹⁵

(a) a service supplied by NBN Co that supports an Access Seeker to perform activation and assurance related transactions, and

(b) a test and verification service supplied by NBN Co.

In Module 1 the SAU states that "NBN Co will offer to supply the Platform Interfacing Service, the Sandpit and such other Ancillary Services that are introduced...as the means of implementing its obligations under this Special Access Undertaking in connection with the Ancillary Services".²⁹⁶ The SAU specifies that the "offer to supply" these services "provides the means by which" NBN Co will fulfil its obligations under the SAU and the SAOs.²⁹⁷

In Module 2, the SAU states that "NBN Co will offer to supply the Ancillary Services...as the means of implementing its obligations under this Special Access Undertaking in connection with the Ancillary Services".²⁹⁸ The SAU specifies that the "offer to supply" these services "provides the means by which" NBN Co will fulfil its obligations under the SAU and the SAOs.²⁹⁹

²⁹⁰ Ibid, Main Body, Attachment C, clause 1.

²⁹¹ Ibid, Main Body, Attachment C, clause 1.

²⁹² Ibid, Schedule 1A, clause 1A.3.

²⁹³ Ibid, Schedule 2A, clause 2A.1.2.

²⁹⁴ Ibid, Schedule 2A, clause 2A.1.3.

²⁹⁵ Ibid, Main Body, Attachment A, clause 3.

²⁹⁶ Ibid, Schedule 1A, clause 1A.4.1.

²⁹⁷ Ibid, Schedule 1A, clause 1A.4.2.

²⁹⁸ Ibid, Schedule 2A, clause 2A.1.4.

²⁹⁹ Ibid, Schedule 2A, clause 2A.1.5.

3.3. Facilities Access Service

Module 0 describes the Facilities Access Service as a service that provides:

- cross connection;
- co-location;
- NBN Co ODF termination points; and
- other facilities supplied by NBN Co that are necessary to facilitate entry to buildings, such as cable trays or building duct access.³⁰⁰

The SAU states that it includes terms and conditions relating to the Facilities Access Service in connection with the satisfaction of NBN Co's interconnection obligations under subsection 152AXB(4) of the CCA in relation to the NBN Access Service and the Ancillary Services.³⁰¹

In Module 2, the SAU states that NBN Co will "offer to supply" the Facilities Access Service as the means of implementing its obligations under the SAU.³⁰²

3.4. Submissions

NBN Co submits that:

- Module 1 sets out in detail the implementation of the NBN Access Service, Ancillary Services and the Facilities Access Service.³⁰³
- Module 2 makes higher level commitments in relation to these services, without setting out the specifics of how these services will be implemented — replacement modules will set out the details of implementation, at a similar level to Module 1.³⁰⁴
- The NBN Access Service will be implemented initially through four Product Components — the UNI, AVC, CVC and NNI.³⁰⁵
- Product components are intended to reflect the key building blocks of an end-to-end service on the NBN, while product features denote the aspects of each product component that are selectable and configurable by an access seeker, such as downlink speeds and classes of service.³⁰⁶ This construct is designed to give access seekers the flexibility to configure capacity and features on the NBN as if it were the access seeker's own network.³⁰⁷
- The service description is technology neutral and is intended to capture services supplied by NBN Co over the fibre, wireless and satellite platforms for the life of the SAU.³⁰⁸ The service description will therefore assist in addressing its uniform national wholesale pricing objectives.³⁰⁹

³⁰⁰ Ibid, Main Body, Attachment B, clause 2.

³⁰¹ Ibid, Main Body, Attachment B, clause 1.

³⁰² Ibid, Schedule 2A, clause 2A.1.6.

³⁰³ NBN Co Supporting submission, p. 59.

³⁰⁴ Ibid, p. 59.

³⁰⁵ Ibid, p. 61.

³⁰⁶ Ibid, p. 69.

³⁰⁷ Ibid, p. 69.

³⁰⁸ Ibid, p. 62.

³⁰⁹ Ibid, p. 63.

- The NBN Access Service fulfils the minimum requirements that the ACCC set out in the FANOC decision, but that some issues (such as those relating to contention) were developed in the context of a FTTN network, and are not relevant in an FTTP context.³¹⁰
- The NBN Access Service fulfils the directions of the Government by offering a Layer 2 bitstream service, but the network will also require some limited Layer 3 awareness to provide multicast and voice services, and its interim satellite solution.³¹¹
- In relation to Ancillary Services, in light of feedback through consultation, NBN Co has now determined that these should be declared upon acceptance of the SAU.³¹² NBN Co has sought to set out a functional service description for the Ancillary Services — it will supply the services initially through the NBN Co Platform Interfacing Service and the Sandpit Service during Module 1.³¹³
- In relation to the Facilities Access Service, the service provides the means for access seekers to physically connect to NBN Co's network at points of interconnection — it is not declared by the SAU, but enforceable commitments in relation to long-term pricing and availability are made.³¹⁴ NBN Co makes an explicit submission that the Facilities Access Service will not be a declared service pursuant to subsection 152AL(8E) of the CCA.³¹⁵

A number of submissions in response to the ACCC's Consultation Paper on the SAU raised issues in relation to the breadth of the service description for the NBN Access Service.³¹⁶ In particular, AAPT submits that the service description is extremely broad because it effectively covers any Layer 2 access service that is or might be provided over the NBN, and greatly limits the ACCC's ability to exercise its powers.³¹⁷ Nextgen Networks also raise concerns that the breadth of the service description would prevent the ACCC's regulatory oversight in the future.³¹⁸

Telstra submits that it is supportive of the service descriptions that have been used to define the Platform Interfacing Service and the Sandpit.³¹⁹ Macquarie Telecom notes that it is currently not aware of any Ancillary Services supplied by NBN Co which should be included but fall outside the scope of the service description in the SAU.³²⁰

Vodafone Hutchison Australia submits that the Facilities Access Service should be declared by the SAU as it is an eligible service.³²¹ In addition, Macquarie Telecom notes that it does not understand how NBN Co can take the position that despite setting out terms and conditions for the service in the SAU, the service is not declared.³²²

³¹⁰ Ibid, p. 72.

³¹¹ Ibid, p. 65.

³¹² Ibid, p. 76.

³¹³ Ibid, pp. 76-77.

³¹⁴ NBN Co, *NBN Co's revised SAU: Overview*, 28 September 2012, p. 4.

³¹⁵ NBN Co Supporting submission, p. 79.

³¹⁶ CCC submission, p. 6; Nextgen Networks submission, p. 9; AAPT submission, pp. 7-8.

³¹⁷ AAPT submission, pp. 7-8.

³¹⁸ Nextgen Networks submission, p. 9.

³¹⁹ Telstra submission, p. 40.

³²⁰ Macquarie Telecom submission, p. 10.

³²¹ Vodafone Hutchison Australia submission, p.6.

³²² Macquarie Telecom submission, p. 4.

3.5. Preliminary ACCC views

It is important to determine what services the SAU relates to, as this determines the scope of the services that become declared services upon acceptance of the SAU and what services the Category B SAOs subsequently apply to. The ACCC provides its preliminary views on this issue in section 3.5.1.

The ACCC has also previously considered that the service description for a bitstream service should include certain elements which, if met, would mean that the service would promote the long-term interests of end-users. Accordingly, section 3.5.2 provides the ACCC's preliminary views on whether those elements are satisfied by the service description proposed by NBN Co.

3.5.1. Services to which the SAU relates

The service description for each service is defined broadly in the body of the SAU,³²³ but is limited by other parts of the SAU.

The NBN Access Service is broadly defined as a Layer 2 service supplied on the NBN Co network between a UNI and a NNI.³²⁴ Similarly, the Ancillary Services are services supplied by NBN Co that facilitate the supply of, and are necessary for access seekers to acquire, the NBN Access Service.³²⁵

Despite these broad service descriptions, what NBN Co actually offers to supply under the SAU is more specific. The SAU states that NBN Co will offer to supply the product components and associated product features on each NBN Co network as the means of implementing its obligations under the SAU in connection with the NBN Access Service.³²⁶ The SAU also states that NBN Co will offer to supply the Platform Interface Service, the Sandpit Service and other Ancillary Services that NBN Co introduces in accordance with the product development and withdrawal provisions as the means of implementing its obligations under the SAU in connection with the Ancillary Services.³²⁷ The SAU also sets out a list of reference and non-reference offers and the processes for introducing new offers and withdrawing existing ones.³²⁸ (The SAU provisions about product development and withdrawal are discussed in more detail in chapter 4.)

In accordance with subsection 152AL(8E) of the CCA, if the undertaking is subject to limitations, the service supplied by NBN Co is a declared service only to the extent to which the service falls within the scope of the limitations. As indicated in the ACCC's Consultation Paper on the SAU, the ACCC considers that the provisions in the SAU that narrow what is to be supplied by NBN Co under the SAU constitute limitations on the broadly defined NBN Access Service and Ancillary Services. Under this approach, the Category B SAOs only apply to the limited service. Where the provisions are classified as limitations, the ACCC considers that it is appropriate to assess the provisions to determine if they promote the objective of Part XIC — the long-term interests of end-users.

However, an alternative view is that those provisions could be seen as terms and conditions relating to the Category B SAOs. Indeed, NBN Co states in its letter to the ACCC on 1 November 2012 that all terms and conditions contained in the SAU should be categorised as terms and conditions for the purposes of subsection 152CBA(3A).³²⁹ Under this approach, the

³²³ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, Attachments A and B.

³²⁴ Ibid, Main Body, Attachment A.

³²⁵ Ibid, Main Body, Attachment A.

³²⁶ Ibid, Schedule 1A, clauses 1A.1.2 and 1A.1.3; Schedule 2A, clauses 2A.1.2 and 2A.1.3.

³²⁷ Ibid, Schedule 1A, clauses 1A.4.1 and 1A.4.2; Schedule 2A, clauses, 2A.1.4 and 2A.1.5.

³²⁸ Ibid, Schedule 1C, clauses 1C.1.2 and 1C.2; Schedule 1D, clauses 1D.1.2 and 1D.2; Schedule 2B, clauses 2B.1.2, 2B.2 and 2C.1.3; Main Body, clauses 4.7 and 4.10.

³²⁹ Letter from NBN Co to ACCC, *Re NBN Co SAU request for clarification*, 1 November 2012, p. 1.

ACCC would be required by the CCA to assess the provisions to determine if they are consistent with the Category B SAOs and are reasonable.³³⁰

This section discusses the ACCC's preliminary views on issues arising from the service description in the SAU.

3.5.1.1. Uncertainty about interaction with Part XIC

While the ACCC considers that the provisions are limitations on the service description, under either approach, an issue arises as to whether the provisions create uncertainty about the interaction between the SAU and the powers conferred on the ACCC by Part XIC to declare services and set regulated terms and conditions for services.

As discussed further in chapter 4, under the SAU, NBN Co has a high degree of discretion as to what new products may be created and what existing products may be withdrawn.³³¹ A number of submissions have raised concerns that it is not appropriate to allow NBN Co, a monopoly provider, to have discretion to determine the specifications of the services to supply to wholesale customers.

The ACCC considers that it is in NBN Co's legitimate business interests to determine the products it supplies and how and when new products will be introduced, and that there are likely to be times throughout the SAU term when NBN Co faces appropriate incentives to develop and withdraw products in line with evolving end-user and access seeker demand.

On the other hand, there may also be times throughout the SAU term when NBN Co does not face these incentives.

As discussed in chapter 5, NBN Co expects that for a period of time during the SAU term, it will face 'revenue sufficiency risk' — that is, the risk that it will be unable to recover the prudent costs of its investments (including a normal commercial return). The ACCC considers that if NBN Co faces this risk, it is likely to face incentives to develop and supply products in line with end-user and access seeker demand, in order to enhance the prospect that it is able to recover its prudent costs. On the other hand, there may also be periods throughout the SAU term when NBN Co does not face revenue sufficiency risk (for example, during the revenue cap phase described in chapter 5). During these times, NBN Co may face weaker incentives to develop and supply products having regard to evolving access seeker and end-user demand, as it would expect to be able to recover its prudent costs from its existing product set. In turn, it may be less likely to supply products (such as higher capacity products) which would encourage efficient use of the NBN.

Under Part XIC of the CCA the ACCC can declare a service (even if the service is, to any extent, covered by the SAU) if, after holding a public inquiry, it is satisfied that the making of the declaration will promote the long term interests of end-users.³³² If the ACCC declares a service, NBN Co is subject to the Category B SAOs in respect of the service — NBN Co would therefore be obligated to supply the service on request. The ACCC may also make an Access Determination setting terms and conditions in respect of the specific service declared.

The SAU does not, however, appear to accommodate a scenario where the ACCC declares a specific service. Rather, the drafting of the SAU creates uncertainty as to how the SAU interacts with any specific service that may be declared by the ACCC and the terms and conditions specified in an Access Determination in respect of such a service.

The SAU could be interpreted as intending that the products specified in the SAU or developed in accordance with the processes set out in the SAU are *all* of the Layer 2 services that

³³⁰ CCA, s. 152CBD(2)(b).

³³¹ For example, see clauses 5 and 6 of Annexure 1 to Schedule 11 of the SAU.

³³² CCA, s. 152AL(8F).

NBN Co will supply. Specifically, under the SAU, the supply of the products specified in the SAU or developed under the SAU “provides the means by which NBN Co will fulfil any category B standard access obligations that apply to NBN Co under the CCA regarding [the NBN Access Service or the Ancillary Services]”.³³³ These provisions in the SAU could be interpreted as intending to exclude the obligations in relation to any service declared by the ACCC (which would be likely to be covered by the broadly defined NBN Access Service or the Ancillary Services). This uncertainty is of heightened concern given that under Part XIC, regulatory determinations made by the ACCC have no effect to the extent of inconsistency with the SAU.

Another example of where the uncertainty arises is in relation to the revenues to be included in the long-term revenue constraint methodology set out in the SAU. This is because the SAU does not expressly contemplate the inclusion, as part of total revenues, of amounts received by NBN Co in respect of any specific service declared by the ACCC.

The ACCC considers that the provisions in the SAU that narrow what is to be supplied by NBN Co under the SAU create uncertainty as to how the SAU interacts with the powers conferred on the ACCC by Part XIC to declare services and set terms and conditions for those services. If these provisions are characterised as 'limitations', the ACCC therefore considers that they do not promote the long-term interests of end-users; if they are characterised as 'terms and conditions' the ACCC considers that they are not reasonable having regard to the matters in section 152AH.

In light of this, the Consultation Paper on the Notice to Vary proposes that explicit statements be included in the SAU which acknowledge that:

- Part XIC of the CCA allows the ACCC to declare services; and
- the means by which NBN Co will fulfil its obligations in relation to the broad service descriptions for the NBN Access Service and Ancillary Services will include through the supply of services declared by the ACCC.³³⁴

3.5.1.2. The Facilities Access Service

As noted, NBN Co submits that the Facilities Access Service will not, upon acceptance of the SAU, be a declared service pursuant to subsection 152AL(8E) of the CCA.³³⁵

In contrast to NBN Co's position, the ACCC considers that, in the event that the SAU was accepted, this acceptance would have the effect of making the Facilities Access Service a declared service under subsection 152AL(8E).

As noted in the ACCC's Consultation Paper on the SAU, an 'eligible service' is defined in section 152AL of the CCA as either a “listed carriage service or a service that facilitates the supply of a listed carriage service”. The service for which NBN Co may give an SAU under section 152CBA of the CCA is also either a “listed carriage service or a service that facilitates the supply of a listed carriage service”. The ACCC considers that all aspects of the Facilities Access Service “facilitate supply of a listed carriage service” (that is, the NBN Access Service). Further, the cross-connection component of the Facilities Access Service fulfils the definition of a “listed carriage service” within the meaning of the *Telecommunications Act 1997*.

Under the CCA, if NBN Co gives an undertaking to the ACCC in relation to a service, the undertaking is in operation and NBN Co supplies a service, then the service supplied by NBN Co is a declared service.³³⁶ The ACCC interprets these provisions to mean that, where an SAU

³³³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1A, clauses 1A.1.3 and 1A.4.2; Schedule 2A, clauses 2A.1.3 and 2A.1.5.

³³⁴ Section 4.2.2 of this Draft Decision also proposes additional related changes for the withdrawal of products. NBN Co Supporting submission, p. 79.

³³⁶ CCA, s. 152AL(8E).

that “relates to” a service is accepted by the ACCC, and NBN Co supplies the service, then the service is a declared service.

NBN Co has included a number of terms and conditions in the SAU relating to the supply of the Facilities Access Service, including:

- offering to supply cross-connect, co-location, ODF termination point and other facilities supplied by NBN Co that are necessary to facilitate entry to buildings and such other types of facilities access that NBN Co introduces in accordance with the product development and withdrawal provisions;³³⁷
- the conferral of a ‘Facilities Access Decision’ power on the ACCC;³³⁸
- a Facilities Access Service reference offer comprising the cross-connection and ODF termination point;³³⁹
- setting out a \$0 maximum regulated price for the period between the SAU commencement date and 30 June 2017 for cross-connection and the ODF termination point;³⁴⁰
- commitments in relation to the treatment of zero-priced reference offers that apply to the Facilities Access Service Offer;³⁴¹
- commitments in relation to the maximum regulated price on introduction of non-reference offers, which includes aspects NBN Co’s Facilities Access Service co-location component;³⁴²
- commitments in relation to the treatment of zero-priced other charges that includes components of NBN Co’s Facilities Access Service co-location component;³⁴³
- insurance requirements for ordering a Facilities Access product;³⁴⁴
- commitments in relation to withdrawal of the Facilities Access Service;³⁴⁵
- service levels in relation to Facilities Access Service orders;³⁴⁶ and
- an offer to supply the Facilities Access Service in Module 2.³⁴⁷

Further, NBN Co commits to offer to supply the service.

The ACCC therefore considers that the SAU is given “in relation to” the Facilities Access Service for the purposes of subsection 152A(8E). Accordingly, in the event that the SAU was accepted, the ACCC considers that this acceptance would have the effect of making the Facilities Access Service a declared service under subsection 152AL(8E).

On a separate note, the elements for a Layer 2 bitstream service that have previously been specified by the ACCC included that there must be arrangements for access to buildings,

³³⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1A, clause 1A.6.

³³⁸ Ibid, Schedule 1B, clause 1B.2.3.

³³⁹ Ibid, Schedule 1C, clause 1C.2.9.

³⁴⁰ Ibid, Schedule 1C, clause 1C.3.1(i).

³⁴¹ Ibid, Schedule 1C, clause 1C.4.5.

³⁴² Ibid, Schedule 1D, clause 1D.3.2(d).

³⁴³ Ibid, Schedule 1D, clause 1D.4.3(b)(ii).

³⁴⁴ Ibid, Schedule 1H, Annexure 3, clause 6.1(b)(B).

³⁴⁵ Ibid, Schedule 1I, clause 1I.5.1(a) and Schedule 2E, clause 2E.6.2.

³⁴⁶ Ibid, Schedule 1J, Annexure 1, clause 9; Schedule 2F, clause 2F.2.

³⁴⁷ Ibid, Schedule 2A, clause 2A.1.6; Schedule 2B, clause 2B.2.7.

shelters and facilities for interconnection.³⁴⁸ The ACCC considers that the inclusion of terms and conditions relating to the Facilities Access Service in the SAU adequately addresses this element.

3.5.1.3. Compliance and consistency with the SAOs

As noted in section 1.3, under the CCA, the ACCC must not accept an SAU unless the terms and conditions contained in the SAU are consistent with the Category B SAOs in section 152AXB of the CCA. This obligation requires, amongst other things, that “the NBN Corporation, if requested to do so by a service provider, supply the service to the service provider”.³⁴⁹ This section provides the ACCC’s preliminary views on whether it considers the terms and conditions in the SAU to be consistent with the Category B SAOs.

In the SAU, NBN Co has consistently described its commitment to supply the NBN Access Service, Ancillary Services, and the Facilities Access Service as an “offer to supply”. The commitment to “offer to supply” may be satisfied by, for example, making an offer in an SFAA. It falls short of a direct commitment enforceable under the SAU that NBN Co supply on request the services that are declared by acceptance of the SAU.

The ACCC considers that some of the references to an “offer to supply” refer to limitations on the service description,³⁵⁰ while others refer to terms and conditions of compliance with the SAOs.³⁵¹ For those references that reflect limitations on the service description, the ACCC considers that the wording “offer to supply” contradicts NBN Co’s commitment to comply with the SAOs in clause 1.1 of the body of the SAU. On the other hand, for those references that reflect terms and conditions in relation to compliance with the SAOs, the ACCC considers that these are inconsistent with the SAOs. This is because, in the event that an access seeker does not accept NBN Co’s offer, NBN Co could refuse to supply the service but the SAU states that NBN Co will have complied with the SAOs by making the offer to supply.

The Consultation Paper on the Notice to Vary therefore proposes variations to ensure that these references are consistent with the SAOs.

The SAU also specifies that NBN Co will offer to supply the UNI, AVC, CVC and NNI subject to the terms and conditions in clause 1A.3 of Schedule 1A of the SAU. The ACCC’s preliminary views on clause 1A.3 of Schedule 1A are as follows:

- Clause 1A.3.1 specifies conditions that must be met before NBN Co will supply product components. These conditions are that NBN Co must have determined the premises to be serviceable, that the access seeker’s network must be interconnected at the relevant point of interconnection for the premises, that testing has been successful, and that the access seeker has satisfied “any other terms and conditions specified in an Access Agreement to be able to acquire the Product Component”. Whilst the ACCC is satisfied that the first three conditions are consistent with the SAOs and reasonable, the ACCC is not satisfied that the last condition is consistent with the SAOs or reasonable, because it would require an access seeker to enter into an Access Agreement in order to obtain access to a declared service, even if the terms and conditions in the Access Agreement were not reasonable.
- Clause 1A.3.2 gives NBN Co the right to make supply of the UNI, AVC, CVC or NNI conditional on the acquisition of a bundle of these components. This is in addition to NBN Co’s legislative authorisation to bundle products as reasonably necessary to achieve uniform wholesale pricing.³⁵² The ACCC considers that

³⁴⁸ *FANOC Draft Decision*, p. 12.

³⁴⁹ CCA, s. 152AXB(2).

³⁵⁰ For example, clause 1A.1.2 of Schedule 1A of the SAU.

³⁵¹ For example, clause 1A.3.1 of Schedule 1A of the SAU.

³⁵² CCA, s. 151DA.

this clause goes beyond the authorisation provided in the legislation and does not promote the long-term interests of end-users.

- Clauses 1A.3.3 and 1A.3.4 make supply of an AVC contingent on the maximum data rate for the relevant Network Termination Device (NTD) and the availability of a UNI on that NTD. The ACCC considers that these clauses are consistent with the SAOs and reflect a legitimate business interest of NBN Co (subject to the ACCC's views on the drafting of commitments with respect to 'Customers' rather than 'Access Seekers', as discussed in Chapter 2).

The Consultation Paper on the Notice to Vary proposes that the contractual and bundling requirements noted above be removed from the SAU.

3.5.2. Elements of the service description that promote the long-term interests of end-users

The NBN Access Service is a Layer 2 bitstream service provided over a FTTP network. It is therefore similar to the 'Broadband Access Service' in the Special Access Undertaking lodged by FANOC on 30 May 2007. In its assessment of the FANOC Special Access Undertaking, the ACCC noted that an FTTN service with specifications that address certain elements would be likely to provide access seekers with sufficient flexibility and control over the access service to allow any-to-any connectivity and enable access seekers to compete effectively and make appropriate decisions in relation to the efficient use of and investment in infrastructure.³⁵³ The ACCC considered that such a service description would therefore be likely to promote the long-term interests of end-users.³⁵⁴

Some of the elements specified by the ACCC previously, and the ACCC's preliminary views on whether NBN Co's SAU meets these elements, are discussed below. The elements which are more relevant to other matters considered in the ACCC's assessment of the SAU are discussed in the following chapters of this Draft Decision, and are as follows:

- 'Points of interconnection as close to customers as is appropriate and efficient, which in the first instance is likely to mean at or near existing local access switches and other points of interconnection' — discussed in section 6.7.
- 'Well-described and appropriate protocols for how congestion in shared network elements is to be handled' — discussed in section 6.2.
- 'Equivalent treatment of access seekers in relation to quality of service parameters such as jitter, delay and packet loss' — discussed in section 6.2.

3.5.2.1. A Layer 2 bitstream access service, which may be offered at a variety of speeds but should include a product that is not throttled as well as a product that is symmetric to the extent the technology permits. Products (both consumer and business-grade) should be available to all access seekers on a non-discriminatory basis

The ACCC considers that the SAU offers a service at a variety of speeds (including symmetric services), by virtue of the inclusion of a range of product features. In particular, the ACCC notes that the desired inclusion of a non-throttled product was framed in the context of an FTTN implementation, where the ACCC wanted to ensure that the data rate was not significantly constrained. In the context of the SAU given by NBN Co, the ACCC is satisfied that the range of data rates proposed by NBN Co are sufficient to enable access seekers to offer a wide variety of products to end-users.

³⁵³ FANOC Draft Decision, p. 12.

³⁵⁴ Ibid, p. 12.

In relation to making consumer and business-grade products available to access seekers on a non-discriminatory basis, NBN Co is a wholesale-only provider and it therefore does not have incentives to favour particular downstream providers. The context is therefore different to that which applied to the FANOC SAU, where the members of the G9 consortium were also downstream providers. In addition, the ACCC notes that NBN Co has non-discrimination obligations under the CCA and has made commitments consistent with these obligations in the SAU.³⁵⁵

In relation to whether or not the service offered is a Layer 2 bitstream service, the service description for the NBN Access Service states that the service includes “some Layer 3 awareness referred to in clause 1A.2.6”.³⁵⁶ Telstra has raised concerns regarding the Layer 3 aspects specified in the terms and conditions for the supply of the service.³⁵⁷ While Telstra does not consider the functionality in clause 1A.2.6 to be problematic, it submits that it is important to ensure that the SAU does not leave scope for the introduction of further Layer 3 functionality. The ACCC agrees with this view. While some Layer 3 functionality is required for the supply of voice and multicast services, it is important that NBN Co’s service description does not give it discretion to offer a broader range of Layer 3 products than is required. This is because it could result in access seekers competing with NBN Co in the supply of Layer 3 capability — if this were to occur, NBN Co may have an incentive and the ability to discriminate against access seekers in its supply of Layer 2 services (in favour of supplying to itself), with subsequent implications for competition. The ACCC considers that the Layer 3 functionality should be limited to that specified in clause 1A.2.6.

In light of the above assessment, the Consultation Paper on the Notice to Vary proposes that amendments be made to the terms and conditions for the supply of the NBN Access Service which specify the Layer 3 awareness that will be used by NBN Co.

3.5.2.2. A service (whether the bitstream service or another service) that allows access seekers to provide a voice service

The ACCC considers that the fibre service proposed by NBN Co makes specific allowance for the provision of a voice service by including in both the Basic Access Offer (BAO) and Enhanced Access Offer (EAO) an option to use the UNI-V port for an additional 150kbps CIR (TC-1) symmetrical data transfer rate. There is also a similar 500kbps provision in the Standard Business Offer (SBO).

However, in relation to wireless and satellite service areas, NBN Co does not provide a separate option on the UNI-V port. Instead, NBN Co assumes that VoIP over the UNI-D port (150 kbps on wireless, 60 kbps on satellite, both CIR (TC-1)) will be used, or that the customer will keep using an existing copper service. This means that end-users on the wireless and satellite services will need additional equipment to use the equipment that they currently use to connect to the copper-based public switched telephone network (PSTN). Alternatively, they will need to obtain replacement VoIP equipment.

3.5.2.3. Interconnection protocols based on well-accepted standards for broadband, voice, and if applicable, video, which are sufficiently well-described to allow access seekers to design and build their own interconnecting facilities

The ACCC notes that it is important that open and non-proprietary protocols are adopted. This helps ensure that access seekers have a wide range of technological choices available to them and reduces the risks of assets being stranded by only being able to connect through limited protocols.

³⁵⁵ CCA, ss. 152AXC and 152AXD. For an example of a consistent SAU commitment, see clause 1H.5.2 of Schedule 1H: NBN Co commits to resolve disputes in a manner that ensures it is capable of complying with its non-discrimination obligations.

³⁵⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, Attachment A, clause 2(b) and Schedule 1A, clause 1A.2.6.

³⁵⁷ Telstra submission, pp. 39-40.

The ACCC notes that NBN Co has adopted open standards such as Ethernet and the OSI model, which satisfies this criterion.

3.5.2.4. Well-described and appropriate protocols for how packets are to be prioritised and handled

As noted above, NBN Co has used open and non-proprietary protocols such as 'Committed Information Rate' (CIR) and 'Peak Information Rate' (PIR) to describe how it will handle traffic on the NBN.

In relation to the prioritisation and handling of packets, NBN Co has sought to include a variety of traffic classes; however these are not well defined in the SAU. In particular, the SAU does not define all of the technical specifications for TC-2 and TC-3 products.

3.5.2.5. Interaction by access seekers with operations support systems, including visibility of provisioning, fault reporting and rectification and service assurance; and control of own customer configuration and use of the access seeker's allocated part of the capacity

It is important that access seekers have access to, and can connect to, operations support systems. These systems must perform a range of functions such as provisioning and fault reporting.

The ACCC notes that the SAU specifies Ancillary Services which support an access seeker performing activation and assurance related transactions as well as testing and verification. The ACCC considers that the Ancillary Services specified in the SAU adequately fulfil the requirements of this criterion.

3.5.2.6. No barriers to multicasting and IPTV by access seekers

The SAU includes a multicast service as a non-reference offer. Issues associated with the price of this offer are noted in chapter 5 of this Draft Decision.

3.5.2.7. An appropriate process for amending service specifications in later periods as needed or desirable

The SAU allows for the precise scope of the service description to change over time as and when new product components and product features are introduced by NBN Co. The issues associated with the approach to amending service specifications in later periods are outlined in section 3.5.1.1.

4. Product development and withdrawal

This chapter discusses the ACCC's preliminary views on the provisions in the SAU which relate to how NBN Co will develop, vary and withdraw the products, product components and product features, Ancillary Services and types of Facilities Access Services that it supplies over the term of the SAU.

As outlined in chapter 3, the SAU is given in respect of the NBN Access Service and Ancillary Services. The ACCC also considers that the SAU has been given in respect of the Facilities Access Service. As the means of implementing its obligations in connection with these services, NBN Co commits to supplying:

- product components (for example, AVC and CVC product components) and associated product features (for example, different data rate AVCs);³⁵⁸
- the Platform Interfacing Service and the 'Sandpit';³⁵⁹ and
- cross connection, co-location, ODF termination and other facilities necessary to facilitate entry into buildings.³⁶⁰

The SAU also refers to 'offers', which may be either reference or non-reference offers. The 'offers' are essentially comprised of collections of different product features and the different types of Ancillary Services and Facilities Access Services. Product collections that are defined as reference offers cannot be withdrawn whilst they are defined as such;³⁶¹ whereas product collections that are defined as non-reference offers can be withdrawn.³⁶²

The SAU also states that NBN Co will (as the means of implementing its obligations in connection with the NBN Access Service, Ancillary Services and Facilities Access Service):

- supply such other non-reference offers that NBN Co introduces in accordance with the product development and withdrawal provisions in the SAU, from the date it introduces the non-reference offer by including it in any SFAA, and withdrawing it only in accordance with the product development and withdrawal provisions in the SAU;³⁶³
- supply such other Ancillary Services introduced in accordance with the product development and withdrawal provisions in the SAU;³⁶⁴ and
- supply such other types of facilities access that NBN Co introduces in accordance with the product development and withdrawal provisions in the SAU.³⁶⁵

Provisions about product development, variation and withdrawal are included in both Modules 1 (Schedule 1I) and 2 (Schedule 2E).

³⁵⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1A, clause 1A.1.3.

³⁵⁹ Ibid, Schedule 1A, clause 1A.4.1.

³⁶⁰ Ibid, Main Body, Attachment B, clause 2.

³⁶¹ Ibid, Schedule 1C, clause 1C.1.2; Schedule 2B, clauses 2B.1.2(a) and 2B.1.2(b).

³⁶² Ibid, Schedule 1C, clause 1C.1.2; Schedule 2E, clause 2E.2(a).

³⁶³ Ibid, Schedule 1D, clause 1D.1.2(a).

³⁶⁴ Ibid, Schedule 1A, clause 1A.4.1.

³⁶⁵ Ibid, Schedule 1A, clause 1A.6(e).

The provisions about product development and variation apply to products, product components and product features (that is, the components of the NBN Access Service) as well as to the Platform Interfacing Service, the Sandpit and the Facilities Access Service, but do not appear to apply to the development or variation of Ancillary Services that are not the Platform Interfacing Service or the Sandpit Service.³⁶⁶ On the other hand, the provisions about product withdrawal apply to all components of the NBN Access Service (that is, product components and product features), as well as to the withdrawal of all types of Ancillary Services and Facilities Access Services.³⁶⁷

In a general sense, how services provided over the NBN are developed, varied and withdrawn over time can have implications for the extent to which both competition in downstream markets is promoted, and the economically efficient use of and investment in the NBN is encouraged. Changes in technology, costs and end-user demand are inevitable over the term of the SAU. To the extent that, over the term of the SAU, NBN Co supplies products that its customers and their end-users are willing to pay for (both in terms of the introduction of new products, and the withdrawal of existing products), efficient use of, and investment in, the NBN is likely to be promoted. Similarly, to the extent that NBN Co and its customers share information about and consult with each other on these things, this will likely enhance the prospect of supply and demand being aligned. Further, if NBN Co's customers are able to develop, with NBN Co, wholesale Layer 2 products that support the development of new and innovative downstream products, the vigour of competition in downstream markets is likely to be promoted, as retailers strive to compete on the basis of product innovation.

This chapter provides the ACCC's preliminary views about whether the specific provisions proposed by NBN Co in the SAU in relation to product development, variation and withdrawal are likely to lead to outcomes such as these, and whether the provisions promote the long-term interests of end-users.

4.1. Product development and variation

The ACCC has categorised the product development and variation provisions as conduct under subsection 152CBA(3C) of the CCA. The ACCC has therefore considered whether the product development and variation provisions of the SAU promote the long-term interests of end-users.³⁶⁸

Provisions about product development and variation are contained in both Module 1 and 2 of the SAU.

Module 1 contains both:

- product development principles and clauses about minor product variations and enhancements; as well as
- specific processes which determine how consultation and decision-making will occur (the 'PDF Processes').

³⁶⁶ That is, while the SAU states that it will supply additional Ancillary Services and Facilities Access Services that have been developed via the product development provisions in the SAU (see clauses 1A.4.1, 1A.6(e), and 1D.1.2(a)), the product development provisions only apply to products, product components and product features (see clauses 11.1.2 and 2E.1.2(a)). The definition of 'Product' includes the Platform Interfacing Service, the Sandpit Service and Facilities Access Service, but does not include Ancillary Services more generally. Similarly, the definition of 'Product Component' excludes Ancillary Services or Facilities Access Services.

³⁶⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 11, clauses 11.5.1(a), 11.5.1(b), 11.5.2(a), 11.5.2(b), 11.5.2(c) and 11.5.3; Schedule 2E, clauses 2E.2, 2E.6.2(a), 2E.6.2(b), 2E.6.3(a), 2E.6.3(b), 2E.6.3(c) and 2E.6.4.

³⁶⁸ CCA, s. 152CBD(2)(cb).

Module 2 contains the same general product development principles and clauses about minor product variation as Module 1, but does not include PDF Processes.

The product development provisions in Modules 1 and 2:

- commit NBN Co to consulting and sharing information with customers about NBN Co's development of and variations to products;³⁶⁹
- require that NBN Co establishes a Product Development Forum (PDF),³⁷⁰
- provide that the PDF Processes will be adopted for that Forum, and require NBN Co and access seeker compliance with the PDF Processes;³⁷¹
- commit NBN Co to consulting on prices and services levels for products that have been developed via the PDF;³⁷² and
- allow NBN Co to decide which products will and will not be developed or varied via the PDF.³⁷³

Module 1 and 2 also set out in which circumstances these product development commitments do not apply. These are for:

- products covered by, or contemplated within, NBN Co's Initial Product Roadmap;³⁷⁴
- the introduction of a product that NBN Co is obliged to offer as a result of a licence condition;³⁷⁵ and
- a minor variation or enhancement to a product.³⁷⁶

The PDF Processes themselves (which are only included in Module 1) set out:

- the basis on which NBN Co will engage with customers via the PDF;³⁷⁷
- the parties that are able to take part in the PDF and requirements the parties must comply with if they wish to take part;³⁷⁸
- how parties can submit product ideas to NBN Co;³⁷⁹
- that NBN Co may at any time suspend or change the priority of its assessment and development of product ideas;³⁸⁰
- that NBN Co will provide information about its development of product ideas;³⁸¹

³⁶⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I, clause 11.1.2; Schedule 2E, clause 2E.1.2.

³⁷⁰ Ibid, Schedule 1I, clause 11.3.1; Schedule 2E, clause 2E.4.1.

³⁷¹ Ibid, Schedule 1I, clause 11.3.2; Schedule 2E, clause 2E.4.2.

³⁷² Ibid, Schedule 1I, clauses 11.3.5 and 11.3.6; Schedule 2E, clauses 2E.4.4 and 2E.4.5.

³⁷³ Ibid, Schedule 1I, clause 11.3.3; Schedule 2E, clause 2E.4.3.

³⁷⁴ Ibid, Schedule 1I, clause 11.1.3(b)(i); Schedule 2E, clause 2E.1.3(b)(i).

³⁷⁵ Ibid, Schedule 1I, clause 11.1.3(b)(ii); Schedule 2E, clause 2E.1.3(b)(ii).

³⁷⁶ Ibid, Schedule 1I, clause 11.1.3(b)(iii); Schedule 2E, clause 2E.1.3(b)(iii).

³⁷⁷ Ibid, Schedule 1I, Annexure 1, Background, clause B.

³⁷⁸ Ibid, Schedule 1I, Annexure 1, clause 2.

³⁷⁹ Ibid, Schedule 1I, Annexure 1, clause 4.1.

³⁸⁰ Ibid, Schedule 1I, Annexure 1, clause 4.2.

³⁸¹ Ibid, Schedule 1I, Annexure 1, clauses 3, 4.3 and 10.

- the rights and obligations of NBN Co and access seekers with respect to the treatment of confidential information and intellectual property associated with product development;³⁸²
- how NBN Co will assess product ideas, including providing NBN Co with 'absolute discretion' to decide whether or not to develop a product and whether or not to suspend the development of a product;³⁸³
- the different types of consultation forums that NBN Co may use (for example, workshops and formal submissions);³⁸⁴ and
- that the dispute resolution provisions in Access Agreements do not apply to the PDF Processes (other than for some aspects of the confidentiality and intellectual property provisions of the PDF Processes).³⁸⁵

The SAU provides that the PDF Processes (whilst applicable for the duration of Module 1) would be subject to review as part of the midpoint review of Module 1. As noted in chapter 2 the ACCC is not satisfied that the processes and criteria set out in the SAU in respect of this review would lead to decisions that promote the long-term interests of end-users, nor that its decisions would in all circumstances be implemented in a manner that promotes the long-term interests of end-users. The ACCC notes that the Consultation Paper on the Notice to Vary proposes that the PDF Processes should only operate for the first five years of Module 1.

4.1.1. Submissions

NBN Co submits that:

- The product development obligations are intended to ensure that customers are central to NBN Co's product development and improvement processes and to provide customers with certainty about the way NBN Co will assess and implement product ideas over time.³⁸⁶
- The exclusion of products covered or contemplated within the Initial Product Roadmap is appropriate because NBN Co has already developed these products through a consultative and collaborative product development process which informed the prioritisation shown on that roadmap and procurement and other decisions necessary to implement that roadmap — requiring these products to now go through the PDF Processes would be unnecessary and inefficient.³⁸⁷
- The PDF Processes balance strict obligations on NBN Co with flexible timeframes and modes of consultation to allow for products ideas to be developed in a manner most effective and appropriate to each idea — flexibility is needed because there is uncertainty about what products customers will require and request.³⁸⁸
- Emphasis is placed on customer responsibility for their own confidentiality and intellectual property rights, including identifying confidential information and intellectual property and imposing costs on customers for failing to identify this information as required — this is important to ensure that the PDF Processes

³⁸² Ibid, Schedule 11, Annexure 1, clauses 5 and 6.

³⁸³ Ibid, Schedule 11, Annexure 1, clause 7.

³⁸⁴ Ibid, Schedule 11, Annexure 1, clauses 8, 9 and 10.

³⁸⁵ Ibid, Schedule 11, Annexure 1, clause 12.

³⁸⁶ NBN Co Supporting submission, p. 89.

³⁸⁷ Ibid, p. 89.

³⁸⁸ Ibid, p. 92.

are not 'gamed' to hinder product development, stifle innovation and divert resources from legitimate product ideas.³⁸⁹

Submissions generally support the inclusion of product development and variation provisions in the SAU. However:

- Telstra, Optus, ACCAN and Macquarie Telecom consider that the product development carve-outs for Initial Product Roadmap products and minor variations should be removed entirely or their scope clarified and reduced;³⁹⁰ and Telstra and Optus also consider that the carve-outs for products that NBN Co is obliged to introduce should also be removed.³⁹¹
- Vodafone Hutchison Australia argue that the drafting of the NBN Access Service, Ancillary Services and Facilities Access Services in the SAU means that it may be possible for NBN Co to argue that any Access Determination or Binding Rules of Conduct that related to an aspect of a declared service that was already covered by the SAU, or any 'Product' supplied by NBN Co, would be inconsistent with the SAU and hence of no effect.³⁹²
- Macquarie Telecom and ACCAN note that end-users or end-user advocates are not represented in the Product Development Forum.³⁹³
- Telstra notes that there is confusion as to whether Ancillary Services and Facilities Access Service are subject to the product development provisions.³⁹⁴
- Telstra argue that the definition of 'product idea' does not appear to include ideas that have been developed by NBN Co and hence the PDF Processes may not apply to these products.³⁹⁵

In addition, a number of submissions consider that given NBN Co is a monopoly wholesale provider, it is not appropriate to allow it to have sole discretion to determine the specifications of the services to supply to wholesale customers.³⁹⁶

Submissions also comment on the PDF Processes, as follows:

- Telstra and Optus argue that the PDF Processes provide NBN Co with too much discretion about:
 - assessing product ideas (including suspending assessment);
 - the decision to proceed with developing a product idea;
 - the ability to reject product ideas with little or no feedback; and
 - how and when it will consult with customers.³⁹⁷
- As a consequence, Telstra argues that the current product development regime provides limited incentives for NBN Co to meaningfully engage with

³⁸⁹ Ibid, pp. 92-93.

³⁹⁰ Telstra submission, pp. 49-50; Optus submission (Public version), p. 107; ACCAN, *NBN Co 2012 SAU Consultation Paper: Submission to the ACCC*, 18 January 2013, p. 4 (ACCAN submission); Macquarie Telecom submission, p. 11.

³⁹¹ Telstra submission, p. 49; Optus submission (Public version), p. 107.

³⁹² Vodafone Hutchison Australia submission, pp. 14-16.

³⁹³ ACCAN submission, p. 4; Macquarie Telecom submission, pp. 10-11.

³⁹⁴ Telstra submission, pp. 50-51.

³⁹⁵ Telstra submission, pp. 51-52.

³⁹⁶ AAPT submission, p. 8; CCC submission, pp. 6-7; Macquarie Telecom submission, p. 9.

³⁹⁷ Telstra submission, p. 48; Optus submission (Public version), p. 108.

industry on the one hand, and for industry to participate in product development on the other.³⁹⁸

- A number of submissions support the inclusions of confidentiality and intellectual property provisions; however a number of concerns were raised:
 - Telstra considers that these provisions do not adequately recognise and protect RSP confidential information and/or intellectual property rights; do not adequately recognise and address third party intellectual property rights; impose onerous obligations (and potentially 'penalties') on RSPs for a failure to identify submitted confidential information or intellectual property rights at or shortly after the time of submission; include provisions that are not relevant in a product development context; and are overly rigid and do not support the flexibility that is required to encourage product innovation through the PDF by RSPs of different sizes and risk profiles.³⁹⁹
 - As a result, Telstra considers that it is likely that RSPs will be reluctant to submit materials to the PDF or even to actively participate, thereby compromising the intended effect of the PDF and the achievement of the product development principles.⁴⁰⁰
 - Optus raises a number of concerns with whether confidential information and intellectual property rights will be adequately protected under the PDF Processes.⁴⁰¹

4.1.2. Preliminary ACCC views

The product development and variation provisions in Modules 1 and 2 broadly fall into four categories which:

- commit NBN Co to share information and consult (included in both Modules 1 and 2);
- establish rights for, and obligations on, NBN Co and its customers about how consultation will occur (included in the PDF Processes, and therefore only in Module 1);
- allow for consultation to not be undertaken in particular circumstances (included in both Modules 1 and 2); and
- set out NBN Co's ability to make a decision about whether or not to develop or vary a product (included in both Modules 1 and 2).

The ACCC's preliminary views in respect of these provisions are set out below.

4.1.2.1. Commitments by NBN Co to share information and consult

NBN Co makes commitments in Module 1 and 2 to share information and consult — namely NBN Co commits to:

- publishing and maintaining a product roadmap;⁴⁰²

³⁹⁸ Telstra submission, p. 48.

³⁹⁹ Telstra submission, p. 56.

⁴⁰⁰ Telstra submission, p. 56.

⁴⁰¹ Optus submission (Public version), pp. 109-111.

⁴⁰² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 11, clause 11.2; Schedule 2E, clause 2E.3.

- implementing a Product Development Forum that is open to participation by all customers;⁴⁰³
- ensuring that the Product Development Forum: identifies and records all product ideas; provides a forum that facilitates open and consultative dialogue with customers in respect of product ideas; provides a forum for customers to obtain certain information from NBN Co and assist NBN Co in developing new products;⁴⁰⁴ and
- consulting on the prices and service levels of products developed via the Product Development Forum.⁴⁰⁵

The ACCC's preliminary view is that in reducing asymmetries in information about the types of products that are needed to support end-users' evolving demand, the prospect that NBN Co will be in a position to be able to supply products that access seekers are willing to pay for is heightened. Similarly, NBN Co providing information about the products it is going to supply will provide access seekers with the information they need to be able to plan for making complementary investment. The ACCC considers that this in turn is likely to encourage economically efficient investment in and use of the NBN. In facilitating the ability of access seekers to propose product ideas to NBN Co, the potential for the vigour of competition to be promoted is also enhanced.

The ACCC does however consider that the effectiveness of the commitments in reducing information asymmetries would be enhanced if there was also a role for consumer advocacy groups in NBN Co's consultation processes. The Consultation Paper on the Notice to Vary therefore proposes variations to this effect.

4.1.2.2. Provisions which establish rights for and obligations on NBN Co and its customers about how consultation will occur

The commitments in Module 1 establish rights for and obligations on NBN Co and its customers about how consultation will occur. Namely the provisions that:

- state that NBN Co will comply with the PDF Processes;⁴⁰⁶
- provide that to participate in the Product Development Forum, customers will be required to comply with the PDF Processes;⁴⁰⁷
- require customers to maintain contact information on NBN Co's website;⁴⁰⁸ and
- establish rights for and obligations on NBN Co and its customers about the treatment of confidential information and intellectual property rights associated with new product ideas.⁴⁰⁹

The ACCC considers that whether the first two of these provisions promote the long-term interests of end-users will depend on the substance of the PDF Processes. Discussion in this section therefore focuses on the provisions which establish rights for and obligations on NBN Co and its customers about the treatment of confidential information and intellectual property rights associated with new product ideas.

The ACCC's preliminary views about the confidentiality terms are as follows.

⁴⁰³ Ibid, Schedule 1I, clause 1I.3.1; Schedule 2E, clause 2E.4.1.

⁴⁰⁴ Ibid, Schedule 1I, clause 1I.3.1(c); Schedule 2E, clause 2E.4.1(c).

⁴⁰⁵ Ibid, Schedule 1I, clauses 1I.3.5 and 3.6; Schedule 2E, clauses 2E.4.4 and 2E.4.5.

⁴⁰⁶ Ibid, Schedule 1I, clause 1I.3.2(a); Schedule 2E, clause 2E.4.2(a).

⁴⁰⁷ Ibid, Schedule 1I, clause 1I.3.2(b); Schedule 2E, clause 2E.4.2(b); Schedule 1I, Annexure 1, clause 2(b).

⁴⁰⁸ Ibid, Schedule 1I, Annexure 1, clauses 2(a), 2(c) and 2(d).

⁴⁰⁹ Ibid, Schedule 1I, Annexure 1, clauses 5 and 6.

A number of clauses make it unclear whether confidential information will be adequately protected — for example:

- When confidential information is disclosed to third parties under clauses 5.3(c)(v)(B) and (vi) and clause 5.4, the requirement that the recipient of the confidential information must ensure that a person to whom it is to be disclosed is made subject to the same confidentiality obligations to those set out in clause 5 of the PDF Processes may be overridden by lesser obligations.
- When confidential information is disclosed to third parties under clauses 5.3(c)(iv), (ix) and (x) and clause 5.4, the party whose confidential information is to be disclosed is not given an opportunity to query or challenge the disclosure and/or the breadth of, or basis on which, the information is to be disclosed.
- In clause 5.7(a), the reference to 'internal governance processes' is broad and does not restrict what may be included in the internal governance processes; and this clause does not impose any obligations that the information be retained in confidence.

In addition, the definitions of confidential information that apply to customers and NBN Co are not reciprocal, as NBN Co is not required to identify which of its information is confidential.

The ACCC's preliminary views about the intellectual property rights terms are that:

- no benefit appears to be given to a customer if NBN Co develops products based on that customer's product idea or third party's intellectual property;
- the requirements that a customer identify exactly the intellectual property it is submitting and the exact nature of the rights in third party material provided by the customer as part of the PDF Processes may be onerous and complicated for some customers;
- some of the clauses make it unclear whether customer intellectual property rights will be adequately protected; and
- the provisions could impose potentially significant costs on customers for failing to identify third party intellectual property rights.

In light of these views, the ACCC considers that the effect of the confidential information and intellectual property rights terms could be that customers are discouraged from participating in the Product Development Forum.

This view is supported by the submission from Telstra, which considers that the likely effect of the confidential information and intellectual property rights terms is that RSPs will be reluctant to submit materials to the PDF or even to actively participate.⁴¹⁰

If the terms discourage access seekers from participating in the Product Development Forum, the terms could reduce the extent to which the product development and variation provisions result in the achievement of the objectives of promoting competition in markets for listed services and encouraging the economically efficient use of and investment in the NBN. This is because:

- the amount of consultation and sharing of information about product development activities might be reduced, and in turn, the prospect of supply

⁴¹⁰ Telstra submission, p. 56.

and demand being aligned would be reduced — this could have implications for economically efficient use of, and investment in, the NBN; and

- customers might be dissuaded from developing with NBN Co wholesale Layer 2 products that support the development of new and innovative downstream products — this could in turn reduce the vigour of downstream competition.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that clauses 5 and 6 in the PDF Processes be removed. The effect of this removal would be that terms and conditions about the handling of confidential information and intellectual property rights would be subject to commercial negotiation between NBN Co and its customers. The removal of these terms from the SAU would also mean that they could be the subject of any later ACCC regulatory determinations. In making such regulatory determinations, the ACCC would be required to take into account particular matters specified by Part XIC — such as NBN Co's legitimate business interests, the interests of access seekers and whether the determination would promote the long-term interests of end-users.

4.1.2.3. Provisions which allow for consultation to not be undertaken in particular circumstances

Certain provisions establish that NBN Co does not have to consult in particular circumstances — namely the provisions which:

- set out that none of the product development and variation provisions apply to the introduction of a product covered by, or contemplated within, NBN Co's Initial Product Roadmap;⁴¹¹ the introduction of a product that NBN Co is obliged to offer as a result of a licence condition;⁴¹² and a minor variation or enhancement to a product;⁴¹³ and
- are unclear as to whether the product development provisions apply to ancillary services other than for the Platform Interfacing Service and the Sandpit Service.⁴¹⁴

In addition:

- commitments in the SAU to consult on prices and service levels only apply for services that have been developed via the PDF;
- the definition of 'product idea' does not include Ancillary Services and Facilities Access Services — hence the SAU does not require that NBN Co consults on the development and variation of these services;⁴¹⁵ and
- the provisions appear to largely pertain to customer-initiated development and variation of products, as opposed to NBN Co-initiated development and variation.⁴¹⁶

⁴¹¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 11, clause 11.1.3(b)(i); Schedule 2E, clause 2E.1.3(b)(i). The initial product roadmap specifies broad categories of products, such as 'broadband and telephony', 'multicast', 'business and medium business services', 'enterprise Ethernet services' and 'service enhancements'. The ACCC considers that the Initial Product Roadmap could be interpreted to include all the products that NBN Co will supply in the foreseeable future.

⁴¹² Ibid, Schedule 11, clause 11.1.3(b)(ii); Schedule 2E, clause 2E.1.3(b)(ii).

⁴¹³ Ibid, Schedule 11, clause 11.1.3(b)(iii); Schedule 2E, clause 2E.1.3(b)(iii).

⁴¹⁴ Ibid, Schedule 1A, clauses 1A.4.1 and 1A.6(e); Schedule 1D, clause 1D.1.2(a); Schedule 11, clause 11.1.2; Schedule 2E, clause 2E.1.2(a).

⁴¹⁵ Ibid, Main Body, Attachment C.

⁴¹⁶ See clause 11.3(c)(i) of Schedule 11 and clause 4 of Annexure 1 to Schedule 11. It is not clear from these clauses whether the processes for submitting and recording product ideas with the PDF applies to product ideas initiated by NBN Co.

The ACCC's preliminary view is that provisions such as these limit the circumstances in which NBN Co will consult and share information with its customers about the development and variation of products, and the terms and conditions associated with those products. This in turn lessens the extent to which the provisions reduce asymmetries in information about the types of products that are needed to support end-users' evolving demand, and lessens the prospect that NBN Co will be in a position to be able to supply products that access seekers are willing to pay for. It could also reduce access seekers' access to the information they need to be able to plan for making complementary investments. The ACCC's preliminary view is that both of these outcomes would reduce the extent to which the product development and variation provisions encourage economically efficient investment in and use of the NBN.

While NBN Co argues that:

- the exclusion of products covered or contemplated within the Initial Product Roadmap is appropriate because NBN Co has already developed these products through a consultative and collaborative product development process;⁴¹⁷ and
- requiring these products to now go through the PDF processes would be unnecessary and inefficient;⁴¹⁸

the ACCC notes that, given the broad range of products that could be "covered or contemplated within the Initial Product Roadmap", it is possible that different product features on that roadmap will have gone through varying degrees of, or no, consultation to date. The ACCC therefore considers that, despite NBN Co's submission, the current scope of the Initial Product Roadmap exclusion is too broad.

In light of these views, the Consultation Paper on the Notice to Vary proposes a narrowing of the scope of, and provision of further clarity about, the circumstances in which consultation will not be undertaken. The effect of this variation would be to increase the extent to which the proposed consultation processes about product development and variation promote the long-term interests of end-users.

Were these exclusions from consultation removed from the SAU or narrowed, NBN Co and its customers would nonetheless not be precluded from agreeing to not develop a particular product, product component or product feature further via the Product Development Forum. As noted in chapter 2, the SAU has no effect to the extent of any inconsistency with an Access Agreement.

4.1.2.4. Provisions which set out NBN Co's ability to make a decision about whether or not to develop or vary a product

As noted in chapter 3, under the SAU, NBN Co has a high degree of discretion as to what new products may be created. As noted in section 4.1.1, a number of submissions have raised concerns that it is not appropriate to allow NBN Co, a monopoly provider, to have discretion to determine the specifications of the services to supply to wholesale customers.⁴¹⁹

The ACCC considers that it is in NBN Co's legitimate business interests to determine the products it supplies and how and when new products will be introduced. The ACCC also considers that at certain times throughout the SAU term, NBN Co is likely to face appropriate incentives to develop and vary products in line with evolving end-user and access seeker demand — in turn, economically efficient use of and investment in the NBN is likely to be encouraged. For example, NBN Co may face incentives to develop and vary products if to do so would generate revenue streams greater than the costs of providing the new or varied product, or greater margins than those being earned from its existing product set. These

⁴¹⁷ NBN Co Supporting submission, p. 89.

⁴¹⁸ Ibid, p. 89.

⁴¹⁹ AAPT submission, p. 8; CCC submission, pp. 6-7; Macquarie Telecom submission, p. 9.

incentives might be heightened during times when NBN Co faces demand and revenue uncertainty.

On the other hand, as NBN Co becomes a more established network operator and begins earning sufficient revenue streams to recover its costs, its incentive to develop new products (for example, higher data rate products) in line with evolving end-user and access seeker demand could weaken. This might be because firstly, NBN Co would expect to be able to recover its costs without developing new products, and secondly, because the operation of the long-term revenue constraint methodology would mean that NBN Co could not earn revenues above its costs, or margins above the regulated rate of return, from developing new products. In effect, NBN Co may perceive little, if any, benefit in developing new products.

As discussed in detail in chapter 5, the ACCC considers that whether or not NBN Co faces demand and revenue uncertainty is likely to change over the SAU term. Therefore, at certain times throughout the SAU term (such as during the roll-out), NBN Co may face appropriate incentives to develop and vary commercially viable products in line with customer demand; however, there may also be times throughout the SAU term when NBN Co does not face these incentives.

As noted in chapter 3, under Part XIC of the CCA the ACCC can declare a service (even if the service is, to any extent, covered by the SAU) if, after holding a public inquiry, it is satisfied that the making of the declaration will promote the long term interests of end-users.⁴²⁰ If the ACCC declares a service, NBN Co is subject to the Category B SAOs in respect of the service — NBN Co would therefore be obligated to supply the service on request. Hence, during those times where NBN Co does not face incentives to develop new products, if, following an inquiry, the ACCC was satisfied that the supply of a particular product would promote the long term interests of end-users, NBN Co could be obligated to supply the product in this way.

However, as discussed in chapter 3, the drafting of the SAU creates uncertainty as to how the SAU interacts with any specific service that may be declared by the ACCC and the terms and conditions specified in any Access Determination in respect of the service. The relevant clauses in Module 1 and Module 2 that create this uncertainty are those which define that the products, product components and product features that NBN Co will supply include those that it introduces pursuant to the product development provisions in the SAU (which have the effect of narrowing what products are to be supplied by NBN Co under the SAU),⁴²¹ and clauses which state that NBN Co will introduce, develop, prioritise, assess and suspend assessing product ideas at its “absolute discretion”.⁴²²

In effect, the SAU could be interpreted as intending that the products specified in the SAU or developed in accordance with the processes set out in the SAU are all of the Layer 2 services that NBN Co will supply.

