



Australian
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Commission

ACCC submission to the *NBN non-commercial services funding options* consultation paper

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1 Introduction

The ACCC welcomes the opportunity to comment on the Bureau of Communications Research (BCR) consultation paper on NBN non-commercial services funding options.

The ACCC understands that the Australian Government has asked the BCR to assess the non-commercial losses expected to be incurred from building and operating satellite and fixed wireless services offered in regional areas and to consider options for funding these losses via contributions from owners of high-speed broadband access networks.

The BCR's consultation paper seeks input from interested parties on the approach to:

- quantifying the losses from NBN non-commercial services and
- developing transparent funding arrangements that support competitive outcomes.

The ACCC has previously stated that subsidies to support non-commercial services should be as transparently and efficiently delivered as possible. The ACCC considers the most efficient subsidies are generally those that minimise market distortions and are targeted towards promoting specific and measurable pricing and service objectives.¹ The ACCC welcomes the Government's response to the Vertigan Review on this matter and the BCR consultation on developing a more transparent funding model for non-commercial services.

The Government has indicated its intention to remove NBN Co's internal cross-subsidy and replace it with a scheme requiring contributions from owners of high-speed broadband access networks. The ACCC considers that consultation on an alternative funding model is an important step in supporting the Government objective of not restricting infrastructure based competition and the structural separation of NBN Co.

This submission does not seek to address each of the questions raised in BCR's consultation paper. Rather, the submission focuses on some of the existing regulatory concepts incorporated within NBN Co's SAU that may assist the BCR's consideration of an appropriate approach to quantifying losses from non-commercial services or which may be useful in developing a framework for funding these services. In particular, this submission addresses the following matters:

- The ACCC's role in relation to special access undertakings,
- Principles highlighted by the BCR for developing funding options for NBN non-commercial services, and
- Cost and financial modelling concepts currently within the SAU that could potentially be adopted in developing a funding model for NBN non-commercial services.

¹ ACCC submission to the *Independent Cost Benefit Analysis Review of Regulation first issues framing paper*, March 2014 p.17.

2 The ACCC's role in relation to special access undertakings

The BCR's consultation paper seeks comments on the elements of NBN Co's Special Access Undertaking (SAU) that would require changes to accommodate the introduction of an alternative funding model for non-commercial services.

NBN Co is subject to access regulation under Part XIC of the *Competition and Consumer Act 2010* (CCA). Part XIC establishes a regulatory framework governing access to telecommunications infrastructure. The ACCC has powers under Part XIC to declare services and to specify terms and conditions of access for declared services through access determinations and binding rules of conducts. Part XIC also contains a range of provision relating specifically to the NBN, including the ability for NBN Co to lodge special access undertakings to the ACCC for assessment. On 13 December 2013 the ACCC accepted an SAU given by NBN Co under Part XIC. The SAU forms a key part of the regulatory framework that governs NBN Co and is in operation until 2040.

When considering a SAU submitted by NBN Co, the ACCC must either accept or reject the SAU based on statutory criteria set out in section 152CBD of the CCA. Among other things, the ACCC must be satisfied that the conduct included in a SAU promotes the long-term interests of end-users (the LTIE) and that any terms and conditions within the SAU for access to the services are reasonable. Part XIC also includes provisions for the variation of a SAU while it is in operation. If NBN Co gives a variation of the SAU to the ACCC,² the ACCC must decide whether to accept or reject the variation.³ In assessing a variation, the ACCC must apply the legislative criteria that apply to the assessment of a SAU.⁴

Importantly, the ACCC does not have powers under Part XIC to require NBN Co to vary an existing SAU, or to otherwise initiate changes to an existing SAU.

While the structure and wording of NBN Co's SAU is such that it can accommodate a range of policy approaches, the ACCC agrees with the BCR's conclusions that some elements of the SAU will likely need to be modified to accommodate the introduction of an alternative funding arrangement for non-commercial services. The ACCC anticipates that NBN Co would need to consider the details of an alternative funding model before it would be able to advise on the extent to which the SAU would need to be varied, if at all.

3 Key design principles

The BCR consultation paper identifies five overarching principles which should guide the development of an appropriate funding model for non-commercial NBN services. These five principles are transparency, economic efficiency, contestability, sustainability and equity. The ACCC agrees with the BCR that these principles are key considerations for developing a transparent funding arrangement that will promote contestability and sustainability. In addition to considering each principle independently, the interactions and trade-offs between these principles should also be a key consideration in the development of any funding alternatives.

² CCA, s. 152CBG(2).

³ CCA, s. 152CBG(3).

⁴