The Consultation Paper on the Notice to Vary therefore proposes that the SAU be varied to include:

- recognition that Part XIC of the CCA allows the ACCC to declare services; and
- statements that the means by which NBN Co will fulfil its obligations in relation to the broadly defined NBN Access Service and Ancillary Services will include the supply of products that are declared by the ACCC or required to be supplied under the ACCC’s Access Determination or Binding Rules of Conduct and that fall within the definition of those services.

⁴²⁰ CCA, s. 152AL(8F).

⁴²¹ For example, clauses 1A.1.3 and 2A.1.2, 1A.4.1, 1A.6(e), 1D.1.2(a), and the definitions of Product and Product Component in Attachment C to the Main Body of the SAU.

⁴²² For example, clauses 11.1.3, 11.3.3 and 2E.4.3; and in the PDF Processes, clauses 4.2, 7.4(a), 7.5, 7.6 and clause 12(a).

The effect of these variations would be to clarify how the SAU interacts with the powers that Part XIC of the CCA confers on the ACCC to declare services and set terms and conditions for those services. NBN Co's decisions about whether or not to introduce a new product would nonetheless in the first instance be subject to commercial negotiation and agreement between NBN Co and its customers. In the event that agreement could not be reached, and in circumstances where the ACCC considered that NBN Co did not face incentives to respond to evolving end-user demand, the ACCC could conduct an inquiry into whether the supply of the particular product would promote the long term interests of end-users, and following the inquiry, declare the product if it was satisfied that supply of the product would promote the long term interest of end-users.

As noted, the ACCC considers that — during the NBN rollout at least — NBN Co is likely to face appropriate incentives with respect to product development. In turn, it is unlikely that the ACCC would need to be involved in such matters during that time.

4.2. Product withdrawal

The ACCC considers that the provisions of the SAU about product withdrawal could be categorised as conduct under subsection 152CBA(3B), terms and conditions relating to that conduct, or terms and conditions about compliance with the SAOs. The ACCC has not at this stage definitively categorised the provisions about product withdrawal. The ACCC has considered whether the provisions promote the long-term interests of end-users.

During both Modules 1 and 2, the SAU establishes that any service that is defined as a reference offer cannot be withdrawn for as long as it is defined as a reference offer.⁴²³

For all other services (that is, non-reference offers — which include product features, types of Ancillary Services and types of Facilities Access Services that are not defined as reference offers) NBN Co can withdraw these services at its discretion and NBN Co will:

- provide written notice to customers of its intention to withdraw the service not less than 24 months for a product, product component, Ancillary Service or type of Facilities Access Service and not less than 12 months for a product feature — as well as notice of any arrangements to migrate customers to alternate services;⁴²⁴
- when considering whether to withdraw a product, product component, product feature or Ancillary Service or type of Facilities Access Service, have regard to a number of factors when considering whether to withdraw the service, such as the level of existing demand, the cost of maintaining and supplying the service and the feasibility, commercial viability and price of alternatives;⁴²⁵ and
- discuss and consider in good faith any feedback received from its customers, and access seekers in some circumstances,⁴²⁶ in relation to the withdrawal.⁴²⁷

During Module 1, the services that are reference offers will not be changed;⁴²⁸ during Module 2, there is a process in the SAU which would allow for (subject to ACCC approval) the services

⁴²³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.2.1(a); Schedule 2E, clause 2E.6.1.

⁴²⁴ Ibid, Schedule 1I, clause 1I.5.2; Schedule 2E, clause 2E.6.3.

⁴²⁵ Ibid, Schedule 1I, clause 1I.5.2(b); Schedule 2E, clause 2E.6.3(b).

⁴²⁶ Ibid, Schedule 1I, clause 1I.3.1(b); Schedule 2E, clause 2E.4.1(b).

⁴²⁷ Ibid, Schedule 1I, clause 1I.5.2(c); Schedule 2E, clause 2E.6.3(c).

⁴²⁸ Ibid, Schedule 1C, clause 1C.2.1(a).

that are reference offers to be changed.⁴²⁹ This in turn means that during Module 2, there is the potential for the services that are defined as reference offers in Module 1 to be withdrawn.⁴³⁰

The SAU also:

- precludes NBN Co from withdrawing a product and introducing a new product that is substantially similar to, or comparable with, the withdrawn product for the purposes of circumventing the SAU price controls (the price controls are discussed in chapter 5);⁴³¹ and
- establishes that the product withdrawal provisions do not apply to the withdrawal of a product that NBN Co is required by law or a Shareholder Minister to withdraw or which NBN Co is prohibited from providing under subsection 41(3) of the *NBN Companies Act 2011*.⁴³²

4.2.1. Submissions

NBN Co submits that:

- reference offers, which cannot be withdrawn for the term for which they apply, provide regulatory certainty to access seekers and NBN Co, thereby promoting competition in a range of retail and wholesale markets;⁴³³
- the product withdrawal commitments in the SAU are the appropriate means by which to address the issues of product withdrawal for all non-reference offers;⁴³⁴ and
- the product withdrawal commitments for non-reference offers provide customers with long lead times to prepare for any product withdrawal and with a high degree of input into proposals for withdrawal.⁴³⁵

Submissions generally supported the inclusion of product withdrawal provisions in the SAU. However:

- Optus and Telstra consider that the withdrawal of products as required by law or a Shareholder Minister or which NBN Co is prohibited from providing under the *NBN Companies Act 2011* should not be exempt from the product withdrawal commitments in the SAU;⁴³⁶
- Optus and Telstra raise concerns with the transitional arrangements for withdrawing products. They consider that the requirement to develop transitional arrangements should be mandatory,⁴³⁷ and Telstra considers that NBN Co should be required to consult on the transition plan.⁴³⁸

⁴²⁹ Ibid, Schedule 2B, clause 2B.1.2.

⁴³⁰ Ibid, Schedule 2B, clause 2B.1.2(d).

⁴³¹ Ibid, Schedule 11, clause 11.5.1; Schedule 2E, clause 2E.6.2.

⁴³² Ibid, Schedule 11, clause 11.5.3.

⁴³³ NBN Co Supporting submission, p. 163.

⁴³⁴ Ibid, p. 103.

⁴³⁵ Ibid, p. 94.

⁴³⁶ Telstra submission, p. 63; Optus submission (Public version), p. 110.

⁴³⁷ Telstra submission, p. 62; Optus submission (Public version), p. 111.

⁴³⁸ Telstra submission, p. 62.

4.2.2. Preliminary ACCC views

This section provides the ACCC's preliminary views about the extent to which the provisions of the SAU which:

- allow NBN Co to withdraw non-reference offers;
- set out how reference offers will be changed over time; and
- establish what NBN Co will do prior to withdrawing a product (such as providing written notice, having regard to certain factors, discussing and consider in good faith any feedback received from its customers);

are likely to result in the achievement of promoting competition and encouraging the efficient use of and investment in infrastructure — and in turn, whether the ACCC is satisfied that they promote the long-term interests of end-users.

Some of the ACCC's views on these matters have been developed having regard to the interaction of the provisions with the price-related terms in the SAU — and in particular, the implications of the withdrawal of products for the effectiveness of the proposed CPI-1.5 per cent price control in creating incentives for NBN Co to invest and operate efficiently.

4.2.2.1. Encouraging efficient use of and investment in the NBN

As noted, the SAU allows NBN Co to withdraw non-reference offers. Given the proposed duration of the term of the SAU, it is to be expected that changes in technology and end-user demand could result in end-users and in turn access seekers not being willing to pay a sufficient amount for particular services relative to the costs of supplying the services. Withdrawing services in such circumstances would be likely to promote efficient investment in and use of the NBN — this is because withdrawing the loss-making services would allow NBN Co to focus resources on developing and supplying services that access seekers are willing to pay a sufficient amount for to recover the costs of supplying the service.

However, the SAU allows NBN Co to withdraw services not only in circumstances in which services are loss-making, but essentially in any circumstance in which a service is not defined as a reference offer. The ACCC considers that the withdrawal of products may in some cases undermine the effectiveness of the CPI-1.5 per cent price control in creating incentives for NBN Co to invest and operate efficiently.

The ACCC's preliminary view is that the combined implications of the following aspects of the SAU:

- the exclusion of particular services from the specification of reference offers during Module 1;
- provisions in Module 2 which allow NBN Co to redefine the services which make up the reference offers (albeit subject to ACCC approval);
- provisions in Module 1 and Module 2 which allow NBN Co to withdraw services once they are no longer reference offers; and
- the uncertainty created by the SAU as to how it interacts with any services declared by the ACCC (as noted in chapter 3);

mean that the SAU will not ensure that:

- NBN Co has incentives to price its services in such a way as to promote take-up of higher functionality services and in turn promote efficient use of the NBN;

- NBN Co will face significant demand risk, and in turn (in combination with the proposed price controls) revenue sufficiency risk — which in turn calls into question the efficacy of the proposed price controls as a mechanism for creating incentives for NBN Co to invest and operate efficiently; or
- current consumers of services provided over copper and HFC networks will not be made worse off as a result of the transition to the NBN — and that in turn those consumers that desire and are willing to pay for services that offer greater functionality than currently available over copper and HFC contribute more to the recovery of the costs of the NBN upgrade than those that do not desire such services.

On the other hand, as outlined in chapter 5, the ACCC considers that if these outcomes were to be delivered by the SAU, economically efficient use of and investment in the NBN would more likely be encouraged.

Hence, the ACCC's preliminary view is that — due to their combined operation — the provisions relating to product withdrawal, the definition of reference and non-reference offers and service description are unlikely to result in the achievement of the objective of encouraging efficient investment in and use of the NBN.

Implications of product withdrawal for incentives to set prices efficiently (the 'anchoring' effect)

The ACCC considers that, as further outlined in chapter 5, NBN Co may have incentives during the earlier years of the SAU term to change existing prices and set new prices in a manner that encourages efficient use of the NBN, due to the possibility that it will face 'revenue sufficiency risk'.

However, the ACCC also considers that these incentives may change over the SAU term. Once NBN Co's revenue sufficiency risk reduces, the provisions in the SAU will have important implications for NBN Co's incentives to change prices and set new prices in such a way as to encourage efficient use of the NBN.

In particular, the ability to withdraw non-reference offers could have implications for these incentives, as — especially for AVC and CVC product features — the prices of existing services are likely to 'anchor' the new prices that NBN Co is able to set, as well as its ability to change existing prices over time.

Where an AVC product feature is withdrawn, access seekers purchasing — and in turn, consumers of — the withdrawn services would have to either purchase a lower data rate service (possibly for a lower price) or a higher data rate service (possibly for a higher price) relative to that which they were previously purchasing — alternatively they might cease purchasing services over the NBN altogether.

The ability to shift demand onto higher data rate services by withdrawing lower data rate services might reduce NBN Co's incentives to price its services in such a way as to encourage voluntary take-up of higher data rate services.

In contrast, were NBN Co to price in such a way as to make it attractive for access seekers and consumers to shift their purchases towards higher data rate services, access seekers and consumers would transition voluntarily to the services on the basis of the attractiveness of the offer, as opposed to having to do so by virtue of there being no alternative. In turn, the prices of existing services would have an 'anchoring' effect on new prices, as well as on how NBN Co changes its existing prices, over time.

As another example, during Module 2, NBN Co would be able to (subject to ACCC approval) change the tiers of CVC capacity that are defined as reference offers.⁴³⁹ Once a particular tier of CVC capacity was no longer a reference offer, it would be able to be withdrawn.⁴⁴⁰ If NBN Co were to withdraw CVC tiers which offered small increments of capacity, access seekers would have to purchase CVC tiers which offer only large increments of capacity. Access seekers could hence potentially be required to purchase significantly more CVC capacity than they actually require to service the needs of their end-users. This is as opposed to NBN Co pricing its tiers of CVC capacity in such a way as to incentivise access seekers to purchase greater amounts of capacity (and similarly, to encourage end-users to consume more data).⁴⁴¹

Implications of reduced anchoring effect for incentives to invest efficiently

The ACCC considers that NBN Co's ability to withdraw services might reduce the degree of demand risk that NBN Co is subject to. This is because it could provide NBN Co with a heightened ability to 'shape' demand for each of its services, relative to if it could only rely on its pricing to do so.

Reduced demand risk would in turn be likely to reduce NBN Co's revenue sufficiency risk and, as outlined in chapter 5, the risk that NBN Co would not be able to recover the costs of its investment. Subsequently, the proposed price controls in the SAU (CPI-1.5 per cent on the prices of all services) may be less effective in creating incentives for NBN Co to invest and operate efficiently.

These issues are discussed further in chapter 5 of this Draft Decision.

Ensuring users only pay more for getting greater functionality or usage

During Module 2, the AVC data rate tiers which make up the Basic Access Offer (BAO) and Enhanced Access Offers (EAO) (which cannot be withdrawn) must be:

- (for the BAO) 'the UNI and an AVC...with the lowest data transfer rate which is likely to be acquired over the regulatory cycle by a material number of end-users...'; and⁴⁴²
- (for the EAO) 'a UNI and an AVC...with the data transfer rate which is likely to be most frequently acquired over the regulatory cycle...'.⁴⁴³

This means that AVC data rate tiers which:

- have a lower data rate than the BAO but which are not anticipated to have a 'material number of end-users' acquiring them; and
- have a data rate which is not anticipated to be the most frequently acquired data rate;

would be able to be withdrawn.

In addition, the 50/20 Mbps and 100/40 Mbps AVC services are not defined as reference offers in Module 1, and could hence be withdrawn during Module 1.

⁴³⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.2.1(a); Schedule 2B, clauses 2B.1.2(d) and 2B.2.4.

⁴⁴⁰ Ibid, Schedule 1C, clause 1C.2.1(a); Schedule 2B, clause 2B.1.2(d).

⁴⁴¹ The ACCC acknowledges that such a pricing approach could take the form of a discount based on the volume of CVC capacity purchased by the access seeker, and that such a discount could in turn have implications for competition in downstream markets, given the current shares of data traffic in those markets.

⁴⁴² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2B, clause 2B.2.1.

⁴⁴³ Ibid, Schedule 2B, clause 2B.2.2.

These services (those initially defined as the BAO and EAO, and the 50/20 Mbps and 100/40 Mbps services) are likely to represent those which are broadly equivalent to those being purchased by end-users over copper and HFC networks today.

The SAU therefore may not guarantee the ongoing supply of these services. In turn, current consumers of services provided over copper and HFC networks may not be guaranteed that if they do not wish to purchase higher data rate or quality services to what they purchase today, they will not have to. In turn, the SAU may not ensure that only those consumers that desire and are willing to pay for services that offer greater functionality than currently available over copper and HFC contribute more to the recovery of the costs of the NBN upgrade than those that do not desire such services.

The ACCC does not consider that there are likely to be substantial (if any) differences in the incremental or marginal costs associated with supplying, for example, a 12/1 Mbps AVC service versus a, for example, 100/1 (or higher) Mbps AVC service.⁴⁴⁴ That is, whilst — given the price of higher data rate AVC services — they might earn higher margins than lower data rate AVC services, it is unlikely that lower data rate AVC services could be considered 'loss-making' relative to the marginal costs of supplying them. Hence, the withdrawal of lower data rate AVC services could unlikely be justified on the grounds that ongoing provision of the service would result in losses to NBN Co.

'Anti-circumvention' provisions

The ACCC acknowledges that the SAU includes clauses which state that NBN Co will not:

- withdraw any product; and
- in conjunction with that product withdrawal, introduce any new product that is substantially similar to, or comparable with, the withdrawn product;

for the purpose of circumventing, or avoiding the operation of, the price control in the SAU.⁴⁴⁵

The ACCC is not satisfied that this clause as currently drafted would address all of the issues identified above. In particular, it would not prevent NBN Co from withdrawing products for the purposes of compelling access seekers and consumers to purchase already *existing* products. Further, it would need to be demonstrated that NBN Co's purpose in withdrawing a product and introducing a new one was to circumvent, or avoid the operation of, the price control. It is not clear how the ACCC or other parties would be able to demonstrate that NBN Co had this purpose in withdrawing a product and introducing a new one.

4.2.2.2. Promoting competition

Whether the withdrawal of particular products is likely to result in the achievement of promoting competition (or to detract from achieving that objective) is at this stage unclear. The ACCC notes that submissions did not express concerns that the withdrawal of products would detract from the achievement of this objective.

4.2.2.3. Summary

On balance of the issues discussed above, the ACCC's preliminary view is that the clauses in the SAU which allow NBN Co to withdraw non-reference offers and which define how the services that are reference offers will be changed over time are unlikely to promote the long-

⁴⁴⁴ Whilst there are likely to be different requirements in terms of the capacity of the NBN that is used in supplying each of these different AVCs — that is, whilst the provision of a 100/1 Mbps service would be likely to use more network capacity than the 12/1 Mbps AVC — NBN Co recovers these additional costs via its CVC charge.

⁴⁴⁵ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 11, clause 11.5.1; Schedule 2E, clause 2E.6.2.

term interests of end-users, when their interaction with the CPI-1.5 per cent price control is considered.

The Consultation Paper on the Notice to Vary therefore proposes amendments to the SAU to acknowledge that there will be a role for the ACCC in the process of withdrawing products. The primary purpose of this amendment would be to allow the ACCC to ensure that:

- NBN Co faces incentives to price its services in such a way as to promote take-up of higher functionality services and in turn promote efficient use of the NBN;
- the effectiveness of the CPI-1.5 per cent price control in the SAU in creating incentives on NBN Co to invest and operate efficiently is preserved; and
- current consumers of services provided over copper and HFC networks will not be made worse off as a result of the transition to the NBN.

4.2.2.4. Other clauses related to product withdrawal

As noted, the SAU also includes clauses which state that NBN Co will:

- provide written notice to customers of its intention to withdraw the service not less than 24 months for a product, product component, Ancillary Service or type of Facilities Access Service and not less than 12 months for a product feature — as well as notice of any arrangements to migrate customers to alternate services;⁴⁴⁶
- when considering whether to withdraw a product, product component, product feature or Ancillary Service or type of Facilities Access Service, have regard to a number of factors such as the level of existing demand, the cost of maintaining and supplying the service and the feasibility, commercial viability and price of alternatives;⁴⁴⁷ and
- discuss and consider in good faith any feedback received from its customers, and access seekers in some circumstances,⁴⁴⁸ in relation to the withdrawal.⁴⁴⁹

The ACCC's preliminary view is that these clauses are likely to some extent to result in the achievement of the objective of encouraging efficient use of and investment in infrastructure, as well as promoting competition, because:

- they ensure that access seekers will have sufficient time (and an equivalent amount of time) to plan to make changes to their business models and investments as a result of NBN Co's product withdrawal; and
- they require NBN Co to consider the interests of its customers in deciding whether or not to withdraw a product, in turn potentially reducing asymmetries in information about demand in retail markets.

The ACCC does however consider that the effectiveness of the commitments to notify customers of NBN Co intention to withdraw a product would be enhanced if NBN Co was also required to notify consumer advocacy groups. This would have regard to the interests of end-users that are using the products that are to be withdrawn, as it would allow these groups to raise concerns directly with NBN Co and/or retail service providers. The Consultation Paper on the Notice to Vary therefore proposes variations to this effect.

⁴⁴⁶ Ibid, Schedule 11, clause 11.5.2; Schedule 2E, clause 2E.6.3.

⁴⁴⁷ Ibid, Schedule 11, clause 11.5.2(b); Schedule 2E, clause 2E.6.3(b).

⁴⁴⁸ Ibid, Schedule 11, clause 11.3.1(b); Schedule 2E, clause 2E.4.1(b).

⁴⁴⁹ Ibid, Schedule 11, clause 11.5.2(c); Schedule 2E, clause 2E.6.3(c).

The ACCC also notes Optus and Telstra's submissions that the withdrawal of products as required by law or a Shareholder Minister, or which NBN Co is prohibited from providing under the *NBN Companies Act 2011*, should not be exempt from the product withdrawal commitments in the SAU, and concerns with the transitional arrangements for withdrawing products.⁴⁵⁰ The ACCC has not formed a view on these matters at this point in time and welcomes further submissions on the issues.

⁴⁵⁰ Telstra submission, p. 63; Optus submission (Public version), p. 110.

5. Price-related matters

This chapter sets out the ACCC's preliminary views about NBN Co's proposed approach to pricing in the SAU.

As outlined in chapter 2, the ACCC considers that the terms and conditions that the SAU requires NBN Co to include in SFAAs are terms and conditions about how NBN Co will engage in conduct relating to access. The ACCC must not accept the undertaking unless it is satisfied that these terms and conditions are reasonable.⁴⁵¹

5.1. Overview

The SAU contains initial prices for all product components, product features, types of ancillary services, types of facilities access services and other activities (referred to as 'other charges') for which prices were known at the time of SAU lodgement (some of which are priced at \$0).⁴⁵² Throughout this chapter, when referred to collectively, these products are described as 'services'.

The SAU classifies these services as 'reference offers', 'non-reference offers' or 'other charges'. As noted in section 4.2, services that are defined as reference offers are not able to be withdrawn,⁴⁵³ whilst services that are non-reference offers are able to be withdrawn.⁴⁵⁴ This is the case during both Module 1 and Module 2. The services that are defined as reference offers cannot be changed during Module 1, but may change during Module 2 (subject to ACCC approval).⁴⁵⁵ Once a service is no longer defined as a reference offer it becomes a non-reference offer, and can therefore be withdrawn.

The prices of the services that are initially defined as reference offers will be fixed in nominal terms until 30 June 2017,⁴⁵⁶ after which time they will be subject to price controls which will limit the allowable annual price increase to CPI-1.5 per cent.⁴⁵⁷ The prices of the services that are defined as non-reference offers will be subject to the price controls from the first year of the SAU term.⁴⁵⁸ The CPI-1.5 per cent price control operates during both Module 1 and Module 2.⁴⁵⁹

The manner in which new prices — for new services and for currently zero-priced services — will be determined varies depending on the nature of the service. (Once determined, the initial price will be subject to the price controls.) The SAU establishes that the ACCC will generally not (other than in its current assessment of the SAU) have an 'upfront' role in assessing or approving new prices.

⁴⁵¹ As noted in chapter 2, the ACCC considers that these terms and conditions are not terms and conditions in relation to the SAOs referred to in subsection 152CBA(3A) of the CCA. That said, for the purposes of assessing these terms and conditions, the ACCC must have regard to the same matters (that is, the matters set out in section 152AH) as it would if these terms and conditions were terms and conditions in relation to the SAOs.

⁴⁵² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.3; Schedule 1D, clause 1D.3.

⁴⁵³ *Ibid*, Schedule 1C, clause 1C.1.2.

⁴⁵⁴ *Ibid*, Schedule 1I, clause 1I.1.2.

⁴⁵⁵ *Ibid*, Schedule 2B, clause 2B.2.

⁴⁵⁶ *Ibid*, Schedule 1C, clause 1C.3.1.

⁴⁵⁷ *Ibid*, Schedule 1C, clause 1C.4.

⁴⁵⁸ *Ibid*, Schedule 1D, clause 1D.4.1.

⁴⁵⁹ *Ibid*, Schedule 1C, clause 1C.4.1; Schedule 1D, clause 1D.4.1; Schedule 2C, clause 2C.2.1.

The SAU also contains a long-term revenue constraint methodology, which is based on the building block methodology often adopted in regulating utilities, but which also includes an 'initial cost recovery account'.⁴⁶⁰

The long-term revenue constraint methodology is aimed at providing assurance to NBN Co that it will not be precluded by the SAU from being able to recover its efficient costs of supply over the term of the SAU (including a normal commercial return), and to access seekers that NBN Co will be able to recover no more than this.

The long-term revenue constraint methodology will be applied to determine 'annual revenue requirements' which represent the amount of revenue that NBN Co would be required to earn to recover its annualised costs (including a return on capital) in a particular year.⁴⁶¹

NBN Co assumes that for a period of time, given the levels of its initial prices, the expected low initial take-up of the NBN and the proposed price controls, it will be unlikely to earn sufficient revenues to meet its annual revenue requirements (hereafter described as the 'loss accumulation phase'). The SAU establishes that any such revenue shortfalls will be included in an initial cost recovery account.⁴⁶²

NBN Co also expects that it may at some point during the SAU term become able to earn sufficient revenues each year to meet its annual revenue requirement. At that point, the SAU establishes that NBN Co will be permitted to recover more than its annual revenue requirement in each year until such time as the accumulated revenue shortfalls in the initial cost recovery account reduce to zero (hereafter referred to as the 'loss recovery phase').⁴⁶³

Once the accumulated revenue shortfalls have been recovered and the initial cost recovery account reaches zero, the SAU establishes that NBN Co will set prices in such a way as to only recover its annual revenue requirements (hereafter referred to as the 'revenue cap phase') during the remainder of the term of the SAU.⁴⁶⁴

The ACCC understands that it is NBN Co's intention that throughout the above described three periods — the loss accumulation phase, the loss recovery phase and the revenue cap phase — whether the CPI-1.5 per cent price control takes precedence in constraining NBN Co's prices over the annual revenue requirements varies. That is:

- Whilst NBN Co is in the loss accumulation and loss recovery phases, even if setting prices up to the maximum allowed by the price controls prevented NBN Co from earning enough revenue to recover its accumulated revenue shortfalls, it would still not be able to increase prices above the price controls.
- Whilst NBN Co is in the revenue cap phase, its prices will be set to only allow it to recover its annual revenue requirements. So, if setting prices up to the maximum level allowed by the price controls were to allow NBN Co to earn more than its annual revenue requirements, NBN Co would be required to reduce prices below those allowed for by the price controls in order to reduce its revenues and comply with the revenue requirements.

The ACCC notes that the SAU drafting is not clear on this matter and it has hence proposed in the Consultation Paper on the Notice to Vary that an amendment be made to the SAU to clarify that this is the case.

⁴⁶⁰ Ibid, Schedule 1F.

⁴⁶¹ Ibid, Schedule 1F, clause 1F.3.1.

⁴⁶² Ibid, Schedule 1F, clause 1F.4.

⁴⁶³ NBN Co Supporting submission, pp. 15-16.

⁴⁶⁴ Ibid, pp. 15-16.

5.2. Views of interested parties on overall pricing approach

NBN Co states that the key objectives of its overall pricing approach in the SAU include uniform national wholesale pricing, long-term cost recovery (providing the opportunity to recover prudently incurred costs over time, including an appropriate return on capital), price stability and predictability (striking a balance between pricing certainty for access seekers and pricing flexibility for NBN Co), and encouraging the economically efficient take-up and usage of NBN Co's products.⁴⁶⁵

NBN Co has submitted two expert reports on the pricing methodology in the SAU, one by Synergies Economic Consulting and one by Ordovery and Champagne.

Synergies states that the pricing mechanisms in the initial regulatory period (that is, during Module 1) can be expected to deliver efficient outcomes for the following reasons:

- the initial reference offer prices are set at levels consistent with similar services from alternative technologies, and are therefore consistent with the prices one might expect from a workably competitive market;
- the reference offers are consistent with NBN Co recovering its prudent operating and investment costs only;
- the initial fixed price period for the reference offers followed by clearly specified maximum price increases after July 2017 provides certainty that should allow NBN Co's customers to make complementary investments necessary to maximise take-up and utilisation of the NBN;
- year-on-year price increases of the reference offers are constrained to CPI-1.5 per cent, which limits the likelihood of inefficient 'hold-up' from unexpected price increases; and
- the SAU allows NBN Co additional but safeguarded pricing flexibility (such as temporary discounts), which can deliver allocative and productive efficiency benefits.⁴⁶⁶

Synergies states that the replacement module approach in the subsequent regulatory period (that is, following the expiry of Module 1) can be expected to deliver efficient outcomes because:

- it helps to ensure that the NBN is not encumbered by out-dated services that are provided solely because they are preserved by the regulatory arrangements;
- it fosters dynamic efficiency by subjecting hitherto guaranteed offers to consideration for withdrawal if they are no longer appropriate, and replacing them with superior, more widely accepted services;
- it provides that where the composition of a reference offer is to be updated, the services that make up the old reference offer will become a non-reference offer; and

⁴⁶⁵ Ibid, p. 99.

⁴⁶⁶ Synergies Economic Consulting, *Advice on NBN Co Ltd's Special Access Undertaking*, September 2012, p. 5. (Synergies Economic Consulting report)

- it promotes productive efficiency by allowing NBN Co (and potentially NBN Co's customers) to reduce costs associated with NBN Co's services that are no longer relevant to current market needs, while addressing the concerns of any remaining customers using such services in making any decision to withdraw the product.⁴⁶⁷

Ordover and Shampine consider that NBN Co's pricing methodology will generate incentives for NBN Co to price in a manner which encourages take-up of services and the development of downstream markets.⁴⁶⁸ This is because the reference offers and non-reference offers provide explicit assurances to potential customers that future prices for an extensive list of services will not exceed specified prices.⁴⁶⁹ Furthermore, Ordover and Shampine consider that the long-term revenue constraint methodology will provide appropriate incentives for investment by NBN Co because the revenue cap will include the allowed return on previous and planned investment, which offers assurance that the investment will not be expropriated.⁴⁷⁰

The key themes which emerged from submissions from other interested parties are as follows:

- NBN Co's overall pricing approach does not provide strong incentives for NBN Co to incur or recover its costs in an efficient manner — in particular, the prudence provisions are ineffective and difficult to enforce;⁴⁷¹
- the price controls are likely to be the only constraint on NBN Co's prices during the SAU term;⁴⁷²
- the initial pricing principles do not provide an adequate constraint on NBN Co's ability to set new prices and charges;⁴⁷³ and
- the ACCC should have a role to periodically review NBN Co's prices and pricing structures, which may not otherwise remain reasonable over the entire SAU period.⁴⁷⁴

5.3. Framework for assessment

As noted, the ACCC must be satisfied that the price-related terms and conditions are reasonable. In determining whether this is the case, the ACCC has had particular regard to:

- whether the terms and conditions promote the long-term interests of end-users — particular regard has been had to the extent to which the terms and conditions are likely to result in the achievement of the following objectives:
 - promoting competition in markets for listed services;⁴⁷⁵ and
 - encouraging the economically efficient use of, and economically efficient investment in, the infrastructure by which the listed services are supplied.⁴⁷⁶

⁴⁶⁷ Ibid, p. 6.

⁴⁶⁸ Ordover and Shampine report, p. 22 and p. 25.

⁴⁶⁹ Ordover and Shampine report, p. 24.

⁴⁷⁰ Ordover and Shampine report, p. 16.

⁴⁷¹ Optus submission (Public version), p. 41; Telstra submission, p. 14; Macquarie Telecom submission, p. 18; Nextgen Networks submission, p. 16.

⁴⁷² Optus submission (Public version), p. 57; Letter from NBN Co to ACCC, *Response to NBN Co SAU request for further information*, 15 February 2013, p. 4.

⁴⁷³ Macquarie Telecom submission, p. 14; Nextgen Networks submission, p. 16; Optus submission (Public version), p. 83; Telstra submission, p. 13.

⁴⁷⁴ Nextgen Networks submission, p. 13; Macquarie Telecom submission, p. 13.

⁴⁷⁵ CCA, s. 152AB(2)(c).

⁴⁷⁶ CCA, s. 152AB(2)(e).

- the legitimate business interests of NBN Co and its investment in facilities used to supply the declared service concerned;⁴⁷⁷
- the interests of persons who have rights to use the declared services;⁴⁷⁸
- the direct costs of providing access to the declared service concerned;⁴⁷⁹
- the operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility;⁴⁸⁰
and
- the economically efficient operation of a carriage service, a telecommunications network or a facility.⁴⁸¹

The approach adopted by the ACCC in taking these matters into account is outlined in section 1.3 of this Draft Decision. This section of the Draft Decision applies that approach to NBN Co's proposed price-related terms and conditions.

Of note, in this context, the ACCC refers to a 'constrained efficiency' — that is, the ACCC is not considering the efficiency of the Government's directions to NBN Co about the infrastructure that NBN Co should build, the services that it should supply, and the timeframe in which this should be done. Rather, it is considering whether the implementation of that policy is efficient.

5.3.1. Incentives faced throughout the SAU term

The ACCC acknowledges that NBN Co may, for some periods throughout the SAU term, face incentives that differ in some ways from those of other utilities regulated by the ACCC and the AER. As outlined above, the ACCC considers that the following three phases may occur during the SAU term:

- A loss accumulation phase — this phase is characterised by NBN Co not being able to earn sufficient revenues to recover its annualised prudent costs, including a normal commercial return. This phase would end when NBN Co is able to begin earning revenues that consistently exceed its annual revenue requirement — the ending of the phase would be characterised by the value of the initial cost recovery account reaching its maximum level.
- A loss recovery phase — this phase would be characterised by NBN Co being able (and permitted) to earn revenues in excess of its annual revenue requirement. This would in turn result in the value of the initial cost recovery account reducing. This phase would end when the initial cost recovery account reaches zero, indicating that NBN Co would have recovered the revenue shortfalls that occurred during the loss accumulation phase (inclusive of a return that accounts for this delay in recovery).
- A revenue cap phase — this phase would be characterised by NBN Co being able to and limited to earning its annual revenue requirement.

It is possible that NBN Co could have different incentives during each of these phases.

During the loss accumulation phase, NBN Co may be more likely of its own accord to invest in and operate its network efficiently and to encourage efficient use of its network.

⁴⁷⁷ CCA, s. 152AH(1)(b).

⁴⁷⁸ CCA, s. 152AH(1)(c).

⁴⁷⁹ CCA, s. 152AH(1)(d).

⁴⁸⁰ CCA, s. 152AH(1)(e).

⁴⁸¹ CCA, s. 152AH(1)(f).

This could be the case if, during this phase, NBN Co perceives that it faces what it describes as ‘revenue sufficiency risk’. This perception of revenue sufficiency risk could arise if NBN Co faces a high degree of ‘demand risk’ (that is, uncertainty as to the take-up of its services),⁴⁸² and it makes strong commitments about limiting its price increases over time. To the extent that this results in NBN Co facing a risk that it will not be able to recover the costs of its investment (including a normal commercial return), this could create incentives for NBN Co to both invest and operate efficiently, and for it to price its services in such a way as to encourage end-users to increase their use of the NBN.

Having said this, if the price commitments are too restrictive, this could mean that NBN Co is never able to recover its costs, regardless of how demand ultimately develops. This could, in turn, create incentives for NBN Co to under-invest and under-spend on operations and maintenance, which could result in the delivery of lower quality services, a slowing down of the network rollout and the safety and reliability of the network being compromised.

On the other hand, if the price controls are not restrictive enough, this could mean that NBN Co does not actually face revenue sufficiency risk; and that its accumulation of losses during its early stages of operations simply reflects differences in the timing of cash outflows and inflows. If this were the case, the price commitments might not create the aforementioned incentives to invest, operate and price efficiently.

Similarly, if the aforementioned ‘demand risk’ is not present, or once it has diminished over time, NBN Co would be unlikely to face revenue sufficiency risk; in turn, the aforementioned incentives to invest, operate and price efficiently might be weakened. In this regard, the ACCC highlights the view that it expresses in section 4.1.2 of this Draft Decision — the ability for NBN Co to withdraw services and compel access seekers and consumers to purchase higher data rate products (be they AVC data rate tiers or tiers of CVC capacity) could reduce the level of demand risk that NBN Co is subject to. This is because it provides NBN Co with a heightened ability to ‘shape’ demand for each of its services, relative to the case where it could only rely on its pricing to do so.

If, or once, NBN Co does not face revenue sufficiency risk (be it driven by demand uncertainty or the price controls), its incentives are likely to more closely reflect those of other utilities regulated by the ACCC and AER, and the types of regulatory approaches typically adopted to create incentives to invest, operate and price efficiently are likely to be required.

The ACCC considers that whether or not NBN Co is accumulating losses could give an indication of whether or not NBN Co is likely to be facing revenue sufficiency risk. Similarly, the point in time at which the initial cost recovery account peaks could give an indication that any revenue sufficiency risk it had faced has begun to reduce, or has reduced entirely.

5.3.2. Results of ACCC analysis of cost, demand and prices

On 29 January 2013, the ACCC requested that NBN Co provide information to the ACCC about its forecasts of prices, demand, revenues and costs. NBN Co provided this information to the ACCC on 15 February 2013.⁴⁸³ The ACCC has analysed this information in order to inform itself about broadly when the initial cost recovery account is expected to peak, and in turn about when any revenue sufficiency risk that NBN Co had faced is reduced.

The ACCC recognises that this is a forward-looking exercise — the conclusions that can be drawn from the information are highly sensitive to the assumptions that are made about the

⁴⁸² That is, in terms of the number of end-users connecting to the NBN, the amount of data they wish to download and at what data rate, how much they are willing to pay for these things, and how their purchasing behaviour changes in response to changes in price.

⁴⁸³ Available on the ACCC website at www.accc.gov.au

costs that will be incurred in different periods of the SAU, price changes over time and the response of demand to those price changes (that is, assumptions about demand elasticities). In the information provided, NBN Co has made assumptions about the following matters:

- That the costs are mostly fixed in both the short- and long-term due to the nature of the rollout. Significant levels of forecast capital expenditure after the network rollout are forecast, and are due to ongoing costs associated with greenfields expansion and asset replacement.⁴⁸⁴
- It has made assumptions about the average access speeds and usage over time that customers will demand and, using assumptions about willingness to pay for various access speed tiers, has forecast prices that would result in this level of demand being realised.⁴⁸⁵

These assumptions may or may not be an accurate reflection of the costs that NBN Co actually ultimately incurs over the term of the SAU, and how demand actually eventuates. In turn, the initial cost recovery account could actually peak at different times to those suggested by the ACCC's modelling exercise.

The ACCC's analysis of the information provided by NBN Co has found that:⁴⁸⁶

- Under the 'best case scenario' modelled by the ACCC, it may be possible that the loss accumulation phase could end as soon as {CIC} if NBN Co was able to increase its prices by the maximum permitted by the CPI-1.5 per cent price control in each year, whilst maintaining a level of demand that is consistent with the assumptions in NBN Co's Corporate Plan. Thus, under this scenario, a considerable amount of any revenue sufficiency risk that NBN Co had faced would reduce by around {CIC}.
- Under other scenarios, any revenue sufficiency risk faced by NBN Co would likely reduce {CIC}. If NBN Co's assumptions about demand levels and price changes made in the Corporate Plan were to be realised, the loss accumulation phase would end {CIC}.
- There are a range of possible alternative outcomes. For example, if forecast expenditure is reduced by 10 per cent in each year, the loss accumulation phase would end by {CIC}. Similarly, if forecast demand for the higher AVC speed tiers and usage is increased by 10 per cent in each year, the loss accumulation phase would end {CIC}.

In summary, the exact periods during the SAU term when NBN Co will be in each of the three phases outlined above, and when its initial cost recovery account will peak, are not known with certainty at this time. In any case, the ACCC's analysis suggests that NBN Co will be in the loss accumulation phase, and likely to be facing uncertainty around revenue sufficiency as a result of demand risk {CIC}. The point when NBN Co will move from the loss accumulation phase into the loss recovery phase (at which point its revenue sufficiency risk is assumed to have reduced) is uncertain and will depend on actual expenditure and demand outcomes. Depending on the assumptions made about future expenditure and demand, this point may occur {CIC}.

⁴⁸⁴ Letter from NBN Co to ACCC, *Re NBN Co Special Access Undertaking – Request for further information*, 20 March 2013, p. 4.

⁴⁸⁵ *Ibid.*, p. 3.

⁴⁸⁶ It should be noted that the ACCC has not examined the assumptions and methodologies that are set out in NBN Co's *Corporate Plan* in order to reach a view about whether the *Corporate Plan* outcomes are likely to occur. This is because the ACCC's role is not to assess whether the SAU guarantees that the outcomes forecast in the *Corporate Plan* are delivered; rather, the ACCC's role is to assess whether it is satisfied that the SAU will promote the long-term interests of end-users and is reasonable.

The ACCC considers that its findings mean that the approach to regulated pricing must be suitably flexible to adapt to a range of possible future scenarios.

5.3.3. Principles for regulating NBN Co's pricing

The ACCC has developed a set of principles, which if met by NBN Co's proposed pricing approach, are likely to satisfy the ACCC that the price-related terms and conditions are reasonable. These principles are as follows.

Firstly, end-users should not be made worse off by virtue of their migration to the NBN — this means that:

- for the term of the SAU, there should be functionally equivalent services supplied over the NBN to those currently being supplied over Telstra's fixed-line copper network and Telstra's and Optus' HFC networks; and
- during the rollout period (Module 1), the prices for those services should be comparable to the equivalent copper or HFC service in order to ensure that there is no price shock associated with migrating to the NBN.

The ACCC considers that if these conditions are met, efficient use of the NBN is likely to be encouraged. This is because:

- Assuming that use of the copper and HFC networks is efficient, any increase in the price that access seekers must pay to receive a particular functionality on migrating to the NBN has the potential to decrease use of the NBN below an efficient level.
- In ensuring that for the SAU term, access seekers are able to provide services to current end-users of a similar functionality to what they receive today, these access seekers, and in turn their end-users, will only purchase services of a higher quality (in terms of higher data rates or better quality traffic classes) if the price of those services makes them want to do so. This could in turn create incentives for NBN Co to price in such a way as to encourage greater use of its higher quality services. Were access seekers, and their end-users, compelled to purchase higher quality services by virtue of their existing services being withdrawn, as noted in section 4.2, they might reduce their use of the NBN relative to their current usage, or cease purchasing services altogether. Further, NBN Co's incentives to price its new services in such a way as to encourage their take-up could be reduced.
- By ensuring that access seekers, and their end-users, that do not wish to pay higher prices for higher quality services are not forced to do so, end-users that do value higher quality services will bear proportionally more of the costs of the NBN upgrade. To the extent that this results in those users who highly value the greater capabilities of the NBN relative to the copper and HFC networks contributing more towards the recovery of the costs of investing in the NBN, efficient use of the network is more likely to be encouraged. Further, NBN Co's ability to recover its costs will depend on it pricing its higher quality services in such a way as to encourage their take-up.

Secondly, NBN Co must expect to be able to recover its efficient costs of investing in the network, including a normal commercial return given the risks associated with the investment, as well as the efficient costs of operating and maintaining the network in a safe and reliable manner. This is not to say that NBN Co should be guaranteed recovery of its efficiently incurred costs — but rather that, subject to it investing and operating efficiently, and subject to adequate demand for its services developing, it should expect to have the opportunity to recover these costs. This expectation would provide NBN Co with an appropriate incentive to maintain, improve and invest in the efficient provision of services. Were it to expect to be compensated

for less than its efficient costs (including a normal commercial return given the risks of the investment), it may not be able to fund the capital investments that are needed to provide services that access seekers and end-users demand and are willing to pay for, and deliver upon the Government's expectations. On the other hand, were NBN Co to be compensated for more than its efficient costs (including a normal commercial return given the risk of the investment), it may have incentives to over-invest in capital and inflate its regulatory asset base. In such circumstances, NBN Co might not be delivering on the Government's expectations in the most productively efficient way possible.

Finally (and related to the above), NBN Co should face incentives to invest and incur expenditure in an efficient manner. This means that the SAU should include a mechanism, or package of mechanisms, that create incentives for it to not over-spend in delivering the Government's policy objectives (and which are appropriate in the context of NBN Co's operating environment).

As noted, as an overarching point, the approach must also be suitably flexible to ensure that the most appropriate regulatory pricing approach is in place for the context that NBN Co is operating in at different points in time throughout the SAU term.

If these principles are met, the ACCC is more likely to be satisfied that the proposed price-related terms and conditions are reasonable.

The rest of this chapter provides the ACCC's assessment of whether or not these principles are met, and in turn, whether or not it is satisfied that the price-related terms are reasonable. The chapter is structured as follows:

- Section 5.4 provides the ACCC's preliminary views about NBN Co's proposals for how its prices will be set for individual products over the SAU term:
 - section 5.4.1 provides the ACCC's views on the initial prices that are included in the SAU;
 - section 5.4.2 provides the ACCC's views on the commitments in the SAU about how these prices will change over time and how new prices will be introduced;
 - section 5.4.3 provides the ACCC's views on the proposed approach to dealing with tax change events; and
 - section 5.4.4 provides a summary of the ACCC's views on the pricing of individual services.
- Section 5.5 provides the ACCC's preliminary views about the long-term revenue constraint methodology (including prudency commitments), as follows:
 - section 5.5.1 provides the ACCC's views on the long-term revenue constraint methodology during Module 1;
 - section 5.5.2 provides the ACCC's views on the long-term revenue constraint methodology during Module 2; and
 - section 5.5.3 summarises the ACCC's views on the long-term revenue constraint methodology.
- Section 5.6 provides the ACCC's preliminary views about whether the price-related terms and conditions are reasonable.

5.4. Prices for individual products

This section provides the ACCC's preliminary views about NBN Co's proposals for how its prices will be set for individual products over the SAU term.

5.4.1. Initial price levels

The SAU contains initial prices for all product components, product features, types of ancillary services, types of facilities access services and other activities (referred to as 'other charges') for which prices were known at the time of SAU lodgement (some of which are priced at \$0).⁴⁸⁷

This section considers whether these initial prices are reasonable. (How these initial prices change over time is considered in section 5.4.2.)

As noted in section 5.3, the ACCC considers that end-users should not be made worse off by virtue of their transition to the NBN. In terms of initial prices, this means that for services for which there is a copper or HFC based functional equivalent, it is desirable that the price of the NBN service is comparable to that of the copper or HFC service, in order to ensure that there is no 'price shock' for an end-user as it migrates to the NBN. The ACCC has therefore assessed the initial prices included in the SAU to determine whether, for services for which there is a copper or HFC-based equivalent, the price of that service is broadly comparable to the copper or HFC-based equivalent. To the extent that this is the case for the price of a service, the ACCC is satisfied that this price is reasonable.

The ACCC also considers that NBN Co should have some flexibility in setting prices for services for which there is no copper or HFC-based equivalent. The ACCC provides its views on what this means for its assessment of the initial prices of services for which there is no copper or HFC-based equivalent below. Broadly however, in the context of pricing these kinds of services within an overall revenue cap — and in circumstances where NBN Co faces revenue sufficiency risk in particular — the ACCC considers that providing flexibility to NBN Co to set initial prices for these services should generally encourage the economically efficient investment in and use of infrastructure. Such flexibility should provide incentives for investment by providing a greater share of the value created through product innovation in respect of particular products to NBN Co, while balancing these incentives with efficient use of infrastructure within an overall revenue cap. Consequently, the ACCC is generally satisfied that providing flexibility to NBN Co to set initial prices for services for which there is no copper or HFC-based equivalent will promote the long-term interests of end-users.

As noted in section 5.4.1.1, NBN Co submits in support of the initial prices set out in the SAU that they are the result of an extended process of consultation with customers and are therefore reasonable.⁴⁸⁸ While the ACCC recognises the importance of engagement between access providers and access seekers on pricing (as well as other aspects of access), it does not follow that reasonable prices necessarily result from such processes. In relation to a small number of specific initial prices included in the SAU, the ACCC is not satisfied on the information currently before it that the proposed initial prices are reasonable. The ACCC is seeking further views about these particular initial prices. These particular initial prices are listed at Attachment B to this Draft Decision.

The ACCC notes that the SAU includes a large number of initial prices for reference offers, non-reference offers and other charges. These initial prices are listed in Attachment A to this Draft Decision. The ACCC has added numbers to the tables and lists of services that are included in Attachment A in order to assist in the readability of the following section, and the identification of the specific services that are being discussed.

⁴⁸⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.3; Schedule 1D, clause 1D.3.

⁴⁸⁸ NBN Co Supporting submission, p. 110.

5.4.1.1. Submissions

NBN Co submits that:

- the initial prices for its services provide for a smooth transition from legacy services to the NBN on a like-for-like product basis;⁴⁸⁹
- the initial prices set out in the SAU are designed to allow customers to provide a smooth transition for end-users to the NBN and to develop compelling offers that make use of the NBN's greater capability relative to the legacy network;⁴⁹⁰
- its pricing strategy should allow it 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);⁴⁹¹
- its initial prices set out in the SAU conform with a range of relevant 'pricing standards', including lying between marginal and stand-alone costs, recovering fixed and common costs (taking into account differences in willingness to pay for different products), being set on an expectation of future price and demand evolution, and providing for a smooth transition from legacy services to the NBN;⁴⁹²
- the initial prices set out in the SAU are the result of an extended process of consultation with customers;⁴⁹³ and
- the intent of the reference offers is to provide greater stability and predictability for access seekers regarding a selection of products that will be most significant for end-users to connect to the NBN.⁴⁹⁴

Optus submits that:

- the initial price structure and levels in the SAU means that purchasers of some existing products will face significantly higher prices for the same functionality than under legacy networks.⁴⁹⁵ {Optus CIC}⁴⁹⁶
- the best efforts traffic class (TC- 4) AVC provided for in the standard business offer is not sufficient for business grade services and therefore is inconsistent with NBN Co's stated intention of ensuring a smooth transition to the NBN.⁴⁹⁷ In particular, the provision of best-efforts bitstream is not sufficient to supply business-grade services. Current business services contain a committed minimum bitstream rate. A particular set of NBN product components to replicate existing business-grade services will result in higher prices over the NBN.⁴⁹⁸ {Optus CIC}⁴⁹⁹
- there is no evidence that the initial prices levels will promote a smooth transition to the NBN;⁵⁰⁰

489 Ibid, pp. 109-110.

490 Ibid, p. 108.

491 Ibid, p. 100.

492 Ibid, pp. 109-110.

493 Ibid, p. 110.

494 Ibid, p. 102.

495 Optus submission (Public version), p. 89.

496 Ibid (Confidential version), p. 99.

497 Ibid (Public version), pp. 100-101.

498 Ibid, p. 100.

499 Ibid Confidential version), p.101.

500 Ibid (Public version), p. 95.

- there has been no consultation or assessment on the methodology used to calculate initial prices;⁵⁰¹ and
- multicast prices will inhibit the development of multicasting. Before RSPs can justify use of NBN Co's multicast product they must have a "critical mass of subscribers".⁵⁰² The key concern for RSPs is what that critical mass is and what content is needed to achieve it.⁵⁰³ {Optus CIC}⁵⁰⁴

Macquarie Telecom submits that the initial set of reference offers are sufficient to allow access seekers to provide entry-level residential and business grade services to end-users, but argues that the AVC (TC-1) pricing for voice services puts ISDN and SIP trunk pricing above current market levels for equivalent services.⁵⁰⁵

There were no concerns raised by other interested parties on the level and structure of initial prices in the SAU.

5.4.1.2. Preliminary ACCC views — services for which there is a current copper or HFC equivalent

The SAU includes both reference and non-reference offers. Typically, the reference offers represent services that appear to be broadly equivalent to copper or HFC-based services that are currently available to end-users (that is, end-users may be able to obtain peak data rates today that are broadly equivalent to these services supplied over the NBN). However, there are also non-reference services that appear to be broadly equivalent to services that end-users are currently able to obtain over copper and HFC networks. This section considers the prices set out in the SAU for these kinds of services, and the 'other charges' set out in the SAU that are closely related to these services.

As noted, the ACCC has considered whether end-users will be able to obtain comparable NBN services at prices that are broadly equivalent to the prices of existing services supplied over copper and HFC networks, in order to reach a view about whether the prices that are specified by the SAU are reasonable.

However, the ACCC recognises that direct comparisons of the functionality and prices of NBN Co's services with the functionality and prices of copper and HFC-based access/wholesale services are not straightforward.

For example, differences in functionality between NBN Co's services and copper based services arise from:

- there being different numbers of POIs for the Unconditioned Local Loop Service (ULLS) (around 570), the wholesale ADSL service (14) and the NBN Access Service (121) — the access services therefore cover different geographic distances, from the relatively short (the ULLS) to the much longer (wholesale ADSL), and have different costs relating to transmission and interconnection associated with them.
- the services being provided at different 'layers' — the ULLS is a Layer 1 service, therefore the access seeker installs its own digital subscriber line access multiplexer (DSLAM) equipment in the Telstra exchange. Conversely, the NBN Access Service is provided at Layer 2, therefore the access seeker does not install any DSLAM equivalent electronics⁵⁰⁶ at the POI. Further, the

⁵⁰¹ Ibid, pp. 93-94.

⁵⁰² Ibid, p. 97.

⁵⁰³ Ibid, p. 97.

⁵⁰⁴ Ibid (Confidential version), p. 98.

⁵⁰⁵ Macquarie Telecom submission, p. 12.

⁵⁰⁶ The DSLAM equivalent in NBN Co's fibre network is known as an Optical Line Terminal (OLT).

Wholesale ADSL service provides some functionality over and above that of the NBN Access Service or the ULLS — such as authentication of users or devices before granting them access to the network.⁵⁰⁷

These differences have implications for the degree of investment required by the access seeker in its own infrastructure (for example, in DSLAMs and optical line terminals (OLTs)), as opposed to it relying on the access provider's network.

Further, the peak data rate that is available to a particular end-user over the copper network tends to be dependent on that end-user's physical distance from the exchange, and the quality of the network infrastructure that is being used to supply the service to that end-user.

In addition, there are differences between the network architectures used to deliver NBN services and those used to deliver copper-based services, which results in somewhat different cost structures for NBN and copper-based services.

Hence, whilst there may appear to be some differences between the price of an NBN service and its copper or HFC-based access/wholesale equivalent, this may reflect differences in the functionality and cost structure associated with the service.

Similarly, there may be some differences between services supplied over the NBN and existing HFC networks, as follows:

- services supplied over HFC networks may not be available in all the areas where the NBN will offer similar peak data rates to HFC;
- services offered over the NBN typically have higher upload speeds relative to services offered over HFC networks;
- HFC services tend not to be sold at the wholesale level; and
- some segments of HFC networks may not be capable of providing services up to 100 Mbps.

Consequently, the ACCC has considered a range of factors in the following section to assess whether the prices set out in the SAU in relation to services for which there is a current copper or HFC-based service are equivalent (and therefore reasonable).

The ACCC notes that the Basic Access Offer, the Enhanced Access Offer, and the 25/10 asymmetric AVC offer (item 24 of Attachment A) appear to allow access seekers to supply services that are broadly equivalent (at least in terms of downstream peak data rates) to those currently available to end-users over the copper network. The ACCC considers that the price specified by the SAU (between \$24 and \$30 per month per service in operation) should allow end-users to obtain services over the NBN at prices that are broadly equivalent to comparable services that are supplied over the copper network when considering:

- that these prices are broadly equivalent to the monthly charges per end-user specified by the ACCC in the draft Final Access Determination for the Wholesale ADSL service (which specifies prices between approximately \$25 and \$31),⁵⁰⁸ especially in light of the fact that customers must also have an active voice service in order to purchase wholesale ADSL;⁵⁰⁹

⁵⁰⁷ Telstra, *Response to the Commission's Issues Paper (a second discussion paper) into the public inquiry to make a final access determination for the wholesale ADSL service – witness statement*, 24 August 2012, pp. 10-11.

⁵⁰⁸ ACCC, *Public enquiry to make a final access determination for the Wholesale ADSL service: draft report – public version*, March 2013, Schedule 1, p. 1.

⁵⁰⁹ *Ibid.*, p. 101.

- the additional functionality provided by the NBN services (for example, higher upstream data rates) that may be valued by some end-users; and
- that, based on a comparison of recent ADSL2+ retail prices for entry-level bundled voice and data services (inclusive of line rental) with retail services provided over the NBN, it appears that retail prices over the NBN will be broadly similar to prices for services available today. In particular, the ACCC has compared the prices for entry-level bundled phone and internet services from four key retail service providers (Telstra, Optus, iiNet and Primus). Current ADSL2+ prices (as of 6 February 2013) range from \$59 to \$62, while current retail offers over the NBN from the same suppliers range from \$44.50 to \$70.⁵¹⁰

The ACCC notes that submissions from interested parties do not express views as to whether the initial prices for these services are reasonable or otherwise.

The \$38 price for the 100/40 asymmetric AVC offer (item 26 of Attachment A) is \$11 above the \$27 price for the Enhanced Access Offer — this appears to be similar to the additional amount charged for high data rate services supplied over HFC networks.⁵¹¹ As the \$34 price for the 50/20 asymmetric AVC offer (item 25 of Attachment A) is also within this range, it also appears to permit access seekers to supply services over the NBN to end-users that are broadly equivalent to prices for comparable services currently supplied over HFC networks.

In relation to TC-4 CVC charges (items 3 to 16 of Attachment A), the ACCC considers that the price specified by the SAU (\$20 per megabit per second per month) should result in end-users obtaining services over the NBN at prices that are broadly equivalent to comparable services supplied over copper and HFC networks when considering the following:

- The analysis of recent ADSL2+ retail prices set out above.
- That it is a considerably lower price than the aggregating virtual circuit charge specified by the draft Final Access Determination for the Wholesale ADSL service (of \$33.65 per megabit per second per month).⁵¹² (The ACCC does however note that there are material differences between the CVC service and the AGVC service, including the distance over which the service is provided and whether the service includes interconnection at the port at the handover point between the access network and the transmission network.)
- The rebates for TC-4 CVC charges that are set out in clause 1C.4.2(a) of Schedule 1C, which may allow access seekers to provide services to end-users that are broadly equivalent to current services without attracting substantial, if any, CVC charges per end-user while these rebates are in effect.

The ACCC notes that submissions from interested parties do not express views as to whether the initial CVC price of \$20 per megabit is reasonable or otherwise.

The SAU also specifies prices for a range of different CVC 'capacity tiers' and traffic classes. However, all CVC capacity tiers and traffic classes specified by the SAU adopt a monthly \$20

⁵¹⁰ Current ADSL2+ prices: Telstra Elite; Optus classic phone and broadband bundle; iiNet ADSL2+ home-1 with phone-1; Primus ADSL2+ starter plus – available from the providers' respective websites. Current NBN retail prices: available from the providers' respective websites.

⁵¹¹ As of 5 March 2013, Telstra offered an upgrade from 'elite' (approximately 30Mbps) to 'ultimate' data rates (approximately 100Mbps) for an additional \$10 per month for its entry-level retail 'naked' cable plans: <http://telstra.com.au/latest-offers/broadband-offer/>. Similarly, Optus offered an 'Optus Cable Premium Speed' inclusion for its 120GB broadband retail plan, which it described as being valued at \$20 per month: <https://www.optus.com.au/shop/broadband/naked/120>

⁵¹² ACCC, *Public enquiry to make a final access determination for the Wholesale ADSL service: draft report – public version*, March 2013, Schedule 1, p. 1.

per megabit per second price.⁵¹³ The other traffic classes (TC-1 to TC-3) support the delivery of higher quality services than the TC-4 traffic class, which suggests that the monthly price per megabit per second of CVC in these traffic classes should be at least as high as the TC-4 CVC price. As the ACCC is satisfied that the initial monthly \$20 per megabit per second price is reasonable for the TC-4 CVC price, it follows that the ACCC is satisfied that the monthly prices for the CVC reference offer (for TC-4, items 3 to 16 in Attachment A; and for TC-1, items 1 to 11 in Attachment A) and the prices for the CVC offers (TC-2 and TC-3) (items 53 to 65 in Attachment A) are reasonable. It should be noted, however, that this does not imply that the ACCC considers that CVC charges for all traffic classes should always be the same on a per megabit per second basis.

The ACCC notes that there are a range of services that appear to be equivalent to services that are supplied over copper and HFC networks (or to access seekers utilising such networks) for which the SAU specifies prices. Submissions from interested parties did not provide information about whether these specific prices are or are not equivalent to prices for equivalent services or activities supplied today. In the absence of further information about why these specific prices are not reasonable, the preliminary view of the ACCC is that the following prices are reasonable:

- Network to Network Interface Offer (items 17 to 21 in Attachment A) and the NNI installation and activation charges (items 92 to 96 in Attachment A);
- NBN Co co-location offer (items 83 and 84 in Attachment A) and the set-up charges (items 111 and 112 in Attachment A);
- Additional/replacement access card (item 116 in Attachment A); and
- Enhanced-12 fault rectification service levels (\$15 per AVC, per month).

The ACCC also notes that, subject to the views set out in section 5.4.2.3, subsequent periodic revenue neutral price rebalancing should ensure that these initial prices do not result in prices that are not reasonable over time.

Consequently, for the reasons set out above, the preliminary view of the ACCC is that the initial prices for the services that are discussed in this section are reasonable.

However, a number of the services that are considered above are specified as non-reference offers. As noted in section 4.2, the SAU provides for NBN Co to withdraw non-reference offers by notice in accordance with the SAU. As outlined in chapter 4, this means that there is uncertainty about the ongoing supply — even during the rollout period — of some services for which there are currently copper and HFC-based equivalents and which end-users are currently purchasing. The implications of this are discussed in that chapter. As noted, the Consultation Paper on the Notice to Vary proposes that amendments be made to include a role for the ACCC in relation to NBN Co's decisions about product withdrawal.

5.4.1.3. Preliminary ACCC views — services for which there is not a current copper or HFC equivalent

The SAU includes prices for a range of different services and activities for which there is no current copper or HFC equivalent. The costs associated with supplying some of these services are likely to be common to a range of services (such as in the case of AVC and CVC product features of different data rates and service quality), whereas for other services or activities, it is likely to be possible to clearly attribute the costs of supplying or engaging in them.

A key principle in setting prices for individual services to achieve efficient outcomes is that each price should be based on the cost of providing the service to which the price relates.

⁵¹³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.3.1(d); Schedule 1C, clause 1C.3.1(e); Schedule 1D, clause 1D.3.1(e).

However, this principle is often not straightforward to apply in practice for regulated businesses, including NBN Co, and it is often not possible to identify a single efficient price at a point in time for an individual service. This is for the following reasons.

Firstly, similar to other network industries, a significant proportion of NBN Co's costs will be fixed costs (that is, they will not vary with use of the NBN) or shared costs (for example, the costs of particular network elements that can be used to provide a range of individual services). Both fixed and shared costs make the attribution of costs to individual services to establish a price for each product difficult. There are a range of ways to determine cost allocations under this scenario, including by reference to usage, price elasticities of demand or revenue shares.

Secondly, NBN Co is proposing an initial cost recovery account that will operate while it is earning less revenue than the annual revenue requirement in the initial stages of the SAU.⁵¹⁴ That is, its prices will collectively be set at less than the cost reflective level. After this initial stage, the initial cost recovery account will allow it to earn more revenue than the annual revenue requirement. That is, its prices will collectively be set at more than the cost reflective level. The spreading of cost recovery over an extended period in this manner adds an additional layer of complexity to the cost reflective principle and how it relates to efficiency.

In these circumstances, an approach which can lead to prices that encourage efficient cost recovery and use of a network is to charge higher prices for those services for which customers are willing to pay more. Or put another way, to increase the prices of services for which consumer demand is less responsive to changes in price by more than for those services for which consumer demand is more responsive to changes in price. Such prices are argued to encourage efficient cost recovery and use of the network because the access provider recovers a higher proportion of its costs from those users who value its services the most.⁵¹⁵

Consequently, where a service has costs associated with its supply that are shared and common to the supply of other services, and where the service is not otherwise available to end-users of services supplied using copper and HFC networks, the ACCC considers that it is reasonable for NBN Co to have a degree of flexibility in setting the price for that service.

The ACCC considers that many of the services for which prices are specified by the SAU fall into this category. In accordance with the reasons above, the ACCC considers that it is reasonable to accept the initial prices that are specified by the SAU for:

- Half of the asymmetric AVC offers — the high data rate asymmetric AVCs (items 27 to 29 in Attachment A), as services of this kind are not available to end-users of copper and HFC services.
- The additional asymmetric AVCs — to the extent services of this kind are currently available to end-users, it would seem that end-users would need to separately purchase two of these services to obtain this functionality over copper or HFC networks. As the additional asymmetric AVCs are priced below levels that the ACCC is satisfied are equivalent for comparable functionality (that is, items 30 to 34 correspond to the Basic Access Offer and items 24 to 26 in Attachment A) or are not available to end-users (that is, items 35 to 37 correspond to items 27 to 29 in Attachment A), the ACCC is satisfied that the prices for the additional asymmetric AVCs are reasonable.
- The second UNI-V and AVC offer — like the additional asymmetric AVCs, it would seem that end-users would need to separately purchase two services to obtain comparable functionality (that is, two voice services) over copper or HFC networks. This service appears to be broadly equivalent to wholesale line rental, albeit with some slightly different functionality (such as the second UNI-

⁵¹⁴ Ibid, Schedule 1F, clause 1F.4.

⁵¹⁵ D. Sappington, & D. Weisman, *Designing incentive regulation for the telecommunications industry*, 1996, pp. 240-242.

V and AVC offer not including a phone number and not including Layer 3 capability — that is, additional equipment, such as a soft-switch, would be required by the access seeker). The ACCC currently specifies a price of \$22.84 for wholesale line rental in the Fixed Line Services Final Access Determination.⁵¹⁶ The ACCC is therefore satisfied that the price for the second UNI-V and AVC offer (\$17.50 per service in operation per month) is broadly equivalent to a broadly comparable service supplied using the copper and HFC networks.⁵¹⁷

- Most symmetric access capacity offers — the ACCC understands that most of these data rates (specifically, the upstream data rates) are not available to end-users over copper (using ULLS service as an input) or HFC networks (specifically, items 43 to 52 in Attachment A).

Consequently, the ACCC is satisfied that prices for the services that are set out above are reasonable.

5.4.1.4. Preliminary ACCC views — business services with a current copper equivalent

The SAU specifies a reference offer (the Standard Business Offer) that NBN Co submits is intended to provide business grade broadband connectivity to the NBN for voice and broadband services.⁵¹⁸ This offer consists of access to a UNI-D, an AVC with 25/10 Mbps upstream peak data rates, and 500 kbps of TC-1 symmetric access capacity.⁵¹⁹

In some respects, the Standard Business Offer appears to reflect certain services that end-users (specifically, small to medium business end-users) are able to obtain over existing copper and HFC networks. For example, the 500 kbps of symmetric access capacity would appear to support some kinds of voice services that are available to these users (that is, 'multiline' voice services). However, in other ways, this reference offer may not be available over these networks. For example, the 10 Mbps upstream peak data rate does not appear to be available to end-users who are supplied with services using an unbundled local loop (ULL).⁵²⁰ This means that the Standard Business Offer is only currently available to end-users of copper and HFC-based services in certain respects.

In its submission, Optus raised concerns that the Standard Business Offer is not sufficient for business grade services.⁵²¹ Macquarie Telecom raised similar concerns in its submission.⁵²² Optus submits that a particular set of NBN product components that it would purchase to replicate existing business grade services will result in higher prices than currently.⁵²³

It is not clear to the ACCC that the Standard Business Offer is necessarily intended to provide equivalent functionality to the service to which Optus has compared this offer (that is, a standard business internet connection with committed information rate of 2 Mbps). In particular, it seems that the apparent divergence in prices for these two services arises at least in part from the inclusion of a symmetric access capacity AVC with 2 Mbps of committed information rate (CIR) TC-1 capacity.

⁵¹⁶ ACCC, *Inquiry to make final access determinations for the declared fixed line services – final report*, July 2011, p. 24.

⁵¹⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1D, clause 1D.3.1(d).

⁵¹⁸ NBN Co Supporting submission, p. 7.

⁵¹⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.2.4.

⁵²⁰ See, for example, International Telecommunications Union recommendations G.992.5 (ADSL2+) and G.991.2 (Single-pair high-speed digital subscriber line (SHDSL)) for data rates that can be supplied over the current copper network – <http://www.itu.int/en/pages/default.aspx>

⁵²¹ Optus submission (Public version), p. 100.

⁵²² Macquarie Telecom submission, p. 21.

⁵²³ Optus submission (Public version), pp. 99-101.

See, for example, International Telecommunications Union recommendations G.992.5 (ADSL2+) and G.991.2 (Single-pair high-speed digital subscriber line (SHDSL)) for data rates that can be supplied over the current copper network - <http://www.itu.int/en/pages/default.aspx>.

In addition to the Standard Business Offer, the SAU specifies pricing for symmetric access capacity AVCs.⁵²⁴ Some of these symmetric access capacity AVCs have data rates that appear to be equivalent to those that may be able to be supplied with copper and HFC-based services. The ACCC understands that the data rates that are currently available to end-users over copper (via ULLS) correspond to the AVCs with symmetrical data transfer rates between 0.15 Mbps and 2 Mbps (items 38 to 42 in Attachment A).

The ACCC considers that there may be multiple bundles of NBN products that could be used to supply a comparable service to those that are currently supplied to businesses over the copper network. Whilst it is not clear on the information before the ACCC whether submissions have identified the lowest cost means of providing comparable services over the NBN, in the absence of further information about these charges, the ACCC is not satisfied at this time that the charges are reasonable.

This is particularly the case because there is the possibility — depending on the assumptions about how some existing services should be supplied using the NBN — that at least some of these prices may mean that end-users are not able to obtain comparable services at equivalent prices over the NBN.

The ACCC is seeking further information from interested parties about the circumstances in which this may or may not occur (including any assumptions made about how these circumstances arise).

The ACCC also notes that the identified symmetric access capacity AVC offers may give rise to similar concerns as are expressed above in relation to the 50/20 and 100/40 Mbps services — that is, that services that are currently available over copper and HFC networks may be withdrawn under the SAU.

5.4.1.5. Preliminary ACCC views — multicast

The SAU specifies a number of prices for multicast functionality. Specifically, the SAU specifies prices for the Multicast AVC offer (items 66 to 70 in Attachment A), the Multicast Domain offer (item 71 to 80 in Attachment A), and media streams associated with the Multicast Domain offer (items 81 and 82 in Attachment A).

The ACCC understands that this functionality is generally not supplied to access seekers who currently purchase services at or above Layer 2 in ADSL markets in Australia, and only some access seekers self-supply this functionality via their own DSLAMs used to provide ADSL over the copper network.

Submissions from interested parties generally suggested that these prices may inhibit the development of multicasting.⁵²⁵ In particular:

- take-up of 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 average revenue per user (ARPU) that non-premium content can attract in the Australian market; and
- the bundling condition upon which this functionality is offered (that is, NBN Co requires that both the AVC and the multicast AVC be supplied by it to the same

⁵²⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1D, clause 1D.3.1(c).

⁵²⁵ Optus submission (Public version), pp. 97-98.

RSP) make it more difficult to successfully supply the NBN multicast product, as there can be no ‘over-the-top’ multicast through the NBN.⁵²⁶

However, the ACCC notes that:

- other NBN services (such as standard AVC and CVC products used for best efforts, over-the-top delivery) may support similar end-user applications in situations where access seekers have not achieved sufficient scale or scope to economically acquire multicast products, and thus may have somewhat ‘anchored’ multicast pricing;
- there appears to be a number of potential substitutes available for this service (such as broadcast of linear content via satellite in certain situations and locations), which suggests that access seekers may have some countervailing bargaining power in respect of the pricing for this functionality, and these substitutes may have placed some additional constraints on multicast pricing;⁵²⁷ and
- given that most multicast AVC offers provide high data rates that are unlikely to be available over copper and HFC networks (with the possible exception of the lower data rate offers in items 66 and 67 in Attachment A), it is likely to be reasonable for NBN Co to have some flexibility in setting the price for these services for the same reasons as set out in section 5.4.1.3.

While the ACCC recognises submissions from interested parties about the difficulties associated with the profitable supply of services to end-users using multicast functionality over the NBN, it is not necessarily clear that these issues can be alleviated solely through the pricing of the multicast functionality in the SAU.

In the absence of additional information about why the initial prices for multicast functionality are not reasonable, the preliminary view of the ACCC is that these initial prices are reasonable.

The ACCC notes that, as discussed in section 5.4.2, NBN Co could, at a future time, reduce multicast prices to encourage take-up if it so chose — if it did so, the price control path would also lower in response. Hence, the SAU would not preclude NBN Co from responding to future market conditions, while still providing some certainty about pricing over time.

Having said this, for the reasons set out in section 5.4.2, NBN Co may not always face incentives to, of its own accord, lower particular prices. Hence, the ACCC considers that the SAU should provide for the ACCC to be able to periodically review and rebalance price relativities among NBN Co services over time. If the initial multicast prices were resulting in few end-users being supplied with services using multicast functionality, it may be that multicast pricing would be something that could be considered in reviews of this kind.

The ACCC also notes that NBN Co is subject to non-discrimination obligations set out in Part XIC. As discussed in the ACCC non-discrimination explanatory material (‘Part XIC non-discrimination guidelines’),⁵²⁸ there may be some circumstances where discrimination should be taken to have occurred if only a limited number of access seekers could, in practice, acquire the service on the terms offered to all access seekers.⁵²⁹ These obligations may therefore place some further constraints on multicast pricing.

⁵²⁶ Ibid, p. 98.

⁵²⁷ Ibid, p. 98.

⁵²⁸ Available at the ACCC website at www.accc.gov.au

⁵²⁹ ACCC, *Part XIC non-discrimination guidelines: ACCC explanatory material relating to the Part XIC anti-discrimination provisions and the form of Statements of Differences*, April 2012, p. 11.

5.4.1.6. Preliminary ACCC views — other charges and other services

The ACCC notes that a substantial proportion of the other charges and other services that have not been considered in the above sections are zero-priced (that is, the SAU specifies a price of \$0). Since there is no charge for these other charges and other services, it follows that these prices must be equivalent to (or lower than) prices for any equivalent services that exist.

However, there are a number of other charges and other services where the SAU does specify a non-zero price.

Firstly, there are a number of other charges where the SAU specifies a charge that is determined by reference to labour and materials costs. With the exception of specific items that are considered further below, it appears that charges that are based on these costs should result in access seekers being charged prices for NBN Co to perform activities that are equivalent to (or lower than) those prices that access seekers are currently charged by other carriers who perform equivalent activities. Further, the charges will be directly cost-based. The ACCC is therefore satisfied that these charges are reasonable.

Secondly, the 'subsequent installation' charge (item 87 in Attachment A) includes a fixed charge of \$270 in addition to hourly labour and costs of materials. It appears that retail pricing for additional service connections over the copper network is approximately \$300 (including GST),⁵³⁰ which indicates that this retail pricing would be below a charge that is exclusive of GST and will increase with the additional labour and materials charges specified in this price. However, it may be that this activity is not equivalent to the provision of an additional copper connection, and it may occur in fewer circumstances than for the copper network (given that an NBN Co NTD can simultaneously supply multiple services). The ACCC notes that parties did not make submissions as to the reasonableness or otherwise of this charge. In the absence of further information, the ACCC's preliminary view is that it is satisfied that this charge is reasonable.

Thirdly, there are a number of other charges where the SAU specifies a charge that is related to the allocation of risk or liability or related to disputes between NBN Co and access seekers.

- Service modifications and equipment removals charges (items 102 and 103 in Attachment A) are calculated by reference to hourly labour rates and costs of materials. These items appear to be related to the risk and liability clauses that NBN Co has included in the SAU (and which the ACCC is not satisfied are reasonable — see chapter 6).
- Restoration (item 110 in Attachment A) is a \$50 per ordered product charge that NBN Co may impose where, broadly speaking, a dispute occurs between NBN Co and an access seeker.⁵³¹ This item appears to be related to the dispute management clauses that NBN Co has included in the SAU (and which the ACCC is not satisfied are reasonable — see chapter 6).

The ACCC notes that interested parties have not made any submissions as to the reasonableness or otherwise of the specific charges for these items (102, 103 and 110 of Attachment A).

In the absence of further information, the ACCC's preliminary view is that it is satisfied that the charges for the service modifications (items 102 and 103) are reasonable.

⁵³⁰ As of 6 March 2013, Telstra advertised a new service connection charge of \$299: <http://www.telstra.com.au/home-phone/plans-rates-connections/homeline-budget/>

⁵³¹ NBN Co has rights to impose an ordering freeze, service reduction, suspension or disconnection in some circumstances: NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 1, clause 10.1(b).

On the other hand, in the case of the restoration charge (item 110), in the absence of further information, the ACCC is not satisfied that the price (which suggests certain rights and obligations should exist between NBN Co and access seekers) is reasonable.

Fourthly, there are a number of charges related to service management and missed appointments (items 106 and 107, and 117 and 118 of Attachment A) where the SAU either specifies a fixed fee or a charge that is determined by reference to labour and materials costs, but with specified minimum increments (that is, the charge is 'lumpy').

Interested parties have not made any submissions about these specific charges.

The ACCC recognises that there may be merit to the SAU specifying prices that will provide certain incentives (that is, to keep appointments and to accurately report faults). Therefore, in the absence of further information to the contrary, the preliminary ACCC view is that it is satisfied that these charges are reasonable.

5.4.1.7. Summary of preliminary ACCC views on initial prices

The SAU specifies prices for a large number of services, and the ACCC is generally satisfied that the initial prices for most of these services are reasonable. However, as set out throughout the above sections, there are specific services where the ACCC is not satisfied that the initial pricing in the SAU is reasonable.

The ACCC has included a summary in Attachment B of the services for which it is not satisfied that the initial prices are reasonable. The ACCC welcomes further submissions from interested parties about these prices.

5.4.2. Changes to prices over time, including determining new prices

A number of aspects of the SAU impact upon how the initial prices discussed above will change over the SAU term, how the services that NBN Co will supply will change over the SAU term and how new prices (for new services and for currently zero-priced services) will be set. This section considers the implications of these aspects of the SAU. In particular, the ACCC considers whether, over the term of the SAU, the proposed commitments:

- ensure that end-users who do not wish to purchase services of a higher quality and price to what they are purchasing currently on the copper and HFC networks are not forced to do so (section 5.4.2.1);
- provide NBN Co with an incentive to set new prices at levels that promote competition and efficient use of the network (section 5.4.2.2);
- allow for the price levels of individual services to change appropriately in response to unforeseen circumstances (section 5.4.2.3); and
- provide an incentive — in addition to the commitments made in the SAU about prudence (discussed in section 5.3 and 5.5) — for NBN Co to invest in and operate its network in an efficient manner (section 5.4.2.4).

5.4.2.1. Preliminary ACCC views — ensuring current consumers are not worse off over the term of the SAU

The key aspects of the SAU that determine whether or not this objective will be met are:

- which services are defined as reference offers initially and the process for changing the services that are defined as reference offers over the term of the

SAU — because this determines whether a service can be withdrawn (see chapter 4); and

- the price controls that NBN Co must apply in accordance with the SAU.⁵³²

As noted in section 4.2, the ACCC considers that the scope of services initially defined as reference offers does not include all services for which there are currently copper and HFC-based equivalents. Hence, the SAU does not ensure the ongoing supply of all of these services. Also as noted in section 4.2, the ACCC does not consider that the approach proposed in Module 2 of the SAU by which NBN Co proposes the services to be defined as reference offers in replacement modules and the ACCC approves or rejects those proposals will ensure the ongoing supply of services for which there currently is a copper or HFC based equivalent. As noted in section 4.2, the Consultation Paper on the Notice to Vary therefore proposes that an ACCC role be incorporated in relation to NBN Co's withdrawal of services.

The SAU places restrictions on how the prices of services can change over time by imposing price controls upon each of the elements of the services supplied by NBN Co.⁵³³ During Module 1, the prices of reference offers will remain fixed for the first five years of the SAU term and, after this time, these prices will be subject to a CPI-1.5 per cent price control.⁵³⁴ The price controls on reference offers therefore impose constraints on how the prices of some of the services that are equivalent to services supplied using copper and HFC may change over time. All other prices (including for the remaining services that are equivalent to services supplied using copper and HFC) are subject to CPI-1.5 per cent price controls from the start of the SAU.⁵³⁵ This therefore places restrictions on how prices for these services may change from initial prices set out in the SAU (and discussed in section 5.4.1) or from prices determined upon introduction of these kinds of services (discussed in section 5.4.2.2).

The ACCC is not satisfied that these price controls will ensure that, for the duration of the rollout period, price shocks do not occur when end-users migrate to the NBN. Access seekers will migrate their end-users to the NBN progressively as the network is rolled-out and the copper and HFC networks are decommissioned. Whilst the initial prices in the SAU for copper and HFC equivalent services are broadly comparable to the prices of the copper and HFC services today (as discussed in section 5.4.1), over the network rollout period it is likely that the prices of copper and HFC-based services will change. At the retail level, prices for telecommunications services have been steadily decreasing, with average real prices for internet services across wireless, DSL, cable and dial-up services decreasing by 3.6 per cent in 2010-11 and 2.7 per cent in 2011-12.⁵³⁶ At the wholesale level, the ACCC sets regulated prices for certain key inputs on the copper network, such as WLR and ULLS. The ACCC will make decisions regarding the future regulation and pricing of these services through the relevant public inquiry processes as required in the CCA. It is therefore possible that the prices of NBN equivalent services could diverge over the period — that is, the prices that access seekers have to pay for a particular level of functionality may no longer be comparable to the prices they pay at the time over the copper network and HFC networks.

In light of this, the Consultation Paper on the Notice to Vary proposes variations to the SAU so as to provide the ACCC with the opportunity to periodically (for example, every five years) review and rebalance prices in a revenue neutral manner.

⁵³² Clause 1C.4.1 of Schedule 1C and clause 1D.4.1 of Schedule 1D require NBN Co to determine maximum regulated prices for services during Module 1 in accordance with rules set out in these clauses. Clause 2C.2.1 is an equivalent provision that applies during Module 2.

⁵³³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1D, clause 1D.4; Schedule 1C, clause 1C.4.

⁵³⁴ *Ibid*, Schedule 1C, clauses 1C.3 and 1C.4.

⁵³⁵ *Ibid*, Schedule 1D, clause 1D.4.

⁵³⁶ ACCC, *Changes in the prices paid for telecommunications services in Australia*, 2011-12, p. 95.

5.4.2.2. Incentives to set new prices at levels that encourage efficiency and promote competition

The SAU establishes that new prices will be determined by NBN Co during Module 1 and Module 2 as follows:

- When determining any new prices (other than those determined in relation to zero-priced reference offers or zero-priced other charges that are associated with reference offers), NBN Co must have regard to (among other relevant matters) the matters set out in clauses 1D.6 and 2C.5 and, in accordance with these clauses, publish a pricing rationale statement describing how it has done so.
- For new services that are developed through the Product Development Forum during Module 1, clause 11.3.5 states that NBN Co will determine prices for these services after consultation with customers. Clause 2E.4.4(b) is an equivalent clause that applies during Module 2.
- For any new prices for other charges introduced during Module 1 that are not associated with the supply of a reference offer, NBN Co must not introduce a price unless it reasonably considers that one or more of the matters in clause 1D.4.3(a) are satisfied. If this is the case, clause 1D.4.3(c) states that NBN Co will determine these other charges under clause 1D.6. Clause 2C.4 provides for an equivalent process to apply during Module 2.

During Module 1 and Module 2, for zero-priced reference offers and zero-priced other charges that are associated with the supply of reference offers, NBN Co generally determines new prices, subject to the following constraints:

- For zero-priced reference offers, NBN Co must not introduce a price unless it reasonably considers that one or more of the matters in clause 1C.4.5(a) are satisfied. Clause 2C.4 provides for an equivalent process to apply during Module 2.
- For zero-priced other charges associated with reference offers, NBN Co must not introduce a price unless it reasonably considers that one or more of the matters in clause 1D.4.3(a) are satisfied.
- In addition to these constraints that apply when NBN Co determines new prices for zero-priced reference offers and zero-priced other charges associated with a reference offer, there is a limited role for the ACCC, as follows:
 - if NBN Co introduces a new price for a zero-priced reference offer,⁵³⁷ or a new price for other charges that are associated with the supply of a reference offer;⁵³⁸ and
 - the ACCC makes an Access Determination or Binding Rules of Conduct (or, for certain types of prices, a decision using the same process as the Facilities Access Decision) relating to the new price within three months of NBN Co providing notification of its intention to introduce the new price;⁵³⁹ then

⁵³⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1C, clause 1C.4.5(b); Schedule 2C, clause 2C.4(b).

⁵³⁸ *Ibid*, Schedule 1D, clause 1D.4.3(b); Schedule 2C, clause 2C.4(b).

⁵³⁹ *Ibid*, Schedule 1D, clause 1D.4.3(b)(iii); Schedule 1C, clause 1C.4.5(b)(ii); Schedule 2C, clause 2C.4(b)(ii).

- the price will be as determined by the ACCC,⁵⁴⁰ and is the maximum regulated price in that Financial Year.⁵⁴¹

Clauses 1F.1.2 and 2D.1.2 also state that NBN Co will determine prices for services that it supplies in a manner that is consistent with the long-term constraint methodology.

Submissions

NBN Co submits that the SAU pricing arrangements are intended to apply for 30 years with no further recourse to the ACCC after the approval of the SAU (other than in relation to zero-priced reference offers and zero-priced other charges associated with reference offers).⁵⁴²

NBN Co notes that, as is the case with other SAU commitments, the ACCC will have an ongoing role in overseeing NBN Co's compliance with the SAU pricing commitments, and the publication of a pricing rationale statement provides transparency to both the ACCC and access seekers about how NBN Co has determined initial prices for new products.⁵⁴³

NBN Co submits that it is appropriate to exclude most initial prices for new products from the 'regulatory recourse' provisions in the SAU because:

- NBN Co faces strong incentives to price its services efficiently in order to recover the significant fixed costs associated with the network, given its long-term revenue sufficiency risk and the way the initial cost recovery account roll forward is specified in the subsequent regulatory period (using forecast rather than actual revenue).⁵⁴⁴
- NBN Co faces appropriate incentives in setting prices for new products because it has "aligned interests with customers with regard to development of downstream markets and there is a clear financial benefit to NBN Co from developing new products and pricing them appropriately".⁵⁴⁵
- NBN Co will be constrained by the anchoring effects of other products (even though these effects are intended to address the objective of pricing stability and predictability, rather than to provide NBN Co with appropriate pricing incentives).⁵⁴⁶

Synergies submits that:

- The initial pricing principles circumscribe the factors that would need to be considered in establishing an efficient price. Synergies notes that these principles, collectively, limit the scope for NBN Co to set prices for new offers that differ substantially from those that would be considered efficient.⁵⁴⁷
- The pricing principles allow NBN Co to balance the desirability of rapid uptake with the need to appropriately incentivise innovation and new product development.⁵⁴⁸

Submissions from interested parties raised the following key issues:

⁵⁴⁰ Ibid, Schedule 1C, clauses 1C.4.5(b)(ii) and 1D.4.3(b)(ii); Schedule 2C, clause 2C.4(b)(ii).
⁵⁴¹ Ibid, Schedule 1C, clauses 1C.4.5(b)(iii) and 1D.4.3(b)(iii); Schedule 2C, clause 2C.4(b)(ii).
⁵⁴² NBN Co Supporting submission, p. 112.
⁵⁴³ Ibid, p. 97.
⁵⁴⁴ Ibid, p. 9.
⁵⁴⁵ Ibid, p. 112.
⁵⁴⁶ Ibid, pp. 112-113.
⁵⁴⁷ Synergies Economic Consulting report, p. 6.
⁵⁴⁸ Ibid, p. 42.

- The fact that NBN Co will be wholesale-only does not mean that it will always set efficient wholesale access prices.⁵⁴⁹
- The processes by which NBN Co will consult with customers on prices for new products do not ensure these new prices will be reasonable over the SAU term.⁵⁵⁰
- The anchoring effect of reference offers will not provide an effective means of constraining the pricing of new products.⁵⁵¹
- The requirement for NBN Co to have regard to the pricing principles for new products does not provide an adequate and enforceable constraint to ensure that new prices will be reasonable over the SAU term.⁵⁵²
- The pricing principles do not align with the statutory criteria (for example, there is no requirement for NBN Co to have regard to the effect on competition or the long-term interests of end-users).⁵⁵³

Preliminary ACCC views

Over the term of the SAU, the nature of the new services and other charges that NBN Co introduces are likely to differ substantially, as does currently the nature of the services that are supplied at a zero charge.

In turn, what constitutes an ‘efficient initial price’ for those services is also likely to differ, depending on whether:

- the costs of supplying the new service are common to the costs of supplying existing services — as noted in section 5.4.1, in circumstances where there are significant fixed and common costs, allowing a degree of flexibility for the regulated business to set prices for individual services can lead to prices which encourage efficient cost recovery and use of its network; and
- the costs of supplying the new service are attributable to that service — as noted in section 5.4.1, cost based prices would be desirable in these circumstances, because such prices would reflect the value of society's resources that are consumed in providing the service.

The degree to which NBN Co has an incentive to price its new services in an efficient manner might depend on the degree to which the new service is substitutable for services that NBN Co is already supplying when it introduces the service. For example, were NBN Co to set the price of the new service at a level where end-users and/or access seekers did not value the additional functionality of the new service as much as the mark-up on the price of the existing service, end-users and/or access seekers would not purchase the new service. This may occur in relation to the pricing of a new AVC speed tier. (Having said this, as noted in chapter 4, this ‘anchoring’ effect might be reduced if NBN Co is able to withdraw lower data rate services that would have otherwise provided an anchor on the price of the new service.) Similarly, if a new service is contestable with other services already in the market (such as a new multicast service being contestable with standard AVC and CVC products used for best efforts, over-the-top delivery, and/or the broadcast of linear content via satellite in certain situations and locations), NBN Co may have greater incentives to price that new service in such a way as to encourage its use.

⁵⁴⁹ Optus submission (Public version), p. 97.

⁵⁵⁰ Macquarie Telecom submission, pp. 14-15.

⁵⁵¹ Telstra submission, p. 72; AAPT submission, p. 14.

⁵⁵² iiNet submission, p. 23; Macquarie Telecom submission, p. 14; Nextgen Networks submission, p. 16; Optus submission (Public version), p. 83; Telstra submission, p. 13.

⁵⁵³ iiNet submission, p. 23; Macquarie Telecom submission, p. 14; Nextgen Networks submission, p. 16; Optus submission (Public version), p. 49.

In addition, NBN Co may face incentives to price its new services in such a way as to encourage efficient use of the NBN during periods when it faces revenue sufficiency risk, in order to drive revenue growth. These new prices would then be subject to the CPI-1.5 per cent price control.

On the other hand, once NBN Co no longer faces this revenue sufficiency risk (for example, whilst it is operating in the revenue cap phase), it may have weaker incentives to set new prices to encourage take-up if it expects to be able to earn its regulated return from its existing product set and at their existing price paths. Having said this, it is likely that, the higher NBN Co sets new prices, the more existing prices would need to be reduced in order to comply with the annual revenue requirement, which may in turn constrain the pricing of new services.

The ACCC notes that in order to deal with the range of different new prices that NBN Co might introduce over the SAU term, NBN Co has proposed that different approaches (set out above) will be adopted for setting different 'types' of new prices. The following observations can be made about these approaches, as well as the other aspects of the SAU which might constrain the new prices that NBN Co sets:

- The mechanisms are complex – there are a large number of interrelated provisions to address new prices throughout Module 1 and Module 2 of the SAU.
- The initial pricing principles — these principles are non-exhaustive, which means NBN Co can take into account anything it considers relevant when setting initial prices for new products.
- The requirement to consult with customers on prices for new products that are developed through the Product Development Forum — NBN Co is not required to consult with customers on new products that are not developed through the PDF and, as noted in chapter 4, a broad range of products is not required to be consulted on via the PDF.
- The circumstances where the ACCC may determine prices — NBN Co may have greater incentives to price services efficiently and to reasonably consider the views of customers in the circumstances where the ACCC may determine prices; however, the range of circumstances in which the ACCC can do so are limited.
- The anchoring effect of existing prices — non-reference offers are able to be withdrawn, hence the extent to which such services will constrain new prices over the term of the SAU is unclear. Whilst the updating of the service that makes up the Enhanced Access Offer may ensure there is a constraint on the pricing of new substitutable services, it may not have this anchoring effect for all new prices introduced by NBN Co.
- New prices for zero-priced offers — whilst the SAU limits the circumstances in which NBN Co may introduce non-zero prices for these services, it also limits the circumstances in which the ACCC may determine these prices if NBN Co does so.
- The long-term revenue constraint methodology — while the long-term revenue constraint methodology may provide some constraint on NBN Co's ability to set inefficiently high prices during the revenue cap phase, it may also create incentives for NBN Co to inefficiently structure its prices. This is because during this phase NBN Co would not be able to earn more than its regulated return, and hence, would not benefit financially from structuring prices in such a way as to encourage take-up of the network. Further, as noted in section 5.1, whilst the ACCC understands that it is NBN Co's intention that whether the CPI-1.5 per cent price control takes precedence in constraining NBN Co's prices over the annual revenue requirements will vary across the loss-

accumulation phase, the loss recovery phase and the revenue cap phase, the current SAU drafting is not clear on this matter.

In summary, the ACCC is not satisfied that the approaches proposed in the SAU will, in and of themselves, ensure that NBN Co sets new prices in a manner that encourages efficient use of the network.

As noted above though, the ACCC recognises that in many circumstances NBN Co will have incentives to set new prices efficiently of its own accord.

However, it is possible that during the term of the SAU these incentives will not prevail (for example, if the 'anchoring' effect of existing products is not effective, and once it has become clear that NBN Co will reach its revenue cap phase). It is unclear when during the SAU term any revenue sufficiency risk that NBN Co faces will reduce — in turn, it is not clear for how long during the SAU term NBN Co will have incentives to, of its own accord, set new prices in a manner which encourages efficient use of the network.

In light of this, the Consultation Paper on the Notice to Vary proposes that:

- The clauses in the SAU about the setting of new prices be removed from the SAU — including clauses about who sets these prices. This variation would allow for the ACCC to determine new prices in circumstances where it considered that NBN Co faced weak incentives to set new prices efficiently. .
- The SAU be amended to allow for periodic (e.g. five yearly) revenue neutral rebalancing of all prices by the ACCC. Such reviews would allow for the ACCC to consider whether new prices had been set in an efficient manner and to address any issues that arise at that time.

While these variations would *permit* the ACCC to determine new prices, or to re-balance them in a revenue neutral manner at a point in time after they had been set by NBN Co, the ACCC expects that it would not do so in most circumstances. This is because the ACCC recognises that it is appropriate for NBN Co to have a degree of pricing flexibility for new products, and that allowing this flexibility can lead to efficient outcomes. Nonetheless, the possibility of ACCC recourse could, in and of itself, reduce the likelihood that the sorts of circumstances where it would be desirable for the ACCC to determine prices arise.

The ACCC notes that, in determining new prices in an Access Determination, it would be required by Part XIC to take into account particular matters specified by Part XIC — such as NBN Co's legitimate business interests, the interests of access seekers and whether the determination would promote the long-term interests of end-users.

5.4.2.3. Ability for relative price levels to change in response to unforeseen circumstances

The SAU allows NBN Co to increase the prices contained in SFAAs for its services by up to CPI-1.5 per cent for the duration of the SAU.⁵⁵⁴ This CPI-1.5 per cent price control applies to the prices of all services, including those for new services introduced during the SAU term.⁵⁵⁵

The CPI-1.5 per cent price control effectively establishes for each service a path of maximum prices that NBN Co must not exceed for the term of the SAU. If NBN Co were to decrease the nominal price in a particular year for a particular service (or decrease it in real terms by more than that required by the price control), this would in turn 'shift' the path of maximum prices for that service to a lower level of prices.

⁵⁵⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2C, clause 2C.2; Schedule 1C, clause 1C.4; Schedule 1D, clause 1D.4.

⁵⁵⁵ *Ibid*, Schedule 1C, clause 1C.4; Schedule 1D, clauses 1D.4 and 1D.6(c).

Under these arrangements, the ACCC would not be able to determine that a higher or lower price should be charged for a particular service during the SAU term.

Submissions

NBN Co submits that its approach to pricing strikes a balance between pricing certainty for access seekers and pricing flexibility for NBN Co, having regard to the need to account for evolving technology, applications and demand.⁵⁵⁶

Submissions from interested parties highlighted the dynamic nature of communications markets.⁵⁵⁷ Access seekers sought a more flexible approach to price terms in the SAU and, in particular, suggested that the ACCC should have a role in reviewing NBN Co's prices and pricing structures.⁵⁵⁸ These submissions identified a number of ways that this could be achieved, including:

- imposing different kinds of price caps, such as on bundles of access products on a per end-user basis;⁵⁵⁹
- matching increases in average wholesale prices to the outcomes in NBN Co's current corporate plan;⁵⁶⁰ and
- providing for the ACCC to rebalance prices.⁵⁶¹

Preliminary ACCC views

The ACCC considers that circumstances could arise over the term of the SAU which would suggest that prices for particular services are not encouraging efficient use of and investment in the network and/or competition. Some examples of these circumstances are outlined in Box 1.

To respond to such circumstances, under the approach proposed in the SAU, the price of an individual service could not be increased by more than CPI-1.5 per cent from one year to the next; but NBN Co could of its own accord decrease prices by any amount.

It is not clear whether NBN Co will have incentives throughout the term of the SAU to reduce prices of its own accord. Whether it does have such an incentive might depend on:

- Whether it is in a phase of its operations where it faces demand uncertainty — if it faces demand uncertainty, it may have an incentive to lower prices to increase usage of the network; on the other hand, if it was confident that it could earn sufficient revenues to recover its costs from existing demand, it may have less incentive to lower prices to increase use of the network.
- Interactions between how end-users change their purchasing behaviour in response to changes in price (or 'demand elasticities') — that is, how end-users increase or decrease the amount of data they download and at what data rate in response to price changes. This in turn has implications for whether a price increase or decrease would increase or decrease NBN Co's overall revenues.

Even if NBN Co did have an incentive to reduce particular prices, doing so could (depending on demand elasticities) reduce its overall revenues because the price controls would preclude it from raising the prices of other services. To the extent that this hindered its ability to recover its efficient costs, this could have subsequent implications for its incentives to adequately invest in

⁵⁵⁶ NBN Co Supporting submission, p. 99.

⁵⁵⁷ Telstra submission, p. 7; Macquarie Telecom submission, p. 25; Nextgen Networks submission, p. 12.

⁵⁵⁸ Nextgen Networks submission, p. 13; Macquarie Telecom submission, p. 13.

⁵⁵⁹ Telstra submission, pp. 69-70.

⁵⁶⁰ Telstra submission, p. 66.

⁵⁶¹ Macquarie Telecom submission, p. 13.

the network, and/or give NBN Co incentives to spend below an efficient level on operations and maintenance.

In light of the above issues, the ACCC does not consider that the SAU precluding NBN Co from being:

- required to lower prices beyond those allowed for by the CPI-1.5 per cent price control; and
- able to raise prices above the levels allowed for by the CPI-1.5 per cent price control;

will encourage efficient use of and investment in the network throughout the SAU term.⁵⁶² This is because there may be times when NBN Co does not face incentives to lower prices of its own accord; and because if it did lower some prices, depending on demand elasticities, its overall revenues might fall if it is unable to increase other prices above the price control, with subsequent implications for its ability to recover its costs.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be amended to allow for periodic (for example, five yearly) revenue neutral rebalancing of all prices by the ACCC. Such reviews would allow for the ACCC to, for example, rebalance AVC and CVC charges in order to encourage greater use of the network. Having said this, the ACCC notes that if NBN Co were to change CVC prices in line with its expectations in its Corporate Plan, it is unlikely that there would be a need for the ACCC to rebalance AVC and CVC prices at the time of a revenue neutral rebalancing.

Box 1. Circumstances which suggest prices may not be efficient

Example 1. Underutilisation of network capacity — changes to CVC prices over time

Utilisation of the network could be found to be persistently well below its capacity, suggesting that the cost to access seekers of purchasing capacity is too high.

In this regard, a number of submissions have raised concerns about the manner in which the CVC price is able to be changed over time, including that:

- Rationing speed will lead to an underutilisation of capacity, and NBN Co's pricing model imposes scarcity where none exists.⁵⁶³
- NBN Co's future decisions about whether to adjust the CVC price may have significant impacts on RSP business models, the efficiency of end-user charges and the development of new services offered in the market.⁵⁶⁴
- The SAU should contain a firmer commitment to review and reduce the CVC price over time.⁵⁶⁵
- The CVC price should be reduced over time in line with the forecasts in the Corporate Plan and based on the achievement of certain usage levels.⁵⁶⁶

DBCDE notes that take-up and use of the NBN require an appropriate balance between access charges (AVC) and usage charges (CVC), and that if NBN Co is to recover its costs then any

⁵⁶² That is, during the loss accumulation, loss recovery and revenue cap phases.

⁵⁶³ John de Ridder, *A submission to the ACCC consultation on the NBN Co SAU*, 18 December 2012, pp. 2-3.

⁵⁶⁴ Telstra submission, p. 13.

⁵⁶⁵ Nextgen Networks submission, p. 13; Macquarie Telecom submission, p. 11.

⁵⁶⁶ Nextgen Networks submission, pp. 13-14.

mechanism that forced lower CVC charges would need to be reflected in higher AVC or other charges.⁵⁶⁷

The CVC product is a bitstream link for use by access seekers to aggregate and manage multiple access virtual circuits (AVCs) for a given service area.⁵⁶⁸ Access seekers purchase CVC according to the number and capacity of AVCs they have in that service area and the degree to which they want to contend their network (that is, share network capacity between multiple end-users). By doing so, access seekers can influence the level of service quality they wish to provide for their end-users. That is, access seekers choose the amount of CVC they purchase based on the value proposition they wish to put to their customers (for example, high prices and higher service quality, or lower prices and lower service quality). Service quality in this context refers to what data rate end-users actually experience relative to their AVC peak information rate.

Rather than being a usage charge, the CVC price is a charge for capacity in the network. That is, CVC is sold on a data rate (Mb per second) basis, rather than a data volume (Mb) basis. (The initial CVC price is \$20 per Mb per second.)⁵⁶⁹ The data rate that access seekers require from NBN Co is nonetheless closely linked to the volume of data that end-users demand overall. This is because the data rate (Mb per second) that access seekers purchase from NBN Co will affect the volume of data (Mb) that they can pass through the network during a given period of time.

The costs that access seekers incur in purchasing CVC capacity are likely to influence the prices they charge end-users for data consumption — similarly, the prices that end-users are charged for data consumption are likely to influence their consumption of data. The extent to which changes in the per Mb per second price of CVC capacity affect end-users' consumption of data will depend of their elasticity of demand — that is, how much more or less data they consume and at what data rate in response to decreases or increases in prices. These elasticities are at present uncertain. Hence, the extent to which increasing the CVC price by CPI-1.5 per cent over time will affect end-users' data usage patterns, and in turn the amount of capacity in the network that is utilised, is also uncertain.

Example 2. Inefficient use of services due to prices being above costs

As noted in section 5.4.2, in the case of services for which there is a clearly identifiable cost of supply, a new price could be found to have been set well above the costs of supplying the service or engaging in the activity. As noted above, cost based prices are desirable in these circumstances, as these prices promote dynamic efficiency by encouraging efficient investment decisions, and promote allocative efficiency by reflecting the value of society's resources that are consumed in providing the service.

Example 3. Competition issues arising from, and the implications for use of the network of, price relativities between multicast and AVC/CVC products

As another example, the relativity between the prices of the multicast and the AVC/CVC products may have implications for use of the NBN and the development of downstream markets, as may the pricing of the data rate tiers within the multicast product.

At a certain scale, the multicast service is likely to deliver linear content over the NBN more efficiently than it can be delivered via NBN Co's AVC and CVC products, because multicasting would use less of the NBN's capacity. This might suggest that efficient use of the NBN would be encouraged if the multicast service presented a more attractive proposition to access seekers than the alternative of providing content 'over the top' using the AVC and CVC

⁵⁶⁷ DBCDE submission, p. 2.

⁵⁶⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1A, clause 1A.2.4.

⁵⁶⁹ *Ibid*, Schedule 1D, clause 1D.3.1(e); Schedule 1C, clauses 1C.3.1(d) and 1C.3.1(e).

products.

On the other hand, it is likely that only access seekers with access to a large number of end-users and range of different content that is packaged into linear channels will find multicasting commercially viable (for a range of reasons, including — but not limited to — the current price structure that NBN Co has adopted). It is therefore possible that only one or two access seekers would purchase the multicast service in any event. Lowering the price of the multicast product, to the extent that doing so favoured these access seekers in the delivery of content, might therefore have implications for competition in downstream markets.

5.4.2.4. Incentives created by the approach to pricing of individual services for NBN Co to invest in and operate the network efficiently

As noted, the ACCC recognises that long-term commitments to not increase prices above particular levels can have implications for a regulated business' incentives to invest. This section considers the implications for NBN Co's incentives to invest of its proposed price control.

Submissions

NBN Co submits that, taken together, the price-related terms and conditions in the SAU provide "appropriate and balanced incentives for NBN Co in regard to investment, expenditure efficiency and quality."⁵⁷⁰

NBN Co also notes that it will face significant ongoing risk as to its long-term revenue sufficiency throughout the network rollout period, and it will therefore be commercially rational for NBN Co to only incur expenditure in a prudent and efficient manner.⁵⁷¹

Ordovery and Shampine submit that price caps are effective at providing incentives for firms to minimise costs.⁵⁷²

The ACCC notes that this matter was not otherwise addressed in submissions.

Preliminary ACCC views

The ACCC considers that long-term commitments to not increase prices above particular levels can, in theory, generate incentives for NBN Co to invest efficiently in the network and operate the network efficiently. This is because NBN Co would not be able to increase prices above the price control to recover any costs associated with over-investment or inefficient operating expenditure. If NBN Co were to over-invest or incur expenditure in an inefficient manner, this would increase the likelihood that it would be unable to recover its investment via its prices over the SAU term, and create risks that further investments to maintain service quality over time are not made.

These incentives are likely to be strengthened if, by virtue of uncertain demand, NBN Co subsequently faces a high degree of what it calls 'revenue sufficiency risk'. As noted in section 5.3.2, it is unclear for how long throughout the SAU term such revenue sufficiency risk will be faced by NBN Co, however it is likely that it will exist during the network rollout and loss accumulation phase in particular (which is the phase during which a significant proportion of the total expenditure that will be incurred during the term of the SAU will occur).

The ACCC therefore considers that there is considerable potential for the proposed price controls to create incentives for NBN Co to operate and invest efficiently.

⁵⁷⁰ NBN Co Supporting submission, p. 131.

⁵⁷¹ Ibid, p. 46.

⁵⁷² Ordovery and Shampine report, p. 19.

However, as noted in chapter 4, the ACCC considers that NBN Co's ability to withdraw services has the potential to reduce the degree of demand risk that NBN Co is subject to, which would in turn reduce the extent to which the price controls contribute to NBN Co's revenue sufficiency risk and create incentives for it to invest and operate efficiently.

The ACCC is therefore not satisfied that the proposed price control currently sufficiently creates incentives for NBN Co to invest and operate efficiently over the SAU term.

The ACCC notes that it would expect that the changes it is proposing to address issues raised in relation to product withdrawal (in chapter 4) would enhance the effectiveness of the price control in creating these incentives.

5.4.3. Tax change events

Module 1 and Module 2 allow NBN Co to increase maximum regulated prices in the SAU above the levels permitted by the price controls, in circumstances that are defined as 'tax change events'.⁵⁷³ Tax change events are defined by the SAU to include any new or increase in tax⁵⁷⁴ (other than GST) imposed on NBN Co (including charges to NBN Co by a third party that is a result of a tax), including the land and facilities it uses or occupies and the supply of its products or anything used, occupied or accessed in connection with the supply of its products.⁵⁷⁵

If a tax change event occurs in Module 1, clauses 1C.5 and 1D.5 state that the maximum regulated price of each reference offer, non-reference offer and other charge will increase "by an amount estimated by NBN Co to be a reasonably apportioned amount equivalent to that imposed or increased as a result of the tax change event."⁵⁷⁶ Importantly, this change in the maximum regulated prices will apply in addition to the individual price increase limit in the SAU.⁵⁷⁷ These clauses also set out a method by which NBN Co will give notice to customers and the ACCC of the price change.

If the tax change event occurs in Module 2, clause 2C.3 states that NBN Co is entitled to pass-through to customers and reflect the incremental tax effect in connection with a tax change event, by increasing maximum regulated prices of reference offers, non-reference offers and other charges, and amending its annual forecast revenues and forecast annual revenue requirements. The proposed changes to maximum regulated prices and revenue forecasts will be included in replacement modules for ACCC approval.⁵⁷⁸

In both Module 1 and Module 2, any tax imposed on NBN Co (other than GST and taxes relating to income or profit) is defined as operating expenditure. This means the cost of these taxes will be included in the operating expenditure component of NBN Co's annual revenue requirements.

Submissions

Submissions raised the following concerns about the tax change event clauses:

- there is uncertainty over the nature of a tax change event,⁵⁷⁹

⁵⁷³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1D, clause 1D.5 and Schedule 2C, clause 2C.3.

⁵⁷⁴ 'Tax' is defined as any tax, levy, charge, franchise, impost, duty, fee, rate, deduction, compulsory loan or withholding, which is assessed, levied, imposed or collected by any Government Agency, including the ACT Utility Tax, but excludes tax that relates to income, profit or capital gains.

⁵⁷⁵ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, Attachment C.

⁵⁷⁶ *Ibid*, Schedule 1C, clause 1C.5.1(a); Schedule 1D, clause 1D.5.1(a).

⁵⁷⁷ *Ibid*, Schedule 1C, clause 1C.5.1(b)(iv); Schedule 1D, clause 1D.5.1(b)(iv).

⁵⁷⁸ *Ibid*, Schedule 2C, clause 2C.3(b).

⁵⁷⁹ Macquarie Telecom submission, p. 15.

- there is no clarity on the methodology to be applied by NBN Co in determining the impact on it of a tax change event and how this will be passed on to its customers;⁵⁸⁰
- the tax pass-through provisions are asymmetric and only provide for NBN Co to pass through tax increases, not tax decreases;⁵⁸¹ and
- the application of the pass through clauses should be time limited, so that RSPs and end-users know when maximum price changes can occur.⁵⁸²

Preliminary ACCC views

Taxes imposed on NBN Co by Government agencies are a direct cost of doing business. These costs may change from time to time, and any change is outside NBN Co's control. Allowing NBN Co to recover these costs from its customers would have appropriate regard to its direct costs and legitimate business interests.

However, the amount by which prices for particular products and services supplied by NBN Co are increased to recover changes in these costs can have implications for the efficient use of the NBN, and in some circumstances the efficient investment in the NBN. In particular, increases in prices for particular services will affect the extent to which end-users purchase particular services from NBN Co (for example, high data rate services and capacity), and the time period over which NBN Co will be able to recover its investment.

As noted previously, if NBN Co faces a high degree of 'demand risk' (that is, uncertainty as to the take-up of its services) and it makes strong commitments with respect to how much it will change prices over time, this could create incentives for NBN Co to both invest and operate efficiently and for it to encourage efficient use of the NBN. This means that NBN Co's ability to increase prices above the price control could, depending on the size of the price increase applied, have implications for these efficiency incentives.

Similarly, as noted in section 5.4.2.3, the relative prices of different products (and changes to the relative prices) supplied by NBN Co will also have implications for the efficient use of the NBN. This means that any changes made by NBN Co to relative prices in response to a tax change event (for example, changes in the relative changes in AVC and CVC prices, AVC price tiers and ancillary and other changes) could have implications for the efficient use of the NBN.

Under the tax change event clauses in Module 1 and Module 2, NBN Co generally has discretion to decide how much maximum regulated prices will increase by to account for the tax change event, and how much of the change will be apportioned to each product or service supplied by NBN Co. The ACCC is not satisfied that this will lead to changes in relative prices that will encourage efficient use and investment in all circumstances that may arise over the term of the SAU. This is for the same reasons as outlined in section 5.4.2.3 above.

In addition, the tax change event mechanism does not account for reductions in taxes imposed on NBN Co. This means that NBN Co is not required to reduce prices or change the relative prices of its products, following a tax change event, when reducing prices or changing relative prices will encourage the efficient use of, and investment in, the NBN.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be varied so that changes to prices (both increases and decreases) in response to a tax change event could be considered as part of the proposed periodic revenue neutral price rebalancing.

⁵⁸⁰ Telstra submission, p. 82.

⁵⁸¹ Macquarie Telecom submission, p. 15; Telstra submission, p. 82.

⁵⁸² Telstra submission, p. 82.

5.4.4. Summary of preliminary ACCC views on pricing of individual products

The SAU specifies initial prices for a large number of services, including services that are broadly equivalent to services currently available on copper and HFC networks; services that are not currently available on copper and HFC networks; multicast services, and other charges. A summary of the ACCC's preliminary views on the initial prices in the SAU is as follows:

- The initial prices for copper and HFC equivalent services are broadly comparable to the prices of the copper and HFC services today. However, as noted in section 5.1.1.2, NBN Co's ability to withdraw non-reference offers means that current consumers of services provided over copper and HFC networks that allow for data rates between 50 Mbps and 100 Mbps are not guaranteed supply of equivalent services following their transition to the NBN.
- The initial prices for most of the services in the SAU that are not currently available on copper and HFC networks are reasonable. However, the ACCC is not satisfied, given the information before it, that the initial prices of some specific services are reasonable. These services are listed in Attachment B of this Draft Decision. The ACCC is seeking further views on the prices of these particular services.
- The initial prices for multicast services are reasonable, on the information currently available to the ACCC.

Whilst the ACCC is generally satisfied that most of the initial prices in the SAU are reasonable, the ACCC is not satisfied that:

- the clauses about how NBN Co will set new prices (including for previously zero-prices services); and
- the clauses about how prices for all services will or will not change over time (including the proposed CPI-1.5 per cent price control on all products and the tax change event clauses);

will ensure that relative prices between services are set in such a way as to encourage efficient use of the NBN in all circumstances that may arise over the term of the SAU (including relative price levels between the NBN and copper and HFC networks during the network rollout period). Whilst NBN Co is likely to face incentives to price in such a way as to encourage use of the NBN if it faces revenue sufficiency risk, it is possible that this risk will reduce over the SAU term.

In light of these views, the Consultation Paper on the Notice to Vary proposes the following key variations to the SAU:

- Varying the SAU to permit periodic (for example, five yearly) revenue neutral rebalancing of all prices by the ACCC. Such reviews would allow for the ACCC to review whether new prices had been set in an efficient manner and to address any issues that arise at that time, such as a need to rebalance AVC and CVC charges.
- Removing the clauses about the setting of new prices, including clauses about who sets these prices. This variation would allow for the ACCC to determine new prices in circumstances where it is considered that NBN Co faced weak incentives to set new prices efficiently..

While these variations would *permit* the ACCC to determine prices in certain circumstances, the ACCC expects that it would not do so in most circumstances. The ACCC recognises that it is desirable for NBN Co to have a degree of pricing flexibility in certain circumstances.

Nonetheless, the possibility of ACCC recourse could in and of itself reduce the likelihood that the sorts of circumstances where it would be desirable for the ACCC to determine prices would arise.

The ACCC notes that, in determining new prices in an Access Determination, it would be required by Part XIC to take into account particular matters specified by Part XIC — such as NBN Co's legitimate business interests, the interests of access seekers and whether the determination would promote the long-term interests of end-users.

5.5. Long-term revenue constraint

This section discusses the ACCC's preliminary views about the long-term revenue constraint methodology in the SAU (including prudency commitments).

As noted in section 5.1, the SAU contains a long-term revenue constraint methodology, which is based on the building block methodology often adopted in regulating utilities, but which also includes an 'initial cost recovery account'.⁵⁸³

The long-term revenue constraint methodology is aimed at providing assurance to NBN Co that it will not be precluded by the SAU from being able to recover its efficient costs of supply over the term of the SAU (including a normal commercial return), and to access seekers that NBN Co will be able to recover no more than this.

The key components of the long-term revenue constraint are annual revenue requirements, a regulatory asset base (RAB) and an initial cost recovery mechanism:

- The long-term revenue constraint methodology would be applied to determine 'annual revenue requirements' which represent the amount of revenue that NBN Co would be required to earn to recover its annualised costs (including a normal commercial return) in a particular year.⁵⁸⁴
- The RAB represents the value of capital investments made by NBN Co. The SAU proposes a RAB roll-forward process (the 'RAB roll-forward equation') to determine how these capital investments would be recovered over time.⁵⁸⁵
- The initial cost recovery account would allow NBN Co to defer the recovery of initial revenue shortfalls. NBN Co assumes that for a period of time, given the levels of its initial prices, the expected low initial take-up of the NBN and the proposed price controls, it will be unlikely to earn sufficient revenues to meet its annual revenue requirements. The SAU establishes that any such revenue shortfalls will be included in an initial cost recovery account.⁵⁸⁶

The long-term revenue constraint methodology contains some elements that would remain unchanged for the full SAU term, via the combined operation of Modules 0, 1 and 2, as follows:

- the RAB roll-forward equation — the initial value of the RAB would be zero and it would then be rolled-forward each year by adding the actual capital expenditure that NBN Co incurred in the previous year;
- the adoption of the initial cost recovery account; and

⁵⁸³ This section discusses Schedules 1E, 1F, 1G and 2D of the SAU.

⁵⁸⁴ NBN Co Supporting submission, p. 114.

⁵⁸⁵ Ibid, p. 114.

⁵⁸⁶ Ibid, p. 114.

- the building block components that can be included in the annual revenue requirements.

On the other hand, the way in which the value of the building block components which make up the annual revenue requirements and the value of the initial cost recovery account would be calculated would change over the SAU term, as follows:

- During Module 1, the annual revenue requirements would be determined annually by NBN Co, by applying methodologies set out in the SAU to calculate the value of each building block component for the preceding year. NBN Co would then update the initial cost recovery account based on the difference between these annual revenue requirements and the actual revenues NBN Co had earned in the preceding year. NBN Co is required to report the values of its RAB, annual revenue requirements and initial cost recovery account to the ACCC annually.
- During Module 2, NBN Co's annual revenue requirements would be determined ex-ante, based on three to five year forecasts of each building block component — the ACCC would approve or reject these forecasts. Module 0 requires NBN Co to submit these forecasts as part of replacement module applications — the forecasts must be calculated in a manner consistent with a number of methodologies and criteria contained in Module 2. These methodologies and criteria are fixed principles; the ACCC could not reject the replacement module application for 'a reason concerning' the fixed principle. Whilst the initial cost recovery account is in operation, it would be updated based on the difference between the forecast annual revenue requirements and the forecast actual revenues that NBN Co expects to earn.

Submissions about the principle of adopting the long-term revenue constraint methodology

NBN Co states that:

- under the long-term revenue constraint methodology it would be allowed to recover its prudently incurred costs over time (inclusive of an appropriate return on capital) but no more;⁵⁸⁷
- it has adopted a building block approach to calculating its annual revenue requirements that is consistent with that commonly used in utility regulation;⁵⁸⁸
- its RAB approach is consistent with established regulatory practice, including the ACCC's adoption of the building block model for fixed access services pricing in place of the total service long run incremental cost (TSLRIC) model in response to industry demands for greater certainty over time in the ACCC's pricing framework;⁵⁸⁹ and
- the initial cost recovery account mechanism is of particular importance in its operating environment because it recognises the timing difference between the costs of the initial network build and when revenues are received, and facilitates the transition to the NBN by allowing entry-level services to be priced with reference to wholesale legacy network prices (as the recovery of losses can be deferred until later in the SAU term).⁵⁹⁰

The Synergies report states that:

⁵⁸⁷ Ibid, p. 113.
⁵⁸⁸ Ibid, p. 117.
⁵⁸⁹ Ibid, p. 119.
⁵⁹⁰ Ibid, p. 113.

- NBN Co's building block and RAB approach is similar to that used in other regulatory contexts in Australia, and that it can reasonably be expected to be efficient on the basis that the elements of the approach are consistent with NBN Co recovering no more than its prudently incurred costs.⁵⁹¹
- NBN Co's adoption of the initial cost recovery account is efficient given the context of NBN Co's operating environment and that loss capitalisation (that is, the initial cost recovery account) is an accepted feature of undertakings where a network business is in its developmental stages and initial revenue is low.⁵⁹²

The report by Ordover and Shampine states that the long-term revenue constraint methodology as a whole, including the initial cost recovery account, is a credible form of rate of return regulation intended to guarantee an eventual return on NBN Co's investment.⁵⁹³ It considers that NBN Co's general approach of using a credible long-term commitment to a rate of return acceptable to investors is commonly used, and a reasonable and effective means of encouraging investment.⁵⁹⁴

NBN Co's views on the different approaches to implementing the long-term revenue constraint methodology in Module 1 and 2 are discussed in sections 5.5.1 and 5.5.2 below.

Submissions did not raise concerns with the adoption of the key components of the long-term revenue constraint methodology, these being the annual revenue requirements, the RAB, and the initial cost recovery account. However, concern was raised with their operation in practice over Module 1 and Module 2. These views are discussed throughout the relevant sections.

Preliminary ACCC views about the principle of adopting the long-term revenue constraint methodology

The ACCC considers that the adoption of the long-term revenue constraint methodology would be likely, in principle, to:

- encourage efficient investment in, operation of, and use of the NBN;
- allow NBN Co to recover its direct costs;
- have appropriate regard to NBN Co's legitimate business interests; and
- take appropriate account of the operational and technical requirements necessary for the safe and reliable operation of the NBN.

This is for the following reasons.

The adoption of the long-term revenue constraint methodology is 'locked-in' for the term of the SAU. The SAU term would approximately correspond with the economic life of key network infrastructure such as civil works and passive equipment for the fibre network, with wireless and satellite network infrastructure having shorter economic lives. Given that a significant proportion of NBN Co's investments over the SAU term would occur in its early years, locking in the building block components that can be recovered under the long-term revenue constraint methodology would provide certainty around the recovery of NBN Co's initial (prudent) costs. This is because capital expenditure would be depreciated over the economic life of the NBN and would be fully or near fully depreciated at the end of the SAU term, and all prudent capital expenditure during the initial network build is rolled into the RAB, which cannot be re-valued at any point during the SAU period. The annual revenue requirement, which incorporates a value

⁵⁹¹ Synergies Economic Consulting report, p. 55.

⁵⁹² Ibid, p. 82.

⁵⁹³ Ordover and Shampine report, p. 16.

⁵⁹⁴ Ibid, p. 16.

for asset depreciation in each year and a return on the RAB, would therefore allow NBN Co recover any prudent costs incurred during the initial rollout of the NBN.

Whilst the annual revenue requirement provides certainty in relation to the prudent costs that NBN Co is permitted to recover, given the revenue shortfalls that NBN Co expects to incur in the early years of the SAU period, full cost recovery may not be achieved until later in the SAU period. Like the RAB, the initial cost recovery account cannot be re-valued over time and it is rolled forward with revenue shortfalls using a locked in mechanism.⁵⁹⁵ Therefore, given sufficient future revenue streams over the SAU term, the combined operation of the initial cost recovery account and RAB roll-forward mechanisms would provide certainty around NBN Co's ability to recover its prudent costs.

In principle therefore, the long-term revenue constraint methodology would allow NBN Co to recover, via access prices, its prudently incurred costs and no more over time. This would in turn encourage efficient investment and operating expenditure — if NBN Co expected to recover more than the prudent costs of its investment and its prudent operating expenditure, this might encourage inefficient over-expenditure by NBN Co; conversely, if NBN Co expected not to be able to recover its prudent costs, this may discourage it from making prudent investments and engaging in prudent operating and maintenance activities. (In this context, the ACCC refers to a 'constrained' efficiency, in that the ACCC is not assessing the efficiency of the policy parameters that the Government has set for NBN Co; rather, it is only assessing whether NBN Co will be encouraged to implement those policy parameters in an efficient manner).

In addition, in allowing NBN Co to recover its prudent costs over time (including a normal commercial return), and no more:

- efficient use of the NBN would also be encouraged in an allocative sense over the SAU term, because the revenues that NBN Co can earn from its access prices would over time reflect only NBN Co's prudently incurred costs — end-users would therefore be charged no more or less than NBN Co's prudent costs of supply, and so the value end-users place on NBN Co's services will be equal to the value of the resources used by NBN Co to supply the services;
- NBN Co will be allowed to recover its direct costs of providing access (and no more), and earn a normal commercial return on its investment, in turn satisfying its legitimate business and commercial interests; and
- the methodology has appropriate regard to the operational and technical requirements necessary for the safe and reliable operation of the NBN and NBN Co's services, as it allows NBN Co to recover the operating and capital expenditure associated with such things.

The ACCC has assessed the long-term revenue constraint methodology in order to determine whether the methodology results in NBN Co being systematically under- or over-compensated relative to its efficient costs. If the methodology establishes an expectation that NBN Co will be able to recover the prudent cost of its investment (including a normal commercial return) over time and no more, then the net present value of expected future cash flows should be zero.

The assumptions which underpin this expectation with respect to the timing of cash flows should reflect NBN Co's actual circumstances as accurately as possible.

NBN Co has implicitly assumed in its long-term revenue constraint methodology that capital expenditure will be incurred evenly throughout the year, and that on average, it will be incurred

⁵⁹⁵ It is noted that the equations which determine the value of the initial cost recovery account differ between Module 1 and Module 2; however this is due to the fact that the inputs are derived from forecast values of revenues and expenditure during Module 2, whereas the inputs during Module 1 are derived from NBN Co's actual revenues received and expenditure incurred.

half-way through the year. To compensate for the fact that any capital expenditure incurred during the year will not be rolled into the RAB and thus will not contribute to the return on the RAB until the following year, the SAU proposes that an additional half-WACC be applied to all capital expenditure before it enters the RAB. This would mean that the capital expenditure rolled into the RAB would be inflated by half the WACC (to reflect the six month average period between capital expenditure being incurred and being rolled into the RAB).

However, the long-term revenue constraint methodology also assumes that all operating expenditure will be incurred, and revenues received, at the end of the year.

This means that there is an inconsistency within NBN Co's assumptions about the timing of cash flows. If these assumptions do not reflect NBN Co's actual circumstances as accurately as possible (if, for example, operating expenditure is also incurred and revenues are also received evenly throughout the year rather than at the end of the year), and the long-term revenue constraint methodology is applied as it is set out in the SAU, this may result in a scenario where NBN Co is systematically over-compensated with respect to its prudent costs. This means that NBN Co could expect to earn a return on its investment in excess of what may otherwise be reasonable (where the assumptions about the timing of cash flows are aligned).

The ACCC's assessment has indicated that the methodology as proposed in the SAU results in a net present value of zero of expected future cash flows. However, this result depends on the assumptions regarding the timing of NBN Co's cash flows as implied in the SAU.

Submissions from interested parties did not provide views or information in relation to the half-WACC applied to capital expenditure or the cash flow timing assumptions implied in the SAU.

The ACCC is seeking further information from interested parties about whether the assumptions made in the SAU about cash flow timing are likely to reflect NBN Co's actual circumstances.

The ACCC also notes that there is a distinction between defining the cost components or types of costs that can be recovered (referred to as the 'building block components') under the long term revenue constraint methodology versus the methodologies that are used to calculate the values of those cost components. While allowing the recovery of a particular cost component might in principle be appropriate in the context of encouraging efficient investment and operations, allowing NBN Co to recover its direct costs and in having regard to its legitimate business interests, the manner in which the value of that cost component is determined is also relevant to the assessment. To the extent that a particular methodology leads to over- or under-recovery of NBN Co's efficient costs (including a normal commercial return), this can result in efficient investment not being encouraged, and NBN Co being over or under-compensated relative to its direct costs and its legitimate business interests.

The ACCC is not satisfied that the methodologies proposed in the SAU for calculating the values of the building block components would mean that, at all times over the duration of the SAU term, NBN Co had an expectation that it would be allowed to recover only its prudent costs. In turn, the ACCC is not satisfied that the proposed implementation of the long-term revenue constraint methodology will be reasonable at all times during the SAU term.

The remainder of this section discusses the methodologies proposed in the SAU for calculating the values of the inputs to the long-term revenue constraint methodology, and is structured as follows:

- Section 5.5.1 discusses the long-term revenue constraint in Module 1;
- Section 5.5.2 discusses the long-term revenue constraint in Module 2 and replacement modules; and
- Section 5.5.3 summarises the ACCC views on the long-term revenue constraint methodology.

5.5.1. Long-term revenue constraint in Module 1

This section discusses how the inputs into the RAB, annual revenue requirements and the initial cost recovery account would be calculated in Module 1.⁵⁹⁶

5.5.1.1. Adoption of ex-post compliance approach in Module 1

During Module 1, the RAB would be calculated annually by NBN Co adding actual capital expenditure to the RAB, and subtracting actual depreciation and actual disposal of assets.⁵⁹⁷ The inclusion of actual capital expenditure would be subject to NBN Co complying with a number of prudency requirements (discussed in section 5.5.1.2 below).⁵⁹⁸

NBN Co's annual revenue requirements would be calculated by NBN Co applying methodologies set out in Module 1 for determining the value of the building block components.⁵⁹⁹ (The building block components are operating expenditure, depreciation, return on capital —calculated as the WACC multiplied by the RAB, tax and an annual construction-in-progress allowance). The methodologies for calculating the value of each of the building blocks are discussed below — of note, NBN Co may include its actual operating expenditure in the annual revenue requirement, subject to complying with a number of prudency requirements.⁶⁰⁰

These processes would be 'self-administering', in that NBN Co would be responsible for applying the methodologies each year to determine the values for the RAB, annual revenue requirements and the initial cost recovery account.⁶⁰¹ The ACCC would have no role in approving or overseeing the application of these methodologies on an ex-ante basis. Rather, the ACCC would monitor and enforce compliance with these methodologies on an ex-post basis⁶⁰² — if it considered that NBN Co had applied the methodologies incorrectly, it would be able to pursue enforcement action in the Federal Court for a breach of the SAU.

Under Schedule 1G of the SAU:

- NBN Co would be required to report the values of its RAB, annual revenue requirements and initial cost recovery account to the ACCC annually (including forecast values for future years);⁶⁰³
- NBN Co would be required to submit annual compliance reports that certify that NBN Co had complied with the prudency requirements in the SAU that apply to capital and operating expenditure;⁶⁰⁴ and
- the ACCC could request additional information.⁶⁰⁵

NBN Co states that this information would provide the ACCC with clear and transparent oversight of NBN Co's compliance with its cost recovery commitments in Module 1.⁶⁰⁶

Submissions

⁵⁹⁶ This section discusses Schedules 1E, 1F and 1G of the SAU.
⁵⁹⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.2.1(b).
⁵⁹⁸ Ibid, Schedule 1E, clause 1E.3.1.
⁵⁹⁹ Ibid, Schedule 1F, clause 1F.3.1.
⁶⁰⁰ Ibid, Schedule 1F, clause 1F.7.1.
⁶⁰¹ Ibid, Schedule 1E, clauses 1E.1.2(a), 1F.1.3(b) and 1F.1.3(c).
⁶⁰² Ibid, Schedule 1G.
⁶⁰³ Ibid, Schedule 1G, clauses 1G.1.2 and 1G.1.3.
⁶⁰⁴ Ibid, Schedule 1G, clause 1G.2.1.
⁶⁰⁵ Ibid, Schedule 1G, clause 1G.2.2.
⁶⁰⁶ NBN Co Supporting submission, p. 156.

NBN Co did not provide views about the fact that the long-term revenue constraint methodology is administered by NBN Co, with the ACCC's role only being in relation to ex-post compliance.

However, submissions raised the following points:

- Telstra considers that there should be greater regulatory oversight of NBN Co's long-term revenue constraint methodology calculations and the inputs into these calculations (including expenditure amounts).⁶⁰⁷
- Macquarie Telecom considers that the ACCC should have an explicit role to review or approve NBN Co's calculations of its annual revenue requirements — it states that, without such independent oversight of NBN Co's calculations, NBN Co has little incentive to ensure that they are reasonable and appropriately calculated.⁶⁰⁸

Similarly, the NERA report submitted by Optus considers that:

- in the absence of a workable incentive regime, there would be considerable merit in the SAU providing for some form of supervisory or review arrangement to cover expenditure being undertaken over the initial period (say, three to five years) — such review arrangements could be in the form of either an ex-ante or ex-post review of NBN Co expenditure;
- the SAU should establish the principles by reference to which such review would be undertaken, including that NBN Co has a reasonable prospect of recovering its prudent and efficient expenditure; and
- the potential for efficiency gains implied by the very substantial scale of expenditure in the initial rollout phase would comfortably outweigh the costs associated with such a review.⁶⁰⁹

Preliminary ACCC views

Typically, regulated businesses are required to submit forecast annual revenue requirements (including forecast capital and operating expenditure) to the regulator for approval.⁶¹⁰ The ACCC is not aware of any regulatory regime in which the regulated revenues are calculated by the regulated business, and these calculations can only be disputed or varied via ex-post enforcement action in the courts.

In considering whether NBN Co's proposed approach of administering the methodology itself is appropriate, the ACCC has assessed whether, for each of the building block components — including capital and operating expenditure — NBN Co would have both an incentive and the ability to overstate its costs relative to efficient levels. The ACCC considers that if it does, allowing NBN Co to administer the methodology itself could result in NBN Co being over-compensated relative to its efficient costs (including a normal commercial return given the risks associated with its investment). The ACCC also considers that it is important that affected parties are able to have confidence that administration of the methodology is done in an impartial manner.

Generally speaking, the ACCC considers that — under the SAU as currently proposed — NBN Co is not likely to face incentives to invest efficiently and incur operating expenditure efficiently. As discussed previously, the ACCC is not satisfied that the proposed CPI-

⁶⁰⁷ Telstra submission, p. 130.

⁶⁰⁸ Macquarie Telecom submission, p. 16.

⁶⁰⁹ NERA Economic Consulting, *Review of the Long Term Revenue Constraint in NBN Co's SAU: A report for Optus*, 18 January 2013, p. 12. (NERA report)

⁶¹⁰ For example, electricity and gas transmission and distribution network service providers which are regulated by the AER. See the National Electricity Rules (Chapter 6) and the National Gas Rules (Part 9).

1.5 per cent price control will encourage NBN Co to invest efficiently or incur efficient operating expenditure, due to NBN Co's ability to withdraw non-reference offers.

However, even if NBN Co did face some incentives to invest and operate efficiently, the operation of the ex-post compliance approach in practice will likely reduce these incentives to invest and operate efficiently. This is because a number of the clauses in Module 1 which describe how the values of the building block components will be calculated contain room for differing interpretations of whether or not the methodologies have been applied correctly, which could, in practice, allow NBN Co to overstate its costs relative to an efficient level. Given that the ACCC would only have a compliance role in overseeing whether NBN Co had correctly applied the methodologies in Module 1, in the event NBN Co did not correctly apply the methodologies, the only recourse for the ACCC would be to pursue enforcement action in Court. The implication of this is that, even if the ACCC considered that inefficient costs had been included in the regulatory cost base, provided that those costs complied with the clauses set out in the SAU, NBN Co would be entitled to recover those costs.

The ACCC considers that either of the above two conclusions, in isolation, will mean that it cannot be satisfied that NBN Co's administration of the long-term revenue constraint methodology would ensure that it is only able to earn revenues that reflect efficient costs.

Further, the ACCC considers that NBN Co administering the application of the methodology could give rise to perceptions that the outputs of the methodology are not impartial.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the ACCC calculate the values of the building block components that are inputs to the annual revenue requirements, as well as the roll-forward of the RAB and initial cost recovery account. The nature of this role is discussed further in the Consultation Paper on the Notice to Vary.

The ACCC considers that, if these calculations are performed by an independent party (rather than NBN Co), confidence would be provided to affected stakeholders that the outcomes have been calculated in an impartial manner. The ACCC also considers that, it would enhance the prospect that only the costs of efficient investments and expenditure are included in the RAB, annual revenue requirements and the initial cost recovery account. By providing for an ACCC role in this manner, NBN Co's incentives to invest and operate efficiently will likely be enhanced.

The remaining sections provide the ACCC's assessment of the individual methodologies for calculating capital expenditure, operating expenditure, the rate of return, depreciation, tax and the annual construction-in-progress allowance, including the implications of an ex-post compliance approach to calculating these values.

5.5.1.2. Capital expenditure

During Module 1, NBN Co would be allowed to roll into its RAB all actual capital expenditure that satisfies certain prudence conditions contained in Schedule 1E of the SAU. These conditions are:

- The 'Prudent Design Condition' — capital expenditure that is materially consistent with or within the scope of NBN Co's Network Design Rules.⁶¹¹
- The 'Prudent Cost Condition' — capital expenditure incurred using competitive tendering and procurement processes that comply with the NBN Co Procurement Rules.⁶¹²

⁶¹¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.4.

⁶¹² *Ibid*, Schedule 1E, clause 1E.5.

The SAU allows NBN Co to change the Network Design Rules over the SAU term. During Module 1, NBN Co can update the Network Design Rules under the following circumstances:⁶¹³

- Firstly, NBN Co can update the rules to reflect a network design change that is in connection with a 'permitted variation' (outlined below).
- Secondly, NBN Co can update the rules based on a change to the Government's *Statement of Expectations*, or any Shareholder Minister, legal, policy, regulatory or administrative requirement that has the effect of varying the network design scope.
- Thirdly, NBN Co can update the rules by following a customer consultation and endorsement process (outlined below).

Module 1 also establishes that capital expenditure does not have to meet the prudent design and prudent cost conditions for a number of 'deemed prudent' categories.⁶¹⁴

Submissions

NBN Co states that it adopts this approach to capital expenditure in Module 1 to reflect the fact that NBN Co is building an entirely new network to satisfy a number of objectives (as set out in the Government's *Statement of Expectations*) and that in all circumstances it is likely to be unworkable to apply the standard utility regulation approach.⁶¹⁵ NBN Co recognises that its proposed approach does not rely on ex-ante regulatory approval of forecasts or any ex-post reviews of capital expenditure; but argues that compliance with the prudent design condition and the prudent cost condition places appropriate controls on NBN Co's capital expenditure.⁶¹⁶

NBN Co also argues that these prudency requirements are intended to complement the significant expenditure incentives already faced by NBN Co as a result of its commercial context and the rigorous cost control and transparency measures which apply to it as a Government Business Enterprise.⁶¹⁷

The Synergies report states that the capital expenditure prudency conditions in the SAU, together with the deemed prudent categories of expenditure, are appropriate mechanisms to ensure that NBN Co does not deviate from efficient levels of investment during the network rollout.⁶¹⁸ Furthermore, the Ordover and Shampine report considers that the prudent design and prudent cost conditions are reasonable as a means of addressing potential over-investment in the network.⁶¹⁹

The Department of Broadband Communications and the Digital Economy (DBCDE) submits that:

- NBN Co has been directed by the Government to build the NBN in a particular way so as to achieve the Government's policy objectives; and
- these are design and operational parameters that have been set for NBN Co by the Government and are fixed elements in the assessment of the SAU.⁶²⁰

On the other hand:

⁶¹³ Ibid, Schedule 1E, clause 1E.6.4(a).

⁶¹⁴ Ibid, Schedule 1E, clause 1E.3.2.

⁶¹⁵ NBN Co Supporting submission, p. 210.

⁶¹⁶ Ibid, pp. 209-210.

⁶¹⁷ Ibid, pp. 210.

⁶¹⁸ Synergies Economic Consulting report, p. 64.

⁶¹⁹ Ordover and Shampine report, p. 18.

⁶²⁰ DBCDE submission, p. 2.

- Telstra, Optus, Macquarie Telecom and Henry Ergas submit that NBN Co would not face incentives external to the SAU to encourage efficient investment and a number of cost incentives that private firms face do not apply to NBN Co.⁶²¹
- Telstra and Optus do not consider that the approach in Module 1 would generate incentives as NBN Co is able to recover a return on all capital expenditure and any cost inefficiencies can be recovered in future years rather than resulting in financial losses.⁶²²
- Similarly, the NERA report submitted by Optus considers that, when compared against all regulatory regimes of which they are aware, the arrangements proposed in the SAU are anomalous because they provide no incentive for NBN Co to minimise its costs over the 27 year period of the SAU.⁶²³
- Telstra considers that NBN Co's unique circumstances suggest that NBN Co's spend should be subject to greater prudence incentives and regulatory review than would normally be expected for a more established network service provider.⁶²⁴
- The CCC states that it accepts that there is a good argument in the early rollout years for NBN Co to be afforded flexibility with regard to prudence issues, but expresses concern that there are extremely large areas of expenditure, including expenditure to large downstream retailers Telstra and Optus, which are deemed efficient.⁶²⁵
- Optus submits that the prudent design and prudent cost conditions set a very low hurdle in terms of the criteria that needs to be satisfied for NBN Co to be able to include capital expenditure in its RAB.⁶²⁶ Optus notes that NBN Co's expert advice from Synergies provides minimal justification for their conclusion that these conditions are reasonable.⁶²⁷

Submissions on the Network Design Rules

On the Network Design Rules, NBN Co submits that:

- its objective is to provide certainty with respect to the capital expenditure it may recover in relation to the design of the NBN;⁶²⁸ and
- if the SAU is accepted, the Network Design Rules would provide a foundation for the design of the fibre, wireless and satellite networks in relation to which NBN Co would be able to incur capital expenditure over time and recover it via the pricing methodology outlined in the SAU, provided that the prudence conditions are met.⁶²⁹

⁶²¹ Telstra submission, p. 65; Optus submission (Public version), p. 34; Macquarie Telecom submission, p. 17; Henry Ergas, *Submission to the ACCC in relation to the revised Special Access Undertaking filed by NBN Co*, 10 October 2012, p. 1.

⁶²² Telstra submission, pp. 19-20; Optus submission (Public version), pp. 35-36.

⁶²³ NERA report, p. 10.

⁶²⁴ Telstra submission, p. 75.

⁶²⁵ CCC submission, p. 4.

⁶²⁶ Optus submission (Public version), p. 62.

⁶²⁷ Ibid, p. 62.

⁶²⁸ NBN Co, *Network Design Rules*, 18 September 2012, p. 1.

⁶²⁹ Ibid, p. 1.

NBN Co has submitted supporting advice from Analysys Mason which concluded that NBN Co's design of its fibre, wireless and satellite networks, as outlined in the Network Design Rules, reflects an efficient and prudent network design.⁶³⁰

Submissions from interested parties relating to the Network Design Rules do not provide views on the physical design characteristics in the Network Design Rules. However, Telstra submits that the deeming prudent of all expenditure which falls within NBN Co's network design during the rollout, with no ACCC review or establishment of expenditure efficiency benchmarks, is not likely to provide sufficient incentives to avoid inefficient expenditure.⁶³¹

Submissions on changes to the Network Design Rules

NBN Co states that it will need an appropriate degree of flexibility to improve and alter the design of the NBN as the network is being rolled out.⁶³² It submits that it has preserved a limited and appropriate degree of flexibility within the Network Design Rules themselves, but has also provided for permitted variations from the Network Design Rules.⁶³³

The Synergies report states that the inclusion of the customer engagement and endorsement process in the SAU in relation to changes to the Network Design Rules is appropriate.⁶³⁴

Submissions raised the following points:

- Telstra submits that, given the likely development in technology and the evolution of end-user preferences, the updating of the Network Design Rules should not be left to NBN Co's discretion for the entire SAU term.⁶³⁵
- Optus refers to its submission on the December 2011 SAU, which it notes is still applicable. In this submission, Optus states that there is considerable scope for NBN Co to make changes to the Network Design Rules through the variation and enhancement processes (that is, permitted variations) without an appropriate level of scrutiny or ACCC oversight.⁶³⁶
- Macquarie Telecom considers that concerns with the Network Design Rules and the processes by which they may be updated by NBN Co will most likely arise during the early years of NBN Co's operation.⁶³⁷

Submissions on the 'Prudent Cost Condition'

On the prudent cost condition, NBN Co submits that:

- best commercial outcomes are evaluated considering all the relevant costs, benefits and risks on a whole-of-life basis,⁶³⁸
- the principle means by which it must incur capital expenditure and third party operating expenditure in order to satisfy the prudent cost condition is through a competitive tendering and procurement process,⁶³⁹

⁶³⁰ Analysys Mason, *Review of the efficiency and prudence of NBN Co's fibre, wireless and satellite network design*, 26 September 2012, p. 2.

⁶³¹ Telstra submission, p. 75.

⁶³² NBN Co Supporting submission, p. 217.

⁶³³ Ibid, p. 217.

⁶³⁴ Synergies Economic Consulting report, p. 73.

⁶³⁵ Telstra submission, p. 23.

⁶³⁶ Optus, *Submission to the ACCC Supplementary Consultation: NBN Co's Special Access Undertaking*, 30 March 2012, p. 33.

⁶³⁷ Macquarie Telecom submission, p. 19.

⁶³⁸ NBN Co Supporting submission, p. 222.

⁶³⁹ Ibid, p. 222.

- while the competitive tendering process in the prudent cost condition is the main basis on which NBN Co will incur costs, some flexibility is required to give effect to NBN Co's procurement strategy in a manner that would still fulfil the requirement that NBN Co prudently incurs its costs,⁶⁴⁰ and
- some of the concepts considered in the prudent cost condition are similar to concepts which are used in the Commonwealth Procurement Rules (for example, commodity markets and exceptionally advantageous acquisitions).⁶⁴¹

Optus submits that:

- the prudent cost condition criteria do not guarantee that only prudently incurred costs will be allowed to be recovered through the RAB;⁶⁴² and
- the inclusion of the clause allowing the CEO to essentially deem that competitive tendering need not be adopted makes the prudence provisions unenforceable, and therefore, not effective in ensuring only prudent costs are incurred.⁶⁴³

Submissions on the 'Deemed Prudent' categories

On the deemed prudent categories, NBN Co submits that the categories relate primarily to initial and interim arrangements that NBN Co has already entered into, as well as the arrangements that it has negotiated with Telstra and Optus.⁶⁴⁴

Submissions raised the following points:

- Telstra, Optus, Macquarie Telecom and the CCC all submit that the SAU deems prudent potentially significant amounts of capital expenditure, which will be rolled into the RAB without any initial or ongoing regulatory scrutiny.⁶⁴⁵
- The CCC argues that the deemed prudent expenditures have the potential to impact on competitive conduct — if they are not efficient, competitors suffer a double blow: their retail competitors gain windfall benefits and they themselves pay inflated prices over time to allow NBN Co to recover these costs.⁶⁴⁶
- Macquarie Telecom submits that deeming potentially large categories of expenditure as prudent appears to be inconsistent with the notion that NBN Co would only be allowed to recover expenditure that is efficient.⁶⁴⁷ It also argues that the threshold of determining what is efficient in this context appears to be low.⁶⁴⁸
- Optus submits that NBN Co has provided little assessment as to the prudence of the deemed prudent categories of expenditure.⁶⁴⁹ As a result, Optus considers that the ACCC does not have before it sufficient information to make an informed assessment as to whether this expenditure has been prudently incurred.⁶⁵⁰

⁶⁴⁰ Ibid, p. 223.

⁶⁴¹ Ibid, p. 223.

⁶⁴² Optus submission (Public version), p. 63.

⁶⁴³ Ibid, p. 64.

⁶⁴⁴ NBN Co Supporting submission, p. 212.

⁶⁴⁵ Telstra submission, p. 74; CCC submission, p. 6; Macquarie Telecom submission, p. 18; Optus submission (Public version), p. 41.

⁶⁴⁶ CCC submission, p. 6.

⁶⁴⁷ Macquarie Telecom submission, p. 18.

⁶⁴⁸ Ibid, p. 18.

⁶⁴⁹ Optus submission (Public version), p. 60.

⁶⁵⁰ Ibid, p. 60.

Preliminary ACCC views

The ACCC considers that the majority of, if not all, capital expenditure incurred during the network rollout would be likely to fall within the scope of the capital expenditure requirements set out in Module 1, and in turn be allowed to be included in the RAB.

The ACCC recognises that, in most contexts, allowing a regulated business to recover its actual expenditure does not encourage efficient investment. This is because if the business incurs higher capital expenditure than it expected over a regulatory period, it is able to recover the additional expenditure from customers (subject to any price controls). Conversely, if it incurs lower capital expenditure than expected, these savings may be passed through to customers rather than being retained by the business. Together, these do not provide effective incentives on the business to either limit over-expenditure or seek cost savings because it is not rewarded from doing so.

In the current context, in theory, the ACCC considers that there is potential for the price controls to create incentives for NBN Co to operate and invest efficiently. As discussed in section 5.3, the combination of demand and revenue sufficiency risk and the price control in the SAU means that, if NBN Co over-invests or incurs expenditure in an inefficient manner, this will increase the likelihood that it will be unable to recover its investment via its prices over the SAU term. In effect, this means that allowing NBN Co to essentially roll into the RAB all of its actual capital costs might not lead to over-expenditure and might not dissuade NBN Co from seeking cost savings.

In this regard, as noted in section 5.3, it is unclear when throughout the SAU term any revenue sufficiency risk that NBN Co faces will begin to reduce. Having said this, the ACCC's analysis suggests that NBN Co is likely to be subject to a high degree of revenue sufficiency risk for most if not all of Module 1. In turn, the price control may provide incentives for it to invest efficiently during this period.

However, as noted in section 4.2, the ACCC considers that NBN Co's ability to withdraw non-reference offers reduces the degree of demand risk, and therefore revenue sufficiency risk, that it is subject to. This in turn reduces the efficacy of the price controls in creating incentives for NBN Co to invest efficiently.

In light of this, the ACCC is not satisfied that the price controls will ensure that the actual capital expenditure that NBN Co incurs during the rollout period will be efficient.

In any event, even if NBN Co were subject to greater incentives to invest efficiently as a result of the price controls, the ACCC considers that the prudent design condition and the prudent cost condition may nonetheless allow NBN Co to overstate its efficient costs during Module 1. As noted, the ACCC considers that the majority of, if not all, capital expenditure incurred during the network rollout would be likely to fall within the scope of these conditions. To the extent that the ACCC is unable to prevent NBN Co from recovering inefficiently incurred investments via ex-post enforcement, the incentives for NBN Co to invest efficiently will likely be significantly reduced.

As noted above, in this context, the ACCC refers to a 'constrained' efficiency, in that the ACCC is not assessing the efficiency of the policy parameters that the Government has set for NBN Co; rather, it is only assessing whether NBN Co will be encouraged to implement those policy parameters in an efficient manner. In this regard:

- NBN Co has been directed by the Government to construct the network within a particular time period and to provide particular services via this infrastructure; and
- NBN Co's expenditure decisions during the network rollout would be subject to a degree of scrutiny through government and parliamentary processes that are not always faced by other regulated businesses.

The ACCC considers that government directions and parliamentary processes that apply to NBN Co could limit the potential for what might otherwise be considered inefficient expenditure by NBN Co. However, these mechanisms are unlikely to be effective in isolation.

The ACCC also notes that, in most contexts, it is appropriate for regulated businesses to be subject to more explicit incentive-based mechanisms (such as the forecast based approach that NBN Co has proposed in Module 2) to address the lack of incentives generated by allowing the business to recover its actual capital expenditure. However, during the network rollout phase, forecasts of NBN Co's expenditure are likely to be (potentially highly) inaccurate, given the novel nature of the rollout.

Given that NBN Co will face more uncertainty than other regulated utilities about how much it is going to spend in any given year, if NBN Co's capital expenditure were subject to incentive mechanisms based on up-front expenditure approval or other ex-ante expenditure restrictions, NBN Co could be discouraged from making otherwise efficient investments (in the context of Government policy parameters for NBN Co). This could lead to lower levels of investment that reduce service quality and delay the network rollout. This would be unlikely to encourage investment in delivering the Government's policy objectives for the NBN.

The ACCC considers however that once NBN Co has constructed its network and begins earning stable revenue streams — and enters into its loss recovery and revenue cap phases — it should also be subject to such mechanisms. (This is discussed in section 5.5.2.)

The ACCC provides its views on the following matters in the rest of this section:

- the Network Design Rules;
- changes to the Network Design Rules via permitted variations and the customer engagement process;
- competitive tendering and procurement; and
- the deemed prudent categories.

Preliminary ACCC views — Network Design Rules

As noted, for capital expenditure to be included in the RAB, it must first satisfy the 'Prudent Design Condition'.⁶⁵¹ This establishes that capital expenditure that is "materially consistent with or within the scope of" NBN Co's Network Design Rules can be included in the RAB.⁶⁵²

The Network Design Rules provide an overview of NBN Co's initial physical network architecture and the high level design of NBN Co's fibre, wireless and satellite networks. NBN Co states that the document describes the high level solution that has been developed by NBN Co to achieve the network coverage objectives established by the Government's *Statement of Expectations*.⁶⁵³ Generally speaking, the Network Design Rules specify the dimensioning of the fibre, wireless and satellite networks, but exclude detailed descriptions of NBN Co's IT platforms and systems relating to network management, data communications, control and lawful interception.

The ACCC recognises that aspects of the Network Design Rules are based on an initial network design scope that is required by the Government. This includes the scope of the network coverage (for example, fibre to 93 per cent of premises) and the choice of fibre technology (for example, gigabit passive optical network). In its assessment of the SAU, the ACCC does not propose to assess the efficiency of the network design and operational

⁶⁵¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.3.1.

⁶⁵² *Ibid*, Schedule 1E, clause 1E.5(a).

⁶⁵³ NBN Co, *Network Design Rules*, 18 September 2012, p. 1.

parameters specified by the Government, and considers, given that NBN Co is responsible for the design, construction and operation of the NBN, that NBN Co is in the best position of all parties to develop the design and operational requirements necessary to implement the Government's stated objectives.

However, the ACCC is not satisfied that allowing NBN Co to determine whether or not particular investments are materially consistent with or within the scope of the Network Design Rules will encourage efficient investment. This is because:

- As discussed above, due to the lack of incentives created by the proposed price control for NBN Co to invest efficiently, NBN Co is unlikely to face particularly strong incentives to only undertake efficient investments if the prudence conditions are the sole mechanisms by which the SAU would encourage efficient investment during Module 1.
- Even if NBN Co faced greater incentives, the expression "materially consistent with or within the scope of" gives NBN Co considerable discretion in determining whether an investment falls within the scope of the Network Design Rules. This means that circumstances could arise whereby NBN Co incurs actual capital expenditure that an independent party, such as the ACCC, would consider is not efficient, but over which there is scope for disagreement as to whether the capital expenditure is materially consistent with, or within the scope of the Network Design Rules.

The ACCC considers that either of these two points, in isolation, will mean that NBN Co is unlikely to face incentives to invest efficiently for the duration of Module 1.

In summary, whilst the ACCC has not considered whether or not the Network Design Rules reflect an efficient network design (because a number of the parameters of the Rules have been set by the Government), the ACCC does not consider that allowing NBN Co to determine whether particular investments fall within the scope of those Rules will create incentives for NBN Co to only undertake efficient investments.

Preliminary ACCC views — changes to the Network Design Rules — permitted variations and customer engagement

As noted, the SAU allows NBN Co to change the Network Design Rules over the term of Module 1 when the change:

- is a 'permitted variation' as set out in the SAU;
- relates to a change to the Government's *Statement of Expectations*, or any Shareholder Minister, legal, policy, regulatory or administrative requirement that has the effect of varying the network design scope;
- is made by following a customer engagement and endorsement process; or
- is made in accordance with the terms of any variation to the SAU or any Access Determination or Binding Rules of Conduct made by the ACCC, to the extent it is not inconsistent with the terms of the SAU.⁶⁵⁴

NBN Co must then provide a copy of the updated Network Design Rules to the ACCC.⁶⁵⁵

The 'permitted variation' categories allow NBN Co to vary and update the Network Design Rules under various scenarios. The permitted variations include changes:

⁶⁵⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.6.4.
⁶⁵⁵ *Ibid*, Schedule 1E, clause 1E.6.4.

- as contemplated by, or made pursuant to, the Network Design Rules;
- that improve performance or functionality and result in the same total cost of ownership;
- that achieves savings in total cost of ownership;
- that are reasonably necessary to establish and maintain quality, reliability and security of supply;
- that are required in connection with a force majeure event;
- that are required in order to comply with the Government's *Statement of Expectations*, or any Shareholder Minister, legal, policy, regulatory or administrative requirement;
- that relate to maintenance, replacement or re-routing of assets that have the substantial primary purpose other than the augmentation or extension of the network;
- network changes within a minor expenditure limit (initially \$100 million); and
- urgent and unforeseen circumstances.⁶⁵⁶

NBN Co must also ensure that each permitted variation is made with the objective of achieving the lowest total cost of ownership.⁶⁵⁷

The ACCC considers that the permitted variation categories are broadly defined and appear to give NBN Co a significant amount of discretion to update or vary the Network Design Rules over the term of Module 1. The permitted variations could allow NBN Co to change the Rules in order for it to be able to determine that inefficient investments fall within the scope of the Rules, in turn undermining any incentives created by the rules for NBN Co to engage only in efficient expenditure.

The ACCC considers that the following permitted variations categories could have this effect:

- Clause 1E.6.2(a)(i): "contemplated by, or made pursuant to, the Network Design Rules." Similar to the discussion on the Network Design Rules, the phrase "contemplated by, or made pursuant to" gives NBN Co considerable discretion in determining whether an investment falls within this definition.
- Clause 1E.6.2(a)(ii): "improves performance or functionality and results in the same total cost of ownership." This clause allows NBN Co considerable discretion in determining whether a network change or investment improves performance or functionality, and whether it results in the same "total cost of ownership".
- Clause 1E.6.2(a)(xi): "urgent and unforeseen network issue." While NBN Co should not be prevented from recovering expenditure associated with urgent and unforeseen events, the phrasing of this clause gives NBN Co considerable discretion in determining whether an event or circumstance was "not reasonably foreseeable by, and was beyond the reasonable control of, NBN Co".
- Clause 1E.6.2(a)(vii): "maintenance, replacement or re-routing of assets that have a substantial primary purpose other than the augmentation or extension

⁶⁵⁶ Ibid, Schedule 1E, clause 1E.6.2(a).

⁶⁵⁷ Ibid, Schedule 1E, clause 1E.6.2(b).

of the network”. The expression “substantial primary purpose” is undefined and therefore gives NBN Co considerable discretion in determining what investments or network changes constitute maintenance, replacement or re-routing of assets.

The ACCC considers that — as NBN Co is given considerable discretion to determine what investments fall within the scope of these clauses — the fact that it is NBN Co that determines whether a change to the Network Design Rules is permitted creates the potential for the Rules to be varied to accommodate inefficient investments.

The ACCC also considers that the following permitted variation category may allow NBN Co to recover inefficient capital expenditure (though the ACCC considers that the scope for differing interpretations as to whether or not a particular investment would fall within the scope of the variation is less than for the above categories):

- Clause 1E.6.2(a)(viii): the minor expenditure limit (initially \$100 million and increased each financial year by CPI). The ACCC is not satisfied that expenditure associated with network changes within this limit will, in all circumstances, represent efficient expenditure. This clause creates the potential for the Network Design Rules to be varied to accommodate inefficient investments.

If NBN Co wishes to make a change to the Network Design Rules that does not fall within the above listed permitted variation categories (or a set of ‘deemed prudent’ categories), NBN Co is required to seek customer endorsement.⁶⁵⁸

The SAU requires that NBN Co only propose network design changes that it considers maximise net economic benefit or that it considers are reasonable.⁶⁵⁹ The ACCC acknowledges that effective customer engagement can play an important role in encouraging efficient investment, and considers that NBN Co’s proposed customer engagement approach could play a role in doing so. This is because access seekers (and potentially end-users) would likely be able to inform NBN Co about whether network design choices are efficient and deliver network capacity and service quality that end-users desire and are willing to pay for. Furthermore, given that NBN Co is a wholesale-only network provider, customer engagement can play an important role in co-ordinating investment between NBN Co and access seekers’ networks that interconnect with the NBN.

However, given the permitted variation categories listed above, it is difficult to foresee how frequently the customer engagement processes will actually be used.

The customer engagement process for capital expenditure would be subject to review as part of the midpoint review of Module 1. As noted in chapter 2, the ACCC is not satisfied that this review would allow it to make decisions that will promote the long-term interests of end-users, nor that its decisions would in all circumstances be implemented in a manner that promotes the long-term interests of end-users. Given this, it is possible that the customer engagement process as currently specified could apply for the duration of Module 1.

The ACCC considers that there is merit in reviewing the operation of the customer engagement processes throughout Module 1 to assess whether they are resulting in effective engagement between NBN Co and its customers on capital expenditure decisions. The Consultation Paper on the Notice to Vary therefore proposes that the customer engagement processes should only operate for the first five years of Module 1.

Preliminary ACCC views — competitive tendering and procurement

⁶⁵⁸ Ibid, Schedule 1E, clause 1E.6.4(a).

⁶⁵⁹ Ibid, Schedule 1E, clause 1E.7.3.

As noted, for capital expenditure to be included in the RAB, it must also satisfy the Prudent Cost Condition in addition to satisfying the Prudent Design Condition.⁶⁶⁰ This establishes that capital expenditure incurred:

- in accordance with NBN Co's Procurement Rules; or
- using competitive tendering and procurement processes; or
- pursuant to arrangements which are on arms length terms; or
- in respect of a good or service in open and competitive market; or
- in order to comply with a Shareholder Minister, legal, policy, regulatory or administrative requirement; or

when NBN Co's CEO is satisfied that:

- there is only one potential suppliers of a particular good or service; or
- such capital expenditure in incurred on exceptionally advantageous terms; or
- such capital 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
- it is in the best interests of the company to incur such capital expenditure with that particular supplier or in those circumstances having regard to the lifetime cost of acquisition and operation of the assets involved;

may be included in the RAB.⁶⁶¹

The NBN Co Procurement Rules must contain a competitive tendering and procurement process which satisfies the following conditions:⁶⁶²

- the process must seek to generate an efficient and competitive outcome by encouraging a reasonable and proportionate amount of competitive tension between tender participants and minimising the possibility of anti-competitive conduct among tender participants in contravention of the CCA;
- there must be a clear process for the calling and conduct of tenders and the involvement of tender participants, and the assessment and awarding of tenders to successful participants, which meets reasonable requirements of procedural fairness, probity, fair dealing and good industry practice;
- any decision to approve a tender that is not the lowest price tender must be appropriately justified and documented;
- the basis for undertaking the works and services must be in accordance with good industry practice and the basis of payment for works and services must be clearly specified; and
- there must be a process for managing contracts (both before and after the award of tenders) that accords with good industry practice and which seeks to achieve value for money and the lowest total cost of ownership.

⁶⁶⁰ Ibid, Schedule 1E, clause 1E.3.1(a).

⁶⁶¹ Ibid, Schedule 1E, clause 1E.4.1.

⁶⁶² Ibid, Schedule 1E, clause 1E.4.2 (a) to (e).

NBN Co has not submitted its Procurement Rules in support of the SAU. NBN Co must provide the ACCC with a copy of the Procurement Rules within 30 days after the SAU commences and after NBN Co makes material amendments to the Procurement Rules.⁶⁶³ The ACCC (and other interested parties) have as yet been unable to assess or consider whether the Procurement Rules that will apply at the commencement of the SAU will satisfy the conditions in clause 1E4.2 of Module 1 of the SAU.

In any event, the ACCC considers that the different criteria within the prudent cost condition are effectively likely to cover any manner in which NBN Co determines the suppliers that it will engage in making capital investments. That is, the prudent cost condition does not require that all transactions are entered into on a competitive tendering basis.

Further, similar to the ACCC's considerations about the Network Design Rules noted above, the ACCC cannot be satisfied that allowing NBN Co to determine whether or not particular investments have been entered into in accordance with the prudent cost condition would encourage efficient investment. This is because:

- as discussed above, due to the lack of incentive created by the proposed price control for NBN Co to invest efficiently, NBN Co is unlikely to face particularly strong incentives to undertake investments in an efficient manner; and
- the nature of the prudent cost condition gives NBN Co considerable discretion to determine whether or not an investment has been entered into in accordance with the prudent cost condition.

The ACCC considers that either of the above issues, in isolation, means that circumstances could arise whereby NBN Co incurs expenditure in making a capital investment that is not efficient, but over which there is scope for NBN Co and independent parties (the ACCC for example) to disagree as to whether the associated contracts were entered into in accordance with the prudent cost condition.

The ACCC considers that if an independent party, such as the ACCC, were to determine whether particular investments were entered into in accordance with the prudent cost condition, this would enhance the prospect that only the costs of efficient investments were able to be included in the RAB.

Preliminary ACCC views — deemed prudent categories

As noted, capital expenditure that is categorised as 'deemed prudent' does not have to meet the prudent design condition and prudent cost conditions.⁶⁶⁴ Similarly, NBN Co can update its Network Design Rules and is not required to satisfy the prudent design condition for 'permitted variations'.⁶⁶⁵

The deemed prudent categories reflect capital expenditure associated with the following:

- Telstra and Optus arrangements — these reflect long-term contracts entered into by NBN Co prior to the commencement of the SAU.
- The interim satellite and transit arrangements, Tasmania Tri-Area service arrangements and the first release trial sites — these reflect expenditure and supply arrangements entered into prior to the commencement of the SAU.
- Third party funded network changes.

⁶⁶³ Ibid, Schedule 1E, clause 1E.4.3.

⁶⁶⁴ Ibid, Schedule 1E, clause 1E.3.1.

⁶⁶⁵ Ibid, Schedule 1E, clause 1E.6.2.

- Capital expenditure incurred by NBN Co from the cost commencement date until the SAU commencement date.⁶⁶⁶

The ACCC recognises that the deemed prudent categories are generally associated with pre-existing NBN Co commitments. The ACCC considers that if expenditure associated with these pre-existing commitments were not deemed prudent, it may create uncertainty as to whether the expenditure would satisfy the prudency conditions in Module 1, and therefore whether NBN Co would be able to recover the costs associated with these contracts via the SAU. Given that these commitments were entered into without the prospect of this occurring, the ACCC does not consider that it would be appropriate for the SAU to preclude these costs from being able to be recovered.

Summary of preliminary ACCC views on capital expenditure and proposed variations

For the reasons outlined throughout this section, the ACCC is not satisfied that the approach to determining the values of capital expenditure that NBN Co can include in its RAB will encourage efficient investment.

In light of this, the Consultation Paper on the Notice to Vary proposes that the ACCC should have a role in determining the value of capital expenditure that rolls-forward the RAB, based on the methodologies in the SAU for determining prudent capital expenditure (subject to some variations to those methodologies, which are also set out in the Consultation Paper on the Notice to Vary and noted below).

While this role could take on a number of forms, the ACCC envisages that NBN Co would provide similar information as it already commits to providing under Schedule 1G (for example, actual capital expenditure incurred and prudency compliance reports) — however, the final determination of the capital expenditure that will roll forward the RAB would be determined by the ACCC. Once capital expenditure has been included in the RAB, this expenditure would not be re-valued or revised and would be able to be fully depreciated over the SAU term.

When determining capital expenditure, the ACCC envisages that it would consider NBN Co's actual capital expenditure and whether it has been incurred in accordance with the prudent design and prudent cost conditions. The ACCC considers that, subject to the price controls providing incentives for NBN Co to invest efficiently, in most cases the ACCC would be likely to roll forward the RAB based on the actual capital expenditure incurred by NBN Co, as submitted to the ACCC.

When considering whether expenditure complies with the methodologies in the SAU, the ACCC would consider such things as:

- whether NBN Co's investments are materially consistent with or within the scope of the Network Design Rules;
- whether the Network Design Rules have been updated in accordance with the permitted variations categories or customer engagement processes;
- whether NBN Co has procured expenditure in accordance with the Procurement Rules, or the other clauses in the prudent cost condition; and
- any capital expenditure that should be deemed prudent.

The ACCC recognises that in reviewing whether or not capital expenditure complies with the methodologies in the SAU, and calculating the RAB roll-forward accordingly, a limited form of ex-post review of NBN Co's capital expenditure occurs. However, as discussed throughout this

⁶⁶⁶ Ibid, Schedule 1E, clause 1E.3.2.

section, the ACCC considers that this is likely to in and of itself encourage efficient investment (and reduce the prospect that the ACCC would find that any expenditure is not efficient).

The Consultation Paper on the Notice to Vary proposes the following additional variations to the SAU:

- the customer engagement provisions in clauses 1E.7 to 1E.11 only apply for first five years of Module 1; and
- the removal of clause 1E.6.2(a)(viii) — the minor expenditure limit.

5.5.1.3. Operating expenditure

During Module 1, NBN Co would be allowed to include in its annual revenue requirements all actual operating expenditure that satisfies a number of principles.⁶⁶⁷ These principles are:

- the operating expenditure is deemed prudent under the SAU; or
- the operating expenditure is third party operating expenditure and NBN Co satisfies the prudent cost condition for this expenditure; or
- NBN Co ensures that the operating expenditure is incurred in a manner that seeks to achieve value for money and the lowest total cost of ownership, and manages and controls operating expenditure in a manner consistent with the Government's *Statement of Expectations*, and any Shareholder Minister, legal, policy, regulatory or administrative requirements.⁶⁶⁸

Submissions

As per its views on capital expenditure, NBN Co argues that these prudency requirements are intended to complement the significant expenditure incentives already faced by NBN Co as a result of its commercial context, and what it refers to as the rigorous cost control and transparency measures which apply to it as a Government Business Enterprise.⁶⁶⁹ In terms of the operating expenditure rules themselves, NBN Co argues that:

- the assessment of lowest total cost of ownership involves looking at the total costs, which may not, in every given situation, lead to the lowest possible operating expenditure, but would still result in value for money when viewed against the totality of capital and operating expenditure over the life of the asset;⁶⁷⁰
- the *Statement of Expectations* requires NBN Co to incur costs in a particular manner, and it is appropriate for such requirements to be considered as part of the assessment of prudent operating expenditure in Module 1;⁶⁷¹ and
- the deemed prudent categories largely reflect pre-existing NBN Co commitments which were entered into on a strict arms-length basis and were subject to normal, robust commercial negotiations.⁶⁷²

Submissions raised the following points:

- Macquarie Telecom submits that NBN Co's proposed approach to determining operating expenditure during Module 1 appears reasonable, however it is

⁶⁶⁷ These operating expenditure requirements are contained in clause 1F.7 of Schedule 1F of the SAU.

⁶⁶⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1F, clause 1F.7.1.

⁶⁶⁹ NBN Co Supporting submission, pp. 120-121.

⁶⁷⁰ Ibid, p. 225.

⁶⁷¹ Ibid, p. 225.

⁶⁷² Ibid, p. 226.

concerned that NBN Co will be the ultimate arbiter of whether or not this expenditure has been incurred efficiently.⁶⁷³

- Optus submits that the rules-based approach to operating expenditure raises concerns because it is self-administering and sets a low threshold in terms of meeting the proposed prudency test.⁶⁷⁴ The ACCC should have the power to review and approve upfront NBN Co's forecast capital and operating expenditure.⁶⁷⁵

Preliminary ACCC views

The ACCC considers that the majority of, if not all, operating expenditure incurred during the network rollout would be likely to fall within the scope of the operating expenditure requirements set out in Module 1, and in turn be allowed to be included by NBN Co in its annual revenue requirements.

As discussed previously, the ACCC is not satisfied that NBN Co faces incentives to operate efficiently as a result of the price controls in the SAU. In light of this, the ACCC is not satisfied that the price controls will ensure that the actual operating expenditure that NBN Co incurs during the roll-out period will be efficient. This would suggest that the operating expenditure principles are the sole mechanisms by which the SAU would encourage efficient operating expenditure during Module 1.

Similar to the ACCC's views about the approach proposed in the SAU for capital expenditure, given the nature of the operating expenditure principles, there is likely to be considerable room for interpretation as to whether or not actual operating expenditure is consistent with the principles.

The ACCC considers that either of these issues, in isolation, means that circumstances could arise whereby NBN Co incurs operating expenditure that is not efficient, but over which there is scope for NBN Co and independent parties (the ACCC for example) to disagree as to whether it is consistent with the principles. The ACCC considers that if an independent party, such as the ACCC, were to determine whether operating expenditure was consistent with the principles, this would enhance the prospect that only efficient operating expenditure would be included in NBN Co's annual revenue requirements.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the ACCC calculate the values of operating expenditure that will be included in NBN Co's annual revenue requirements, based on the operating expenditure principles in the SAU. As noted for capital expenditure, the ACCC envisages that NBN Co would provide similar information as it already commits to provide under Schedule 1G — however, the final calculations that will apply to NBN Co will be determined by the ACCC.

The Consultation Paper on the Notice to Vary discusses this proposed variation in greater detail and seeks views of interested parties on a range of matters.

5.5.1.4. Rate of return

For Module 1, the rate of return is proposed to be determined each year by adding a premium of 350 basis points to the risk free rate.⁶⁷⁶ The risk free rate will be determined as the mean yield on 10-year Commonwealth Government Securities, averaged over the final 20 business days of the preceding financial year and using the indicative mid rates published by the Reserve Bank of Australia.⁶⁷⁷

⁶⁷³ Macquarie Telecom submission, p. 18.

⁶⁷⁴ Optus submission (Public version), p. 41.

⁶⁷⁵ Ibid, p. 41.

⁶⁷⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1F, clause 1F.6.1(a).

⁶⁷⁷ Ibid, Schedule 1F, clause 1F.6.1(b).

Submissions

Officer and Bishop submit that:

- It is reasonable to set a Weighted Average Cost of Capital (WACC) based on the long-term government bond rate plus a real margin, varying annually with the long-term bond rate — but it is important to recognise that the risks associated with such an approach can flow-through to consumers as price changes.⁶⁷⁸
- Based on a review of other regulatory decisions, the proposed WACC margin of 350 basis points is at the lower end of a reasonable range in the current environment. In particular, looking at regulated WACC values in the electricity, gas and water industries, the report found that over the past 13 years, the risk premium values have ranged from 257 to 488 basis points, while over the past 3 years, the risk premium values have ranged from 277 to 488 basis points.⁶⁷⁹
- The average risk margin over the 13 year period for the water, gas and electricity industries was 358 basis points, while the median was 335 basis points.⁶⁸⁰
- Telstra's regulated WACC risk margin has been quite stable at 343 basis points, until recently when it increased in 2008-09 to 380 basis points, then decreased in 2011-14 to 338 basis points (due to a revision of the regulatory debt risk premium and equity beta, determined using the Capital Asset Pricing Model (CAPM)).⁶⁸¹
- Using a bottom-up approach (cost of debt and cost of equity), an appropriate mark-up over the risk free rate for NBN Co's WACC would be between 375 and 420 basis points. The report concluded that 350 basis points would be in a reasonable confidence interval around their estimate of an appropriate mark-up.⁶⁸²

Macquarie Telecom submits that the proposed WACC approach results in "a higher WACC than would otherwise apply, which seems at odds with NBN Co's public ownership and NBN Co's role as a legislated monopoly".⁶⁸³ Macquarie Telecom further submits that there should be a mechanism for the periodic independent review of the WACC.⁶⁸⁴

Optus submits that:

- 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;
- the proposed approach to WACC is not appropriate, since the expected rate of return represents a cost to consumers above the actual costs of building the network; and
- having a WACC above the actual cost of finance creates an incentive to increase the size of the RAB above the efficient level.⁶⁸⁵

⁶⁷⁸ Bob Officer and Steven Bishop, *Report on WACC component of NBN Co's Special Access Undertaking*, September 2012, p. 4. (Officer and Bishop report)

⁶⁷⁹ *Ibid.*, pp. 4-5.

⁶⁸⁰ *Ibid.*, p. 15.

⁶⁸¹ *Ibid.*, p. 15.

⁶⁸² *Ibid.*, p. 21.

⁶⁸³ Macquarie Telecom submission, p. 16.

⁶⁸⁴ *Ibid.*, p. 16.

⁶⁸⁵ Optus submission (Public version), pp. 86-88.

Preliminary ACCC views

As noted in section 1.3, the ACCC must have regard to the legitimate commercial and business interests of NBN Co and its investment in facilities used to supply declared services, as well as to the risks involved in making those investments. This means that NBN Co should be allowed to earn a normal commercial return on its investment in the infrastructure used to supply those services, given the risks associated with that investment. This in turn provides an appropriate incentive for NBN Co to maintain, improve and invest in the efficient provision of the service. Were an access provider to be compensated for more than a normal commercial return (given the particular risk of an investment), it may have incentives to over-invest in capital and inflate its regulatory asset base; were it to be under-compensated, it may not be able to fund capital investments that would otherwise have been efficient.

As a key input to determining the return on capital that NBN Co is allowed to include in its allowable revenues, the rate of return proposed by NBN Co has implications for the return that NBN Co will be allowed by the regulatory framework to earn. Hence, the rate of return is a relevant consideration in having regard to the legitimate commercial and business interests of NBN Co.

In having regard to NBN Co's legitimate commercial and business interests, the ACCC considers that an estimate of the rate of return that is 350 basis points above a risk-free rate in order to determine the return in Module 1 is reasonable in the current context, considering the following unique circumstances.

Generally, the ACCC would determine the rate of return through a bottom-up WACC methodology, where the weighted average of costs of equity and debt are determined through an in-depth analysis of estimation methods and input parameters. However, NBN Co is a new company that is proposed to operate under a unique regulatory regime and that finds itself facing a somewhat exceptional set of circumstances, making it difficult to undertake a traditional WACC analysis.

Firstly, the WACC for NBN Co cannot be estimated in accordance with observable parameters for NBN Co — for example, it is difficult to determine the appropriate credit rating for a firm such as NBN Co, particularly as it currently does not issue any of its own debt. Further, it is unclear what gearing ratio NBN Co will adopt during Module 1 — indeed its financing structure is likely to change significantly over the term of Module 1.

Secondly, while the ACCC and the AER would typically estimate the WACC by assessing the different WACC parameters against appropriate benchmarks, appropriate benchmarks are unlikely to exist for the rate of return for the NBN investment.

In these circumstances, the ACCC considers that these factors justify adopting a different approach to determining the rate of return and that the proposed Officer and Bishop approach of setting the rate of return as a risk-free rate plus a risk premium is reasonable. The ACCC notes though that this approach is unlikely to be reasonable if suitable benchmarks existed that would allow an estimation of each WACC parameter, or actual information about each parameter, for the NBN investment.

In respect of the level of the 350 basis points, the ACCC notes it is difficult at this point in time to form definitive conclusions about whether the proposed risk premium under- or over-compensates NBN Co relative to a 'normal commercial return' for this type of investment. In this context, the ACCC is conscious that attempting to estimate individual WACC parameters for NBN Co at this stage of its operations could give rise to false accuracy and precision. In turn, the ACCC considers that, in the current context, the Officer and Bishop approach of essentially benchmarking at the more general level of the overall WACC and across a broad range of regulatory decisions is appropriate. The ACCC also considers that — in the absence at this point in time of better information — the 350 basis point risk-premium which the Officer and Bishop approach establishes is likely to allow NBN Co to earn a normal commercial return on its investment.

NBN Co has proposed that the rate of return will be re-estimated every year during Module 1 by adding this 350 basis point margin to a prevailing risk-free rate (that is, the risk-free rate is 'reset' every year during Module 1, which resets the rate of return). The risk-free rate is calculated in accordance with clause 1F.6.1(b) by using an average yield on 10-year Commonwealth Government bonds.

For the purposes of setting a regulated rate of return, there is a question as to whether the term of the bond used to calculate a risk-free rate should match the period of time for which the risk-free rate is set for. In the context of NBN Co's approach to determining the rate of return, this may suggest that the risk-free rate should be reset annually, and calculated using a one year bond; or alternatively, it may suggest that — because a ten-year bond rate is adopted — the risk-free rate should not be reset annually.

The ACCC has not yet formed a view on NBN Co's current proposal of not matching the term of the risk-free rate to the period during which it is applied — the ACCC is seeking views of interested parties about this matter and will consider these views in formulating the Notice to Vary.

5.5.1.5. Preliminary ACCC views — depreciation

During Module 1, regulatory depreciation is calculated using a real straight line depreciation approach, with asset lives determined in a manner consistent with NBN Co's audited accounts.⁶⁸⁶

NBN Co states that this approach to calculating depreciation is consistent with standard Australian regulatory practice.⁶⁸⁷ The Synergies report argues that using straight-line depreciation can reasonably be expected to be efficient.⁶⁸⁸

As noted previously, the ACCC considers that it is efficient for the cost of previous capital investment to be recovered from the users of the relevant asset over its economic life. Regulatory depreciation however affects the timing of the recovery of these investments over time. That is, it controls when the business can recover its costs and from which users it recovers its investment, rather than the value of the investment (in net present value terms) that it may recover. For example, the approach to depreciation will control whether and for which proportion of the asset is recovered from current users of the asset or future users of the asset. In this context, depreciation typically has implications for efficient use of the network inter-temporally.

NBN Co submits that the straight-line depreciation approach adopted in the SAU is consistent with standard regulatory practice.⁶⁸⁹ Given the information available before it, the ACCC considers that it is reasonable to adopt straight-line depreciation in Module 1.

Furthermore, the asset lives used in depreciation calculations also affect the timing of the recovery of investments over time — for example, relatively shorter asset lives will mean that more of the asset is recovered in any given year. Under the SAU, the asset types and asset lives are based on asset types and asset lives in NBN Co audited accounts. These accounts are controlled by NBN Co and it may change the values of asset lives in these accounts from time to time without ACCC approval.

Having said this, the ACCC recognises that the effect of the depreciation profile and the asset lives used on efficient use of the NBN will be diminished somewhat during the initial cost recovery period. This is because, during this period, the value of depreciation will affect the level of the initial cost recovery account rather than the prices set by NBN Co. When NBN Co's actual revenues are insufficient to recover depreciation, this will increase the size of the initial

⁶⁸⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1F, clause 1F.8.1.

⁶⁸⁷ NBN Co Supporting submission, p. 127

⁶⁸⁸ Synergies Economic Consulting report, p. 81.

⁶⁸⁹ NBN Co Supporting submission, p. 119.

cost recovery account. Conversely, when actual revenues are more than sufficient to recover depreciation, this will decrease the size of the initial cost recovery account. In either case however, depreciation is simply transferred from the RAB into the initial cost recovery account, without any effect on prices in any given year.

Nonetheless, the ACCC notes that standard regulatory practice typically provides a role for the regulator to determine or approve the asset types and asset lives used by the regulated business to calculate regulatory depreciation. The ACCC therefore seeks the views of interested parties on whether the SAU should specify the asset lives that will be used to depreciate NBN Co's capital expenditure.

5.5.1.6. Preliminary ACCC views — annual construction-in-progress allowance

The SAU recognises capital expenditure in the RAB when the relevant asset is placed into service.⁶⁹⁰ Module 1 allows NBN Co to recover the financing costs of construction prior to the asset being placed into service by including these financing costs in an 'annual construction-in-progress allowance' in the annual revenue requirements.⁶⁹¹

Regulated businesses are typically compensated for the costs of financing the construction of its network assets prior to placing the assets into service and earning revenue by supplying services.⁶⁹² If the SAU prevents NBN Co from recovering these financing costs, this may reduce NBN Co's incentives to, or prevent it from, making investments during the network rollout that would otherwise be considered efficient.

In terms of what constitutes construction-in-progress in any given year, clause 1E.2.4(a) specifies that NBN Co will separately account for prudently incurred capital expenditure that has not been placed-in-service in a 'construction-in-progress' account. This construction-in-progress will be consistent with the values in NBN Co's audited accounts.⁶⁹³ The annual construction-in-progress allowance will then be calculated by applying NBN Co's rate of return to the values of the construction-in-progress balance, and provided that it has been prudently incurred, may be included in NBN Co's annual revenue requirements.⁶⁹⁴

As discussed above, once an asset is constructed and is placed into service, the associated capital expenditure can only be included in the RAB if it is prudently incurred in accordance with the prudent cost condition (that is, clause 1E.4) and the prudent design condition (that is, clause 1E.5). Therefore, it appears that the capital expenditure associated with assets under construction can only be included in the annual revenue requirements if they satisfy the prudent design condition and prudent cost condition.

However, the drafting of the SAU creates some uncertainty as to whether the construction-in-progress balance will only include capital expenditure that has been prudently incurred. This is because, while the annual construction-in-progress allowance will be included in the annual revenue requirements provided it has been prudently incurred, the construction-in-progress balance will be calculated consistent with NBN Co's audited accounts, which is not subject to any prudence requirements.

Even if it was clear that the capital expenditure prudence requirements applied to the construction-in-progress balance, as discussed above, given the nature of the capital expenditure conditions, there is likely to be considerable room for interpretation as to whether or not capital expenditure is consistent with the conditions. Circumstances could arise whereby the construction-in-progress balance contains expenditure that is not efficient; but over which

⁶⁹⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.2.1(b).

⁶⁹¹ NBN Co Supporting submission, p. 126.

⁶⁹² This compensation is applied by the AER in the context of electricity network regulation in the form of the half-WACC adjustment. See Australian Energy Regulator, *Electricity distribution network service providers: Post-tax revenue model handbook*, June 2008, p. 11.

⁶⁹³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1E, clause 1E.2.4(a).

⁶⁹⁴ *Ibid*, Schedule 1E, clause 1E.2.4(b).

there is scope for NBN Co and independent parties (the ACCC for example) to disagree as to whether it is consistent with the prudency conditions in the SAU.

In light of this issue, the Consultation Paper on the Notice to Vary proposes that:

- the SAU clarify the process by which expenditure is classified as prudently incurred before it is included in NBN Co's audited accounts as construction-in-progress; and
- the ACCC calculate the values of the annual-construction-in-progress allowance that will be included in NBN Co's annual revenue requirements.

5.5.1.7. Tax allowance

The SAU allows NBN Co to include an allowance for taxation expenses in its annual revenue requirements. Clause 1F.8.1 of Module 1F of the SAU provides for the net tax allowance to be calculated as follows:

- A notional taxable profit is determined by subtracting nominal taxation expenses from nominal revenue.⁶⁹⁵ Nominal taxation expenses consist of operating expenditure, taxation depreciation expense (calculated in accordance with clause 1F.8.2) and interest expenses (based on actual interest expense recorded in NBN Co's statutory accounts), while nominal revenue would be the actual revenue earned by NBN Co (as opposed to its annual revenue requirement).⁶⁹⁶
- Any tax losses from previous years (as determined in accordance with the tax loss carried forward in clause 1F.8.3) are then added to this notional taxable profit for that year.⁶⁹⁷

If this sum is negative, it becomes the new value of the tax loss carried forward (and will eventually be used to offset notional taxable profits that are earned by NBN Co).⁶⁹⁸ If this sum is positive, the value is then multiplied by the statutory corporate tax rate, and then reduced by gamma (set at 0.25 for the duration of Module 1,⁶⁹⁹ which results in this value being multiplied by 0.75⁷⁰⁰) to reflect the value of imputation credits.⁷⁰¹

The resulting value is NBN Co's net tax allowance for that year, which is included in NBN Co's annual building block revenue requirement.⁷⁰²

Submissions

In support of the method for calculating net tax allowances in Module 1, Officer and Bishop noted that tax savings are typically estimated by using the opportunity cost of debt that is used in the estimate of the WACC to ensure a consistent forward view of cash flow estimates and the required rate of return.⁷⁰³ They also noted that, although the approach adopted in Module 1 is different from this (that is, it is based on NBN Co's actual interest rate), they would expect that the resulting error would be immaterial until all tax losses are used.⁷⁰⁴

⁶⁹⁵ Ibid, Schedule 1F, clause 1F.8.3.

⁶⁹⁶ Ibid, Schedule 1F, clause 1F.8.3.

⁶⁹⁷ Ibid, Schedule 1F, clause 1F.8.3.

⁶⁹⁸ Ibid, Schedule 1F, clause 1F.8.3.

⁶⁹⁹ Ibid, Schedule 1F, clause 1F.8.5(a).

⁷⁰⁰ Reducing by gamma results in multiplication by (1 - gamma): see clause 1F.8.3 of Schedule 1F of the SAU.

⁷⁰¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1F, clause 1F.8.3.

⁷⁰² Ibid, Schedule 1F, clause 1F.3.1.

⁷⁰³ Officer and Bishop report, p. 22.

⁷⁰⁴ Ibid, p. 22.

In its supporting submission, NBN Co further noted that it is unlikely that the tax treatment would be significant in the initial regulatory period because NBN Co expects to incur significant losses in the first 11 years of its operation (from 2009/10), and NBN Co only expects to start using the brought forward tax losses for first time in 2020/21 (two years prior to the expiry of the initial regulatory period).⁷⁰⁵

Regarding gamma, Officer and Bishop argue that the proposed value of 0.25 is consistent with a recent decision made by the Australian Competition Tribunal based on the most recent research available to it.⁷⁰⁶ Officer and Bishop state that they have no grounds for disagreeing with that decision.⁷⁰⁷

Telstra argues that the WACC should apply to the carry forward of tax losses from one year to the next, otherwise this results in NBN Co's tax costs being understated, and impact the calculation of annual revenue requirements and unrecovered cost.⁷⁰⁸ It also argues that the net tax allowance should exclude any capital losses incurred, for example, when disposing assets, and any other amounts not entitled to be treated as a tax deduction under tax law.⁷⁰⁹

Optus noted that net tax allowance is based on actual tax cost rather than benchmark tax costs using regulatory assumptions on financing and other arrangements, which is inconsistent with other building block regulatory regimes applied in Australia, and that the departure from the usual regulatory approach would have a substantial positive value on NBN Co's financial value.⁷¹⁰ 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.⁷¹¹

Preliminary ACCC views

The ACCC considers that allowing the recovery of tax expenses has appropriate regard to the legitimate business interests of NBN Co. Further, and to the extent that the proposed method for calculating the net tax allowance is likely to reasonably reflect NBN Co's tax liabilities over Module 1, it would also reflect recovery of NBN Co's direct costs. Although NBN Co's net tax allowance is likely to be zero in each year of Module 1 under the approach specified in the SAU, it is important that NBN Co is appropriately compensated for any positive tax expenses that occur during Module 1.⁷¹² The ACCC considers that the notional taxation expense that is calculated in accordance with clause 1F.8.3 adequately achieves this objective. In addition, the ACCC considers that if NBN Co is not taken to incur notional taxation expenses during Module 1, it is appropriate to provide for a tax loss carried forward in a manner similar to how this is calculated in clause 1F.8.3.

However, Telstra submits that a return should be provided on the tax loss carried forward (calculated by reference to the WACC) in order to account for the difference in timing between the time tax losses are incurred, and the time that tax losses are recovered.⁷¹³ The ACCC notes that the SAU does not provide for any indexing or compounding of the tax loss carried forward to account for these timing differences, and that the value of the tax loss carried forward may be significantly larger than for other regulated firms. That said, it appears that the statutory treatment of tax losses is similar to the treatment of the tax loss carried forward in clause 1F.8.3 and, in the absence of further information about why the WACC should be applied to the tax loss carried forward, the ACCC is satisfied that calculating the tax loss carried forward in this manner will adequately account for its effect on the NBN Co's direct

⁷⁰⁵ NBN Co Supporting submission, p. 125.

⁷⁰⁶ Officer and Bishop report, p. 22.

⁷⁰⁷ *Ibid.*, p. 22.

⁷⁰⁸ Telstra submission, p. 78.

⁷⁰⁹ *Ibid.*, p. 78.

⁷¹⁰ Optus submission (Public version), p. 78.

⁷¹¹ *Ibid.*, p. 78.

⁷¹² NBN Co's *Corporate Plan* estimates that NBN Co's net tax allowance will only be positive from 2027-28.

Telstra and Optus provided similar results in their submissions.

⁷¹³ Telstra submission, p. 78.

costs incurred in respect of taxation. Otherwise, the ACCC notes that the formulae specified in clause 1F.8.3 that are used to calculate net tax allowance and taxable profit generally reflect those used by the AER in its post-tax revenue model and the ACCC in the fixed-line services model used for Final Access Determinations for Telstra's fixed-line services in 2011.

The ACCC considers that the use of NBN Co's actual interest paid rather than forecast or benchmark values in the calculation of net tax allowance is appropriate for NBN Co during Module 1. This is because the manner in which the WACC is calculated in Module 1 (which the ACCC considers to be appropriate for the reasons discussed in section 5.5.1.4) is not directly calculated by reference to these kinds of benchmarks or forecasts. As a result, issues about consistency between the manner in which tax allowances are calculated and the calculation of the WACC are significantly mitigated. When this is considered in conjunction with the fact that NBN Co does not incur any interest expenses at this time, the ACCC considers this method yields a satisfactory result. However, it should be noted that the appropriateness of this approach to calculating tax allowances is therefore dependent on the special circumstances which justify the approach adopted for WACC (as set out in section 5.5.1.4), and is unlikely to be appropriate in other contexts (such as after Module 1).

In relation to gamma, the ACCC recognises that the proposed value of 0.25 is consistent with the decision of the Australian Competition Tribunal in *Application by Energex Limited (Gamma) (No 5)* [2011] ACompT 9. However, the ACCC currently adopts the value of 0.45 for Telstra in relation to its regulated fixed-line services,⁷¹⁴ and the AER is currently reviewing whether the value of gamma should be 0.25.⁷¹⁵ Consequently, it is not clear that the value specified by the SAU for the duration of Module 1 (that is, 0.25 for 10 years) is reflective of the direct costs faced by NBN Co and its legitimate business interests, and the ACCC is not satisfied on the information before it that adopting a value of gamma of 0.25 for 10 years is reasonable. Given this, the ACCC is seeking views of interested parties about this matter — including whether a value for gamma should be included in the SAU when it is likely to be some time before it is used — and will consider these views in formulating the Notice to Vary.

In light of the other issues identified with the tax allowances, the ACCC has not formed a view at this time in relation to the issues raised by Telstra about whether the approach to tax allowances in the SAU does not correspond with provisions for tax deductions under tax law. The ACCC intends to engage with NBN Co on this issue while addressing the other identified aspects of tax allowances through the Notice to Vary process.

As the ACCC is not satisfied that gamma of 0.25 is reasonable, the method for calculating NBN Co's tax allowance is unlikely to reasonably reflect NBN Co's tax liabilities during Module 1. Consequently, it is not satisfied that the tax allowance is consistent with the legitimate business interests of NBN Co and recovery of NBN Co's direct costs, and therefore the ACCC is not satisfied that tax allowances determined in accordance with clause 1F.8 are reasonable.

5.5.2. Long-term revenue constraint in Module 2 and replacement modules

This section discusses how the elements of the long-term revenue constraint are calculated in Module 2.⁷¹⁶

During the term of Module 2, NBN Co's annual revenue requirements would be determined upfront based on forecast annual revenue requirements approved by the ACCC as part of the replacement module assessment process (discussed further in chapter 2 of this Draft

⁷¹⁴ ACCC, *Public enquiry to make a final access determination for the Wholesale ADSL service: draft report – public version*, March 2013, p. 54.

⁷¹⁵ AER, *Better Regulation: Rate of Return Guidelines Issues Paper*, December 2012, p. 19.

⁷¹⁶ This section discusses clause 7 of the Main Body and Schedules 1A and 2D of the SAU.

Decision). Broadly, NBN Co must submit as part of a replacement module application, for each year of the proposed replacement module:⁷¹⁷

- forecast annual revenue requirements;⁷¹⁸
- forecasts of the individual building blocks that make up these forecast annual revenue requirements;⁷¹⁹
- if during the initial cost recovery period, forecasts of the actual revenue NBN Co expects to earn;⁷²⁰ and
- a description of the incremental tax effect.⁷²¹

Module 2 includes methodologies specified at varying levels of detail and prescription that would be used in calculating the value of the forecasts of these revenues and cost components.⁷²² These methodologies are part of the fixed principles term and condition — the ACCC could not reject a replacement module 'for a reason concerning' the fixed principles term and condition.

As per Module 1, the RAB would be rolled-forward based on the actual capital expenditure incurred by NBN Co throughout the previous replacement module.⁷²³ This is also part of the fixed principles term and condition.

5.5.2.1. Submissions on the adoption of a forecasting approach for costs and allowable revenues

NBN Co submits that:

- NBN Co has a RAB comprised of its actual capital expenditure, and incentives for capital expenditure efficiency are provided by using a standard utility regulation approach;⁷²⁴
- the adoption of a forecasting approach in Module 2 for capital and operating expenditure, which along with the forecast return on capital forms the basis for its forecasts of its annual revenue requirements, will provide incentives for efficient expenditure that exist in conjunction with NBN Co's ongoing incentives arising from its long-term revenue sufficiency risk;⁷²⁵
- NBN Co will have an incentive to beat its forecast revenue requirements, while meeting its service level commitments, as it will be able to retain any cost savings that arise;⁷²⁶
- NBN Co's specification of its forecast annual revenue requirement in Module 2 is deliberately non-exhaustive to allow for possible future modifications, such as efficiency incentive schemes (subject, however, to the requirement that the forecast revenue requirement meets the zero net present value principle within and across regulatory cycles).⁷²⁷

⁷¹⁷ The term of the proposed replacement module will determine the term of the 'regulatory cycle' which will continue until a subsequent replacement module is accepted, and a new regulatory cycle will begin.

⁷¹⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 4.8(a).

⁷¹⁹ Ibid, Main Body, clause 4.8(b).

⁷²⁰ Ibid, Main Body, clause 4.8(c).

⁷²¹ Ibid, Main Body, clause 4.8(a).

⁷²² Ibid, Schedule 2D, clauses 2D.2, 2D.3 and 2D.6.

⁷²³ Ibid, Schedule 2D, clause 2D.7.

⁷²⁴ NBN Co Supporting submission, p. 114.

⁷²⁵ Ibid, p. 121.

⁷²⁶ Ibid, p. 217.

⁷²⁷ Ibid, p. 117.

The Ordover and Shampine report states that because the revenue constraint is based on forecast demand and costs, incorporating NBN Co's allowed rate of return, this will provide appropriate incentives for investment.⁷²⁸

Submissions raised the following points:

- NBN Co appears to have an incentive to over-forecast losses and under-forecast profits, since forecast losses will be incorporated into NBN Co's cost base.⁷²⁹
- There would be inadequate regulatory oversight of NBN Co's forecasts.⁷³⁰
- Whilst NBN Co has argued that its approach in Module 2 is consistent with standard utility-style regulation, the standard practice of utility regulation has recently changed following a review of the National Electricity Rules.⁷³¹
- The AER has raised concerns about being restricted in its ability to assess and modify forecasts of electricity providers.⁷³²

5.5.2.2. Preliminary ACCC views on the long-term revenue constraint methodology in Module 2

In Module 2, NBN Co has proposed an approach to rolling forward its RAB and determining annual revenue requirements that is conceptually similar to 'utility-style' regulation used for other regulated businesses.

The RAB is proposed to be rolled-forward throughout Module 2 based on adding actual capital expenditure and removing actual depreciation and asset disposals.

This approach to updating the RAB is sometimes adopted for other regulated businesses; however it is typically complemented by explicit incentive-based mechanisms to encourage the regulated businesses to invest efficiently. The incentive mechanism adopted can differ between regulated businesses and regulators.

The forecast-based approach to setting annual revenue requirements that is proposed in Module 2 is a fairly well understood form of incentive mechanism that aims to generate financial incentives for NBN Co to incur efficient expenditure. Similar forecast-based approaches are sometimes adopted by the AER and the ACCC in regulating other network utilities, for example electricity and gas distribution and transmission networks.

For the incentives for efficient capital expenditure, it is argued that, because the regulated business is not be able to recover the financing costs associated with expenditure above forecast throughout the regulatory cycle in which it was incurred (that is, by applying a rate of return to this additional expenditure in the year it was incurred), this creates some incentives to not over-invest.⁷³³ Similarly, allowing the regulated businesses to recover forecast capital expenditure provides an incentive to 'beat' their forecast allowance, by incurring less actual expenditure and keeping the difference in revenues until the end of the regulatory cycle.⁷³⁴ The strength of these incentives generated depends on a combination of factors, including:

⁷²⁸ Ordover and Shampine report, p. 16.

⁷²⁹ Telstra submission, p. 14.

⁷³⁰ Telstra submission, p. 80; Optus submission (Public version), p. 28.

⁷³¹ Optus submission (Public version), p. 44.

⁷³² Ibid, p. 44.

⁷³³ For example, see AER, *'Better Regulation – Expenditure incentives guidelines for electricity network service providers' Issues Paper*, March 2013, pp. 5-6.

⁷³⁴ Ibid, pp. 5-6.

- the ability to inflate capital expenditure forecasts — the greater the ability for NBN Co to inflate capital expenditure forecasts above efficient levels, the lower the incentives faced by NBN Co to invest efficiently during the period when the forecasts apply;⁷³⁵
- the length of the regulatory cycle — the longer the regulatory cycle, the stronger the incentive effect for expenditure incurred earlier in the period, because the longer NBN Co would not be able to recover its financing costs (discussed in further detail below);
- the use of forecast or actual depreciation to update the RAB — if actual depreciation is used, the incentive effect is stronger, because if NBN Co overspends on capital expenditure the RAB will decrease by more than NBN Co was allowed to recover via its forecast in the regulatory period.

For operating expenditure, the strength of the incentive effect created by the forecasting approach similarly depends on NBN Co's incentive and ability to inflate operating expenditure forecasts and the length of the regulatory cycle. Incentives to operate efficiently are argued to be created because, if NBN Co incurs more operating expenditure than forecasted, it would not be able to pass these additional costs on to customers.⁷³⁶ Conversely, if NBN Co reduces operating expenditure throughout the regulatory cycle, it would be able to retain these cost savings.⁷³⁷

The ACCC considers that the combination of the RAB roll-forward and any incentive-mechanism that applies to NBN Co should provide an appropriate balance between providing investment certainty to NBN Co, generating strong incentive to invest and spend efficiently, and maintaining efficient levels of service.

To achieve this balance, the overall approach may need to change over time in light of changes in regulatory best practice and the relevant regulatory, operational and economic circumstances faced by NBN Co (including the relevant approach to service levels and quality standards at the time). Given that Module 2 will not commence until 2023 and will then operate until 2040, the ACCC cannot be satisfied that the proposed approach to the long term revenue constraint methodology in Module 2 will be reasonable in all circumstances that may arise throughout the period.

In particular, the ACCC does not consider that the combination of:

- the methodologies and criteria proposed in Module 2 for determining forecasts for the long-term revenue constraint methodology;
- the approach to determining the length of the regulatory cycle; and
- rolling forward the RAB in all circumstances based on actual expenditure;

will ensure that the SAU creates incentives for NBN Co to invest and operate efficiently in all circumstances that arise for the duration of Module 2. Each of these issues is discussed throughout this section.

The ACCC also reiterates its view that, due to NBN Co's ability to withdraw non-reference offers, it does not consider that the price control will create strong incentives for NBN Co to behave efficiently. In any event, as noted in section 5.3, it is possible that at some stage during

⁷³⁵ As noted previously, while expenditure forecasts must be approved by the ACCC, the ACCC cannot reject a variation to the SAU 'for a reason concerning' a fixed principle — the criteria and methodologies that NBN Co will adopt in generating forecasts are fixed principles.

⁷³⁶ AER, *Better Regulation – Expenditure incentives guidelines for electricity network service providers' Issues Paper*, March 2013, pp. 7-8.

⁷³⁷ *Ibid*, pp. 7-8.

Module 2, NBN Co's revenue sufficiency risk will reduce — in that context, the price controls would also be less likely to provide incentives for NBN Co to invest efficiently.

In light of this, the Consultation Paper on the Notice to Vary proposes that the SAU be varied to:

- remove the criteria and methodologies in Module 2 for calculating the forecasts of each of the building block components;
- remove NBN Co's discretion to determine the length of the regulatory cycle; and
- remove the requirement that the RAB will be rolled-forward during Module 2 based on actual capital expenditure and actual depreciation and asset disposals; and amended to require that the RAB be rolled-forward based on prudent capital expenditure and 'depreciation' and 'asset disposals'. (For the avoidance of doubt, the opening RAB at the beginning of Module 2 will still be the closing RAB from the end of Module 1, and the RAB would not be able to be re-valued across regulatory periods.)

Preliminary ACCC views — criteria and methodologies for determining forecasts

Module 2 includes 'methodologies' or criteria that the forecasts of the building block cost components and the annual revenue requirements must be calculated in accordance with or had regard to. This includes criteria for forecasts of:

- capital and operating expenditure;⁷³⁸
- regulatory depreciation;⁷³⁹
- the return on capital;⁷⁴⁰ and
- the tax allowance.⁷⁴¹

The resulting forecasts (if approved) determine the amount of revenue NBN Co is allowed by the regulatory framework to earn, and in turn, influence the strength of the capital and operating expenditure incentive mechanism. It is important to note, however, that the revenue allowance determined with these forecasts is applied differently depending on whether or not the initial cost recovery account has been extinguished. If initial costs have not yet been fully recovered, the forecast annual revenue requirement will be used to calculate the balance of the initial cost recovery account.⁷⁴² On the other hand, if initial costs have been fully recovered, the forecast annual revenue requirement will apply as the annual revenue NBN Co will be permitted to recover under the SAU.⁷⁴³

The ACCC notes that the methodologies and criteria for determining forecasts are fixed principles; hence there is uncertainty about whether the ACCC could reject a proposed variation to the SAU on the basis that the variation does not comply with the methodologies and criteria. This is because there might be an argument that the rejection is 'for a reason that concerns' the fixed principles and therefore not permitted under the CCA.

To the extent that the proposed methodologies and criteria would allow NBN Co to recover more than its efficient costs, as noted above, the strength of the incentive created by the forecast mechanism for NBN Co to invest and operate efficiently would be reduced. The

⁷³⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 2D.6.

⁷³⁹ Ibid, Schedule 2D, clause 2D.2.1(a)(ii).

⁷⁴⁰ Ibid, Schedule 2D, clause 2D.2.1(a)(iii).

⁷⁴¹ Ibid, Schedule 2D, clause 2D.2.1(a)(iv).

⁷⁴² Ibid, Schedule 2D, clause 2D.2.3.1.

⁷⁴³ Ibid, Schedule 2D, clause 2D.2.3.2.

ACCC's assessment of whether this is the case for each of the building block components is outlined as follows.

Generally speaking however, the ACCC is not satisfied that the methodology and criteria for determining annual revenue forecasts is reasonable for two key reasons:

- Firstly, in some cases, the ACCC is not satisfied that the methodologies and criteria will ensure that NBN Co is not systematically over-compensated relative to its direct costs.
- Secondly, the terms and conditions of Module 2 will not begin until 2023 and will then operate until 2040, without a formal mechanism for review by an independent party. Given that best-practice regulation and the relevant circumstances faced by NBN Co may (and are likely to) change over this period, it is difficult for the ACCC to be satisfied that the methodologies and criteria will reflect regulatory best practice and the relevant circumstances faced by NBN Co in all circumstances that may arise for the duration of Module 2.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be varied to remove the criteria and methodologies in Module 2 for calculating the forecasts of each of the building block components.

This would not preclude NBN Co from proposing a variation to the SAU before the expiry of Module 1 which included methodologies and factors used to develop any forecast of expenditure, the return on capital, depreciation and tax allowances. The ACCC would then assess the proposed methodologies at that time having regard to the statutory criteria in Part XIC. Similarly, this approach would also not prevent the ACCC from making an Access Determination or Binding Rules of Conduct, or issuing other forms of guidance, on the methodologies and factors that should be used to develop any forecast of expenditure, the return on capital, depreciation and tax allowances.

Capital expenditure

Capital expenditure forecasts feed into the long-term revenue constraint methodology in Module 2 by forecasted levels of the RAB roll-forward being used to determine forecast depreciation and forecast return on capital (calculated as the WACC multiplied by the RAB).⁷⁴⁴

According to the SAU, whether or not forecast capital expenditure is prudent and efficient would be determined having regard to a range of factors, including:

- the Network Design Rules (as updated by NBN Co from time to time);
- capital expenditure in the previous regulatory cycle, or in the case of the first regulatory cycle, the final three years of Module 1;
- the extent to which NBN Co's asset management and planning framework reflects best practice;
- any relevant regulatory obligations;
- other matters relevant to whether forecast capital expenditure reflects prudent and efficient costs; and
- any amounts of capital expenditure that are deemed prudent under the relevant clauses of the SAU.⁷⁴⁵

⁷⁴⁴ Ibid, Schedule 2D, clause 2D.2.1(a)(ii)(B) and 2D.2.1(a)(iii)(B).

The ACCC is not satisfied that these criteria would ensure that capital expenditure forecasts that apply to NBN Co will only reflect efficient capital expenditure in all circumstances that may arise for the duration of Module 2. This is because the ACCC cannot be satisfied that the criteria would allow for regulatory best practice in assessing forecasts of capital expenditure to be adopted (whatever that best practice may be at a particular point in time).

The ACCC recognises that some of the criteria are similar to, or broadly reflect, criteria for determining capital expenditure forecasts that apply to transmission and distribution network providers under Chapters 6 and 6A of the National Electricity Rules (NER).⁷⁴⁶ However, it is important to note that the NER is developed and administered by independent bodies and Chapters 6 and 6A (and therefore the criteria) may be subject to independent review and variation over time.

Furthermore, the AER is required to periodically release guidelines on its approach to assessing expenditure forecasts proposed by transmission and distribution network providers. These guidelines may also be updated over time.

In contrast, the SAU does not allow for the above listed criteria to be reviewed and updated by an independent party (such as the ACCC) over time.

The ACCC also notes that the criteria are fixed principles; hence there is uncertainty about whether the ACCC could reject a proposed variation to the SAU on the basis that the variation does not comply with the criteria. This is because there might be an argument that the rejection is 'for a reason that concerns' the fixed principles and therefore not permitted under the CCA.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be varied to remove the criteria.

Operating expenditure

Operating expenditure forecasts also feed into the long-term revenue constraint methodology as one of the building blocks in NBN Co's annual revenue requirements.⁷⁴⁷

According to the SAU, whether or not forecast operating expenditure is prudent and efficient would be determined having regard to a range of factors, including:

- the Network Design Rules (as updated by NBN Co from time to time);
- operating expenditure in the previous regulatory cycle, or in the case of the first regulatory cycle, the final three years of Module 1;
- any relevant regulatory obligations;
- other matters relevant to whether forecast operating expenditure reflects prudent and efficient costs; and
- any amounts of operating expenditure that are deemed prudent under the relevant clauses of the SAU.⁷⁴⁸

Similar to the ACCC's views on the proposed criteria for capital expenditure forecasts, the ACCC cannot be satisfied that the criteria would allow for regulatory best practice in assessing forecasts of operating expenditure to be adopted (whatever that best practise may be at a particular point in time).

⁷⁴⁵ Ibid, Schedule 2D, clause 2D.6.1(a).

⁷⁴⁶ For example, see Chapter 6, sections 6.5.7 and S6.2.2A, and Chapter 6A, sections 6A.6.7 and S2A.2.2 of the NER.

⁷⁴⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 2D.2.1(a)(i).

⁷⁴⁸ Ibid, Schedule 2D, clause 2D.6.1(b).

Further, the criteria are fixed principles; hence there is uncertainty about whether the ACCC could reject a proposed variation to the SAU on the basis that the variation does not comply with the criteria. This is because there might be an argument that the rejection is 'for a reason that concerns' the fixed principles and therefore not permitted under the CCA.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be varied to remove the criteria.

Cost of capital

Module 2 sets out principles according to which a return on capital will be determined for NBN Co. Specifically, the SAU states that a return on capital will be calculated for NBN Co as a nominal vanilla WACC,⁷⁴⁹ forecast with reference to:

- the risks involved in providing the NBN Access Service, Ancillary Services and Facilities Access Service;
- a financing structure that meets benchmark standards as to gearing and other parameters for a similar going concern and reflects in other respects best practice; and
- a cost of debt and a cost of equity (determined using a well-accepted financial model, such as the Capital Asset Pricing Model (CAPM)) that meet benchmark standards as to efficient financing of equity and debt for a similar going concern, having regard to past, present and future financial conditions.⁷⁵⁰

Officer and Bishop submit that the principle of using a nominal vanilla WACC as an opportunity cost of capital, estimated in this way, is consistent with practice in both commercial and regulatory environments.⁷⁵¹

Telstra submits that the nominal vanilla WACC described in Module 2 is defined very broadly and offers little certainty or predictability in relation to the WACC that will be adopted.⁷⁵² Further, the proposed approach potentially gives NBN Co substantial discretion in determining the WACC.⁷⁵³ Telstra submits that NBN Co should consider specifying parameter values to be used in calculation or a method of determining these parameter values.⁷⁵⁴

The ACCC considers that the principles proposed for determining NBN Co's WACC in Module 2 may not always allow NBN Co to earn only a normal commercial return on its investment in all circumstances during Module 2. This is for the following reasons:

- Whilst the adoption of a 'nominal vanilla WACC' may be considered to reflect best practice in commercial and regulatory environments today, this may not always be the case. Locking in a nominal vanilla WACC for the duration of Module 2 would also limit how revenue allowance modelling could be implemented.
- The criteria specify that the WACC will be determined with reference to 'risks', rather than specifying that the WACC should only compensate NBN Co for systematic risks. It is assumed under the CAPM that investors can diversify

⁷⁴⁹ A nominal vanilla WACC excludes all tax effects from the WACC and is expressed in nominal (rather than real) terms.

⁷⁵⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 2D.2.1(a)(iii)(A).

⁷⁵¹ Officer and Bishop report, p. 4.

⁷⁵² Telstra submission, p. 79.

⁷⁵³ *Ibid.*, p. 79.

⁷⁵⁴ *Ibid.*, p. 79.

away business-specific risk and therefore investors will only require compensation for bearing non-diversifiable or systematic risk.⁷⁵⁵

- It is possible that during Module 2, NBN Co will supply services that fall outside the definitions of the NBN Access Service, Ancillary Services and the Facilities Access Service (such as a Layer 1 unbundled service). The ability to earn revenues from such services could have implications for the systematic risk that NBN Co is exposed to — under the proposed principles, it would appear that this could not be taken into account in determining the appropriate return on capital.
- Whilst a benchmarking approach is currently adopted in a number of industries regulated by the ACCC and the AER, the ACCC is not able to be satisfied that the adoption of such an approach will reflect best practice regulation for the duration of Module 2.

Whilst the ACCC considers that it is appropriate for Module 2 to provide assurances to NBN Co that it will be able to earn a normal commercial return on its investment, having regard to the risks involved in making those investments, the ACCC is not satisfied that the principles that have been proposed to determine that return will in all circumstances ensure this.

Further, the proposed criteria are fixed principles; hence there is uncertainty about whether the ACCC could reject a proposed variation to the SAU on the basis that the variation does not comply with the criteria. This is because there might be an argument that the rejection is ‘for a reason that concerns’ the fixed principles and therefore not permitted under the CCA.

In the Consultation Paper on the Notice to Vary, the ACCC has therefore proposed that the clauses which set out how the return on capital will be calculated be removed from the SAU; but that the clause which states that the forecast annual revenue requirement must specify and include a return on capital remains.

Depreciation

According to the SAU, the forecast depreciation building block must be calculated as nominal straight-line depreciation applied to the forecast opening RAB and the remaining asset lives must be determined in a manner consistent with NBN Co’s audited accounts.⁷⁵⁶

As noted in section 5.5.1.5, by determining the period in which previously incurred capital expenditure would be recovered, regulatory depreciation and the asset lives adopted have implications for efficient use of the network inter-temporally. There may be circumstances in which it is appropriate to allocate varying levels of the annual revenue requirement across regulatory cycles, which can be implemented by changing the depreciation schedule or increasing or decreasing the assumed asset lives. This will be most relevant once the initial cost recovery period has concluded and depreciation directly affects the annual revenues that NBN Co may earn — as noted in section 5.3.2, the exact times throughout the SAU term when the initial cost recovery account will peak are not known with certainty at this time. However, under certain assumptions about demand, the initial cost recovery period could conclude within the duration of Module 2.

The ACCC is therefore not satisfied that:

- locking in a straight-line depreciation approach for the duration of Module 2; and

⁷⁵⁵ AER, *Electricity transmission and distribution network service providers – review of WACC parameters*, May 2009, p. 239.

⁷⁵⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 2D.2.1(a)(ii).

- allowing NBN Co to determine the asset lives that apply to the calculation of depreciation;

would promote efficient use of the network in all circumstances that could arise for the duration of Module 2.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be varied to remove the criteria which specify how depreciation will be calculated.

Tax allowance

According to the SAU, the tax allowance building block must be calculated by taking into account a number of factors, including:

- the tax rate to be used in estimating tax liabilities set equal to the corporate tax rate, as amended from time to time;
- estimated utilisation of dividend imputation credits;
- annual forecast revenues;
- forecast tax deductible expenses;
- any tax loss carried forward consistent with prior year annual revenue requirements;
- taxation asset lifetimes for each asset type determined in a manner consistent with the Australian Tax Office; and
- tax depreciation applied in prior year annual revenue requirements.⁷⁵⁷

Officer and Bishop submit that “the use of the nominal vanilla WACC means all taxation effects of financing are accounted for in the other components of the building block approach viz. the tax benefit of interest deductions is in the estimate of net cash flows whereby the statutory tax rate is adjusted to reflect the value of imputation tax benefits”.⁷⁵⁸ The assumption of Officer and Bishop is that this consistency between the WACC definition and the definition of the building block components is adhered to.⁷⁵⁹

The ACCC is not satisfied that the methodology is consistent with the legitimate business interests of NBN Co and recovery of NBN Co’s direct costs.

While the ACCC considers that the treatment of the tax allowance in this methodology is largely consistent with that adopted in standard regulatory practice for post-tax regulatory methodologies, it is difficult to be satisfied that it will remain reasonable for the duration of Module 2, given that best practice regulation and the relevant circumstances faced by NBN Co may change over the period. Therefore, the ACCC is not satisfied that the approach to calculating NBN Co’s tax allowance will be consistent with the legitimate business interests of NBN Co and recovery of NBN Co’s direct costs in all circumstances that could arise.

In addition, given that the ACCC is not satisfied that prescribing a nominal vanilla WACC for the duration of Module 2 is reasonable, the ACCC considers that it is by consequence difficult to be satisfied that prescribing the factors that must be taken into account when calculating a tax allowance is also reasonable. This is because the approach to the cost of capital and the tax allowance should be consistent in regulatory methodologies to ensure that the regulated business is not under- or over-compensated relative to its tax liabilities and its cost of capital.

⁷⁵⁷ Ibid, Schedule 2D, clause 2D.2.1(a)(iv)(A)-(G).

⁷⁵⁸ Officer and Bishop report, p. 4.

⁷⁵⁹ Ibid, p. 4.

Further, the proposed criteria are fixed principles; hence there is uncertainty about whether the ACCC could reject a proposed variation to the SAU on the basis that the variation does not comply with the criteria. This is because there might be an argument that the rejection is ‘for a reason that concerns’ the fixed principles and therefore not permitted under the CCA.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the SAU be varied to remove the factors that must be taken into account in determining the value of the tax allowance.

Preliminary ACCC views — length of regulatory cycle

The length of the regulatory cycle determines the length of time for which forecast revenues and forecast annual revenue requirements would apply to NBN Co. Under clause 4.6(b)(i) of the main body of the SAU, the length of the regulatory cycle is determined by NBN Co as between three, four or five years and submitted to the ACCC as part of a replacement module application. However, the effect of clauses 2A.3(b) and (c) of Module 2 is that NBN Co’s decision on the length of the regulatory cycle will apply regardless of whether or not the ACCC accepts or rejects a replacement module application. This means that the length of the regulatory cycle is determined by NBN Co.

As noted, the length of the regulatory cycle could have implications for NBN Co’s incentives to invest and operate efficiently. Generally speaking, longer regulatory cycles (for example, five years) could create stronger incentives for NBN Co to invest and operate efficiently. This is because a longer period means that any additional financing costs for cost overruns would be absorbed by NBN Co for a longer period, thereby reducing NBN Co’s incentives to incur these cost overruns — and similarly, the additional revenues associated with reduced costs will also be retained by NBN Co for a longer period. Essentially, longer regulatory cycles mean that the expenditure forecast in the later years of the period (for example, year five) will be less accurate than earlier years — hence, NBN Co would be exposed to some uncertainty. Conversely, shorter regulatory cycles (for example, one and two years) allow for a greater degree of certainty as to expenditure forecasts, but reduce the length of time NBN Co will be allowed to keep additional revenues or absorb cost overruns, in turn reducing the strength of the incentive created for NBN Co to spend efficiently.

The ACCC does not consider that allowing NBN Co to determine the length of the regulatory cycle would encourage efficient investment and operating expenditure. This is because it is not clear to the ACCC why NBN Co would ever have an incentive to subject itself to the higher degree of forecasting uncertainty associated with proposing a long regulatory period. Given its implications for NBN Co’s incentives to invest and operate efficiently, the length of the regulatory cycle should not be determined unilaterally by NBN Co, but rather, should be subject to consultation and independent decision making, in order to ensure that NBN Co is subject to the appropriate degree of strength of incentive mechanism.

In light of this issue, the Consultation Paper on the Notice to Vary proposes that NBN Co’s discretion to decide the length of the regulatory cycle be removed.

Preliminary ACCC views — rolling forward the RAB

As noted, during the term of Module 2, the RAB is updated each year by adding the actual capital expenditure incurred by NBN Co in the previous year, and deducting the actual levels of depreciation and asset disposals.⁷⁶⁰ At the commencement of Module 2, the RAB will be equal to the RAB at the end of Module 1.⁷⁶¹

⁷⁶⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 2D.2.7.1(b).

⁷⁶¹ *Ibid*, Schedule 2D, clause 2D.2.7.1(a).

NBN Co submits that in Module 2, incentives for capital expenditure are provided by using a standard utility regulatory approach (that is, use of expenditure forecasting), so there is no need for standalone prudent conditions on capital expenditure.⁷⁶²

Optus argues that the RAB roll-forward does not provide for any ability for the ACCC to review the inclusion of NBN Co's capital costs,⁷⁶³ and this approach risks replicating the flawed elements of the previous electricity regulatory regime.⁷⁶⁴

As discussed, if actual capital expenditure incurred during the previous year is used to update the RAB, this provides NBN Co with a high degree of certainty that it would be able to recover its expenditure, including any deviations from forecasts. This certainty would prevent NBN Co from being dissuaded to pursue otherwise efficient investments. However, this approach could also generate incentives for NBN Co to over-invest or incur capital expenditure in an inefficient manner, as it would not be prevented from recovering this expenditure over time.

Due to the weak incentives created by rolling forward actual expenditure into the RAB, as noted, regulated businesses are typically subject to additional ex-ante incentive-based mechanisms that aim to generate incentives to invest and spend efficiently. In addition to such efficiency incentive mechanisms, expenditure can be subject to ex-post review by the regulator to prevent inefficient capital expenditure from being rolled into the RAB. This is currently adopted in Chapters 6 and 6A of the NER that apply to electricity transmission and distribution network service providers.⁷⁶⁵ Under the NER, any expenditure in excess of the forecast previously approved by the AER may be subject to ex-post review by the AER, and the AER may ultimately preclude some or all of that excess expenditure from being rolled-into the RAB.⁷⁶⁶

The ACCC's preliminary views about the incentives for NBN Co to invest and operate efficiently that are created by the forecast-based approach that is currently proposed in the SAU are outlined above – to summarise though, the ACCC considers that the proposed approach will provide only weak efficiency incentives. Further, whilst the SAU does not preclude NBN Co from proposing additional incentive mechanisms during Module 2 (such as an ex-post expenditure review mechanism, or the types of efficiency benefit sharing schemes currently being considered by the AER), the SAU does not require it to do so.⁷⁶⁷

Further, as noted in section 5.3, whilst if NBN Co were to face revenue sufficiency risk, the proposed price controls could (subject to resolution of the previously outlined implications of NBN Co's ability to withdraw products) provide strong incentives for NBN Co to invest efficiently, it is unclear for how long throughout Module 2 this revenue sufficiency risk will exist.

The ACCC is therefore not satisfied that efficient investment and expenditure will be encouraged over the term of Module 2 if it is prescribed that the RAB will always be updated based on actual capital expenditure and actual depreciation and asset disposals.

In light of the issues presented in this section, the Consultation Paper on the Notice to Vary proposes that the SAU be varied to remove the requirement that the RAB will be rolled-forward within Module 2 based on actual capital expenditure and actual depreciation and asset disposals; and amended to require that the RAB be rolled-forward based on prudent capital expenditure and 'depreciation' and 'asset disposals'.

⁷⁶² NBN Co Supporting submission, p. 118.

⁷⁶³ Optus submission (Public version), p. 32.

⁷⁶⁴ Ibid, pp. 44-45.

⁷⁶⁵ See NER, Chapter 6A, Schedule 6A.2; and Chapter 6, Schedule 6.2.

⁷⁶⁶ NER, Chapter 6A, Schedule 6A.2, section 6A.2.2A; and Chapter 6, Schedule 6.2, section S6.2.2A.

⁷⁶⁷ NBN Co submits that the specification of its forecast annual revenue requirement in Module 2 is deliberately non-exhaustive to allow for possible future modifications such as the inclusion of efficiency incentive schemes.

This would allow for different approaches to determining what reflects prudent expenditure to be proposed by NBN Co, and assessed by the ACCC, at different points in time throughout Module 2. It would also reduce any uncertainty that, if the ACCC considered that efficiency sharing schemes should apply to NBN Co in the future, the ACCC would not be precluded from rejecting any variation to the SAU that did not include such a scheme.

For the avoidance of doubt, the opening RAB at the beginning of Module 2 will still be the closing RAB from the end of Module 1; and the proposed variation is not intended to allow for the RAB to be re-valued over time.

5.5.3. Summary of preliminary ACCC views on long-term revenue constraint methodology

For the reasons outlined in the introduction to section 5.5, the ACCC considers that in principle, adopting the proposed long-term revenue constraint methodology would:

- encourage efficient investment in and use of the NBN;
- satisfy the operational and technical requirements necessary for the safe and reliable operation of the NBN;
- allow NBN Co to recover its direct costs; and
- have appropriate regard for NBN Co's legitimate business interests;

for the term of the SAU.

However, as noted, there is a distinction between defining the cost components or types of costs that can be recovered versus the methodologies that are used to calculate the values of those cost components. To the extent that a particular methodology leads to under or over-recovery of NBN Co's efficient costs (including an appropriate return on capital), this can result in efficient investment not being encouraged, and NBN Co being under or over-compensated relative to its direct costs and its legitimate business interests.

For the reasons outlined in sections 5.5.1 and 5.5.2, the ACCC is not satisfied that all of the methodologies proposed in Modules 1 and 2 for calculating the values of the building block components would mean that at all times over the duration of the SAU NBN Co had an expectation that it would be allowed to recover only its prudent costs. In turn, the ACCC is not satisfied that the proposed implementation of the long-term revenue constraint methodology would at all times during the SAU term allow NBN Co to recover only its direct costs, compensate NBN Co only for its legitimate business interests and encourage efficient investment in and operation of the NBN.

In particular, during Module 1:

- the adoption of an ex-post compliance approach to the long-term revenue constraint methodology will not encourage efficient investment and efficient operating expenditure by NBN Co; and
- a number of provisions relating to capital expenditure may allow NBN Co to overstate its costs relative to efficient levels.

During Module 2, whilst a forecast-based mechanism could, in principle, encourage efficient investment and efficient operating expenditure by NBN Co, the ACCC is not satisfied that:

- the methodologies proposed for calculating the forecast values of the components of the annual revenue requirements would ensure that NBN Co is only compensated for its efficient costs for the duration of Module 2, nor is it

satisfied that they would encourage efficient use of the network — this is likely in turn to reduce the effectiveness of the forecasting approach in creating incentives for NBN Co to invest in and operate the NBN efficiently;

- NBN Co determining the length of the regulatory cycle would encourage efficient investment by NBN Co; and
- prescribing for the full duration of Module 2 that the RAB would be updated based on actual capital expenditure and actual depreciation and asset disposals will encourage only efficient investment by NBN Co.

5.6. Preliminary ACCC view on price-related terms

The ACCC's preliminary view is that it is not satisfied that the price-related terms and conditions are reasonable. They are unlikely to encourage efficient use of and investment in the infrastructure used to supply listed services over the term of the SAU and may over-compensate NBN Co relative to its efficient costs (including a normal commercial return on its investment), and in turn over-compensate NBN Co relative to its direct costs and legitimate business interests and investments.

In particular, whilst the ACCC is generally satisfied that most of the initial prices in the SAU are reasonable, the ACCC is not satisfied that:

- the clauses about how NBN Co will set new prices (including for previously zero-prices services); and
- the clauses about how prices for all services will or will not change over time (including the proposed CPI-1.5 per cent price control on all products and the tax change event clauses);

will ensure that relative prices between services are set in such a way as to encourage efficient use of the NBN in all circumstances that may arise over the term of the SAU (including relative price levels between the NBN and copper and HFC networks during the network rollout period). Whilst NBN Co is likely to face incentives to price in such a way as to encourage use of the NBN if it faces revenue sufficiency risk, it is possible that this risk will reduce over the SAU term.

Further, whilst the ACCC considers that the long-term revenue constraint methodology will, in principle, provide assurances that NBN Co will be able to recover only its efficient costs of supply over the term of the SAU (including a normal commercial return), the proposed implementation of the long-term revenue constraint methodology could allow NBN Co to recover more than its efficient costs (including a normal commercial return) and could allow for NBN Co to be compensated for more than the direct costs of providing access to the declared services.

In light of these views, the Consultation Paper on the Notice to Vary proposes the following key variations to the SAU:

- Varying the SAU to permit periodic (for example, five yearly) revenue neutral reviews and rebalancing of all prices by the ACCC. Such reviews would allow for the ACCC to assess whether new prices had been set in an efficient manner and to address any issues that arise at that time, such as a need to rebalance AVC and CVC charges.
- The clauses in the SAU about the setting of new prices be removed from the SAU — including clauses about who sets these prices. This variation would

allow for the ACCC to determine new prices in circumstances where it considered that NBN Co faced weak incentives to set new prices efficiently.

- Varying the long-term revenue constraint methodology to, during Module 1, include a role for the ACCC in calculating the values of the annual revenue requirements, RAB roll-forward and initial cost recovery account, and during Module 2, allow for a greater degree of flexibility in the approach that is adopted, to mirror usual regulatory practice and so encourage efficient investment in and operation of the NBN.

As noted throughout this chapter, while these variations would *permit* the ACCC to determine prices in certain circumstances, the ACCC expects that it would not do so in most circumstances. The ACCC recognises that it is desirable for NBN Co to have a degree of pricing flexibility in certain circumstances. Nonetheless, the possibility of ACCC recourse could in and of itself reduce the likelihood that the sorts of circumstances where it would be desirable for the ACCC to determine prices would arise.

The ACCC further notes that, in determining new prices in an Access Determination, it would be required by Part XIC to take into account particular matters specified by Part XIC — such as NBN Co's legitimate business interests, the interests of access seekers and whether the determination would promote the long-term interests of end-users..

The proposed variations to the long-term revenue constraint methodology are intended to address the concern that the methodology could be applied by NBN Co in a way that results in inefficient expenditure being included in the RAB and annual revenue requirements. For the avoidance of doubt, the variations are *not* intended to allow for the ACCC to revalue the RAB or in any way revisit the levels of capital expenditure that have already been included in the RAB in previous years.

6. Non-price matters

This chapter sets out the ACCC's preliminary views about NBN Co's proposed non-price terms.

6.1. Overview

The SAU addresses a range of non-price matters in Module 1. The only non-price matter addressed in Module 2 is service levels (in the form of general principles).

The SAU does not cover all non-price matters that are relevant to supply of NBN Co services. NBN Co submits that it has tried to ensure:

- the commitments are 'standalone' commitments that are not subject to extraneous documents; and
- there is a certain and clear role for the ACCC (if required) via the regulatory recourse mechanism in clause 1B. Any non-price terms and conditions not covered by the SAU may be subject to the regulatory recourse mechanism in Schedule 1B (provided the requirements in clause 1B.2 are met).⁷⁶⁸

The non-price matters in the SAU are divided into two groups:

- **SFAA commitments** — commitments by NBN Co to include particular terms and conditions in any SFAAs that it publishes; and
- **Standalone commitments** — commitments by NBN Co set out on a standalone basis in the SAU.

These two groups of commitments are described below in this overview, and discussed in detail in sections 6.2 - 6.8. Two additional non-price issues are briefly discussed in this overview: change management of Access Agreements and compliance with retail-level regulatory requirements.

6.1.1. SFAA commitments

Under the SFAA commitments, NBN Co commits that it will include the terms and conditions specified in Annexures to Schedule 1H and Schedule 1J in its SFAAs. These terms and conditions relate to the following non-price matters:

- service levels (Annexure 1 to Schedule 1J);
- risk management (Annexure 3 to Schedule 1H);
- confidentiality and intellectual property rights for 'business as usual' activities (Annexure 2 to Schedule 1H); and
- dispute management rules (Annexure 1 to Schedule 1H).

The ACCC notes that the SFAA commitments operate in a similar fashion to the price provisions discussed in section 5.4 of this Draft Decision. That is, the commitments require NBN Co to include certain content in any SFAA that it publishes. However, except in relation to

⁷⁶⁸ NBN Co Supporting submission, p. 136.

the dispute management rules, NBN Co does not directly commit under the SAU to comply with the terms and conditions that are specified in the Annexures. Instead, NBN Co submits that “[a]ny breaches of the terms and conditions in the Annexures of Schedule 1H that are incorporated into any contractual agreement will be dealt with as a matter between NBN Co and its Customers under their access agreement, rather than as a breach of the SAU”.⁷⁶⁹ The view that the SFAA commitments as drafted would be enforceable only as a contractual matter between the parties is supported by other submissions.⁷⁷⁰ The ACCC’s views on the effects of this approach are outlined in chapter 2.

As noted in section 8.3 of this Draft Decision, the ACCC has categorised these terms and conditions as being about conduct relating to access. The relevant statutory test that the ACCC must therefore apply is reasonableness.⁷⁷¹ This includes consideration of, amongst other things, the long-term interests of end-users, the legitimate business interests of NBN Co and the interests of access seekers.⁷⁷²

The ACCC considers that a commercially negotiated contract within a competitive environment would be expected to set out terms and conditions that represent an appropriate balance between the parties’ interests, since the parties would not otherwise have entered into the contract. However, a monopoly access provider may have incentives and the ability to exercise market power to impose onerous terms on access seekers in order to minimise its exposure to risk. This could impose costs on access seekers that create barriers to entry, and ultimately result in higher retail prices and reduced service quality for end-users.⁷⁷³ It is therefore important that the regulated terms and conditions specified by an SAU provide an appropriate balance between the interests of NBN Co and access seekers and allocate risk to the party most able to efficiently bear it.

In relation to the SFAA commitments, NBN Co submits that the terms and conditions in the Annexures provide an appropriate balance between the interests of NBN Co and access seekers because:

“The non-price terms and conditions incorporated into the SAU have been developed via comprehensive and detailed review and engagement with NBN Co’s Customers during the CDP [Contract Development Process]. NBN Co released a number of position papers, held a number of multilateral workshops with Customers and made significant and extensive amendments to the previous terms and conditions in accordance with industry feedback. As such NBN Co is confident that the non-price terms and conditions incorporated into the SAU are appropriate given the level of engagement with Customers and the amendments NBN Co has made in response.”⁷⁷⁴

However, submissions from interested parties disagree with the proposition that the CDP process has resulted in a balanced set of terms and conditions developed jointly by the parties.⁷⁷⁵ In contrast, interested parties submit that significant differences remain between access seekers and NBN Co, despite an extended period of consultation and negotiation between NBN Co and access seekers.⁷⁷⁶ A number of submissions express concerns that the

⁷⁶⁹ Letter from NBN Co to ACCC, *Re NBN Co SAU request for clarification*, 1 November 2012, p. 2.

⁷⁷⁰ DBCDE submission, p. 3; Macquarie Telecom submission, p. 20.

⁷⁷¹ CCA, s. 152CBD(2).

⁷⁷² CCA, s. 152AH.

⁷⁷³ Optus submission (Public version), p. 118.

⁷⁷⁴ NBN Co Supporting submission, p. 136. NBN Co established the CDP to commercially negotiate the terms of the next WBA with access seekers. The CDP utilised bilateral and multilateral engagements to enable NBN Co and access seekers to resolve ‘key issues’ with NBN Co’s current Wholesale Broadband Agreement. The CDP concluded in November 2012.

⁷⁷⁵ Optus submission (Public version), p. 116 and p. 147; Vodafone Hutchison Australia submission, p. 8; CCC submission, p. 2; Telstra submission, p. 14 and pp. 84-85.

⁷⁷⁶ Optus submission (Public version), p. 116; Telstra submission, pp. 84-85.

terms and conditions specified in the SFAA commitments will lock-in a set of detailed terms and conditions on which industry consensus has not been reached with NBN Co.⁷⁷⁷

In a letter to industry, NBN Co noted that it was not possible to reach a general consensus due to the differing views of different access seekers.⁷⁷⁸

There are therefore differing views on whether the terms and conditions specified in the SFAA commitments represent a suitable balance between the interests of NBN Co and access seekers, even though they are the outcome of consultation and negotiation through the CDP process.

However, the ACCC notes that agreement between NBN Co and access seekers would not be wholly determinative of whether terms and conditions meet the statutory criteria for reasonableness under section 152AH of the CCA. In its assessment of the SAU, the ACCC is required to independently consider whether it is satisfied that those criteria are met.

For the reasons set out in this chapter, the ACCC is not satisfied that the SFAA terms and conditions give sufficient weight to the interests of access seekers. In particular, the ACCC acknowledges that, while some of the SFAA terms and conditions are derived from well-founded principles on these issues, the drafting of the terms lacks reciprocity in a way that creates an imbalance between the interests of NBN Co and access seekers. Further, in some instances, the SFAA terms and conditions do not place responsibility for particular risks with the party able to manage those risks most efficiently. This could in turn raise the overall risk of increased costs associated with supplying services to end-users, and in turn the prices that end-users have to pay. Alternatively, it could result in the risks being transferred to end-users in circumstances where those end-users cannot control the likelihood of the risks eventuating. These outcomes could result in end-users taking-up the NBN to a lesser extent than they would have had the risks been managed more efficiently at a higher level of the supply chain. This would not promote the long-term interests of end-users.

The Consultation Paper on the Notice to Vary therefore proposes that the SFAA commitments be removed from the SAU, in order to facilitate further commercial negotiation on these terms.

The ACCC acknowledges that the non-price matters addressed by the SFAA commitments in the SAU have not been the subject of consensus in the negotiations between NBN Co and access seekers to date. The ACCC expects that the observations made in this Draft Decision may provide guidance to NBN Co and access seekers as to the negotiated outcomes that it might consider reasonable.

The SFAA commitments are discussed in further detail in sections 6.2 - 6.6 below.

6.1.2. Standalone commitments

Module 1 also includes standalone commitments relating to:

- the publication of network rollout information and POI rollout progress information;⁷⁷⁹ and
- the opening, closure and relocation of POIs.⁷⁸⁰

⁷⁷⁷ Optus submission (Public version), p. 116 and p. 147; Vodafone Hutchison Australia submission, p. 8; CCC submission, p. 2; Telstra submission, p. 14, pp. 84-85.

⁷⁷⁸ Jim Hassell, *Letter Re: NBN's Draft Wholesale Broadband Agreement (WBA)*, 7 December 2012, cited in Optus submission (Public version), p. 120.

⁷⁷⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, clauses 1H.2 and 1H.3.

⁷⁸⁰ *Ibid*, Schedule 1H, clause 1H.4.

The ACCC considers that these standalone commitments specify conduct in relation to additional activities of an NBN corporation in accordance with subsection 152CBA(3C) of the CCA. The POI commitment also provides for the ACCC to perform functions or exercise powers in relation to the SAU, and to exercise its power under section 151DB of the CBA.

Under the SAU, the standalone commitments would be reviewed under the midpoint review in Module 1.⁷⁸¹ Submissions did not express concerns in relation to the period for which the standalone commitments will be in force.

The standalone commitments are discussed in further detail in sections 6.7-6.8 below.

6.1.3. Other non-price issues

Two additional non-price issues were raised in submissions to the ACCC's Consultation Paper on the SAU: change management of Access Agreements and compliance with retail-level regulatory requirements.

6.1.3.1. Change management of Access Agreements

The ACCC notes that the SAU does not specify terms and conditions in relation to change management under Access Agreements. However, at least one of NBN Co's existing SFAAs contains rights for NBN Co to unilaterally vary executed Access Agreements based on that SFAA.⁷⁸² Submissions have suggested that the presence of such rights in NBN Co's SFAAs has the potential to undermine the SFAA commitments, since NBN Co may thus be able to modify the terms and conditions specified in the Annexures following execution of an Access Agreement.⁷⁸³

The ACCC generally holds the position that, while the ability to vary a contract post-execution allows flexibility in changing circumstances, a contract should only be varied with the consent of both parties to the agreement.⁷⁸⁴ The presence of rights to unilaterally vary an executed Access Agreement, except in very limited circumstances, is more likely than not to reflect the use of unequal bargaining power between the parties. For example, in the ACCC's *Model Non-Price Terms and Conditions*, the power to unilaterally vary terms is limited to operating manuals, and is subject to dispute resolution in the event that the variation undermines the initial bargain between the parties.⁷⁸⁵

As discussed in chapter 2, the ACCC would expect that NBN Co and access seekers would ensure that Access Agreements do not include such terms.

In the event that NBN Co and its customers are unable to agree about the change management terms to be included in Access Agreements, the ACCC would be able to make an Access Determination or Binding Rule of Conduct including terms about contract change management (if the ACCC considered that to do so would promote the long-term interests of end-users).

⁷⁸¹ Ibid, Schedule 1K, clause 1K.3.1.

⁷⁸² NBN Co, *Wholesale Broadband Agreement*, 1 January 2013, Module F, clauses F4.1 and F4.2.

⁷⁸³ Optus submission (Public version), p. 117, p. 119 and p. 121; Telstra submission, p. 120; iiNet submission, pp. 13-14

⁷⁸⁴ ACCC, *Decision to accept: Australian Bulk Alliance Pty Ltd – Port Terminal Services Access Undertaking*, 28 September 2011, p. 14.

⁷⁸⁵ ACCC, *Model Non-Price Terms and Conditions Determination 2008*, 17 November 2008, Part 4, clause I, pp. 27-28.

6.1.3.2. Retail-level regulatory requirements

In relation to retail-level regulatory requirements, the ACCC acknowledges the references to the Customer Service Guarantee (CSG) and Priority Assistance arrangements in the SAU.⁷⁸⁶ However, the ACCC notes that NBN Co has not made any general commitments in the SAU to address its role in supporting retail-level regulatory requirements that apply in downstream markets. This may create significant compliance issues for RSPs if SFAAs and Access Agreements are inconsistent with such requirements.⁷⁸⁷

The ability of access seekers to comply with retail-level regulatory requirements may be affected by NBN Co's attempts to influence contracts and the relationship between access seekers and downstream customers through its SFAAs. For example, clause 15 of the service levels schedule (Annexure 1 to Schedule 1J) effectively requires access seekers to request a waiver from their customers from the Customer Service Guarantee. Even more directly, NBN Co requires access seekers to include specified content in downstream contracts under its *Fair Use Policy*.⁷⁸⁸ The policy also requires RSPs to include a clause requiring compliance with this policy in downstream contracts, enforceable by disconnection or deactivation of the service.⁷⁸⁹ This may cause difficulties for access seekers in complying with retail-level regulatory requirements because it is arguable that the prohibited "Unfair Use" is unclearly defined and subject to variation at NBN Co's discretion.⁷⁹⁰ The SAU also imposes specific requirements on access seekers in relation to end-user communications.⁷⁹¹

The ACCC considers that a general commitment to support retail-level regulatory requirements would promote the long-term interests of end-users. Firstly, it would do so by ensuring that access seekers have the ability to supply high quality retail services to end-users. Secondly, it would ensure that NBN Co could not impose terms on access seekers that would have the effect of impeding compliance with retail-level technical standards and service specifications targeted at achieving any-to-any connectivity. Thirdly, it would reduce investment risks for access seekers by ensuring that they are not placed in a position where they are unable to comply with retail-level regulation, while being required to bear the penalties and costs of failure to do so.

6.2. Service levels

Service levels specify the minimum quality of the service that is to be supplied by an access provider to an access seeker. The SAU contains a number of commitments in relation to service levels and service level rebates in Modules 0, 1 and 2 of the SAU.

Module 0

In Module 0, the SAU requires NBN Co to include a proposal in respect of service levels and service level rebates in all replacement modules.⁷⁹² Any such proposal must be consistent with the requirements in Module 2.⁷⁹³

Module 1

⁷⁸⁶ For example, see NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1J, Annexure 1, clauses 1.1(c), 14 and 15.

⁷⁸⁷ Telstra submission, pp. 118-121.

⁷⁸⁸ Access seekers must comply with the policy because it is part of the Business Rules specified in NBN Co's Wholesale Broadband Agreement: NBN Co, *Wholesale Broadband Agreement*, 1 January 2013, Module C, clause C4.2.

⁷⁸⁹ NBN Co, *Fair Use Policy*, 30 November 2011, clause 2.2.

⁷⁹⁰ Telstra submission, p. 120; iiNet submission, p. 28. For example, it "may include use of NBN-Related Networks in a way that causes or may cause interference, disruption, congestion or, more generally, sub-optimal network performance."

⁷⁹¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 2, clauses 3 and 4.

⁷⁹² *Ibid*, Main Body, clauses 4.6(b)(iv) and 4.9.

⁷⁹³ *Ibid*, Schedule 2F, clause 2F.2.1.

Module 1 specifies detailed commitments that NBN Co will comply with during the initial regulatory period. The key commitment in Module 1 is to include the service levels specified in Annexure 1 to Schedule 1J in any SFAA.⁷⁹⁴ Annexure 1 specifies a range of service levels covering the following areas:

- end user connections;⁷⁹⁵
- activations;⁷⁹⁶
- service fault rectification;⁷⁹⁷
- enhanced-12 fault rectification;⁷⁹⁸
- end user fault rectification appointments;⁷⁹⁹
- modifications;⁸⁰⁰
- disconnections;⁸⁰¹
- facilities access service orders;⁸⁰²
- NBN Co platform interfacing service availability;⁸⁰³ and
- network performance and availability.⁸⁰⁴

The service level framework also provides for:

- measurement and corrective action;⁸⁰⁵
- CSG compensation;⁸⁰⁶
- mitigation of damages;⁸⁰⁷
- operational targets;⁸⁰⁸ and
- exclusions.⁸⁰⁹

The SAU also contains commitments in relation to the remedies that are available in the event that NBN Co does not meet specified service level commitments. There are two types of remedies: rebates and corrective action.⁸¹⁰

Rebates are available in limited circumstances — namely, where NBN Co fails to meet the specified service levels for end user connections and enhanced 12 fault rectification.⁸¹¹ For

⁷⁹⁴ Ibid, Schedule 1J, clause 1J.2(a).

⁷⁹⁵ Ibid, Schedule 1J, Annexure 1, clauses 1-2.

⁷⁹⁶ Ibid, Schedule 1J, Annexure 1, clause 3.

⁷⁹⁷ Ibid, Schedule 1J, Annexure 1, clause 4.

⁷⁹⁸ Ibid, Schedule 1J, Annexure 1, clause 5.

⁷⁹⁹ Ibid, Schedule 1J, Annexure 1, clause 6.

⁸⁰⁰ Ibid, Schedule 1J, Annexure 1, clause 7.

⁸⁰¹ Ibid, Schedule 1J, Annexure 1, clause 8.

⁸⁰² Ibid, Schedule 1J, Annexure 1, clause 9.

⁸⁰³ Ibid, Schedule 1J, Annexure 1, clause 10.

⁸⁰⁴ Ibid, Schedule 1J, Annexure 1, clause 11.

⁸⁰⁵ Ibid, Schedule 1J, Annexure 1, clauses 12-13.

⁸⁰⁶ Ibid, Schedule 1J, Annexure 1, clause 14.

⁸⁰⁷ Ibid, Schedule 1J, Annexure 1, clause 15.

⁸⁰⁸ Ibid, Schedule 1J, Annexure 1, clause 16.

⁸⁰⁹ Ibid, Schedule 1J, Annexure 1, clause 18.

⁸¹⁰ Ibid, Schedule 1J, Annexure 1, clauses 1.4, 5.3 and 13.

⁸¹¹ Ibid, Schedule 1J, Annexure 1, clauses 1.4 and 5.3.

end-user connections, the customer must also submit an accurate forecast of its monthly connections to receive a rebate. Otherwise, the rebate may be reduced by 50 per cent (for forecasts with 15-30 per cent accuracy) or 100 per cent (for forecasts of less than 30 per cent accuracy).⁸¹²

Annexure 1 states that “[w]hile not achieving a Service Level or Performance Objective is not a breach of this Agreement, Customers can request NBN Co take Corrective Action”.⁸¹³ Corrective action is a right for a customer to request that NBN Co take action to fix the issue that is causing NBN Co to fail to meet the service level. It is available for some service levels but not others.⁸¹⁴

Module 1 commitments can be changed or updated in different ways. Firstly, service level commitments contained in the SAU are reviewed once during Module 1, at the midpoint review. Secondly, NBN Co’s commitment to include the service levels in the Annexure in any SFAA is subject to any changes made:

- with the ACCC’s prior approval; or
- in relation to new products, product components, product features, ancillary services and types of facilities access service introduced during Module 1.⁸¹⁵

For new products, NBN Co has included commitments to consult through the Product Development Forum on service levels for new products developed via the PDF.⁸¹⁶ Under these commitments, prior to introducing a new product, product component or product feature which has been the subject of a product idea developed through the PDF, NBN Co will consult with customers in relation to:

- the service levels applicable to such a new product, product component or product feature; or
- if NBN Co is unable to offer service levels prior to the introduction of a new product, product component or product feature the estimated timetable and process of consultation in relation to the introduction of such service levels.⁸¹⁷

However at the end of the process the SAU confers discretion on NBN Co to make the final decision on what service levels will apply for new products because NBN Co has the ability to make any changes to any SFAA that it considers appropriate.⁸¹⁸

For new products that do not go through the Product Development Forum, NBN Co is not required to consult. For further information on the Product Development Forum, see section 4.1.

Module 2

Module 2 of the SAU contains high level commitments about maintaining service levels for existing products and developing service levels for new products.⁸¹⁹ NBN Co must propose service level provisions that are consistent with these principles when preparing a replacement module application for the ACCC’s assessment.⁸²⁰

⁸¹² Ibid, Schedule 1J, Annexure 1, clause 1.4.

⁸¹³ Ibid, Schedule 1J, Annexure 1, Service Levels Schedule Roadmap, p. 243.

⁸¹⁴ Ibid, Schedule 1J, Annexure 1, clause 13.1. Corrective Action is available if NBN Co does not achieve a Service Level or Performance Objective.

⁸¹⁵ Ibid, Schedule 1B, clause 1B.3.1(e)(v).

⁸¹⁶ Ibid, Schedule 1I, clause 1I.3.6.

⁸¹⁷ Ibid, Schedule 1I, clause 1I.3.6.

⁸¹⁸ Ibid, Schedule 1B, clause 1B.3.1(e).

⁸¹⁹ Ibid, Schedule 2F.

⁸²⁰ The replacement module process is discussed in section 2.3.1.

In relation to existing products, the SAU allows NBN Co to vary or update service levels that will apply during an upcoming regulatory cycle.⁸²¹

- to the extent necessary to promote efficient take-up and usage;
- to maintain service levels and service level rebates on terms that are the same or better than previously (having regard to all the circumstances); and
- having regard to the likely cost impacts on NBN Co and customers, and any relevant retail-level regulatory requirements that customers must comply with.

For new products, in Module 2 the SAU contains commitments to consult with customers through the Product Development Forum.⁸²²

Module 2 also contains high level principles relating to the introduction of service levels for new products.⁸²³ These state that the service levels and service level rebates that will apply to a new product component, product feature, Ancillary Service or type of Facilities Access Service introduced during a regulatory cycle:

- will be specified by NBN Co,⁸²⁴
- will apply from the introduction of the new product;⁸²⁵ and
- must be:
 - specified in a manner consistent with promoting the efficient take-up and usage;
 - having regard to the likely cost impacts on NBN Co and customers; and
 - any relevant retail-level regulatory requirements that customers must comply with.⁸²⁶

6.2.1. Submissions

NBN Co submits that:

- it developed the service levels in the SAU following engagement with its customers to address issues they have raised;⁸²⁷
- it has included a requirement to perform corrective action, which "results in NBN Co continuing to look for ways to improve its performance",⁸²⁸ and
- it has included a commercial rebate structure which will incentivise it to meet its service level commitments.⁸²⁹

The Department of Broadband, Communications and the Digital Economy (DCBDE) submits that it is difficult for NBN Co to make definitive commitments on service levels at this time because NBN Co is in the early stages of its network rollout.⁸³⁰

⁸²¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2F, clause 2F.2.1.

⁸²² Ibid, Schedule 2E, clause 2E.4.5.

⁸²³ Ibid, Schedule 2F, clause 2F.2.2.

⁸²⁴ Ibid, Schedule 2F, clause 2F.2.2(a).

⁸²⁵ Ibid, Schedule 2F, clause 2F.2.2(b).

⁸²⁶ Ibid, Schedule 2F, clause 2F.2.2(c).

⁸²⁷ NBN Co Supporting submission, p. 185.

⁸²⁸ Ibid, p. 200.

⁸²⁹ Ibid, p. 187.

Submissions from other interested parties raise the following issues:

- In some cases, the service levels proposed by NBN Co are lower than the corresponding service levels that would be available to end-users today.⁸³¹ In particular, for some services, businesses would incur greater costs to purchase NBN services with the same level of quality as is available in the market currently.⁸³²
- The proposed regime has non-existent or weak sanctions and performance obligations and will therefore not create incentives for NBN Co to provide an appropriate level of service assurance.⁸³³
- Under the SAU, consumers are not guaranteed to benefit from connection timeframes promised by the Customer Service Guarantee.⁸³⁴
- Given the rate of technological change and innovation in the telecommunications sector, the proposed period between reviews of service levels is too long.⁸³⁵
- The proposed service level commitments have emerged from incomplete consultation on NBN Co's Wholesale Broadband Agreement, where some participants were not satisfied that feedback from access seekers had been adequately addressed, such that access seekers and NBN Co had not reached negotiated agreement.⁸³⁶
- The technical specifications are missing for some products for which a price is specified in the SAU, which means that NBN Co could subsequently specify a poor standard of quality for these products.⁸³⁷ Such products include the TC-2 and TC-3 product offerings.⁸³⁸

6.2.2. Preliminary ACCC views

The statutory criteria most relevant to the ACCC's assessment of the conduct and terms and conditions relating to service levels are:⁸³⁹

- encouraging the economically efficient use of, and economically efficient investment in, the infrastructure by which the service(s) are supplied;
- the interests of persons who have rights to use the service(s); and
- the legitimate business interests of NBN Co.

⁸³⁰ DBCDE submission, p. 3.

⁸³¹ Optus submission (Public version), p. 101; iiNet submission, p. 33; Telstra submission, p. 45.

⁸³² Optus submission (Public version), p. 101.

⁸³³ Telstra submission, p. 42.

⁸³⁴ ACCAN submission, p. 5.

⁸³⁵ Nextgen Networks submission, p. 19; Optus submission (Public version), p. 119 and p. 125; AAPT submission, p. 9.

⁸³⁶ Vodafone Hutchison Australia submission, p. 8; AAPT submission, p. 9; Optus submission (Public version), p. 119.

⁸³⁷ Macquarie Telecom submission, p. 9; Optus submission (Public version), p. 126 and p. 131; Telstra submission, p. 45.

⁸³⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 2D, clause 1D.2.6.

⁸³⁹ The ACCC considers that the commitments in relation to service levels in Schedule 1J specify conduct to be undertaken by NBN Co (and the terms and conditions on which that conduct will be undertaken) in accordance with subsection 152CBA(3B). The ACCC considers that that Annexure 1 to Schedule 1J specifies terms and conditions on which NBN Co will undertake this conduct.

Commitments to meet particular service levels may contribute to the first item by encouraging the ongoing expenditure (for example, in upgrading capacity) that is required to meet the service levels on an ongoing basis. The ACCC notes that in order for service levels to have this effect, they should be combined with mechanisms for incentivising compliance with the service levels. In addition, the access provider would need to be allowed to recover this expenditure via the regulatory model.

The ACCC also considers that if access seekers receive a broadly similar level of quality for a similar price to that which they are paying for comparable services provided over the copper network and HFC networks today, economically efficient use of, and investment in, the infrastructure by which the service(s) are supplied will not be discouraged by virtue of the transition to the NBN.

The implications of service levels for the interests of persons who have rights to use the service(s) are as follows:

- The services delivered over the NBN are a key input into downstream markets for the provision of broadband and telephony services. Therefore, access seekers require clarity as to what the service levels are in order to ensure they are able to accurately advertise products offerings to end-users and undertake network planning for downstream markets. Access seekers should have access to complete and reliable information regarding the technical specifications and performance of NBN Co's products, for a range of metrics, such as availability and levels of redundancy.
- Access seekers should have access to appropriate remedies to enforce service level commitments (such as penalties for non-compliance).

The legitimate business interests of the carrier are also an important consideration when assessing the reasonableness of service level provisions. Service levels necessarily involve the potential for trade-offs between quality and price.⁸⁴⁰ From a service provider's perspective, meeting quality requirements involves costs in maintenance and investment. A service provider may also incur costs to comply with reporting and enforcement mechanisms.

For the reasons outlined below, the ACCC is not satisfied that:

- the service level terms and conditions in Annexure 1 to Schedule 1J of Module 1 will encourage the economically efficient use of, and economically efficient investment in, the infrastructure by which the service(s) are supplied. Further, having regard to the interests of persons who have rights to use the service(s), the ACCC is not satisfied that the service level terms and conditions are reasonable. The ACCC therefore proposes in its Consultation Paper on the Notice to Vary that they be removed from the SAU in order to allow continuing negotiation between NBN Co and access seekers.
- the service level principles in Schedule 2F of Module 2 will encourage the economically efficient use of, and economically efficient investment in, the infrastructure by which the service(s) are supplied. Further, having regard to the interests of persons who have rights to use the service(s), the ACCC is not satisfied that the service level terms and conditions are reasonable. The ACCC therefore proposes in its Consultation Paper on the Notice to Vary that these principles be removed from the SAU. This would allow service levels during the operation of Module 2 to be agreed between NBN Co and access seekers, proposed by NBN Co in variations to the SAU, or set by the ACCC in Access Determinations or Binding Rules of Conduct, if required.

⁸⁴⁰ ACCC, *Access Undertakings*, September 1999, p. 51.

In its assessment of the FANOC Special Access Undertaking, the ACCC also specified certain requirements for a bitstream service that relate to service levels. Firstly, the ACCC considered that there should be well described and appropriate protocols for how congestion in shared network elements is handled.⁸⁴¹ The ACCC notes that NBN Co has included commitments in relation to utilisation management to deal with issues relating to congestion.⁸⁴² A further requirement specified in FANOC was the equivalent treatment of access seekers in relation to quality of service parameters such as jitter, delay and packet loss. The ACCC notes that NBN Co has included performance objectives for traffic class operations in its service level provisions.⁸⁴³ The ACCC therefore considers that the SAU meets these requirements.

Ensuring service quality does not deteriorate as a result of migrating from existing networks

A number of submissions from interested parties proposed that some service levels in the SAU are set at a level lower than those currently supplied.⁸⁴⁴ In particular, the enhanced-12 fault rectification commitments proposed by NBN Co do not include two hour, four hour and eight hour fault rectification services which are currently available for legacy network products.⁸⁴⁵

More broadly, at this stage the ACCC does not have sufficient information to ascertain whether acceptance of the SAU would result in current levels of service quality being maintained.

Changes in service levels over time

Service levels are highly dependent on the technology and the network to which they relate.

The service levels in Annexure 1 to Schedule 1J will not be reviewed by an independent party (that is, the ACCC) until the midpoint review in 2018. Following this, the revised service levels will remain in force for another five years until the expiry of Module 1 at around 2023.

In addition to the midpoint review, NBN Co may propose and implement changes to service levels in the following ways.

Firstly, NBN Co can make changes to the service level provisions under the multilateral SFAA forum process — without the ACCC's prior approval — for new products introduced during the initial regulatory period (that is, Module 1).⁸⁴⁶ For other products, NBN Co may make changes to the service levels in the Annexure 1 to Schedule 1J with ACCC approval.⁸⁴⁷

Secondly, some of the service levels make reference to documents outside the scope of the SAU — that is, in a number of areas, service levels and related terms are defined in a way that refers to documents outside the SAU, such as the *Operations Manual* or *Fair Use Policy*.⁸⁴⁸ NBN Co could therefore change those terms and the associated service levels (without needing approval to vary the SAU).

Given that the NBN and the telecommunications industry in general are developing rapidly, the ACCC considers that the service levels specified in the SAU are unlikely to remain appropriate for the term of Module 1, or even during the period until the midpoint review.⁸⁴⁹ The ACCC

⁸⁴¹ *FANOC Draft Decision*, p. 12.

⁸⁴² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1J, Annexure 1, clauses 11.3 and 11.4.

⁸⁴³ *Ibid*, Schedule 1J, Annexure 1, clause 11.5.

⁸⁴⁴ For example, Optus submission (Public version), p. 10, iiNet submission, p. 33; Telstra submission, p. 45.

⁸⁴⁵ Optus submission (Public version), p. 132; Macquarie Telecom submission, p. 21; iiNet submission, p. 33.

⁸⁴⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.3.1(e)(v).

⁸⁴⁷ *Ibid*, Schedule 1B, clause 1B.3.1(e)(v).

⁸⁴⁸ For example, under clause 1.3(c) of Part A of Annexure 1 to Schedule 1J of the SAU, service levels for end-user connections do not apply where the customer has not followed the process in the NBN Co Operations Manual. In addition, under clause 4.5(a) of Part A of Annexure 1 to Schedule 1J, service levels do not apply to end user faults or network faults caused by use of an ordered product which breaches the Fair Use Policy.

⁸⁴⁹ Optus submission (Public version), p. 119; Nextgen Networks submission, pp. 18-19; Telstra submission, p. 11 and p. 43.

agrees with the views of access seekers who consider that more regular reviews should be undertaken.⁸⁵⁰

The ACCC accepts that the above three mechanisms allow for service levels to be changed by NBN Co prior to the midpoint review. However, the SAU does not provide for other parties (for example, access seekers, the ACCC, other technical bodies) to propose changes to service levels prior to the midpoint review.

The ACCC is therefore not satisfied that the service levels specified in the SAU would be changed over time in such a way that reflects improving certainty over the quality of service that the NBN can deliver as the network is built.

Incentives to meet specified service levels

The ACCC considers that there must also be mechanisms in place under the SAU that provide an incentive for NBN Co to actually meet those service levels.

Rebates that are imposed when NBN Co fails to meet an agreed service level are one way of creating incentives for NBN Co to perform to agreed standards.

The SAU only makes commitments to pay rebates in limited circumstances — for failure to meet service levels for end-user connections and enhanced-12 fault rectification.⁸⁵¹ The ACCC considers that the limited scope of the rebate mechanisms significantly reduces NBN Co's incentives to meet the other service level commitments in the SAU. Similarly, submissions from interested parties express concerns that a limited number of service levels attract service level rebates.⁸⁵² In addition, under the SAU and the long-term revenue constraint methodology, it is likely that NBN Co will be able to recover the cost of the rebates. The ACCC considers that this weakens NBN Co's incentives to meet the corresponding service levels.

In order to receive a rebate for failure to meet the end-user connections service level, the SAU also requires that access seekers submit an accurate forecast to NBN Co.⁸⁵³ The amount of the rebate is then adjusted depending on the accuracy of the forecast.⁸⁵⁴ While NBN Co has a legitimate interest in requesting forecasts from access seekers, the ACCC does not consider that the current link between the forecast mechanism and the rebate will give NBN Co an incentive to meet specified service levels. In the situation where rebates are likely to apply, that is, where an access seeker has substantially underestimated its connections for a particular month, NBN Co will not have an incentive to meet any connection service levels for that access seeker because rebates will not apply. However, the ACCC considers that NBN Co should be expected to meet service levels for at least the estimated number of connections, and given an incentive to do so.

Incentives to comply with the service levels might also be created by commitments to undertake corrective action. The SAU contains corrective action as a remedy available to access seekers for certain service levels. While the ACCC supports the remedy of corrective action, such a remedy needs to contain clear and enforceable commitments. The ACCC notes that the corrective action provisions in the SAU do not contain an explicit commitment to take corrective action within a certain period of time. This issue is also noted in submissions.⁸⁵⁵ The ACCC considers that this greatly reduces the effectiveness of this clause, because it could take months or even years before corrective action is undertaken. Without clear, enforceable commitments from NBN Co about the timing of corrective action, access seekers lack the ability to make assurances to customers regarding the quality of their service offerings. An inadequate

⁸⁵⁰ AAPT submission, p. 9; Optus submission (Public version), p. 119 and p. 125.

⁸⁵¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1J, Annexure 1, clauses 1.4 and 5.3.

⁸⁵² iiNet submission, p. 29; Optus submission (Public version), p. 126; Telstra submission, p. 42.

⁸⁵³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1J, Annexure 1, clause 1.4.

⁸⁵⁴ *Ibid*, Schedule 1J, Annexure 1, clause 1.4.

⁸⁵⁵ Optus submission (Public version), p. 126; iiNet submission, p. 33.

corrective action remedy could also result in the SAU failing to encourage the operational and technical requirements necessary for the reliable operation of the NBN.

The ACCC also notes that corrective action will be available to access seekers under their Access Agreement.⁸⁵⁶ In the event that NBN Co is requested to take corrective action in response to failure to meet a service level, it will notify the relevant access seeker of the reasons for the failure and its proposed corrective action.⁸⁵⁷ However, the SAU does not require NBN Co to notify the ACCC of these matters. In the event that NBN Co does not propose to take any corrective action, neither the access seeker nor the ACCC may require NBN Co to do so. The ACCC considers that stronger incentives are required to encourage NBN Co to comply with its service levels. For example, NBN Co could be required to report any failure to meet service levels, identify causes of its failure, and take steps to rectify these causes. The failure to comply with the reporting obligation could be directly enforceable by the ACCC under the SAU.

Currently, access seekers have limited ability to take enforcement action in the event of a failure by NBN Co to meet a service level because the SAU explicitly states that a breach of a service level commitment is not a breach of the agreement.⁸⁵⁸ Another way to create incentives for NBN Co to meet service level standards could be to provide access seekers with the right to enforce compliance with the service levels through the courts, either as a contractual breach or a breach of the SAU. However, individual enforcement by access seekers may not be efficient in the event that NBN Co fails to meet service levels on an industry-wide basis, as each access seeker would need to take its own enforcement action. For example, network availability is measured across all products supplied to NBN Co's customers.⁸⁵⁹ If NBN Co fails to meet this service level, NBN Co would automatically fail to do so for all access seekers due to the way that it is measured. It would not be efficient for each and every access seeker to be required to take separate action to address this failure. In addition, access seekers may not always have incentives to take enforcement action. For example, this might occur in circumstances where liability to end-users was contractually excluded, or if the risk management provisions prevented recovery of loss.

The ACCC is unable to enforce service levels because of the relationship between the SAU and SFAAs. As discussed above in section 6.1.1, the commitment in Module 1 is to include service levels in all SFAAs. However, the lack of a direct commitment to comply under the SAU means that the ACCC cannot enforce a failure to meet those commitments as a breach of the SAU. The ACCC notes that direct enforcement of service levels by the regulator has been implemented overseas — for example, in Singapore, the regulator can impose fines if the service provider fails to meet service levels.⁸⁶⁰ Another alternative would be a service level regime where self-administered and ACCC enforced components operate together in a complementary manner to provide incentives for delivering services of a particular quality.⁸⁶¹

Further, as noted in section 6.6, the risk management and liability terms and conditions proposed in the SAU specifically provide that NBN Co's liability for failure to achieve service levels is limited to the specified service level rebate (if any) (which, as noted above, is only available in limited circumstances).⁸⁶² The ACCC considers that an access seeker should generally have the right to seek damages for material breaches of NBN Co's contractual

⁸⁵⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1J, Annexure 1, clause 13.

⁸⁵⁷ Ibid, Schedule 1J, Annexure 1, clause 13.1.

⁸⁵⁸ Ibid, Schedule 1J, Annexure 1, Service Levels Roadmap, Part A: Service Levels.

⁸⁵⁹ Ibid, Schedule 1J, Annexure 1, clause 11.1(a).

⁸⁶⁰ Infocomm Development Authority of Singapore, *Quality of Service*, revised 26 November 2012, Singapore Government, viewed 27 March 2013, <http://www.ida.gov.sg/Policies-and-Regulations/Industry-and-Licensees/Standards-and-Quality-of-Service/Quality-of-Service.aspx>

⁸⁶¹ For example, under the Telstra SSU, Telstra determines whether rebates for failure to meet a service level are payable under the service level regime as set out in a deed entered into by Telstra and a wholesale customer. This is self-administered in the sense that the deed is enforceable by wholesale customers. In addition, there are service quality and operational commitments in the SSU which are directly enforceable by the ACCC.

⁸⁶² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 3, clause 2.2.

service level commitments. The availability of such remedies would act as a further incentive for NBN Co to achieve its service levels, and support the ability of access seekers to provide and meet downstream service levels. In the alternate case, access seekers might be required to reduce downstream service levels.

For these reasons, the ACCC does not consider that the SAU establishes adequate incentives for NBN Co to meet its service levels.

Module 2 discretion conferred on NBN Co

Module 2 includes general principles relating to service level commitments in clause 2F.2. It is also part of the proposed fixed principles term and condition in the SAU.

For new products, the principles in Module 2 specify that NBN Co will have discretion in determining service levels.⁸⁶³ 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. One argument might be that if in assessing a replacement module application the ACCC is not satisfied that the proposed variation complies with those high-level principles, the ACCC will not be able to reject the application, because to do so would be “for a reason that concerns” the fixed principles term or condition. As a result, it is not clear that NBN Co will always have incentives to set service levels and rebate mechanisms in a way that balances its interests with those of its customers during the full term of the SAU. For this reason, the ACCC considers that it is not satisfied that these principles are reasonable and in the long-term interests of end-users, and does not consider that they should be a fixed principles term and condition.

For existing products, the ACCC notes that the drafting of the principles requires NBN Co to have regard to a number of factors when setting service levels: promotion of efficient take-up and usage; cost impacts on NBN Co and access seekers; retail-level regulatory requirements; and service levels that have the same or better terms as previous service levels.⁸⁶⁴ In taking into account all of these factors, it could be possible for NBN Co to propose lower service levels than were previously in place. However, given that NBN Co would have complied with the principles specified, the ACCC would be unable to reject a replacement module containing such service levels. Therefore, the ACCC considers that the SAU does not ensure that service levels will be maintained or improved during the term of the SAU.

For these reasons, the ACCC does not consider that the service level principles in Module 2 will ensure a reasonable outcome. Therefore, the ACCC is not satisfied that the service level arrangements in Module 2 are reasonable or in the long-term interests of end-users.

6.3. Dispute management

The SAU makes two commitments with respect to dispute management. Firstly, NBN Co commits to include the dispute management provisions set out in Annexure 1 to Schedule 1H of the SAU (‘Dispute Management Rules’) in any SFAA.⁸⁶⁵ Secondly, it commits to resolving disputes in accordance with the Dispute Management Rules, to the extent applicable, and in a manner that ensures it is capable of complying with its non-discrimination obligations.⁸⁶⁶

Key features of the Dispute Management Rules include:

- limited access to the court system to resolve disputes;⁸⁶⁷

⁸⁶³ Ibid, Schedule 2F, clause 2F.2.2(a).

⁸⁶⁴ Ibid, Schedule 2F, clause 2F.2.1.

⁸⁶⁵ Ibid, Schedule 1H, clause 1H.5.1.

⁸⁶⁶ Ibid, Schedule 1H, clause 1H.5.2.

⁸⁶⁷ Ibid, Schedule 1H, Annexure 1, clause 9.

- a three-step approach to dispute resolution: escalation through the parties' specified points of contact, expert determination, and panel arbitration based on the *Commercial Arbitration Act 2010 (NSW) (CAA)*;⁸⁶⁸
- a resolution advisor for each Access Agreement — the resolution advisor is responsible for managing disputes that have not been resolved through escalation and, importantly, the appointment of the arbitration panel from arbitration pool members;⁸⁶⁹
- a decision by the arbitration panel about whether the dispute affects only the parties to the Access Agreement ('bilateral dispute') or also affects other NBN Co customers ('multilateral dispute');⁸⁷⁰
- for multilateral disputes, other NBN Co customers may join in the arbitration of a dispute if the panel determines they have a sufficient interest in the subject matter;⁸⁷¹
- processes for the nomination and appointment of resolution advisors and pool members — an independent third party, the President of the Institute of Arbitrators and Mediators Australia, will decide on the appointment of a resolution advisor or pool member, if the parties cannot agree on a candidate;⁸⁷²
- provisions for the termination of resolution advisors and pool members if NBN Co believes that there is a reasonable danger of bias, ill health or incapacity, or continuing non-compliance with the Dispute Management Rules;⁸⁷³ and
- provisions for the ACCC to veto the appointment or termination of resolution advisors and pool member.⁸⁷⁴

6.3.1. Submissions

NBN Co submits that:

- It "has sought to ensure that there is a robust, speedy, open and non-discriminatory process for the resolution of disputes that might arise between NBN Co and its customers and for the implementation of dispute outcomes."⁸⁷⁵
- It has an interest in ensuring that the decision-makers in the dispute resolution process are "independent and that the process is fair and transparent, to reduce the risk of decisions being appealed on procedural grounds".⁸⁷⁶
- For this reason, it had "devised a number of safeguards...against bias and the appearance of bias".⁸⁷⁷
- Its non-discrimination obligation presents some unique challenges in the context of dispute resolution, such that it was necessary to create a bespoke set of dispute management arrangements.⁸⁷⁸

⁸⁶⁸ Ibid, Schedule 1H, Annexure 1, clause 2.

⁸⁶⁹ Ibid, Schedule 1H, Annexure 1, clause 2.

⁸⁷⁰ Ibid, Schedule 1H, Annexure 1, clause 3.

⁸⁷¹ Ibid, Schedule 1H, Annexure 1, clause 7.3.

⁸⁷² Ibid, Schedule 1H, Annexure 1, clauses 11.1 and 12.1.

⁸⁷³ Ibid, Schedule 1H, Annexure 1, clause 13.

⁸⁷⁴ Ibid, Schedule 1H, Annexure 1, clause 13.1.

⁸⁷⁵ NBN Co Supporting submission, p. 139.

⁸⁷⁶ Ibid, p. 141.

⁸⁷⁷ Ibid, p. 141.

Submissions did not raise concerns about the use of alternative dispute resolution processes.

However, submissions identified a range of issues with the dispute management provisions set out in the SAU:

- the impartiality and independence of resolution advisors and panel members was likely to be compromised by NBN Co's central role in relation to their nomination, appointment and termination;⁸⁷⁹
- the exclusion of access to the courts without the substitution of a demonstrably independent alternative dispute resolution process, particularly given the exclusion of all liability relating to the dispute management process;⁸⁸⁰
- asymmetric rights to commence legal proceedings in favour of NBN Co;⁸⁸¹
- strict procedural requirements that may limit decision makers' ability to make a properly informed and considered decision;⁸⁸²
- limitations on procedural fairness and appeal rights from the CAA, without the benefit of complementary provisions against bias;⁸⁸³
- inadequate protection of confidential information;⁸⁸⁴ and
- the potential for the multilateral disputes to be complex, time-consuming and expensive.⁸⁸⁵

In addition, Optus submits that the dispute management rules may have the effect of limiting access seeker enforcement of breaches of the SAU under the CCA.⁸⁸⁶

There was strong support for additional rights to commence court proceedings, either as a general alternative to the dispute resolution process or in particular cases.⁸⁸⁷

6.3.2. Preliminary ACCC views

The statutory criteria most relevant to the ACCC's assessment of the conduct and terms and conditions relating to dispute management are.⁸⁸⁸

- **The interests of persons who have rights to use the declared service** — a dispute resolution process that provides for the efficient, consistent and unbiased resolution of disputes is likely to be in the interests of NBN Co's customers, as it would enable cost-effective and timely resolution of disputes between NBN Co and its customers. Dispute resolution procedures that are clear are also likely to be in the interest of NBN Co's customers, as such rules

⁸⁷⁸ Ibid, p.139.

⁸⁷⁹ Telstra submission, p. 85-88; Optus submission (Public version), p. 140; Macquarie Telecom submission, p. 23; iiNet submission, p. 37.

⁸⁸⁰ Optus submission (Public version), pp. 139-140; Macquarie Telecom submission, p. 23; iiNet submission, p. 37; Telstra submission, p. 87.

⁸⁸¹ Telstra submission, p. 90; iiNet submission, pp. 37; Macquarie Telecom submission, p. 23.

⁸⁸² iiNet submission, pp. 37-38; Telstra submission, p. 90.

⁸⁸³ Telstra submission, p. 87.

⁸⁸⁴ iiNet submission, pp. 38; Telstra submission, p. 89.

⁸⁸⁵ Telstra submission, p. 87; iiNet submission, p. 37.

⁸⁸⁶ Optus submission (Public version), p. 140.

⁸⁸⁷ Telstra submission, pp. 92-33, 142; Macquarie Telecom submission, p. 24; iiNet submission, p. 37.

⁸⁸⁸ The ACCC considers that the dispute management commitments in clause 1H.5 of Schedule 1H specify conduct to be undertaken by NBN Co (and the terms and conditions on which that conduct will be undertaken) in accordance with subsection 152CBA(3B) of the CCA. The ACCC considers that Annexure 1 to Schedule 1H specifies terms and conditions on which NBN Co will undertake this conduct.

and procedures will assist them to efficiently clarify and enforce their rights and obligations under Access Agreements.

- **The legitimate business interests of NBN Co and NBN Co's investment in facilities used to supply the declared service** — a dispute resolution process that provides for the efficient, consistent and unbiased resolution of disputes is likely to be in NBN Co's business interests for the same reasons as it is in the interests of access seekers.

The ACCC considers that the commitments in clauses 1H.5.1 and 1H.5.2 promote the long-term interests of end-users because they require NBN Co to both include the specified content in its SFAAs, and comply with the specified dispute resolution processes. These commitments provide regulatory certainty to access seekers about the processes that NBN Co will use to resolve disputes, and importantly, mean that the processes will be enforceable directly under the SAU rather than solely through an Access Agreement based on an SFAA.

However, the ACCC considers that certain aspects of the proposed terms and conditions about dispute management do not ensure that disputes will be managed in an efficient, consistent and unbiased manner. Firstly, the ACCC is not satisfied that the process would guarantee the independence of decision makers:

- NBN Co's role in nominating, appointing and terminating resolution advisors and pool members creates a perception that there may be bias on the part of decision makers that is not mitigated by the ACCC's ability to veto such actions due to the discretions conferred on NBN Co to nominate and initiate dismissal of resolution advisors.⁸⁸⁹ While the ACCC can object to the initial appointment of resolution advisors and pool members if there are concerns relating to their independence, the ACCC does not have the power to initiate action during the period of their appointment if circumstances change.
- Whilst the ACCC is able to veto the appointment of a candidate for resolution advisor or pool member, the information to be provided to the ACCC does not appear to assist the ACCC to decide whether to exercise a right to veto.⁸⁹⁰
- In relation to expert determinations, the expert is nominated by the resolution advisor, who in turn has been nominated by NBN Co.⁸⁹¹ This may lead to the expert lacking independence or being perceived as lacking independence.
- The drafting effectively requires customers to demonstrate matters relating to NBN Co's beliefs in order to challenge a candidate on the basis of bias, ill-health or incapacity.⁸⁹² This arguably favours NBN Co's interests over those of access seekers because NBN Co is able to affect the result of the challenge. Such matters should be determined on an objective basis in order to ensure that decision makers are independent and free from bias.

Secondly, the ACCC is not satisfied that the structure of the dispute resolution process will result in efficient, consistent and unbiased resolution of disputes:

- The process provides additional rights to commence court proceedings for NBN Co in relation to the recovery of unpaid debts and insolvency – the asymmetry of rights granted to access seekers and to NBN Co does not appear to be justified by NBN Co's legitimate business interests.⁸⁹³ Although it is more likely that access seekers would have unpaid debts to NBN Co, it is

⁸⁸⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 1, clauses 11.1, 12.1 and 13.

⁸⁹⁰ *Ibid*, Schedule 1H, Annexure 1, clauses 11.1(d) and (e), 12.1 (d) and (e).

⁸⁹¹ *Ibid*, Schedule 1H, Annexure 1, clauses 11.1 and 16.1.

⁸⁹² *Ibid*, Schedule 1H, Annexure 1, clauses 13.1(a) and 13.2(a).

⁸⁹³ *Ibid*, Schedule 1H, Annexure 1, clause 9.1.

possible for the reverse to be true. For example, under the risk management provisions, NBN Co must indemnify an access seeker for any breach of the confidentiality provisions in the Access Agreement.⁸⁹⁴ Although it is unlikely that NBN Co might become insolvent during the period of Module 1, commercial terms on risk and liability may persist in Access Agreements beyond this period. It is therefore preferable that this provision be symmetric. In any case, it is unlikely that there would be any adverse effect on NBN Co's interests from a reciprocal right in this regard, given the low probability that it would become insolvent. For these reasons, the ACCC does not consider that these asymmetric rights are reasonable.

- The dispute management process places a contractual obligation on customers to cooperate with NBN Co to ensure the resolution of any dispute is in accordance with NBN Co's non-discrimination obligations, including a right for NBN Co to vary the executed Access Agreement.⁸⁹⁵ This could allow NBN Co to implement the outcome of the dispute in an unreasonable manner, to the detriment of the access seeker.
- There is no distinction drawn between simple and complex disputes, meaning that the time limits imposed may be too short. For example, the time limit of five business days in which an access seeker needs to determine whether to participate in an arbitration process⁸⁹⁶ may be insufficient if the dispute is complex. As failure to respond within the required time means an access seeker has waived their right to participate, time limits which are too short would disadvantage access seekers. There is also no flexibility for the parties to agree to change the process in circumstances where it would be appropriate to do so.
- Although the arbitration process is based on the *Commercial Arbitration Act 2010* (NSW), it has been modified in a number of ways. For example, the SAU sets out specific requirements relating to NBN Co's non-discrimination obligations.⁸⁹⁷ Similarly, clause 10.3 of Annexure 1 to Schedule 1H appears to exclude certain obligations in relation to procedural fairness.⁸⁹⁸ At this stage, the ACCC does not have before it sufficient information to be satisfied about the effect of these modifications and their implications for the reasonableness of the dispute management process.

The ACCC also notes that the structure of the dispute management process has the potential to be complex and onerous, due to the significant time and procedural requirements. This could favour NBN Co in disputes with those access seekers that do not have sufficient resources to fully engage in the process, particularly in the context of strict procedural time limits. In circumstances where the vast majority of access seekers may have contracts based on the same SFAA, it is likely that many disputes would affect the interests of all these access seekers. The ACCC considers that additional flexibility for parties to agree to modifications of the process may be beneficial in some circumstances.

The ACCC does not consider that the SAU provides for an efficient, consistent and unbiased dispute management process because the process could lead to outcomes that consistently favour NBN Co.

However, the ACCC notes that this conclusion is in the context of a very limited role for court proceedings. If greater access to the courts were available, so that the dispute resolution process was voluntary, the implications of the above points may be lessened because NBN Co

⁸⁹⁴ Ibid, Schedule 1H, Annexure 3, clause 3.1.

⁸⁹⁵ Ibid, Schedule 1H, Annexure 1, clause 15.2.

⁸⁹⁶ Ibid, Schedule 1H, Annexure 1, clause 7.3(b).

⁸⁹⁷ Ibid, Schedule 1H, Annexure 1, clause 15.

⁸⁹⁸ Ibid, Schedule 1H, Annexure 1, clause 10.3(a)(ii).

would have an incentive to act fairly under the dispute management process, in order to avoid court proceedings.

6.4. Confidential information

NBN Co has committed to include the confidentiality provisions in Annexure 2 to Schedule 1H of the SAU in its SFAAs.⁸⁹⁹

Annexure 2 sets out the circumstances in which both NBN Co and its customers can use and disclose the confidential information of the other party,⁹⁰⁰ data security and privacy obligations,⁹⁰¹ and obligations in respect of downstream customer information.⁹⁰²

Annexure 2 provides that each party may use confidential information for the purposes of exercising its rights and performing its obligations under any SAU or the parties' Access Agreement, or for the supply of customer products as contemplated by the parties' Access Agreement.⁹⁰³ Annexure 2 also states that confidential information may be disclosed to various third parties in certain circumstances, such as for purposes connected to the parties' Access Agreement, by consent or where required by law.⁹⁰⁴

NBN Co has additional rights to use and disclose confidential information in certain circumstances, for example, where the use or disclosure is for purposes relating to the NBN Co network, systems and operational matters.⁹⁰⁵ Customers are required to provide specific consents for NBN Co to use and disclose certain information.⁹⁰⁶ Further, customers are required to procure and make available downstream customer information to NBN Co.⁹⁰⁷

6.4.1. Submissions

NBN Co submits that:

"The key principle of the confidential information provisions is that a party may only disclose or use confidential information in accordance with the SFAA. In maintaining another parties' confidential information the recipient must exercise the greater of the degree of care that a reasonable person with knowledge of the confidential nature of the information would apply or the security or degree of care that it applies to its own confidential information of an equivalent nature."⁹⁰⁸

⁸⁹⁹ Ibid, Schedule 1H, clause 1H.6.

⁹⁰⁰ Ibid, Schedule 1H, Annexure 2, clause 1.

⁹⁰¹ Ibid, Schedule 1H, Annexure 2, clause 2.

⁹⁰² Ibid, Schedule 1H, Annexure 2, clause 3.

⁹⁰³ Ibid, Schedule 1H, Annexure 2, clause 1.2(a).

⁹⁰⁴ Ibid, Schedule 1H, Annexure 2, clause 1.2(b).

⁹⁰⁵ Ibid, Schedule 1H, Annexure 2, clauses 1.3, 1.5 and 1.6. For example, for purposes relating to the NBN Co network and systems and operational matters, or for compliance with NBN Co's legal or regulatory obligations.

⁹⁰⁶ Ibid, Schedule 1H, Annexure 2, clauses 1.9 and 1.10. For example, information to which confidentiality obligations apply under section 152AYA of the CCA.

⁹⁰⁷ Ibid, Schedule 1H, Annexure 2, clause 3.2. For example, customers must include terms and conditions in downstream contracts that allow NBN Co to use and process downstream customer details in accordance with the parties' Access Agreement. Customers must also provide downstream customer details to NBN Co on request, and obtain consents and give notifications necessary for NBN Co to use this information.

⁹⁰⁸ NBN Co Supporting submission, p. 142.

It also states that it has increased the number of disclosure rights that are reciprocal and narrowed the scope of non-reciprocal disclosure rights “to the extent this is appropriate and reasonable”.⁹⁰⁹

Submissions express concern about the breadth of the provisions that set out purposes for which use or disclosure are authorised.⁹¹⁰ In particular, ACCAN submits that end-user information should only be used in the performance of necessary functions for the supply of services and not for any other purpose, consistent with the Australian Privacy Principles (APPs).⁹¹¹

Telstra further submits that “the confidentiality provisions continue to contain rights for NBN Co to use and disclose RSP confidential information in a manner that has the potential to compromise commercially valuable information”.⁹¹² Telstra also expresses concerns about the level of protection specified and NBN Co’s ability to require access seekers to carry out communications campaigns.⁹¹³

6.4.2. Preliminary ACCC views

The statutory criteria most relevant to the ACCC’s assessment of the conduct and terms and conditions relating to confidential information are:⁹¹⁴

- **Promoting competition** — it is likely that access seekers will need to disclose confidential information to NBN Co in order to be supplied with the NBN Access Service.⁹¹⁵ Confidentiality provisions may promote competition because access seekers have assurance that commercially sensitive information cannot be disclosed to a competitor to the detriment of the access seeker.⁹¹⁶ Having said this, as a wholesale-only operator, NBN Co is less likely (if likely at all) to intentionally disclose information in this manner (relative to a vertically integrated operator). For this reason, the ACCC has given this criterion less weight.
- **The interests of persons who have rights to use the declared service** — access seekers have an interest in protecting valuable information about their strategic intentions, timing of entry into markets, marketing campaigns, number of targeted customers, and new products/internet plans; they may also need to use NBN Co confidential information, such as network information, in order to develop and supply listed services in downstream markets.
- **The legitimate business interests of NBN Co and NBN Co’s investment in facilities used to supply the declared service** — NBN Co has a legitimate interest in being able to use and disclose confidential information in certain circumstances. For example, it is appropriate for NBN Co to do so in order to fulfil its obligations to supply services, manage its networks and workforce, and comply with legal obligations.

⁹⁰⁹ Ibid, p. 142.

⁹¹⁰ Optus submission (Public version), pp. 134-135; Telstra submission, pp. 97-98.

⁹¹¹ ACCAN submission, p. 6.

⁹¹² Telstra submission, p. 84.

⁹¹³ Ibid, pp. 96-99.

⁹¹⁴ The ACCC considers that the commitments regarding confidential information in clause 1H.6 of Schedule 1H specify conduct to be undertaken by NBN Co (and the terms and conditions on which that conduct will be undertaken) in accordance with subsection 152CBA(3B) of the CCA. The ACCC considers that Annexure 2 to Schedule 1H specifies terms and conditions on which NBN Co will undertake this conduct.

⁹¹⁵ Telstra submission, p. 96.

⁹¹⁶ ACCC, *Final access determination explanatory statement: Local bitstream access service*, October 2012, p. 34.

For these reasons, the ACCC holds the general view that parties should have the obligation to protect confidential information that they hold.⁹¹⁷ In particular, the ACCC considers that authorisations to use and disclose confidential information should be limited. It would therefore generally be reasonable for confidential information to be used and disclosed for purposes required by the contract between the parties or required by law.⁹¹⁸ For example, as discussed by the AER, the use of confidential information should be permitted for complying with listing rules of a stock exchange.⁹¹⁹

In keeping with this view, the ACCC considers that use or disclosure for non-essential purposes should be restricted. The ACCC notes that the range of uses and disclosures authorised by the confidentiality provisions in the SAU is broad, going beyond the extent necessary to perform obligations under Access Agreements. For example:

- The terms and conditions permit disclosure to financiers, investors, potential financiers and investors, and to their professional advisers and financial advisers or bankers.⁹²⁰ In the context of the intended future privatisation of NBN Co, the group of potential investors could potentially be unlimited. Consistent with the views expressed by the AER, the ACCC considers that there should be no disclosure to financiers or prospective financiers without the consent of the other party, and that the other party should have both notice of the disclosure and be able to put in place an appropriate confidentiality regime.⁹²¹
- The terms and conditions authorise disclosure to third parties to the extent necessary for planning, developing, testing, trialling and supplying products.⁹²² This is a wide permission that could cover almost all activities of access seekers and NBN Co. The ACCC considers that this permission is so wide that it is likely to undermine the general principle of protection of confidential information by the parties to the contract. It also seems inappropriate given that there are specific provisions on this issue for product development activities in the PDF (see chapter 4).
- The terms and conditions authorise disclosure to downstream customers for purposes "in connection with" the Access Agreement or an SAU.⁹²³ Some service providers are likely to obtain wholesale or aggregation services from other access seekers, rather than directly from NBN Co, therefore qualifying as downstream customers. This creates a significant risk that confidential information may be disclosed by NBN Co to competitors of the access seeker in retail markets. In addition, given the ability of NBN Co to unilaterally amend Access Agreements, and submit variations and further SAUs during the period for which these terms are intended to remain in place, the scope of this authorisation is potentially uncertain and subject to NBN Co's discretion.
- One undesirable consequence of having such a broad range of authorised uses and disclosures is that it undermines the commitment in clause 1.4 of Annexure 2 to Schedule 1H. This clause provides that NBN Co must not disclose confidential information to other customers of NBN Co, except where expressly contemplated by the Access Agreement. Since the broad range of uses and disclosures mentioned in the provisions in clauses 1.2 and 1.3 of Annexure 2 to Schedule 1H are expressly permitted by the Access Agreement,

⁹¹⁷ ACCC, *Model Non-Price Terms and Conditions Determination 2008*, 17 November 2008, Part 4, clause E.7, p. 17.

⁹¹⁸ *Ibid*, Part 4, clause E.5, pp. 16-77; see also ACCC, *Final Determination – Model Non-Price Terms and Conditions*, p. 25.

⁹¹⁹ AER, *Access arrangement final decision: Roma to Brisbane Pipeline*, August 2012, p. 158.

⁹²⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 2, clause 1.2(b)(vi).

⁹²¹ AER, *Access arrangement final decision: Roma to Brisbane Pipeline*, August 2012, p. 158.

⁹²² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 2, clause 1.2(b)(v)(B).

⁹²³ *Ibid*, Schedule 1H, Annexure 2, clause 1.2(b)(i).

this clause is unlikely to be effective in preventing NBN Co from disclosing information to other access seekers.

NBN Co also has additional rights to use and disclose information that do not apply to access seekers. The ACCC would generally expect confidentiality provisions to apply equally to NBN Co and access seekers. However, the ACCC acknowledges that NBN Co may require non-reciprocal rights in some circumstances due to its role as the access provider. For example, NBN Co may require such rights in emergency circumstances or for network management purposes. However, the circumstances described in clause 1.3 of Annexure 2 to Schedule 1H appear to be wider than necessary. For example, it is not clear why it would be necessary to disclose confidential information of an access seeker to a third party in order for NBN Co to obtain access to that third party's network.⁹²⁴ Similarly, clause 1.3(b)(iii)(c) of Annexure 2 to Schedule 1H could be interpreted as authorising disclosure for any purpose to any government department. It is also arguable that rights to use and disclose information in emergency circumstances or for network management purposes may also be required by access seekers.

Further, the terms and conditions do not appear to require NBN Co to obtain consent from access seekers each time that information is proposed to be disclosed. For example:

- Clauses 1.9 and 1.10 of Annexure 2 to Schedule 1H require access seekers to give NBN Co broad, general forms of consent in relation to sections 152AYA, 152BEA and 152EBC of the CCA.⁹²⁵ These clauses deem consent to have been given by the access seeker for the purposes of those sections, which undermines those statutory protections. The ACCC considers that where consent is required by statute prior to disclosure, the consent should be requested at each and every time that disclosure is required rather than mandated by the SAU, SFAAs and Access Agreements.
- Disclosure may occur without consent, as long as either a confidentiality regime or notice are provided.⁹²⁶

For these reasons, the ACCC does not consider that the confidentiality regime adequately balances the interests of both parties because it may permit NBN Co to (inadvertently or intentionally) use or disclose confidential information in a way that results in competitive detriment to access seekers, and is onerous in that it requires access seekers to waive protections provided by statute in order to obtain supply of the declared service.

6.5. Intellectual property rights

NBN Co has committed to include the intellectual property rights (IPR) provisions in Annexure 2 to Schedule 1H of the SAU in its SFAAs.⁹²⁷

Annexure 2 sets out the circumstances in which NBN Co and customers may use certain IPRs:

- In relation to NBN Co IPRs, NBN Co grants customers a licence to use NBN Co IPRs in order to use and commercialise any ordered products and to perform obligations and exercise rights under the parties' Access Agreement.⁹²⁸ Customers may sub-license rights on the same conditions, but remain liable for acts and omissions of all sub-licensees.⁹²⁹

⁹²⁴ Ibid, Schedule 1H, Annexure 2, clause 1.3(b)(iii)(B).

⁹²⁵ Ibid, Schedule 1H, Annexure 2, clauses 1.9 and 1.10.

⁹²⁶ Ibid, Schedule 1H, Annexure 2, clauses 1.2(b)(viii), (ix) and (x).

⁹²⁷ Ibid, Schedule 1H, clause 1H.6.

⁹²⁸ Ibid, Schedule 1H, Annexure 2, clause 5.2(a). Annexure 2 states that customers may sub-license these rights to downstream customers, however, customers remain liable for the actions of downstream customers.

⁹²⁹ Ibid, Schedule 1H, Annexure 2, clause 5.2(c).

- In relation to customer IPRs, NBN Co may only use customer IPRs internally to perform its obligations and exercise its rights under the parties' Access Agreement and any SAU (excluding the PDF).⁹³⁰ If NBN Co wishes to use customer IPRs for other purposes, it will need to commercially negotiate a licence with the customer and pay the agreed price.⁹³¹
- Both parties are responsible for procuring any third party IPRs reasonably required to perform its obligations under the parties' Access Agreement.⁹³² If a customer submits materials to NBN Co in which a third party holds IPRs, it must indemnify NBN Co on demand the amount of any losses suffered or incurred by NBN Co in connection with 'permitted uses' of those materials by NBN Co.⁹³³

6.5.1. Submissions

NBN Co submits that this approach provides for an appropriate and commercially workable balance between providing customers control over their IPR and protecting NBN Co from IPR infringement claims.⁹³⁴

Optus and Telstra submit that the IP licence granted by NBN Co should be broadened to enable development, marketing and supply of access seeker products and to cover all IPRs in all NBN Co products.⁹³⁵

Telstra submits that NBN Co should not require the use of access seeker IP on a business-as-usual basis, and therefore that there should only be a limited default licence of any such IP.⁹³⁶

Telstra also submits that NBN Co should not be able to claim rights and impose restrictions on the use of the acronym "NBN" through the use of brand guidelines.⁹³⁷

6.5.2. Preliminary ACCC views

The statutory criteria most relevant to the ACCC's assessment of the conduct and terms and conditions relating to intellectual property are:⁹³⁸

- **the interests of persons who have rights to use the declared service** — access seekers have an interest in protecting their IPRs in order to compete effectively in downstream markets. They also have an interest in being able to use NBN Co's IPRs (such as trade marks and interfaces to business/operating systems) to market and supply downstream products based on NBN services without being required to agree to onerous terms.

⁹³⁰ Ibid, Schedule 1H, Annexure 2, clause 5.3(a). This restriction does not apply to the use of customer IPRs under the PDF Processes.

⁹³¹ Ibid, Schedule 1H, Annexure 2, clause 5.5. Annexure 2 sets out the process that the parties will follow: NBN Co will provide written notice to the customer, who will have six weeks to identify its own IPRs and any third party IPRs, and indicate if it is willing to enter negotiations for NBN Co's use of those IPRs.

⁹³² Ibid, Schedule 1H, Annexure 2, clause 5.7.

⁹³³ Ibid, Schedule 1H, Annexure 2, clause 5.6.

⁹³⁴ NBN Co Supporting submission, p. 142.

⁹³⁵ Optus submission (Public version), p. 136; Telstra submission, pp. 105, 107.

⁹³⁶ Telstra submission, pp. 84, 105-107.

⁹³⁷ Ibid, p. 107.

⁹³⁸ The ACCC considers that the commitments regarding intellectual property in clause 1H.6 of Schedule 1H specify conduct to be undertaken by NBN Co (and the terms and conditions on which that conduct will be undertaken) in accordance with subsection 152CBA(3B) of the CCA. The ACCC considers that Annexure 2 to Schedule 1H specifies terms and conditions on which NBN Co will undertake this conduct.

- **the legitimate business interests of NBN Co and NBN Co's investment in facilities used to supply the declared service** — NBN Co has a legitimate interest in protecting and retaining control of its IPRs and branding to protect the value of its investment in developing those IPRs.
- **encouraging efficient use of and investment in infrastructure** — the ability to benefit from IPRs may provide incentives to both NBN Co and access seekers for investment in the creation of intellectual property that end-users value,⁹³⁹ encouraging innovation and therefore promoting dynamic efficiency. However, if the SAU authorises NBN Co to freely use access seeker IPRs, this may give access seekers a disincentive to innovate.

The ACCC's views on the proposed terms and conditions about intellectual property rights are as follows:

- The absolute discretion for the parties to refuse consent and set the terms for the use of any trademarks, service marks, logos or branding ('marks') may undermine the ability of access seekers to supply downstream products based on NBN services.⁹⁴⁰ At the very least, it would not be possible for access seekers to market such products without referring to the acronym "NBN", for which NBN Co has lodged a trademark application.⁹⁴¹ On the other hand, NBN Co is less likely to need to use access seeker IPRs in order to supply its services. The reciprocal rights conferred by this provision therefore have a greater effect on access seekers than on NBN Co.
- NBN Co holds or has lodged applications for a number of NBN-related trademarks. If granted, these would provide NBN Co with exclusive rights to control the use of the trademarks within the scope of the registrations, which NBN Co could do in a way that imposed onerous terms and adversely affect the interests of access seekers. Clause 5.6 of Annexure 2 to Schedule 1H further provides NBN Co with absolute discretion to set the terms for use of these trademarks. It thus constrains the ACCC's ability to make Access Determinations or Binding Rules of Conduct in this respect.
- If a customer submits materials to NBN Co containing third party IPRs, it must indemnify NBN Co if NBN Co suffers or incurs losses in connection with NBN Co's use of those third party IPRs.⁹⁴² However, there is no corresponding liability from NBN Co in relation to third party IPRs. In fact, NBN Co only warrants "to the best of its knowledge" that the use of its products will not infringe third party IPRs,⁹⁴³ and also places significant limitations on the licence that it is granting for the use of those rights.⁹⁴⁴ Given that it is far more likely that a customer would be using NBN Co (and thus third party) IPRs than vice versa, this could leave access seekers exposed to the risk of infringing third party rights by using NBN Co's products (to which they have no alternative). This could reduce access seeker incentives for innovation and therefore adversely affect dynamic efficiency. The ACCC considers that this should be a reciprocal indemnity and that NBN Co should provide stronger warranties of non-infringement of third party IPRs.

⁹³⁹ ACCC, *ACCC submission to the ALRC Copyright and the Digital Economy Issues Paper*, November 2012, p. 2.

⁹⁴⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 2, clause 5.6.

⁹⁴¹ IP Australia, *Australian Trade Mark On-line Search System*, Australian Government, viewed 2 April 2013, http://pericles.ipaustralia.gov.au/atmoss/falcon.application_start, trade mark number 1469865.

⁹⁴² NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 2, clause 5.4(e)(iv)(C).

⁹⁴³ *Ibid*, Schedule 1H, Annexure 2, clause 5.2(d).

⁹⁴⁴ *Ibid*, Schedule 1H, Annexure 2, clause 5.2(b).

- The requirement for NBN Co to negotiate with access seekers for the use of their IPRs, except as required by the Access Agreement or an SAU,⁹⁴⁵ is appropriate because it protects the interests of access seekers while enabling NBN Co to perform its contractual and regulatory obligations. In this way, it encourages innovation by access seekers and therefore promotes dynamic efficiency in the use of infrastructure used to supply listed services.

In summary, the ACCC does not consider that these terms and conditions provide an appropriate balance of NBN Co's legitimate business interests and the interests of access seekers.

6.6. Risk management

NBN Co has committed to include the risk management provisions set out in Annexure 3 to Schedule 1H of the SAU in its SFAAs.⁹⁴⁶

Annexure 3 sets out:

- the liabilities (including exclusions and limitations) of each party to the other;
- the indemnities that are given by a party to the other;
- requirements in relation to the parties' relationships with certain third parties (such as downstream customers);
- insurance requirements; and
- how the parties will deal with any force majeure events.⁹⁴⁷

In relation to liability, each party is liable to pay the other party for losses arising in connection with a range of matters, such as a failure to perform contractual obligations, or in respect of negligent or wilful acts or omissions causing death or personal injury or damage to tangible property, or acts or omissions constituting fraud.⁹⁴⁸

In relation to indemnities, each party will pay to the other party on demand an amount equal to all losses suffered or incurred as a result of the first party's actions where the losses arise from:

- any breach of the confidentiality provisions of the parties' Access Agreement;
- any third party claims alleging an infringement of that third party's intellectual property rights;
- any death or personal injury of any person to the extent that it is caused or contributed to by a negligent act or omission or any wilful acts or omissions that cause or contribute to that death or personal injury in connection with the parties' Access Agreement; or
- any damage to tangible property in connection with the parties' Access Agreement.⁹⁴⁹

⁹⁴⁵ Ibid, Schedule 1H, Annexure 2, clauses 5.3 and 5.4.

⁹⁴⁶ Ibid, Schedule 1H, clause 1H.7.

⁹⁴⁷ Ibid, Schedule 1H, Annexure 3, clause 1.

⁹⁴⁸ Ibid, Schedule 1H, Annexure 3, clause 2.1. Annexure 3 also sets out the limitations on each party's liability, such as annual caps on liability amounts, as well as uncapped liability categories. Further, there is no liability for indirect losses arising in connection with the parties' Access Agreement, and there are exclusions of liability in certain circumstances.

⁹⁴⁹ Ibid, Schedule 1H, Annexure 3, clauses 3.1-3.4.

There are general exclusions of NBN Co's liability in relation to downstream customers, for example, for customer losses caused or contributed to by downstream customers, or for activities in connection with the supply of customer products to downstream customers.⁹⁵⁰ There are also indemnities that only apply to NBN Co, for example, customers are required to indemnify NBN Co against downstream customer claims, such as claims for downstream customer loss, to the extent the claim is caused or contributed to by the customer.⁹⁵¹

6.6.1. Submissions

NBN Co states that “[a] codified liability regime is an appropriate regime to give the parties certainty as to their scope of liability and to try and minimise the likelihood of becoming involved in litigation”.⁹⁵² In developing these terms, NBN Co states that it has sought “to achieve an appropriate allocation of risk that is fair and reasonable and reflects the activities and responsibilities for NBN Co and its Customers, thereby providing certainty, clarity and transparency for all parties”.⁹⁵³

Submissions put forward the view that the risk management provisions in the SAU, particularly when combined with the provisions on service level rebates and the limitation on access to court proceedings, represent an unreasonable transfer of risk and liability from NBN Co to its customers.⁹⁵⁴ In particular, this was due to:

- the risk management provisions allocating risk to RSPs in circumstances where RSPs are unable to control or mitigate the risk and where the risk is within NBN Co's control;⁹⁵⁵
- the general exclusion of liability for NBN Co and the exclusion of broad categories of loss, including liability for downstream losses caused or contributed to by NBN Co;⁹⁵⁶
- service level rebates being specified the sole and exclusive liability for failure to meet a service level, and potentially also for the underlying circumstances which gave rise to the failure;⁹⁵⁷
- liability caps that do not provide for an acceptable level of recovery, and which may cause indirect discrimination, given the risk profile to which RSPs are exposed under these risk management provisions and the fact that access seekers will have differing capacities to manage and absorb risk;⁹⁵⁸
- the combination of the above creating incentives for customers to exclude as much liability as possible and transfer as much risk as possible to downstream customers and end-users, or to increase product prices to reflect the extent to which the risk is absorbed by RSPs;⁹⁵⁹ and
- contradictory provisions in relation to claims under the *Telecommunications (Consumer Protection and Service Standards Act) 1999* (TCPSSA).⁹⁶⁰ iiNet submits that, on the one hand, clause 2.1(e) provides that that the agreement (except for the service level provisions) does not affect rights under the

⁹⁵⁰ Ibid, Schedule 1H, Annexure 3, clause 2.7.

⁹⁵¹ Ibid, Schedule 1H, Annexure 3, clause 3.5.

⁹⁵² NBN Co Supporting submission, p. 143.

⁹⁵³ Ibid, p. 143.

⁹⁵⁴ Optus submission (Public version), p. 138; Telstra submission, p. 84.

⁹⁵⁵ Telstra submission, pp. 111-12.

⁹⁵⁶ Telstra submission, pp. 111-12; Optus submission (Public version), pp. 137-138; iiNet submission, pp. 35-37.

⁹⁵⁷ Telstra submission, pp. 111-12; Optus submission (Public version), pp. 136-137.

⁹⁵⁸ Telstra submission, pp. 111-112.

⁹⁵⁹ Optus submission (Public version), p. 138; Telstra submission, p. 113.

⁹⁶⁰ iiNet submission, pp. 35-37.

TCPSSA. On the other hand, clause 3.5(c) provides that the access seeker must indemnify NBN Co against claims under section 118A of the TCPSSA in relation to wireless NBN services.⁹⁶¹

6.6.2. Preliminary ACCC views

The statutory criteria most relevant to the ACCC's assessment of the conduct and terms and conditions relating to risk management are:⁹⁶²

- **Encouraging efficient use of and investment in infrastructure** — risk should be borne by the party that is best placed to prevent or mitigate the risk.⁹⁶³ Such an allocation of risk would reduce the likelihood of losses due to risk events, since each party has an incentive to take the actions required to prevent or mitigate risks within their control. This is likely to increase productive efficiency in the use of and investment in infrastructure, since the reduction of risk serves to reduce the cost of providing listed services, and thus minimises the ultimate costs that must be borne by end-users. This would likely lead to lower prices and higher demand.
- **The legitimate business interests of NBN Co and NBN Co's investment in facilities used to supply the declared service** — NBN Co has legitimate interests in providing access on terms which encourage the protection of its network and equipment from damage by customers, downstream customers or end-users; absent liability provisions, any such damage might increase NBN Co's costs and reduce the ability of NBN Co to recover its costs.
- **The interests of persons who have rights to use the declared service** — access seekers have an interest in not being subject to onerous terms due to NBN Co's superior bargaining power, particularly since NBN Co has strong incentives to shift risks and associated costs from itself to access seekers, even where this is not efficient because the risks are within NBN Co's control.
- **The operational and technical requirements necessary for the safe and reliable operation of networks by NBN Co, access seekers, downstream customers and end-users** — efficient risk allocation will give the parties incentives to establish and comply with operational and technical processes that contribute towards safe and reliable operation of networks, and therefore reduce overall losses.

The ACCC considers that the terms and conditions in Annexure 3 include a number of provisions that transfer liability away from NBN Co to access seekers. The ACCC notes that extensive protections in favour of NBN Co may mean it has less incentive to establish robust operational processes to minimise risks, which in turn has adverse implications for the efficient operation of infrastructure and the safe and reliable operation of networks.

Provisions that have this effect include:

⁹⁶¹ Section 118A of the TCPSSA relates to rights of contribution for failures to comply with a performance standard. It enables a carriage service provider ('first provider') who is liable for a breach of performance standards penalty to recover the penalty (in whole or in part) from another provider who wholly or partly caused the first provider's failure to comply with the performance standard.

⁹⁶² The ACCC considers that the commitments regarding risk management in clause 1H.7 of Schedule 1H specify conduct to be undertaken by NBN Co (and the terms and conditions on which that conduct will be undertaken) in accordance with subsection 152CBA(3B) of the CCA. The ACCC considers that Annexure 3 to Schedule 1H specifies terms and conditions on which NBN Co will undertake this conduct.

⁹⁶³ AER, *Access arrangement draft decision: Envestra Ltd*, September 2012, pp. 314-315.

- The exclusion of liability for loss suffered by downstream customers, even if it is caused or contributed to by NBN Co.⁹⁶⁴ Access seekers are effectively required to enter into "no liability" contracts with downstream customers, which may not be possible in relation to large customers or where retail-level regulation applies, or to incur the costs of absorbing the risk themselves.
- The exclusion of all liability that NBN Co may have in respect of claims made by customers of the access seeker, if the liability could have been lawfully excluded/limited in the contract between the access seeker and the downstream customer.⁹⁶⁵
- The exclusion of liability for losses caused by NBN maintenance, NBN upgrade, or relocation or replacement of any POI, because these are defined as 'Excluded Events'.⁹⁶⁶ This provision means that NBN Co would not be liable for loss caused by its acts or omissions, or those of its related bodies corporate, personnel and contractors if the relevant events fall within this definition.
- The limitation of liability for claims arising out of NBN Co's negligence in circumstances where the negligence causes personal injury, death or damage to tangible property.⁹⁶⁷ In addition, although NBN Co's liability for such claims is unlimited for direct loss, indirect loss is wholly excluded in these circumstances.⁹⁶⁸
- The exclusion of liability for a failure to meet a service level, apart from any service level rebate provided under the service level arrangements.⁹⁶⁹
- The requirement on the access seeker to hold insurances for workers compensation, public liability and product liability insurance, professional indemnity insurance, motor vehicle insurance, given that NBN Co is the supplier of the services for which such insurances would be required to be in effect.⁹⁷⁰ In addition, the requirement for NBN Co to be named as an additional insured is likely to result in additional costs for access seekers.⁹⁷¹
- The extent of the exclusion of representations, conditions, warranties and guarantees,⁹⁷² which suppliers would generally be expected to include in commercially negotiated contracts for the supply of goods and services.

Further, there are indemnities that only apply for the benefit of NBN Co, for example, access seekers must indemnify NBN Co against downstream customer claims to the extent the claim is caused or contributed to by the access seeker.⁹⁷³ However, there is no reciprocal indemnity from NBN Co. In fact, NBN Co has specifically excluded such liability.⁹⁷⁴ Similarly, access seekers are prevented from making claims against NBN Co's subcontractors or suppliers, even if they have caused or contributed to a loss.⁹⁷⁵

The ACCC considers that the net effect of these terms is to shift responsibility to access seekers for a number of matters which NBN Co is best placed to manage.

⁹⁶⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, Annexure 3, clause 2.7(a)(ii).

⁹⁶⁵ Ibid, Schedule 1H, Annexure 3, clause 2.7(a)(i).

⁹⁶⁶ Ibid, Schedule 1H, Annexure 3, clause 2.7(a)(iii).

⁹⁶⁷ Ibid, Schedule 1H, Annexure 3, clause 2.1.

⁹⁶⁸ Ibid, Schedule 1H, Annexure 3, clause 2.5(a).

⁹⁶⁹ Ibid, Schedule 1H, Annexure 3, clauses 2.2(a) and 2.7(b)(iv).

⁹⁷⁰ Ibid, Schedule 1H, Annexure 3, clause 6.

⁹⁷¹ Ibid, Schedule 1H, Annexure 3, clause 6.2(b).

⁹⁷² Ibid, Schedule 1H, Annexure 3, clause 2.6.

⁹⁷³ Ibid, Schedule 1H, Annexure 3, clause 3.5(a)(i).

⁹⁷⁴ Ibid, Schedule 1H, Annexure 3, clause 2.7(a)(i).

⁹⁷⁵ Ibid, Schedule 1H, Annexure 3, clause 4(b).

The ACCC considers that this allocation of risk could give access seekers incentives to include and enforce strong protections in contracts with downstream customers or end-users. This may result in contractual terms that require downstream parties to bear liability for risks over which they do not have any control, or which another party is able to more effectively manage. For example, the provision that excludes NBN Co's liability for any losses that the access seeker could have excluded in downstream contracts gives access seekers an incentive to pass on liability to their downstream customers or end-users. In the event that access seekers are not able to pass risk to end-users through contractual terms, they may raise prices to cover the costs of managing that risk.

As a further observation, a number of the risk management provisions are unclear and complex, which could make it difficult for some access seekers to understand what they and NBN Co are and are not liable for. For example, clause 3.5 of Annexure 3 to Schedule 1H is quite complex and obscures the fact that NBN Co is not responsible and liable for losses to the access seeker and downstream customers which it has caused or contributed to. Similarly, clause 3.6 is not clearly drafted.

For these reasons, the ACCC considers that the risk management provisions do not provide a balanced allocation of risk between the parties. Instead, they appear onerous in a way that suggests the exercise of bargaining power by NBN Co, rather than the protection of any legitimate commercial interest. The ACCC is therefore not satisfied that they are reasonable or that they will promote long-term interests of end-users, since end-users could receive lower quality services and be charged higher prices than if risk was efficiently allocated between the parties.

6.7. Clauses relating to points of interconnect

A point of interconnection (POI) refers to a location which is a physical point of demarcation between the networks of two or more service providers. Calls or data between the two service providers are handed over at the POI.⁹⁷⁶

The SAU sets out NBN Co's commitments in relation to the changing of POI locations, including a process for ACCC approval of proposed changes to POIs.⁹⁷⁷

The SAU states that NBN Co may open, relocate or close established POIs if it has the ACCC's prior approval.⁹⁷⁸ The SAU requires that the ACCC approve or reject a request from NBN Co to open, close or relocate a POI within 60 business days.⁹⁷⁹ If the ACCC does not make a decision during this timeframe, the request is deemed to be approved.⁹⁸⁰ The SAU also provides that the ACCC must update the 'POI List' (that is, the list of POIs prepared and published by the ACCC under section 151DB of the CCA) to reflect the outcome of this process.⁹⁸¹

The SAU also requires NBN Co to close temporary POIs when NBN Co reasonably considers that they are no longer required.⁹⁸² NBN Co must have regard to:

- whether an established POI is available to serve the premises served by the temporary POI;

⁹⁷⁶ ACCC, *ACCC Advice to Government - National Broadband Network Points of Interconnection* (Public Version), November 2010, p. 12. (POI advice)

⁹⁷⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, clause 1H.4.

⁹⁷⁸ *Ibid*, Schedule 1H, clause 1H.4.1(a). NBN Co must provide at least 12 months' notice prior to the relocation or closure of a POI, except in the case of emergency.

⁹⁷⁹ *Ibid*, Schedule 1H, clause 1H.4.3. The ACCC may extend the period by 20 business days if necessary, and may also undertake consultation on the request.

⁹⁸⁰ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, clause 1H.4.3(c).

⁹⁸¹ *Ibid*, Schedule 1H, clause 1H.4.4.

⁹⁸² *Ibid*, Schedule 1H, clause 1H.4.5(a).

- the number of customers that will need to migrate from the temporary to the established POI; and
- the number of premises served by the temporary POI.⁹⁸³

NBN Co must provide access seekers with at least six months notice of the proposed closure.⁹⁸⁴

6.7.1. Submissions

NBN Co submits that:

- conferring a power on the ACCC to approve NBN Co's decisions in relation to POIs will ensure that POIs are located appropriately;⁹⁸⁵
- the SAU commitments are additional to any commitments specified in SFAAs in relation to providing notice prior to the opening, closure or relocation of a POI;⁹⁸⁶ and
- the proposed process is consistent with the ACCC's role in relation to making and maintaining a list of POIs under section 151DB of the CCA,⁹⁸⁷ and that the requirement for the ACCC to update the POI list ensures that NBN Co's authorisation under section 151DB of the CCA is maintained.⁹⁸⁸

Submissions raised the following concerns:

- Notice for changes to POIs — some submissions considered that the notice period specified in the SAU was insufficient. For example, Optus submits that a minimum of 18 months notification should be provided for all changes to POIs,⁹⁸⁹ while Telstra submits that the notice period for closure of a temporary POI should be increased to 12 months.⁹⁹⁰
- Notifications — some submissions state that NBN Co should provide additional information when it proposes closing, relocating or opening a POI, such as the effective date, ways of minimising disruption, and a list of products affected.⁹⁹¹ Telstra submits that notification of closure or relocation should not take place until a replacement POI is ready for service.⁹⁹²
- Temporary POIs — Nextgen Networks submits that notice should be provided to access seekers where NBN Co shifts traffic from a temporary POI to a permanent POI, even if it is not decommissioning the temporary POI, so that access seekers can plan and make arrangements for the transfer.⁹⁹³ Telstra submits that there should be extra limitations on the use of temporary POIs.⁹⁹⁴

⁹⁸³ Ibid, Schedule 1H, clause 1H.4.5(a).

⁹⁸⁴ Ibid, Schedule 1H, clause 1H.4.5(b).

⁹⁸⁵ NBN Co Supporting submission, p. 138.

⁹⁸⁶ Ibid, pp. 138-139.

⁹⁸⁷ Ibid, p. 139.

⁹⁸⁸ Ibid, p. 139.

⁹⁸⁹ Optus submission (Public version), pp. 122-123.

⁹⁹⁰ Telstra submission, p. 118.

⁹⁹¹ Nextgen Networks submission, p. 20; Telstra submission, p. 118.

⁹⁹² Telstra submission, p. 118.

⁹⁹³ Nextgen Networks submission, p. 20.

⁹⁹⁴ Telstra submission, p.118.

- Timeframes for POI approval process — Nextgen Networks submits that there should be additional flexibility in the timeframe for the ACCC's decision-making process to allow for complex matters and/or industry consultation.⁹⁹⁵

Macquarie Telecom did not have significant concerns about the proposed conduct.⁹⁹⁶

6.7.2. Preliminary ACCC views

The ACCC considers that most of the commitments regarding POIs in clause 1H.4 of Schedule 1H, except clause 1H.4.4, specify conduct to be undertaken by NBN Co in accordance with subsection 152CBA(3C) of the CCA. The ACCC must be satisfied that such conduct promotes the long-term interests of end-users.

The implications of the location of POIs for promotion of the long-term interests of end-users are set out in the ACCC's advice to government on this matter in December 2010.⁹⁹⁷

As noted in that report, reviewing the locations of POIs over time would ensure that the locations continue to promote the long-term interests of end-users over time — changing the locations of POIs over time could allow for:

- any failure by the market to deliver competitive outcomes in transmission capability markets to be addressed; and
- competitive transmission to develop downstream of the POI where market conditions change to make new entry feasible.⁹⁹⁸

The notification periods in the event that the locations of POIs are changed also have implications for the promotion of competition in transmission capability markets and for investment in the infrastructure used to supply both transmission capability and downstream retail services. Appropriate notification periods are required to allow access seekers and potential and existing transmission capability suppliers to have sufficient time to plan for changing transmission capability requirements and investment in associated infrastructure.

6.7.2.1. Implications of the location of POIs for the long-term interests of end-users

In November 2010, the ACCC provided advice to government that initial POIs for the NBN would best meet the long-term interest of end-users if they were located according to a semi-distributed approach, to promote competition and reduce the extent of asset stranding. The advice also set out competition criteria and network planning rules that would need to be satisfied for a POI location to be in the long-term interests of end-users.⁹⁹⁹ The ACCC considered that a bitstream service that provides points of interconnection which are commercially feasible for service providers and support competition, including competition for backhaul services from the first point of aggregation, was most likely to promote the long-term interests of end-users.¹⁰⁰⁰ In consultation with the ACCC, NBN Co developed a set of network planning rules in December 2010, based on the ACCC's competition criteria.¹⁰⁰¹

⁹⁹⁵ Nextgen Networks submission, p. 20.

⁹⁹⁶ Macquarie Telecom submission, p. 24.

⁹⁹⁷ POI advice, pp. 15-17.

⁹⁹⁸ *Ibid*, p. 4 and pp. 62-64.

⁹⁹⁹ *Ibid*, pp. 1-4. Under the Competition Criteria a POI should be located where it is technically and operationally feasible to allow interconnection and there are at least two competitors with optical fibres within a nominated distance from the location which connects to an optical fibre network which is connected to a capital city. In addition, the competitors should deliver wholesale transmission services suitable for service providers who wish to connect to NBN at that location; and there must exist evidence that the particular route is, or is likely to become, effectively competitive. See: <http://www.accc.gov.au/content/index.phtml/itemId/952292>

¹⁰⁰⁰ *Ibid*, p. 12.

¹⁰⁰¹ NBN Co, *POI planning rules extract*, December 2010, ACCC, viewed 27 March 2013,

Following the provision of the ACCC's advice, the government issued its *Statement of Expectations* for NBN Co in implementing the NBN policy initiative in December 2010. The government adopted the ACCC's advice regarding the semi-distributed approach to POIs and informed NBN Co through the *Statement of Expectations* that:

The Government has determined that a semi-distributed POI structure which extends the NBN Co network to meet with, but not overbuild competitive backhaul routes is the preferred outcome...The Government expects that NBN Co will act to ensure that POIs are located in accordance with the 'competition criteria' formulated by the ACCC. It expects NBN Co to provision its physical infrastructure, including POIs and fibre exchanges, to accommodate reasonable expectations for retail competitors' equipment, in anticipation of multiple retail competitors. While NBN Co is expected to consult closely with the ACCC in relation to the POIs, the specific location of the POIs will be a matter for NBN Co.¹⁰⁰²

According to the Category B SAOs, NBN Co is required to offer, upon request, interconnection for the purpose of enabling an access seeker to be supplied with declared services. Amendments to the CCA were made in April 2011, which:

- require the ACCC to prepare a written list of POIs and publish the list in force on its website.¹⁰⁰³ On 5 November 2012 the ACCC published the POI list. The locations of the POIs were established based on the competition criteria and network planning rules;
- authorise, for the purposes of the CCA, any refusal by NBN Co to interconnect at points other than those on the POI list if this is reasonably necessary for NBN Co to achieve uniform national wholesale pricing of its eligible services;¹⁰⁰⁴ and
- provide that until the Minister makes a declaration that the NBN should be treated as built and fully operational, the ACCC must not vary the POI list except with NBN Co's agreement to do so.¹⁰⁰⁵

Interconnection at listed POIs

In complying with the interconnection SAO, the ACCC considers that there is an issue about the choice of listed POI at which NBN Co will offer interconnection for a particular Connectivity Serving Area (CSA) on the fibre and wireless networks. The ACCC considers that interconnection should be offered by NBN Co at the listed POI which is generally closest to the end-users in that area and is consistent with the network planning and dimensioning rules devised to identify the location of the initial POIs to the NBN.¹⁰⁰⁶

The SAU does not include commitments that NBN Co will only offer interconnection in this way.

Instead, the SAU states only that NBN Co will offer interconnection and specify a POI for each CSA.¹⁰⁰⁷ This means that NBN Co could provide interconnection at a POI that is not closest to the end-user — that is, to in effect implement a consolidated 'mega-POI' network architecture by allowing or encouraging access seekers to interconnect at a small subset of POI locations. This could take place even if NBN Co fulfils its obligations to construct the 121 POIs on the POI list. As noted in the ACCC's advice to government, this could have implications for the

<http://www.accc.gov.au/content/item.phtml?itemId=963440&nodeId=64dbfce5537a9f435f389288eaa9e80b&f=n=POI%20planning%20rules.pdf>

¹⁰⁰² *Statement of Expectations*, p. 7.

¹⁰⁰³ CCA, ss. 151DB(1) and 151DB(3).

¹⁰⁰⁴ CCA, s. 151DA.

¹⁰⁰⁵ CCA, s. 151DB(2A).

¹⁰⁰⁶ However, the ACCC notes that customers served by satellite can be an exception.

¹⁰⁰⁷ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1A, clause 1A.3.5.

promotion of competition in backhaul markets, as competitive backhaul infrastructure could be stranded.¹⁰⁰⁸

Therefore, in the Consultation Paper on the Notice to Vary, the ACCC is proposing that such a commitment be included in the SAU to ensure that interconnection on the fibre and wireless networks is offered in such a way that promotes the long-term interests of end-users, in accordance with the ACCC's advice to government in 2010.

Temporary POIs

A small number of temporary POIs have been established on a temporary basis to facilitate the rollout of the NBN. NBN Co is providing aggregation and backhaul from trial sites, new developments and other end-users to a temporary POI while the established POI for the area is being established.

Temporary POIs will be closed following construction of the established POI and migration of existing users to the established POI.¹⁰⁰⁹ As at February 2013, 25 established POIs had gone 'live'.¹⁰¹⁰

Under the SAU, NBN Co has committed to close temporary POIs as soon as practicable.¹⁰¹¹ The ACCC considers that this conduct supports the intended outcomes of the POI list by shifting users to the relevant established POI on that list. The ACCC therefore considers that the conduct promotes the long-term interests of end-users.

Changes to the locations of POIs over time

The ACCC recognised in its advice to government that there may be a need to change the location of POIs in the future, depending on the development of competition in backhaul markets to the 121 POIs.¹⁰¹² In particular, this would necessitate consideration of whether competitive outcomes were being delivered in transmission markets, particularly where the POI is only served by two providers (that is, duopoly routes). If competitive pricing on duopoly routes does not eventuate, consideration might need to be given to moving the POI further away from the end-user. On the other hand, if there was evidence of the prospects for competition in transmission markets increasing (for example, increased investment in transmission infrastructure above the POI and/or increased demand for capacity at a POI) this might lead to consideration of a POI being moved closer to the end-user.

The ACCC considers that, in principle, the conduct in the SAU that requires NBN Co to seek the ACCC's prior approval before opening a new POI, relocating an existing POI or closing an existing POI provides certainty for access seekers that NBN Co will not open, close or relocate POIs in a way that does not promote the long-term interests of end-users.

However, the ACCC notes that the process set out in clause 1H.4.3 of Schedule 1H requires the ACCC to make its decision within a maximum of 80 business days.¹⁰¹³ Otherwise, the request is deemed to be accepted.¹⁰¹⁴ Depending on the scope of the request submitted by NBN Co, the ACCC considers that this timeframe may not always enable it to properly consider a request from NBN Co to open, close or relocate a POI. In particular, the process may not allow sufficient time for the ACCC to consult with industry and for access seekers to make submissions to the consultation process in the event that there is a complex request, for example, if changes to multiple POIs are requested in close succession. This could result in a decision that does not promote the long-term interests of end-users.

¹⁰⁰⁸ POI advice, pp. 1-4.

¹⁰⁰⁹ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, Attachment C, clause 1.

¹⁰¹⁰ Evidence to the Environment and Communications Legislation Committee, Senate Estimates, Canberra, 12 February 2013, p. 122 (Mr Quigley).

¹⁰¹¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, clause 1H.4.5.

¹⁰¹² POI advice, p. 64.

¹⁰¹³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, clauses 1H.4.3(a) and 1H.4.3(b).

¹⁰¹⁴ Ibid, Schedule 1H, clause 1H.4.3(c).

In addition, the ACCC notes that clause 1H.4.4 of Schedule 1H specifies that the ACCC must amend the POI list to reflect the outcome of the approval process. The ACCC considers that this clause purports to impose a requirement on how the ACCC exercises its functions and powers under section 151DB of the CCA. The ACCC considers that this is inconsistent with the discretion granted to the ACCC under the CCA.

In light of these issues, the Consultation Paper on the Notice to Vary proposes that the ACCC be given additional flexibility to extend the period for its decision and that clause 1H.4.4 be deleted.

6.7.2.2. Notification of access seekers about changes to POI locations

In relation to the content of the notification that NBN Co proposes to provide to customers about changes to POI locations, the ACCC notes the improvements suggested by submissions.

However, the ACCC also notes that NBN Co has specified that it will provide this information in its main SFAA.¹⁰¹⁵

The conduct in the SAU is not drafted in such a way as to result in any Access Determination or Binding Rules of Conduct requiring the provision of additional information being inconsistent with the SAU. Nonetheless, the ACCC considers that the insertion of a clause to this effect for the avoidance of doubt would be beneficial.

In relation to the period of notice, the conduct provides for 12 months notice for opening new POIs and making changes to established POIs.¹⁰¹⁶ However, it only provides six months' notice for temporary POIs.¹⁰¹⁷

Significant planning and investment is required to interconnect at a POI, including arrangements for backhaul and access to duct space and other facilities. The ACCC considers that similar work would need to be undertaken when transitioning from temporary POIs as when responding to a change in the location of a permanent POI. It is therefore appropriate that access seekers should be provided with an equal amount of notice.

In addition, the ACCC notes that it is likely that access seekers will require notice of the migration of users from a temporary POI to an established POI, not just notice of the closure of the temporary POI. This is because temporary POIs may serve end-users who will be ultimately served by a number of different established POIs. A temporary POI may therefore remain in operation for some end-users, even though other end-users have been migrated to established POIs. Meanwhile, access seekers will be required to migrate end-users to the established POI 'closest' to those end-users as more and more established POIs come online, rather than being allowed to remain at the temporary POI until it is closed. It will be necessary for access seekers to undertake planning and investment prior to the migration, as described above. For this reason, the ACCC considers that NBN Co should provide notification to access seekers 12 months before the compulsory migration of end-users to a established POI, rather than 12 months before the closure of the temporary POI.

6.8. Rollout information

The SAU includes conduct which requires NBN Co to publish information on the progress of the rollout of the NBN Co fibre and wireless networks and the status of established POIs during Module 1.¹⁰¹⁸

¹⁰¹⁵ NBN Co, *Wholesale Broadband Agreement*, 1 January 2013, Module C, clause C13.1.

¹⁰¹⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1H, clauses 1H.4.1, 1H.4.2.

¹⁰¹⁷ *Ibid*, Schedule 1H, clause 1H.4.5.

6.8.1. Submissions

In relation to rollout information, NBN Co submits that:

“The commitment to provide this information in annual, quarterly and monthly plans which become progressively more detailed the closer it gets to the actual rollout, will benefit Access Seekers and Customers by providing greater visibility and certainty as to the progress of the rollout over time. This will equip Access Seekers and Customers in a transparent and non-discriminatory way to develop product and marketing plans and strategies, and by doing so promote competition and innovation in the market.”¹⁰¹⁹

In addition, NBN Co submits that the rollout information would “give end-users visibility of when the NBN will be built in their area, so that they can make informed decisions with regards to their interim retail arrangements”.¹⁰²⁰

Some submissions state that improved rollout information was required. For example, information regarding the satellite and wireless networks, changes to temporary POIs, geographic boundaries, and serviceable addresses would enable access seekers to plan and make informed decisions regarding connection and migration activities.¹⁰²¹ Similarly, Telstra and Optus submits that there should be an obligation on NBN Co to provide access seekers with accurate and up-to-date information about rollout and migration activities.¹⁰²²

6.8.2. Preliminary ACCC views

The ACCC considers that the commitments regarding rollout information in clauses 1H.2 and 1H.3 of Schedule 1H specify conduct to be undertaken by NBN Co in accordance with subsection 152CBA(3C) of the CCA. The ACCC must be satisfied that such conduct promotes the long-term interests of end-users.

Conduct about the provision of rollout information has implications for the ACCC’s assessment of whether the SAU promotes the long-term interests of end-users in the following ways:

- **promoting competition** — rollout information can reduce barriers to entry into new markets by providing access seekers with information required for developing products, marketing and infrastructure. The provision of this information in a timely fashion enables access seekers to make services available more quickly to end-users.
- **encouraging efficient use of and investment in infrastructure** — giving access seekers clarity and certainty as to the progress of the rollout of the network will enable them to efficiently plan for operations and investment in downstream services, networks and facilities. This is likely to increase dynamic efficiency in the use of and investment in infrastructure because it enables access seekers to respond to the changing environment.

The ACCC considers that the conduct in the SAU about publishing certain information implies that there is an obligation to publish accurate and up-to-date information.

¹⁰¹⁸ Ibid, Schedule 1H, clauses 1H.2-1H.3. This includes commitments to publish 3-year and 1-year fibre network construction rollout plans, monthly ready for service rollout plans for fibre and wireless networks, and a weekly list of ‘NBN Serviceable’ premises.

¹⁰¹⁹ NBN Co Supporting submission, p. 137.

¹⁰²⁰ Ibid, p. 137.

¹⁰²¹ Optus submission (Public version), p. 122.

¹⁰²² Ibid, p. 135; Telstra submission, p. 118.

The ACCC does not consider that the absence of a commitment to provide the additional information suggested by submissions significantly affects the interests of access seekers. The conduct in the SAU is not drafted in such a way as to result in any Access Determination or Binding Rules of Conduct requiring the provision of additional information being inconsistent with the SAU. Nonetheless, the ACCC considers that the insertion of a clause to this effect for the avoidance of doubt would be beneficial.

7. Fixed Principles

As noted in section 1.2, the SAU given by NBN Co provides that every term and condition in Module 0 and Module 2 of the SAU (collectively) is a fixed principles term and condition for the term of the SAU.¹⁰²³ These provisions address a broad range of matters, including the 'regulatory recourse' commitments to publish SFAAs and to ensure consistency of SFAAs with the SAU, service descriptions, pricing commitments (such as the CPI-1.5 per cent price control and principles for setting prices for new products), and a methodology for calculating the long-term revenue constraint.

As noted in section 1.3, the ACCC must reject the SAU if it is not satisfied that the fixed principles term or condition meet certain criteria for the specified notional fixed period.

NBN Co submits that the fixed principles term and condition provides certainty for NBN Co and other stakeholders that the terms in Module 0 and Module 2 will not be open to reassessment by the ACCC during the replacement module variation processes.¹⁰²⁴

Interested parties submit that only the terms necessary for NBN Co to achieve long-term cost recovery should be a fixed principles term or condition, and that many aspects of Module 2 should not be specified as a fixed principle and should be subject to periodic review. (For example, these aspects include pricing commitments such as the CPI-1.5 per cent price control and the principles for setting prices for new products, the updating of reference offers, the principles for resetting service levels, the broad service descriptions, and the detail for the long-term revenue constraint methodology).¹⁰²⁵ One interested party submits that the following circumstances should also be specified as 'qualifying circumstances' (that is, circumstances in which the fixed principle will cease to apply):

- if NBN Co's wholesale-only requirement and non-discrimination obligation ceases to apply; and
- if an amendment or adjustment is necessary or desirable to avoid an unintended consequence of the fixed principles provision.¹⁰²⁶

The implications of the proposed fixed principles term and condition are as follows:

- if the SAU was accepted and NBN Co wanted to submit a new SAU or a variation to the SAU during the term of the SAU that contained the same fixed principles term and condition, it must include all of the terms and conditions in Module 0 and Module 2; and
- the ACCC would therefore not be able to reject the new SAU or proposed variation to the SAU for a reason concerning a term or condition specified in Module 0 and Module 2, unless the specified qualifying circumstances exist.¹⁰²⁷

The ACCC notes that the SAU is the first Part XIC undertaking that specifies fixed principles terms and conditions since amendments to the CCA provided for an undertaking to do so.

¹⁰²³ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 5.

¹⁰²⁴ NBN Co Supporting submission, p. 36.

¹⁰²⁵ AAPT submission, p. 6; CCC submission, p. 4; Macquarie Telecom submission, p. 6; Nextgen Networks submission, pp. 8-9; Optus submission (Public version), pp. 155-156; Telstra submission, pp. 22-24; Vodafone Hutchison Australia submission, p. 3.

¹⁰²⁶ iiNet submission, pp. 38-39.

¹⁰²⁷ CCA, ss. 152CBAA(5) and 152CBAA(6). This would also apply if NBN Co proposes a variation at any other time.

The ACCC has assessed the fixed principles term and condition under subsection 152CBD(4) of the CCA.

Overall, the ACCC's preliminary view is that the proposed fixed principles term and condition should not be a fixed principles term or condition. The key reason for this view is set out below.

Because the ACCC considers that the proposed fixed principles term and condition should not be a fixed principles term or condition, the ACCC has not formed a view on whether the qualifying circumstances specified by NBN Co should be qualifying circumstances, or whether there are additional circumstances that should be specified as qualifying circumstances.

Further, it has not formed a view on whether the proposed fixed principles term and condition should be fixed for the specified notional fixed period of the full SAU term.

The ACCC will consider these issues if NBN Co lodges a varied SAU in response to the Notice to Vary which includes a fixed principles term and condition.

7.1. Scope of the fixed principle

As noted in chapters 2 to 6, the ACCC is not satisfied that some of the provisions in Module 0 and Module 2 promote the long-term interests of end-users and are reasonable. In the Consultation Paper on the Notice to Vary, the ACCC has set out its proposed variations to these provisions (including the deletion of particular provisions).

The ACCC considers that these aspects of the proposed fixed principles term and condition should not be specified as a fixed principles term and condition. Broadly, this view applies to provisions about the following matters. In Module 0:

- the mechanism for extension of the initial regulatory period;
- the mechanism for extension of the SAU term;
- the replacement module approach; and
- the commitment that NBN Co may include terms and conditions in relation to the supply of the Facilities Access Service in SFAAs.

And in Module 2:

- aspects of the implementation of the NBN Access Service, the Facilities Access Service and the Ancillary Services;
- by virtue of the ACCC's views about the proposed replacement module process, the provisions about regulatory cycles;
- by virtue of the ACCC's views about NBN Co's discretion to determine new prices, aspects of the provisions about pricing commitments;
- the proposed methodologies for calculating the building block components of the long-term revenue constraint methodology (but, for the avoidance of doubt, not the adoption of the long-term revenue constraint methodology itself);
- aspects of the provisions about product development; and
- the principles about service level commitments.

As a general proposition, the ACCC considers that only those matters which are reasonably necessary for providing certainty about long-term cost recovery should be specified as fixed principles.

8. Summary of the Draft Decision

This chapter of the Draft Decision summarises the ACCC's preliminary assessment of the SAU against the statutory criteria in section 152CBD of the CCA.

The ACCC's preliminary view is that the SAU has a number of features which, when having regard to these criteria, have merit. For example:

- The 'modular' design of the SAU allows for different matters to be 'locked in' for different periods of time — this allows for a balance to be struck between providing certainty about long-term cost recovery and allowing for flexibility to respond to changing circumstances.
- The initial prices set out in the SAU are, in general, likely to allow for a smooth transition from legacy networks.
- The adoption of the long-term revenue constraint methodology, with an 'initial cost recovery account', provides NBN Co with the opportunity to recover its prudent costs over the term of the SAU.
- Long-term commitments to not raise prices above the levels allowed for by the CPI-1.5 per cent price control provide certainty to access seekers about what maximum prices will be, and have the potential to create incentives for NBN Co to operate and invest in the NBN efficiently.
- Commitments to provide information to and consult with customers on various matters have the potential to reduce information asymmetries between NBN Co and its customers, which could in turn facilitate more efficient use of and investment in the NBN, as well as more efficient use of and investment in downstream infrastructure.

However, despite these features, the ACCC's preliminary view is that it is not satisfied that:

- the terms and conditions in relation to compliance with the Category B SAOs are consistent with the SAOs and are reasonable;
- the conduct specified by the undertaking in relation to access will promote the long-term interests of end-users, nor that the related terms and conditions are reasonable; and
- the conduct specified by the undertaking in relation to matters such as developing new eligible services or enhancing a declared service will promote the long-term interests of end-users.

As noted, the ACCC must be satisfied of these matters in order to accept the SAU.¹⁰²⁸

Further, the ACCC considers that the fixed principles term and condition specified in the SAU should not be a fixed principles term or condition.¹⁰²⁹ The ACCC must reject the SAU if it considers that the fixed principles term and condition should not be a fixed principles term or condition.¹⁰³⁰

¹⁰²⁸ CCA, s. 152CBD(2).

¹⁰²⁹ The fixed principles term and condition is specified in clause 5 of the main body of the SAU.

¹⁰³⁰ CCA, s. 152CBD(4).

As an overarching observation, the ACCC considers that certain aspects of the SAU create uncertainty about the ACCC's ability to respond effectively to changing circumstances over the SAU term.

The ACCC has found (based on its analysis of the information that NBN Co provided about forecast prices, demand and costs) that — taking the existence of losses in the proposed initial cost recovery account as an indication that NBN Co faces demand and revenue sufficiency risk — NBN Co is likely to face such risks for a period of time during the SAU term. If there is uncertainty revenues, NBN Co is also likely to face uncertainty about whether it will be able to recover the costs of its investments (including a normal commercial return) and its operations. This could create incentives for NBN Co to invest and operate efficiently, and to innovate in its approach to products and pricing in order to encourage use of the network. However, the ACCC has also found that there is the potential for the proposed initial cost recovery account to peak and begin to reduce during the SAU term. In the 'best case scenario' that the ACCC has modelled,¹⁰³¹ NBN Co could start recovering its initial losses as early as [CIC]. The ACCC considers that once NBN Co's revenue sufficiency risk reduces, it will face similar incentives to those faced by other utilities that are regulated by the ACCC and the AER, and that it should in turn be regulated in a similar manner to those utilities.

The ACCC therefore considers that the SAU (in combination with other aspects of the regulatory framework) must be able to appropriately respond to changing circumstances over the SAU term. Aspects of the SAU which create uncertainty about the ACCC's ability to respond to changing circumstances have been an important factor in the ACCC's consideration of whether the relevant provisions will promote the long-term interests of end-users over the term of the SAU.

The rest of this chapter is structured as follows:

- Section 8.1 notes some issues relating to the categorisation of particular SAU clauses.
- Section 8.2 provides the ACCC's preliminary views about firstly, whether the terms and conditions in relation to compliance with the SAOs are consistent with those obligations, and secondly, whether those terms and conditions are reasonable.
- Section 8.3 provides the ACCC's preliminary views about firstly, whether the specified conduct relating to access promotes the long-term interests of end-users, and secondly, whether the terms and conditions relating to that conduct are reasonable.
- Section 8.4 provides the ACCC's preliminary views about whether the specified conduct relating to various ancillary activities promotes the long-term interests of end-users.

8.1. Categorisation of SAU clauses

The ACCC has identified in the Draft Decision which clauses of the SAU it considers to be terms and conditions in relation to compliance with the Category B SAOs, conduct in relation to access and related terms and conditions, and conduct relating to ancillary matters.

The ability for an SAU to include these different categories of provisions was enabled by the changes to Part XIC introduced in early 2011. This is the first time the ACCC has assessed an

¹⁰³¹ Where prices are assumed to increase by the maximum allowed by the SAU in each year, and demand is consistent with the levels assumed in NBN Co's *Corporate Plan*.

undertaking under the varied Part XIC regime. The requirement to categorise clauses has added a layer of complexity to the ACCC's assessment of the SAU.

For example, the following terms and conditions could be categorised as terms and conditions about compliance with the SAOs, or as terms and conditions on which conduct relating to access will be engaged in:

- The terms and conditions relating to prices (including the long-term revenue constraint methodology), which are discussed in detail in chapter 5.
- The non-price terms and conditions relating to service levels, dispute management, confidential information and intellectual property and risk management, which are discussed in detail in chapter 6 (sections 6.2. to 6.6).

These commitments are specified in the SAU as commitments to include the particular terms (or to not include different terms) in SFAAs.

The ACCC sought clarification from NBN Co in October 2012 about the intended effects of these terms and conditions.¹⁰³² NBN Co responded that all of the terms and conditions in the SAU are terms and conditions in relation to subsection 152CBA(3A), that is, in relation to compliance with the SAOs.¹⁰³³ However, NBN Co also stated that the above terms and conditions will be dealt with as a contractual matter between NBN Co and an access seeker under their Access Agreement, rather than as a breach of the SAU.¹⁰³⁴ In addition, NBN Co stated that the ACCC could set out different terms and conditions to the SFAA terms and conditions in a regulatory determination, but that such an instrument will have no effect to the extent to which it is inconsistent with the terms set out in the SAU.¹⁰³⁵

The ACCC considers that aspects of NBN Co's response appear to contradict an interpretation whereby the SAU specifies the terms and conditions in relation to the SAOs.¹⁰³⁶

The ACCC considers that the SFAA terms and conditions should be part of commitments enforceable under the SAU and access seekers should not be required to sign an Access Agreement based on an SFAA in order to take advantage of those terms and conditions. Therefore, the Consultation Paper on the Notice to Vary proposes that amendments to the SAU be made with the effect of achieving this clarification.

However, for the purposes of this Draft Decision, in section 8.3 the ACCC has assessed:

- as conduct — the inclusion of the terms and conditions in SFAAs;¹⁰³⁷ and
- as relating to the conduct — the terms and conditions themselves.¹⁰³⁸

¹⁰³² Letter from ACCC to NBN Co, *NBN Co SAU request for clarification*, 26 October 2012, p. 1. It should be noted that the September 2012 SAU and the December 2012 SAU are effectively identical in their references to SFAA terms and conditions.

¹⁰³³ *Ibid.*, p. 1.

¹⁰³⁴ *Ibid.*, p. 2.

¹⁰³⁵ *Ibid.*, pp. 2-3.

¹⁰³⁶ For example, if the SAU specifies the SFAA terms and conditions in relation to the SAOs, this means that the SFAA terms and conditions are not necessarily dealt with only as a contractual matter.

¹⁰³⁷ In accordance with subsection 152CBA(3B)(a) of the CCA. The ACCC notes that the test that the ACCC must apply in considering the terms and conditions is the same — reasonableness — under either categorisation.

¹⁰³⁸ In accordance with subsection 152CBA(3B)(b) of the CCA.

8.2. Terms and conditions in relation to compliance with the SAOs

As noted in section 1.3, the ACCC must not accept the SAU unless it is satisfied that the terms and conditions specified in the undertaking in relation to compliance with the Category B SAOs are consistent with these obligations and are reasonable.¹⁰³⁹ This section of the Draft Decision summarises the ACCC's preliminary views on whether it is satisfied that the terms and conditions specified in the undertaking in relation to compliance with the Category B SAOs are consistent with these obligations and are reasonable.

The Category B SAOs are, on the access seeker's request, to:

- supply a declared service to the access seeker — this SAO requires NBN corporations to supply the declared service to an access seeker, so that the access seeker can provide carriage services and/or content services.¹⁰⁴⁰
- permit interconnection of an NBN corporation's facilities with the access seeker's facilities — this SAO requires NBN corporations to permit interconnection of their facilities with those of the access seeker.¹⁰⁴¹ These obligations do not apply to interconnection which is not at a listed point of interconnection within the meaning of section 151DB of the CCA.¹⁰⁴²
- supply services needed by the access seeker to supply services through conditional-access customer equipment — this SAO requires NBN corporations, where they supply a declared service by means of conditional-access customer equipment to supply the access seeker with any service that is necessary to enable the access seeker to provide carriage services and/or content services by means of the declared service and using the equipment.¹⁰⁴³

The ACCC has categorised provisions about the following matters as terms and conditions relating to compliance with the Category B SAOs:

- the provisions in Schedule 1A, clause 1A.3 which NBN Co describes as 'terms and conditions relating to supply of Product Components' (discussed in detail in chapter 3),¹⁰⁴⁴ and

¹⁰³⁹ CCA, s. 152CBD(2)(b).

¹⁰⁴⁰ CCA, s. 152AXB(2). NBN Co is not required to provide access to a declared service if doing so: would prevent another access seeker from obtaining a sufficient amount of the service to be able to meet its reasonably anticipated requirements; would prevent NBN Co from obtaining a sufficient amount of the service to be able to meet its reasonably anticipated requirements; or would prevent a person who has a pre-existing right under contract from obtaining a sufficient level of access to meet the person's actual requirements. NBN Co is also not required to provide access if it is authorised under section 151DA of the CCA to refuse access to achieve uniform national pricing.

¹⁰⁴¹ CCA, s. 152AXB(4).

¹⁰⁴² CCA, s. 152AXB(4A).

¹⁰⁴³ CCA, s. 152AXB(5). 'Conditional-access customer equipment' means customer equipment that: consists of or incorporates a conditional-access system that allows a service provider to determine whether an end-user is able to receive a particular service; and either: is intended for use in connection with the supply of a content service; or is of a kind specified in the regulations (for example, a set-top box used for the supply of pay television services). NBN corporations do not have an obligation under the Category B SAOs in certain circumstances: where it considers that an access seeker would fail to a material extent, to comply with the terms and conditions on which NBN corporations comply, or are reasonably likely to comply, with the SAOs (for example, where there is evidence the access seeker is not creditworthy); or to protect the integrity and safety of a telecommunications network. (CCA, ss. 152AXB(6)(b) and 152AXB(7))

¹⁰⁴⁴ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1A, clauses 1A.3.1, 1A.3.2, 1A.3.3, 1A.3.4, 1A.3.5.

- some provisions about the manner in which NBN Co will implement and supply the NBN Access Service, the Ancillary Services and the Facilities Access Service (discussed in detail in chapter 3).¹⁰⁴⁵

The ACCC has had regard to the statutory criteria in section 152AH in considering whether the terms and conditions are reasonable. (The criteria upon which, in the ACCC's view, the SAU does not have a significant impact are noted in section 1.3. These criteria are not discussed here.)

8.2.1. Consistency with the Standard Access Obligations

In the SAU, NBN Co has consistently described its commitment to supply the NBN Access Service, Ancillary Services, and the Facilities Access Service as an "offer to supply". This commitment falls short of a direct commitment enforceable under the SAU that NBN Co will supply on request the services that are declared by acceptance of the SAU.

The ACCC is therefore not satisfied that these particular terms and conditions about compliance with the SAOs are consistent with the SAOs.

8.2.2. Reasonableness of the terms and conditions

8.2.2.1. Implementation and supply of the NBN Access Service, the Ancillary Services and the Facilities Access Service

Firstly, the ACCC considers that the provisions in the SAU that narrow what is to be supplied by NBN Co under the SAU create uncertainty about the interaction between the SAU and the powers conferred on the ACCC by Part XIC to declare services and set regulated terms and conditions for those services. If these provisions are characterised as 'limitations', the ACCC considers that they do not promote the long-term interests of end-users; if they are characterised as 'terms and conditions' the ACCC considers that they are not reasonable.

Secondly, the SAU has also specified as a term and condition of supply that access seekers must satisfy 'any other terms and conditions specified in an Access Agreement' to be able to acquire a product component — this means that access seekers must enter into an Access Agreement to obtain access to the declared service, even if the Access Agreement contains terms and conditions that are not reasonable.¹⁰⁴⁶ The ACCC is therefore not satisfied that this term and condition is reasonable.

Lastly, the SAU gives NBN Co the right to make supply of the UNI, AVC, CVC or NNI conditional on the acquisition of a bundle of these components.¹⁰⁴⁷ The ACCC considers that this goes beyond the limited authorisation for bundling in section 151DA of the CCA.

8.2.2.2. Locations for permitting interconnection

The SAU provides that NBN Co will specify a POI for each CSA, and that a POI may serve one or more CSAs.¹⁰⁴⁸

However, the SAU does not include a commitment that NBN Co will only offer interconnection (for the Fibre Access Service) for a particular CSA at the listed POI which is most proximate in the network for that particular CSA — or put another way, at the POI which is generally closest

¹⁰⁴⁵ Some provisions of the SAU that discuss these services form limitations on the service description, whereas others comprise terms and conditions in relation to compliance with the SAOs.

¹⁰⁴⁶ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1A, clause 1A.3.1.

¹⁰⁴⁷ Ibid, Schedule 1A, clause 1A.3.2.

¹⁰⁴⁸ Ibid, Schedule 1A, clause 1A.3.5.

to the end-users in that CSA and is consistent with the network planning and dimensioning rules devised to identify the location of the listed POIs.

Absent such a commitment, NBN Co would not be precluded by the SAU from offering interconnection at listed POIs located in CBD areas to supply the Fibre Access Service to say, regional CSAs. This could have implications for the promotion of competition in transmission markets, to the extent that access seekers no longer purchase transmission services from existing suppliers.

8.3. Conduct relating to access

As noted in section 1.3, the ACCC must not accept the SAU unless it is satisfied that any conduct specified by the undertaking in relation to access referred to in subsection 152CBA(3B) will promote the long-term interests of end-users, and the related terms and conditions are reasonable.¹⁰⁴⁹ This section provides the ACCC's preliminary views on these matters.

The ACCC has categorised clauses about the matters discussed in chapter 2 of this Draft Decision as conduct under subsection 152CBA(3B). Broadly, this conduct relates to:

- Access Determinations and Binding Rules of Conduct (including the 'regulatory recourse' mechanism);
- the 'explicit interaction' between the SAU and Standard Form of Access Agreements ('SFAA'); and
- changes to the SAU that occur through the 'replacement module' approach and the 'midpoint review' of Module 1.

The ACCC sets out its views about whether this conduct promotes the long-term interests of end-users in section 8.3.1.

The ACCC has categorised clauses relating to the following matters as terms and conditions upon which NBN Co will engage in conduct relating to access:

- Clauses which establish how prices will be determined, including those relating to the long-term revenue constraint methodology, discussed in detail in chapter 5. (The associated conduct is NBN Co's commitments about how prices are included in SFAAs.)
- Clauses which relate to service levels, dispute management, confidential information, intellectual property and risk management, discussed in detail in chapter 6, sections 6.2. to 6.6. (The associated conduct is NBN Co's commitments about how terms about these matters are included in SFAAs.)

The ACCC sets out its views about whether these terms and conditions are reasonable in section 8.3.2.

8.3.1. Does the conduct relating to access promote the long-term interests of end-users?

Whilst the ACCC considers that some of the conduct relating to access that is specified in the SAU is likely to promote the long-term interests of end-users, some of the conduct may not. This section sets out reasons for this view.

¹⁰⁴⁹ CCA, s. 152CBD(2)(ca).

The ACCC has not set out detailed analysis of each limb of the long-term interests of end-users criteria separately in this section — the views outlined are applicable to each limb.¹⁰⁵⁰

8.3.1.1. Conduct relating to Access Determinations and Binding Rules of Conduct

The ACCC cannot be satisfied that the specified conduct about Access Determinations and Binding Rules of Conduct will promote the long-term interests of end-users. This view primarily relates to the 'regulatory recourse' mechanism, which requires NBN Co to “give effect” to regulatory determinations by ensuring that new SFAAs are consistent with these instruments.¹⁰⁵¹

The reasons for this are outlined in section 2.2.2.

8.3.1.2. Conduct relating to SFAAs

The SAU refers to SFAAs for a number of different purposes, including:

- The production and maintenance of SFAAs — NBN Co will publish and maintain SFAAs in relation to the supply of the NBN Access Service and Ancillary Services. NBN Co may include terms and conditions in relation to the supply of the Facilities Access Service in SFAAs.¹⁰⁵²
- The development of SFAAs ('multilateral SFAA forum') — NBN Co will establish and conduct a multilateral SFAA forum to consult with access seekers on changes to the terms and conditions of SFAAs.¹⁰⁵³
- The alignment of SFAAs with the SAU — NBN Co will amend published SFAAs to ensure consistency with the terms of the accepted SAU, and will ensure that SFAAs remain consistent with the SAU, including when the SAU is varied over time.¹⁰⁵⁴
- Ensuring consistency between SFAAs and regulatory determinations ('regulatory recourse') — NBN Co will ensure that new SFAAs it publishes are consistent with any Access Determinations and Binding Rules of Conduct that apply in respect of the NBN Access Service and Ancillary Services and any 'Facilities Access Decisions' made by the ACCC in relation to the Facilities Access Service under a power conferred on the ACCC by the SAU.¹⁰⁵⁵
- Including particular terms and conditions in SFAAs — NBN Co is required to include certain terms and conditions in SFAAs for certain non-price matters.¹⁰⁵⁶
- Reference offers — the price that can be included in SFAAs for reference offers will be no higher than the maximum regulated price in certain circumstances.¹⁰⁵⁷
- Non-reference offers and other charges — the price that can be included in SFAAs for non-reference offers and other charges will be no higher than the maximum regulated price in certain circumstances.¹⁰⁵⁸

¹⁰⁵⁰ Noting though that the ACCC considers that the any-to-any connectivity objective is less relevant in assessing the SAU, as the ACCC considers that the SAU will not promote or detract from this objective.

¹⁰⁵¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1B, clause 1B.2.

¹⁰⁵² Ibid, Main Body, clause 6.3.

¹⁰⁵³ Ibid, Schedule 1B, clause 1B.3.

¹⁰⁵⁴ Ibid, Main Body, clauses 6.1 and 6.2.

¹⁰⁵⁵ Ibid, Schedule 1B, clause 1B.2.

¹⁰⁵⁶ Ibid, Schedule 1H, clauses 1H.5, 1H.6 and 1H.7; Schedule 1J, clause 1J.2.

¹⁰⁵⁷ Ibid, Schedule 1C, clauses 1C.1.4, 1C.1.5 and 1C.1.6.

¹⁰⁵⁸ Ibid, Schedule 1D, clauses 1D.1.5, 1D.1.6 and 1D.1.7.

The ACCC is of the preliminary view that some of this conduct specified by the SAU is likely to promote the long-term interests of end-users. In particular:

- The conduct to publish and maintain SFAAs for the supply of the NBN Access Service and the Ancillary Services will promote the long-term interests of end-users. The effect of this commitment is that access seekers will have the *option* of obtaining supply of the NBN Access Service and Ancillary Services via Access Agreements based on an SFAA for the term of the SAU. When read in conjunction with NBN Co's commitment to ensure consistency between the SAU and SFAAs, this conduct provides for access seekers to obtain access to services on the SAU terms and conditions over the term of the SAU by entering into an SFAA-based Access Agreement.
- The conduct which ensures consistency between the SAU and SFAAs will promote the long-term interests of end-users, provided that variations are made clarifying that the SFAA terms and conditions are specified in the SAU in relation to the SAOs and to remove the qualifications around when and how NBN Co will "give effect" to regulated terms. Provisions specified by the SAU will only come into operation if the ACCC is satisfied that they will promote the long-term interest of end-users and are reasonable.¹⁰⁵⁹ Under Part XIC, access seekers can obtain access on the terms and conditions specified by an accepted SAU without signing an Access Agreement based on an SFAA or otherwise commercially agreed to. The ACCC therefore considers that NBN Co's commitment to align SFAAs with the SAU would give access seekers the *option* to access the terms and conditions specified by the SAU by entering into an SFAA-based Access Agreement, as well as by the SAU as a standalone set of terms.
- The conduct to publish a SFAA with a fixed maximum two-year term during Module 1 is likely to promote the long-term interests of end-users. The effect of this commitment is that SFAA-based Access Agreements will have a two-year term during the first 10 years of the SAU term, and will be 'co-terminus'. That is, all Access Agreements based on these SFAAs will expire at the same time (however, NBN Co and access seekers are free to agree to Access Agreements with a different term). At this time, the ACCC is of the preliminary view that a two-year SFAA term is an appropriate length of time.

On the other hand, the ACCC considers that some of the specified conduct listed above would mean that access seekers *must* enter into Access Agreements based on SFAAs in order to obtain supply in accordance with the regulated terms that are included in the SAU, or otherwise established by the ACCC in Access Determinations or Binding Rules of Conduct. The ACCC is not satisfied that such conduct will promote the long-term interests of end-users, for the reasons set out in chapter 2.

8.3.1.3. Conduct relating to changes to the SAU

The ACCC is generally not satisfied that the provisions relating to changes to the SAU that occur through the 'replacement module' approach and the 'midpoint review' of Module 1 will promote the long-term interests of end-users.¹⁰⁶⁰

In relation to the proposed replacement module approach, the deemed application of SAU variation applications that have not been accepted by the ACCC, including where an updated SAU variation application is made as late as 20 business days before it is deemed to apply,¹⁰⁶¹ could result in the SAU specifying terms and conditions that are not reasonable and conduct

¹⁰⁵⁹ CCA, s. 152CBD(2).

¹⁰⁶⁰ The provisions relating to the 'replacement module' approach are contained in clauses 4.5 to 4.11 of the Main Body of the SAU, and the provisions relating the 'midpoint review' are contained in Schedule 1K of the SAU.

¹⁰⁶¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Main Body, clause 4.10(c).

that does not promote the long-term interests of end-users. Further, the SAU provisions, as drafted, create uncertainty about whether Access Determinations and Binding Rules of Conduct about matters that must be addressed in these SAU variation applications would be inconsistent with the SAU, creating uncertainty about the extent to which NBN Co must comply with the ACCC's regulatory determinations in these circumstances.

In relation to the proposed midpoint review process, the ACCC is not satisfied that the review and decision-making role conferred on it will allow it to make decisions that are reasonable and promote the long-term interests of end-users (due to the specified procedural requirements), nor that the conduct that NBN Co will subsequently engage in to implement these decisions will promote the long-term interests of end-users (for the reasons outlined in section 2.3.2). Consequently, the ACCC is not satisfied that the midpoint review will promote the long-term interests of end-users.

8.3.2. Reasonableness of terms and conditions

The ACCC has had regard to the statutory criteria in section 152AH in considering whether the terms and conditions are reasonable. The ACCC's preliminary view is that it is not satisfied that the terms and conditions about the following matters are reasonable:

- The price-related terms and conditions, read in conjunction with the terms and conditions about product withdrawal, are unlikely to encourage efficient use of and investment in the infrastructure used to supply listed services. They may also allow for NBN Co to be over-compensated relative to its efficient costs (including a normal commercial return on its investment), and in turn over-compensated relative to its legitimate commercial and business interests.
- The terms and conditions about service levels are also unlikely to encourage efficient use of and investment in the infrastructure used to supply listed services.
- The non-price terms (which also include those relating to service levels) do not give sufficient weight to the interests of persons that have rights to use the services the subject of the SAU. Further, in some cases, in not placing risk with the party able to most efficiently manage the risk, they may increase the overall costs associated with supplying telecommunications services to end-users, with subsequent implications for consumers and their use of the network.

The ACCC is generally satisfied that the price terms give sufficient weight to the operational and technical requirements necessary for the safe and reliable operation of carriage services supplied over the NBN (and associated facilities). However, the ACCC is not satisfied that the non-price terms relating to service levels and risk management do so, because they do not appear to provide NBN Co with strong incentives to establish and comply with operational and technical processes that contribute towards the safe and reliable operation of networks.

Sections 8.3.2.1 to 8.3.2.7 provide the ACCC's preliminary assessment of the terms and conditions against each limb of the reasonableness criteria. The criteria upon which, in the ACCC's view, the SAU does not have a significant impact are noted in section 1.3. These criteria are not discussed here.

8.3.2.1. Promoting competition

This section summarises the ACCC's considerations about whether the terms and conditions are likely to result in the achievement of the objective of promoting competition in markets for

listed services. The ACCC must have regard to the extent to which obstacles to end-users gaining access to these services are removed.¹⁰⁶²

In the current context, the ACCC considers that competition in retail markets will not necessarily always be promoted merely by an increase (or prevention of a decrease) in the number of retail service providers connecting directly to the NBN (that is, purchasing services directly from NBN Co). This is because barriers to connecting directly to the NBN will not in and of themselves create barriers to entering retail markets — barriers to entering retail markets can be addressed through the provision of aggregation (and other) services by wholesale providers, rather than through the regulation of terms and conditions of access to NBN Co's network.

Nonetheless, the efficacy of relying on wholesale markets to reduce barriers to entry to retail markets (and deliver the benefits of competition to end-users) relies on the continuing development of a vigorously competitive and sustainable wholesale market.

Whilst the ACCC does not presently consider that the proposed terms and conditions are likely to increase barriers to entering retail markets — nor create obstacles to end-users gaining access to services — this view is dependent on the continuing development of a competitive wholesale market. The manner in which these markets will develop over the proposed term of the SAU is at this point uncertain. Hence, the ACCC considers that it must retain some flexibility to be able to intervene in relation to price and non-price terms in the event that they have negative effects on the development of competition in wholesale markets over time.

8.3.2.2. Economically efficient use of and investment in infrastructure used to supply listed services

This section summarises the ACCC's considerations about whether the terms and conditions are likely to result in the achievement of the objective of encouraging the economically efficient use of, and investment in, infrastructure used to supply listed services.

Economically efficient use of infrastructure used to supply listed services

As noted in section 1.3.1.1, in considering whether the economically efficient use of infrastructure is encouraged, the ACCC may consider:

- whether the proposed access prices allow NBN Co to recover the prudently incurred costs of supplying the services at the specified level of quality, but no more; and
- whether NBN Co is likely to make timely changes to technology, products, quality of service, price structures and price relativities in response to changes in consumer tastes.

Both allocative and dynamic efficiency considerations are relevant in this context. Allocative efficiency will be achieved if NBN Co's services of differing qualities are appropriately allocated to those end-users that value them most highly (that is, according to end-users' perceived benefits of the different services relative to the costs of supplying the services). Dynamic efficiency will be achieved where NBN Co faces incentives to make timely changes to technology, products, quality of service, price structures and price relativities in response to changes in consumer tastes and productive opportunities.

Relationship between access prices and efficient use

A key principle in setting prices for individual services to achieve efficient outcomes is that each price should be based on the cost of providing the service (at a particular quality).

¹⁰⁶² CCA, s. 152AB(4).

However, this principle is often not straightforward to apply in practice for regulated businesses because it is often not possible to identify a single efficient price at a point in time for an individual service. This is because a significant proportion of the costs associated with supplying the services may be fixed costs (that is, they will not vary with use) or shared costs (for example, in the case of the NBN, the costs of particular network elements that can be used to provide a range of individual services). In addition, the recovery of capital costs associated with supplying services is typically allocated over multiple time periods — the spreading of cost recovery over an extended period in this manner adds an additional layer of complexity to the cost reflective principle and how it relates to efficiency.

In these circumstances, an approach which can lead to prices which promote efficient cost recovery and use of a network is to charge higher prices for those services for which customers are willing to pay more. Such prices are argued to promote efficient cost recovery and use of the network because the access provider recovers a higher proportion of its costs from those users who value its services the most.

On the other hand, where the costs of supplying a particular service are clearly attributable to that service, prices that reflect costs are more likely to promote efficient use of a network. This is because the value of the resources used to supply the service will be equal to the value that purchasers of the service place on it — in turn, an efficient amount of society's resources will be used in supplying the service. Were prices set 'too high', consumers would be paying more for the service than the value of the resources used in supplying the service — and it follows consuming less than an efficient level of the service. Were prices set 'too low', the supplier of the service would not be sufficiently compensated for the resources it deploys in supplying the service — and it follows that it would be able to supply less than an efficient amount, or quality, of the service. Consumers would be willing to pay more for the service, which would allow the supplier to supply more of the service, or to supply it at a higher quality.

In either case (that is, where the costs of supplying services are or are not attributable to the service) the access provider should, over the life of the assets used to supply the services, not be precluded by regulation from having the opportunity to recover its prudently incurred costs of supplying the services, including a normal commercial return. Absent this, it may face a disincentive to invest in regulated assets, which could in turn have implications for the ongoing provision of services (or for the quality of those services). NBN Co's proposed long-term revenue constraint methodology, which is based on the building block methodology often adopted in regulating utilities, but which also includes an 'initial cost recovery account',¹⁰⁶³ is intended by NBN Co to provide assurances that it will not be precluded by the SAU from being able to recover its efficient costs of supply over the term of the SAU (including a normal commercial return). The ACCC's views on whether the proposed long-term revenue constraint methodology achieves NBN Co's intention are set out in the discussion below about NBN Co's incentives to invest efficiently.

In the current context, the ACCC also considers that efficient use of the NBN will be promoted if consumers (and businesses) get services of broadly the quality they get today for broadly the price they get today — to the extent that consumers pay more than they do today, it should be for services/usage beyond what they get today. This is because, assuming that use of the copper and HFC networks is efficient, any increase in the price that access seekers must pay to receive a particular functionality on migrating to the NBN has the potential to decrease use of the NBN below current levels.

The terms and conditions of the SAU which are most relevant to the ACCC's considerations of these matters are those relating to:

- the initial prices set out in the SAU;
- those which determine how new prices will be set;

¹⁰⁶³ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1F.

- those which allow NBN Co to withdraw non-reference offers;
- those which allow for the services that are defined as reference offers to change;
- the CPI-1.5 per cent price control; and
- service levels.

The conduct proposed in the SAU about product development is also relevant. The ACCC has categorised the clauses relating to these matters as conduct under subsection 152CBA(3C). The ACCC's views on whether the conduct proposed in the SAU relating to product development would promote the long-term interests of end-users is included in section 8.3.

Initial prices and service levels

Whilst the ACCC generally considers that the initial prices set out in the SAU are likely to encourage efficient use of the NBN, the ACCC is unable to be satisfied that the proposed initial service levels will do so.

Initial prices

A range of initial prices are set out in the SAU. This includes initial prices for the different types of Layer 2 bitstream services themselves (that is, AVC and CVC data rate tiers of differing service qualities, for example, different traffic classes), as well as for a range of services and activities that are ancillary to the supply of the bitstream services (such as installation and set up charges). Some of these prices are set at zero.

The ACCC considers that, in general, there are products included in the SAU of a similar functionality to that currently being provided over copper and HFC networks at broadly comparable prices (noting though the ACCC's views on service levels outlined below). Therefore, assuming that use of these networks is currently efficient, efficient use of the NBN should not be discouraged by virtue of access seekers' and end-users' migration to the NBN. Further, to the extent that consumers pay more than they do today, it will be for functionality beyond what they get today.

In light of the views discussed above about the attribution of fixed and shared costs to services (and across time), the ACCC generally considers that NBN Co's approach to pricing its AVC and CVC products could encourage efficient use of the NBN. This is because prices appear to be set in such a way that 'higher value' services have higher prices than 'lower value services'.

For those services or activities that have a zero-price, whilst these prices could potentially be below the costs of providing the particular service, or engaging in the particular activity, the ACCC notes that NBN Co has included in the SAU an ability for NBN Co to introduce prices for these services in particular circumstances, including when it becomes uneconomic for the price of the service to be zero.

Initial service levels

At this stage, the ACCC does not have sufficient information to be able to ascertain whether the proposed service levels set out in Module 1 would result in broadly the same quality of service as that currently offered over the copper access network, or HFC networks.

In any event, the ACCC is not satisfied that the SAU includes sufficient mechanisms to provide an incentive for NBN Co to meet its proposed service levels.

Changes to prices and service levels over time, including setting new prices and service levels

For some periods throughout the SAU term, such as when NBN Co faces revenue sufficiency risk, NBN Co is likely to face incentives to change prices and services levels, and set new ones, in a manner that encourages efficient use of the NBN.

However, the ACCC considers that these incentives may weaken over the term of the SAU.

In turn, the ACCC is unable to be satisfied that the provisions in the SAU about how prices and service levels will change over time, and how new prices and service levels will be set, will encourage efficient use of the NBN for the term of the SAU.

Changes to prices and determining new prices

The SAU sets out that prices can be changed over time by NBN Co by CPI-1.5 per cent annually.¹⁰⁶⁴ Under these arrangements, the ACCC would not be able to determine that a higher or lower price should be charged for a particular service during the SAU term. The SAU also sets out that NBN Co will (generally) set new prices (for new services, or for currently zero-priced services) and includes clauses about how NBN Co will do so.¹⁰⁶⁵ The SAU also allows NBN Co to withdraw services that are 'non-reference' offers.¹⁰⁶⁶

In general, for the reasons set out in chapter 5, the ACCC is not satisfied that:

- the clauses about how NBN Co will set new prices; and
- the proposed CPI-1.5 per cent price cap;

will ensure that prices are set in a way that will encourage efficient use of the NBN over the term of the SAU. (The ACCC does however consider that the proposed CPI-1.5 per cent price cap has the potential to create incentives for NBN Co to invest and operate efficiently, as outlined in the ACCC's considerations about whether the terms and conditions promote efficient investment.)

In addition, for the reasons set out in chapter 4, NBN Co's ability to withdraw non-reference offers could reduce the anchoring effect of 'existing' prices on NBN Co's setting of new prices and reduce NBN Co's incentives to price its existing and new services in a manner which encourages efficient use of the network.¹⁰⁶⁷ The ACCC further considers that NBN Co's ability to withdraw non-reference offers could mean that current consumers of services provided over copper and HFC networks are not supplied with equivalent services for the SAU term.

Changes to service levels and determining new service levels

The manner in which service levels will change over time also has implications for the efficient use of the NBN. This is because for a given price, if service levels were to deteriorate, access seekers (and in turn potentially end-users) would receive less value for the same price. This could in turn cause them to reduce their use of the NBN. Alternatively, if service levels were to improve for a given price, access seekers would receive more value for the same price, and might in turn increase their use of the NBN.

¹⁰⁶⁴ Ibid, Schedule 1C, clause 1C.4.1; Schedule 1D, clause 1D.4.1; Schedule 2C, clause 2C.2.1.

¹⁰⁶⁵ Ibid, Schedule 1D, clauses 1D.4 and 1D.6; Schedule 2C, clauses 2C.4 and 2C.5; Schedule 1I, clause 1I.3.5; Schedule 2E, clause 2E.4.4(b).

¹⁰⁶⁶ Ibid, Schedule 1I, clause 1I.1.2.

¹⁰⁶⁷ The ACCC also considers that it will weaken the effect of the price controls in creating incentives for NBN Co to invest and operate efficiently — this issue is discussed below in the ACCC's consideration of whether the terms and conditions encourage efficient investment.

The ACCC's views on the proposed initial service levels aside, in relation to how they are allowed by the SAU to change over time:

- in light of the rapid development of the telecommunications sector and the nascent stages of the NBN rollout, the ACCC does not consider that Module 1 provides for sufficiently frequent or independent review of the proposed service levels; and
- the ACCC considers that the principles that are proposed in Module 2 to guide the manner in which service levels for existing products can be changed over time could allow NBN Co to propose lower service levels than were previously in place. As the principles are part of the fixed principles term and condition, there is also uncertainty about whether the ACCC would be able to reject a proposed variation to the SAU on the basis that the variation does not comply with the principles. This is because there might be an argument that the rejection is 'for a reason that concerns' the fixed principles and therefore not permitted under the CCA.

In terms of service levels for new products, whilst the ACCC notes and supports NBN Co's commitments in the SAU to consult with its customers in some circumstances about service levels for new products, it does not consider these commitments to be a substitute for a regulatory fallback in the event that agreement with its customers cannot be reached. Module 2 of the SAU appears to create some uncertainty as to whether the ACCC would be able to determine service levels for new products, in the event that agreement between NBN Co and its customers could not be reached.

In summary, the ACCC is not satisfied that the terms and conditions about how service levels will be changed over time, and how service levels for new services will be determined, will encourage efficient use of the NBN.

Economically efficient investment in infrastructure used to supply listed services

As noted in section 1.3.1, in determining the extent to which particular terms and conditions are likely to result in the achievement of the objective of encouraging efficient investment in infrastructure, the ACCC will have regard to:

- whether NBN Co has the opportunity to recover the prudent costs of building, operating and maintaining the infrastructure used to supply the services that will be declared by acceptance of the SAU;
- the legitimate commercial interests of NBN Co — its ability to earn a normal commercial return on its investment in the infrastructure used to supply services the subject of the SAU;
- the risks involved in making the investment; and
- whether NBN Co faces an incentive to invest efficiently in delivering the services that the Government expects it to deliver.

Allowing NBN Co to recover the prudent costs of building, operating and maintaining the infrastructure used to supply the services that will be declared by acceptance of the SAU, and to earn a normal commercial return on its investment (given the risks associated with that investment), provides an appropriate incentive for NBN Co to maintain, improve and invest in the efficient provision of services.

Were it to be compensated for less than a normal commercial return (given the risks of the investment), it may not be able to fund the capital investments that are needed to deliver on the Government's expectations. Allowing NBN Co to earn a normal commercial return on its investment therefore promotes dynamic efficiency, in the sense that NBN Co is not precluded from making timely investments to meet, on an ongoing basis, consumers' current expectations

about the quality of the services they receive, nor from making timely investments in response to changes in consumer tastes.

On the other hand, were NBN Co to be compensated for more than a normal commercial return (given the risk of the investment), it may have incentives to over-invest in capital and inflate its regulatory asset base. Hence, productive efficiency is also a relevant consideration — productive efficiency will be achieved if NBN Co produces the services that the Government expects it to supply, at least cost.

The terms and conditions of the SAU which are most relevant to the ACCC's considerations of these matters are those relating to:

- the long-term revenue constraint methodology, including the proposed return on capital;
- the CPI-1.5 per cent price control;
- the provisions allowing NBN Co to withdraw non-reference offers;
- the proposed approach to ensuring efficient capital and operating expenditure — the 'Prudent Design Condition', the 'Prudent Cost Condition' (and associated exemptions from these conditions) and the proposed operating expenditure principles; and
- the mechanisms proposed in the SAU to incentivise NBN Co to meet its proposed service levels.

The ACCC considers that NBN Co's incentives to invest efficiently are likely to change over the term of the SAU, depending on whether or not NBN Co faces revenue sufficiency risk. As noted, it is not clear when throughout the SAU term this risk will reduce. For the reasons outlined below, and in light of the potential for NBN Co's incentives to change throughout the term of the SAU, the ACCC is not satisfied that the terms and conditions will encourage efficient investment in the NBN during either Module 1 or Module 2.

Whether the terms and conditions allow NBN Co to recover its costs and a normal commercial return, given the risks of the investment

NBN Co has proposed a long-term revenue constraint methodology, which is based on the building block methodology often adopted in regulating utilities, but which also includes an 'initial cost recovery account'.¹⁰⁶⁸ The long-term revenue constraint methodology is intended by NBN Co to provide assurances that it will not be precluded by the SAU from being able to recover its efficient costs of supply over the term of the SAU (including an appropriate return on capital), and assurances to access seekers that NBN Co will be able to recover no more than this.

The long-term revenue constraint methodology contains some elements that would not change for the full SAU term, via the combined operation of Modules 0, 1 and 2. However, the way in which the value of the building block components which make up the annual revenue requirements and the value of the initial cost recovery account would be calculated would change over the SAU term — from, during Module 1, being determined annually by NBN Co based on methodologies set out in the SAU to, during Module 2, annual revenue requirements being determined ex-ante, based on forecasts, approved or rejected by the ACCC. (The methodologies and criteria for determining forecasts are fixed principles; hence there is uncertainty about whether the ACCC could reject a proposed variation to the SAU on the basis that the variation does not comply with the methodologies and criteria. This is because there

¹⁰⁶⁸ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1F.

might be an argument that the rejection is 'for a reason that concerns' the fixed principles and therefore not permitted under the CCA.)

In principle, the proposed long-term revenue constraint methodology would allow NBN Co to recover, via access prices, its prudently incurred costs and no more over time. However, as discussed in chapter 5, the ACCC's assessment of the long-term revenue constraint methodology suggests that NBN Co has implicitly assumed that capital expenditure will be incurred evenly throughout the year, and that on average, it will be incurred half-way through the year. If other assumptions are not consistent with this, it could mean that NBN Co could expect to earn a return on its investments in excess of what may otherwise be reasonable.

Furthermore, in considering the long-term revenue constraint methodology, there is a distinction between defining the cost components or types of costs that can be recovered (referred to as the 'building block components') versus the methodologies that are used to calculate the values of those cost components. Whilst allowing the recovery of a particular cost component might in principle be appropriate, the manner in which the value of that cost component is determined is also relevant to an assessment of whether NBN Co will be under- or over-compensated relative to its prudent costs. To the extent that a particular methodology leads to over or under-recovery of NBN Co's efficient costs (including an appropriate return on capital), this can result in efficient investment not being promoted, and NBN Co being under- or over-compensated relative to its direct costs and its legitimate business interests.

For the reasons outlined in chapter 5, the ACCC is also not satisfied that some of the methodologies proposed in Modules 1 and 2 for calculating the values of the building block components would mean that NBN Co had an expectation that it would be allowed to recover only its prudent costs. In turn, the ACCC is not satisfied that the proposed implementation of the long-term revenue constraint methodology will allow NBN Co to recover only its prudent costs (including a normal commercial return, given the risks of the investment).

As noted in section 1.3.1, in considering whether economically efficient investment is likely to be encouraged, the ACCC must also have regard to the legitimate commercial interests of NBN Co — its ability to earn a normal commercial return on its investment in the infrastructure used to supply services the subject of the SAU — and the risks involved in making the investment. As a key input to determining the return on capital that NBN Co is allowed to include in its allowable revenues, the cost of capital proposed by NBN Co has implications for the return that NBN Co will be allowed to earn by the regulatory framework. Hence, the proposed cost of capital is a relevant consideration in having regard to the legitimate commercial interests of NBN Co.

In relation to the approach proposed to determining the cost of capital in Module 1, the ACCC considers that it is difficult at this point in time to form definitive conclusions about whether the proposal would under- or over-compensate NBN Co relative to a 'normal commercial return' for similar types of investments. In this context, as noted in chapter 5, the ACCC considers that the Officer and Bishop approach of essentially benchmarking the cost of capital at the more general level of an overall Weighted Average Cost of Capital across a broad range of regulatory decisions is appropriate.¹⁰⁶⁹ In the absence at this point in time of better information, the ACCC considers that the 350 basis point risk-premium over the risk free rate which the Officer and Bishop approach establishes is likely to allow NBN Co to earn a normal commercial return on its investment.

On the other hand, whilst the ACCC considers that it is appropriate for Module 2 to provide assurances to NBN Co that it will be able to earn a normal commercial return on its investment, having regard to the risks involved in making those investments, for the reasons outlined in chapter 5, the ACCC is not satisfied that the principles that have been proposed by NBN Co will ensure this.

¹⁰⁶⁹ Officer and Bishop report, pp. 4-5.

The ACCC also reiterates its finding that other assumptions made and methodologies proposed to be adopted in implementing the long-term revenue constraint methodology could allow for NBN Co to be over-compensated relative to its efficient costs. Hence, whilst the ACCC has concluded that the rate of return might be set at a level that reflects a normal commercial return during Module 1, other aspects of the long-term revenue constraint methodology could result in the actual return that NBN Co earns being higher than a normal commercial return.

Whether the terms and conditions create incentives for NBN Co to invest efficiently

As noted above, the ACCC considers that the implementation of the proposed long-term revenue constraint methodology could allow for NBN Co to be compensated for more than its prudent costs (including a normal commercial return). This in turn means that the long-term revenue constraint methodology is unlikely, in isolation, to encourage NBN Co to invest (and operate) efficiently.

Further, for the reasons outlined in chapter 5, the ACCC is not satisfied that the specific principles and methodologies in Module 1 which ensure that the capital expenditure that is allowed to be included in the regulatory cost base is prudent, will, in isolation, encourage NBN Co to invest efficiently. The ACCC also does not consider that — in its current form — the forecasting approach proposed in Module 2 will create incentives for NBN Co to invest efficiently.

The ACCC does however consider that long-term price commitments, such as the CPI-1.5 per cent price control — in combination with NBN Co's significant initial capital outlay and uncertainty around future demand — have the potential to provide NBN Co with strong incentives to incur only efficient investment (and operating) expenditure. However, as noted in chapter 4, NBN Co's ability under the SAU to withdraw non-reference offers and compel access seekers and consumers to purchase higher data rate products could reduce the level of demand risk that NBN Co would be subject to. This is because it could provide NBN Co with a heightened ability to 'shape' demand for each of its services, relative to if it could only rely on its pricing to do so.

Reduced demand risk is likely to reduce NBN Co's revenue sufficiency risk and in turn the risk that NBN Co will not be able to recover the costs of its investment.

Consequently, the proposed price controls in the SAU (CPI-1.5 per cent on the prices of all services) may be less effective than they otherwise would be in creating incentives for NBN Co to invest and operate efficiently.

The ACCC also considers that efficient investment would be encouraged if NBN Co faced suitable incentives to invest in capital to maintain and/or improve service levels over time (in contrast to the above discussion, the concern here relates to avoiding incentives to under-invest). In this regard, the mechanisms proposed in the SAU to incentivise NBN Co to meet its proposed service levels could have implications for NBN Co's incentives to invest efficiently — this is because, in penalising NBN Co for not investing in either capital or operations and maintenance expenditure to maintain service levels, incentives could be created for it to engage in this expenditure. As noted, the ACCC considers that the SAU does not include sufficient mechanisms (in either Module 1 or Module 2) to provide an incentive for NBN Co to meet its proposed service levels.

8.3.2.3. The legitimate business interests of NBN Co and its investment in facilities

The ACCC's considerations summarised above relating to NBN Co's legitimate commercial interests and the risks associated with its investments are also relevant in considering this criterion.

As noted, whilst the ACCC considers that the rate of return might be set at a level that reflects a normal commercial return during Module 1, other aspects of the long-term revenue constraint methodology could result in NBN Co being over-compensated relative to its efficient costs, and

the actual return that NBN Co earns being higher than a normal commercial return. Further, whilst the ACCC considers that it is appropriate for Module 2 to provide assurances to NBN Co that it will be able to earn a normal commercial return on its investment, having regard to the risks involved in making those investments, the ACCC is not satisfied that the principles that have been proposed to determine that return will, in all circumstances ensure this.

The terms and conditions in the SAU about particular non-price matters — those which NBN Co commits to include in SFAAs — are also relevant in having regard to this criteria. These terms and conditions relate to the following non-price matters:

- service levels (Annexure 1 to Schedule 1J);
- risk management (Annexure 3 to Schedule 1H);
- confidentiality and intellectual property rights for ‘business as usual’ activities (Annexure 2 to Schedule 1H); and
- dispute management rules (Annexure 1 to Schedule 1H).

A commercially negotiated contract within a competitive environment would be expected to set out terms and conditions about the above matters that represent an appropriate balance between the parties' interests, since the parties would not otherwise have entered into the contract. However, a monopoly access provider may have an incentive and the ability to impose onerous terms on access seekers in order to minimise its exposure to risk. This could impose costs on access seekers that create barriers to entry, and/or potentially result in higher retail prices and reduced service quality for end-users, if the responsibility for particular risks is not placed with the party able to manage those risks most efficiently, or is transferred to end-users.

The ACCC acknowledges that the non-price matters addressed by the SAU have been highly contentious during negotiations between NBN Co and access seekers, and that the SAU could provide an appropriate regulatory fallback for ongoing commercial negotiations if the ACCC were to find that the terms appropriately balance NBN Co's interests with those of its customers.

However, the ACCC does not consider that the terms and conditions in Module 1 of the SAU about the above matters provide an appropriate balance between NBN Co's legitimate business interests and those of its customers.

8.3.2.4. The interests of persons who have rights to use the declared service

As noted in section 1.3.1, the ACCC considers that the interests of access seekers include not being subjected to overly onerous commercial terms simply because of their status as access seekers.

The terms and conditions in the SAU about particular non-price matters — those which NBN Co commits to include in SFAAs — are relevant in having regard to this criteria. As noted, the ACCC expects that terms and conditions about these matters should reflect an appropriate balance between NBN Co and its customers' interests and should place responsibility for managing risks with the party able to manage those risks most efficiently.

As noted, the ACCC does not consider that the non-price terms and conditions in Module 1 of the SAU (those which NBN Co commits to including in SFAAs) place sufficient weight on the interests of access seekers.

8.3.2.5. The direct costs of providing access to the declared service

The ACCC considers that the long-term revenue constraint methodology in principle provides NBN Co with the opportunity to recover its direct costs in providing access to the services the subject of the SAU. However, as noted, the ACCC generally considers that:

- the proposed methodologies for calculating the values of the inputs to the long-term revenue constraint methodology during Module 1 — when combined with the proposal that those values will be determined by NBN Co; and
- the methodologies proposed in Module 2 for calculating the forecast values of those inputs;

could allow for NBN Co to be compensated for more than the direct costs of providing access to the declared service.

8.3.2.6. The operational and technical requirements necessary for the safe and reliable operation of a carriage service, a telecommunications network or a facility

The ACCC considers that the long-term revenue constraint methodology in principle provides NBN Co with the opportunity to recover the costs associated with operating its network safely and reliably.

However, for the reasons outlined in chapter 6, the ACCC considers that the risk management provisions in the SAU are unlikely to give NBN Co strong incentives to establish and comply with operational and technical processes that contribute towards safe and reliable operation of networks, because they shift risk away from NBN Co in circumstances where NBN Co is best placed to manage the risk efficiently.

The ACCC also considers that the proposed service level regime does not contribute to the reliable operation of the NBN because, as noted, it does not provide strong incentives for NBN Co to meet the specified service levels.

8.3.2.7. The economically efficient operation of a carriage service, a telecommunications network or a facility

The ACCC's views about the implications of the terms and conditions for the economically efficient operation of a carriage service, a telecommunications network or a facility largely reflect those outlined in section 8.1.2.3.

That is, whilst NBN Co is unlikely to be precluded by the price-related terms and conditions from recovering the costs associated with operating the NBN (and hence will not be discouraged from undertaking expenditure on operations and maintenance), the price-related terms and conditions may allow it to recover more than the efficient costs of operating the NBN.

Further, as noted, the ACCC does consider that long-term price commitments, such as the CPI-1.5 per cent price control — in combination with NBN Co's significant initial capital outlay and uncertainty around future demand — have the potential to provide NBN Co with strong incentives to incur only efficient operating expenditure. However, NBN Co's ability under the SAU to withdraw non-reference offers could reduce the effectiveness of the proposed price controls in creating incentives for NBN Co to operate efficiently.

8.4. Conduct relating to ancillary activities

As noted in section 1.3, the ACCC must not accept the SAU unless it is satisfied that any conduct specified by the undertaking in relation to certain matters (such as developing new eligible services or enhancing a declared service) referred to in subsection 152CBA(3C) will

promote the long-term interests of end-users.¹⁰⁷⁰ The ACCC has categorised clauses about the following matters to be conduct under subsection 152CBA(3C):

- product development;¹⁰⁷¹
- changes to the locations of POIs;¹⁰⁷²
- the closure of temporary POIs;¹⁰⁷³
- the provision of information about POIs;¹⁰⁷⁴ and
- the provision of information about the rollout.¹⁰⁷⁵

The ACCC is generally satisfied that the conduct in the SAU about the provision of information will promote the long-term interests of end-users.

However, the ACCC is not satisfied that the conduct about changing the locations of POIs and product development will promote the long-term interests of end-users.

The following section summarises the reasons for this view with respect to each limb of the long-term interests of end-users criteria. (As noted, the ACCC considers that the any-to-any connectivity criterion is neither promoted nor hindered in the context of carriage services that are inputs to an end-to-end service. It is therefore not discussed in this section.)

8.4.1. Product development

8.4.1.1. Promoting competition

In a general sense, if NBN Co's customers can develop, with NBN Co, wholesale Layer 2 products that support the development of new and innovative downstream products, the vigour of competition in downstream markets is likely to be promoted as retail service providers strive to compete on the basis of product innovation. The ability to benefit from any intellectual property rights created may also provide incentives for both NBN Co and access seekers to invest in the creation of intellectual property that end-users value, encouraging innovation and the vigour of competition.

However, the ACCC's preliminary views about the specific product development and variation provisions in the SAU are that the confidential information and intellectual property rights terms associated with the PDF Processes in Annexure 1 to Schedule 1I could discourage access seekers from participating in the Product Development Forum — customers might therefore be dissuaded from developing with NBN Co wholesale Layer 2 products that support the development of new and innovative downstream products, which could in turn reduce the vigour of downstream competition.

8.4.1.2. Economically efficient use of and investment in infrastructure used to supply listed services

Changes in technology and end-user demand are inevitable over the term of the SAU. In a general sense, to the extent that, over the term of the SAU, NBN Co supplies services that its customers and their end-users are willing to pay for (both in terms of the introduction of new services, and the withdrawal of existing services), efficient use of, and investment in, the NBN

¹⁰⁷⁰ CCA, s. 152CBD(2)(cb).

¹⁰⁷¹ NBN Co, *Special Access Undertaking*, 18 December 2012, Schedule 1I; Annexure 1 to Schedule 1I; and Schedule 2E.

¹⁰⁷² Ibid, Schedule 1H, clauses 1H.4.1, 1H.4.2 and 1H.4.3.

¹⁰⁷³ Ibid, Schedule 1H, clause 1H.4.5.

¹⁰⁷⁴ Ibid, Schedule 1H, clause 1H.3.

¹⁰⁷⁵ Ibid, Schedule 1H, clause 1H.2.

is likely to be promoted. Similarly, to the extent that NBN Co and its customers share information about and consult with each other on these things, the prospect of supply and demand being aligned is likely to be enhanced.

During both Module 1 and Module 2, NBN Co commits to consulting with its customers about the development of products.¹⁰⁷⁶ The ACCC welcomes these commitments and considers that they have the potential to reduce information asymmetries about supply and demand conditions, in turn enhancing the prospect that efficient use of and investment in the NBN will be encouraged. The ACCC does however consider that the effectiveness of the commitments in reducing information asymmetries would be enhanced if NBN Co committed to consult in a broader range of circumstances (as discussed in section 4.1.1.2) and if there was also a role for consumer advocacy groups in NBN Co's consultation processes.

The ACCC does not however consider that consultation is a substitute for an effective regulatory fallback, particularly in circumstances where NBN Co faces weak incentives to develop new products in line with evolving end-user demand.

The incentives faced by NBN Co to develop new products in line with the willingness to pay of its customers are likely to change over the term of the SAU. In particular, whilst NBN Co faces revenue sufficiency risk, it may face incentives to develop and vary products to the extent that to do so would generate revenue streams greater than the costs of providing the new or varied product, or greater margins than those being earned from its existing product set. On the other hand, as this revenue sufficiency risk reduces, NBN Co's incentives to develop new products may diminish. This is because NBN Co would expect to be able to recover its costs without developing new products, and because the operation of the long-term revenue constraint would mean that NBN Co would be unable to earn returns above its regulated return from supplying new products.

As noted in chapters 3 and 4, under the SAU, NBN Co has a high degree of discretion as to what new products may be created. Whether or not this discretion is likely to result in the economically efficient use of and investment in the NBN may vary throughout the SAU term, depending on the incentives faced by NBN Co as described above. Therefore, the need for the ACCC to be involved in NBN Co's decisions about product development may also vary. In any event, aspects of the product development provisions which — in combination with the service description — narrow what is to be supplied by NBN Co, create uncertainty as to the interaction between the SAU and the powers conferred on the ACCC by Part XIC to declare services and set regulated terms and conditions for those services in an Access Determination or Binding Rule of Conduct.

8.4.2. Changing the locations of POIs

The ACCC considers that, in principle, the conduct in the SAU which requires that NBN Co seek the ACCC's prior approval before opening a new POI, relocating an existing POI or closing an existing POI would promote competition in transmission markets.¹⁰⁷⁷ Further, the ACCC considers that the conduct about closing temporary POIs as soon as practicable supports the intended outcomes of the POI list by shifting end-users to the relevant established POI on that list. This would in turn be likely to promote competition in transmission markets.

However, the ACCC does not consider that the timeframes for decision making specified in the SAU will enable it to properly consider and consult on a request from NBN Co to open, close or relocate a POI in all circumstances. This could result in a decision that does not enable efficient investment in equipment and facilities required for interconnection, or that does not promote competition in transmission markets.

¹⁰⁷⁶ Ibid, Schedule 1I, clause 1I.1.2, Schedule 2E, clause 2E.4.1.

¹⁰⁷⁷ Ibid, Schedule 1H, clause 1H.4.

Similarly, the ACCC considers that the requirement to only provide 6 months' notification to access seekers before the closure of a temporary POI is unlikely to encourage economically efficient use of and investment in infrastructure. Instead, the ACCC considers that NBN Co should provide 12 months' notification to access seekers, and that the trigger for notification should be the compulsory migration of a group of end-users to a established POI, rather than the closure of the temporary POI.

Attachment A: Initial prices

Reference offers

Basic Access Offer \$24.00, per SIO, per month; (includes a 12/1 Mbps AVC (TC-4), access to one UNI-D, the option to access one UNI-V, and 150kbps voice capacity (TC-1)).¹⁰⁷⁸

Enhanced Access Offer \$27.00, per SIO, per month; (includes a 25/5 Mbps AVC (TC-4), access to one UNI-D, the option to access one UNI-V, and 150kbps voice capacity (TC-1)).¹⁰⁷⁹

Standard Business Offer \$53.00, per SIO, per month; (includes a 25/10 Mbps AVC (TC-4), access to one UNI-D, the option to access one UNI-V, and 500kbps data transfer rate (TC-1)).¹⁰⁸⁰

Connectivity Virtual Circuit Offer \$20.00 per Mbps, per month (TC-1 and TC-4).

Includes CVCs with the following data transfer rates:

ACCC item	Data transfer rate	Traffic class (CIR)
1	5	TC-1
2	10	TC-1
3	20	TC-1 and TC-4*
4	50	TC-1 and TC-4*
5	100	TC-1 and TC-4
6	150	TC-1 and TC-4
7	200	TC-1 and TC-4
8	250	TC-1 and TC-4
9	300	TC-1 and TC-4
10	400	TC-1 and TC-4
11	500	TC-1 and TC-4
12	600	TC-4
13	700	TC-4
14	800	TC-4

¹⁰⁷⁸ For the NBN Co fibre network, NBN Co wireless network and NBN Co permanent satellite network, In respect of the NBN Co interim satellite network only, a 6/1 Mbps AVC (TC-4) and 60kbps voice capacity (TC-1).

¹⁰⁷⁹ For the NBN Co fibre network.

¹⁰⁸⁰ For the NBN Co fibre network.

15	900	TC-4
16	1,000	TC-4

*TC-4 (CIR) for these CVC data transfer rates are applicable in respect of the NBN Co wireless network and NBN Co interim satellite network only.

Network to Network Interface Offer

Includes NNIs with the following NNI interface capacities:

ACCC item	NNI bearer profiles	Interface capacity (Gbps)	Monthly recurring charge, per NNI¹⁰⁸¹
17	1000BaseLX	1	\$200
18	1000BaseT*	1*	\$200
19	10GBaseLR	10	\$400
20	1000BaseEX	1	\$500
21	10GBaseER	10	\$1000

*This NNI bearer profile and interface capacity is applicable in respect of the NBN Co interim satellite network only.

Platform Interfacing Offer \$0

Sandpit Offer \$0

Facilities Access Service Offer

Includes the following types of Facilities Access Service:

ACCC item	Type of Facilities Access Service	Monthly Recurring Charge¹⁰⁸²
22	Cross-connect	\$0
23	NBN Co ODF Termination Point	\$0

Non-reference offers¹⁰⁸³

Asymmetric AVC Offers

¹⁰⁸¹ There is also a one-off establishment charge as set out in clause 1D.3.2(a) of the SAU (for items 17-21).

¹⁰⁸² There is also a one-off establishment charge as set out in clause 1D.3.2(d) of the SAU (for items 22-23).

¹⁰⁸³ For the NBN Co fibre network, unless otherwise noted.

Includes an AVC with the following data transfer rates:¹⁰⁸⁴

ACCC item	Downlink (Mbps)/Uplink (Mbps)	Monthly recurring charge, per SIO
24	25/10	\$30.00
25	50/20	\$34.00
26	100/40	\$38.00
27	250/100	\$70.00
28	500/200	\$100.00
29	1000/400	\$150.00

Additional Asymmetric AVC Offers

Includes an AVC with the following data transfer rates:¹⁰⁸⁵

ACCC item	Downlink (Mbps)/Uplink (Mbps)	Monthly recurring charge, per SIO
30	12/1	\$16.50
31	25/5	\$19.50
32	25/10	\$22.50
33	50/20	\$26.50
34	100/40	\$30.50
35	250/100	\$62.50
36	500/200	\$92.50
37	1000/400	\$142.50

¹⁰⁸⁴ Includes access to one UNI-D for use in conjunction with the AVC, the option to access one UNI-V, and 150kbps voice capacity (TC-1).

¹⁰⁸⁵ Data transfer rates are provided to an existing UNI-D and used in conjunction with another AVC mapped to the same UNI-D.

Symmetric Access Capacity Offers

Includes an AVC with the following symmetrical data transfer rates:¹⁰⁸⁶

ACCC item	TC (CIR)	Symmetrical data transfer rate (Mbps)	Monthly recurring charge, per SIO
38	TC-1	0.15*	\$10.00
39		0.3	\$20.00
40		0.5	\$33.00
41		1	\$66.00
42		2	\$132.00
43		5	\$330.00
44	TC-2	5	\$32.00
45		10	\$64.00
46		20	\$128.00
47		30	\$192.00
48		40	\$256.00
49	TC-3	10	\$48.00
50		20	\$96.00
51		40	\$192.00
52		100	\$480.00

*Available on the NBN fibre access network and the NBN Co wireless network.

Second UNI-V and AVC Offer

\$17.50, per SIO, per month; includes access to one UNI-V for use in conjunction with the AVC, and an AVC with 150kbps voice capacity (TC-1).

¹⁰⁸⁶ Included with the data transfer rates acquired in respect of the same AVC, provided that the data transfer rate does not exceed the TC-4 data transfer rate of the AVC or any other technical requirements of the NBN Co fibre network.

CVC Offers (TC-2 and TC-3)

Includes CVCs with the following data transfer rates:

ACCC item	Data Transfer Rate (Mbps)	Monthly recurring charge for TC-2 (CIR) and for TC-3 (CIR)
53	50	\$1,000
54	100	\$2,000
55	150	\$3,000
56	200	\$4,000
57	250	\$5,000
58	300	\$6,000
59	400	\$8,000
60	500	\$10,000
61	600	\$12,000
62	700	\$14,000
63	800	\$16,000
64	900	\$18,000
65	1,000	\$20,000

For the Multicast AVC Offer

Includes the multicast AVC with the following data transfer rates:

ACCC item	Downstream Mbps (CIR)	Upstream Mbps (CIR)	Monthly recurring charge, per SIO
66	5	0	\$2.00
67	20	0	\$5.00
68	30	0	\$10.00
69	40	0	\$15.00
70	50	0	\$20.00

For the Multicast Domain Offer

For the Multicast Domain

Includes the Multicast Domain and configured media streams within that Multicast Domain with the following data transfer rates:

ACCC item	Downstream Mbps (CIR)	Monthly recurring charge, per Mbps
71	100	\$2.50
72	200	\$2.50
73	300	\$2.50
74	400	\$2.50
75	500	\$2.50
76	600	\$2.50
77	700	\$2.50
78	800	\$2.50
79	900	\$2.50
80	1000	\$2.50

For the Media Streams associated with each Multicast Domain

ACCC item	Media streams per Multicast Domain	Monthly recurring charge
81	0 - 200	\$0.00
82	> 200	\$50.00 per media stream in excess of 200 media streams

NBN Co Co-location Offer

ACCC item	Type of NBN Co Co-location offer	Monthly recurring charge¹⁰⁸⁷
83	Lockable full height equipment rack	\$2,000
84	Lockable half height equipment rack	\$1,200

¹⁰⁸⁷ There is also a one-off establishment charge as set out in clause 1D.3.2(d) of the SAU (for items 83-84).

Other charges***For installations and activations on the NBN Co fibre, wireless and satellite networks***

ACCC item	Activity	Chargeable unit	Charge
85	Initial standard installation	Per installation	\$0
86	Initial non standard installation	Time and materials	Hourly labour rate + cost of materials
87	Subsequent installation	Time and materials	\$270 + hourly labour rate + cost of materials
88	Access component reactivation	Per reactivation	\$0
89	MAVC reactivation	Per reactivation	\$0
90	CVC setup/activation	Per activation	\$0
91	Multicast domain activation	Per activation	\$0
92	NNI 1000BaseLX Setup	Per activation	\$1,000
93	NNI 1000BaseT Setup	Per activation	\$1,000
94	NNI 10GBaseLR Setup	Per activation	\$5,000
95	NNI 1000BaseEX Setup	Per activation	\$7,000
96	NNI 10GBaseER Setup	Per activation	\$35,000
97	Service qualification enquiry	Per enquiry	\$0

For service modifications on the NBN Co fibre, wireless and satellite networks

ACCC item	Activity	Chargeable unit	Charge
98	Access component modification	Per modification	\$0
99	Connectivity component modification	Per event	\$0
100	Multicast domain modification	Per event	\$0

101	NNI modification	Per event	\$0
102	Rearrangement/ modification	Time and materials	Hourly labour rate + cost of materials
103	Equipment removal	Time and materials	Hourly labour rate + cost of materials
104	Equipment repair	Time and materials	Hourly labour rate + costs of materials

For service management on the NBN Co fibre, wireless and satellite networks

ACCC item	Activity	Chargeable unit	Charge
105	Onsite maintenance call out	Per event	\$0
106	No fault found (no truck roll required)	Per event	\$50
107	No fault found (truck roll required)	Per event	Hourly labour rate charged for a minimum of 2 hours plus each hour thereafter
108	Late cancellation (site visit required)	Per event	\$0
109	Missed appointment	Per event	\$0
110	Restoration	Per ordered product	\$50

For the Facilities Access Service

ACCC item	Activity	Charge
111	Set-up NBN Co Co-location (lockable full equipment rack)	\$1,500 per lockable full height equipment rack
112	Set-up NBN Co Co-location (lockable half equipment rack)	\$900 per lockable half height equipment rack
113	Set-up cross connect	\$0 per interface
114	Set-up NBN Co ODF termination point	\$0 per interface
115	Supply of first access card in respect of an aggregation node site	\$0
116	Additional/replacement access card (excluding the first access card)	\$100 per access card

117	Missed appointment (during business hours)	\$300 per missed appointment
118	Missed appointment (outside business hours)	\$450 per missed appointment

Enhanced-12 fault service levels \$15 per AVC, per month.

Attachment B: Services for which the ACCC is not satisfied that the initial prices are reasonable

Standard Business Offer

\$53.00, per SIO, per month; (includes a 25/10 Mbps AVC (TC-4), access to one UNI-D, the option to access one UNI-V, and 500kbps data transfer rate (TC-1).¹⁰⁸⁸

Symmetric Access Capacity Offers

Includes an AVC with the following symmetrical data transfer rates:¹⁰⁸⁹

ACCC item	TC (CIR)	Symmetrical data transfer rate (Mbps)	Monthly recurring charge per SIO
38	TC-1	0.15*	\$10.00
39		0.3	\$20.00
40		0.5	\$33.00
41		1	\$66.00
42		2	\$132.00

*Available on the NBN fibre access network and the NBN Co wireless network.

Other charges

For service management on the NBN Co fibre, wireless and satellite networks

ACCC item	Activity	Chargeable unit	Charge
110	Restoration	Per ordered product	\$50

¹⁰⁸⁸
¹⁰⁸⁹

For the NBN Co fibre network.

Included with the data transfer rates acquired in respect of the same AVC, provided that the data transfer rate does not exceed the TC-4 data transfer rate of the AVC or any other technical requirements of the NBN Co fibre network.

Contacts

Infocentre: 1300 302 502

Website: www.accc.gov.au

Callers who are deaf or have a hearing or speech impairment can contact the ACCC through the National Relay Service, www.relayservice.com.au

For other business information, go to www.business.gov.au

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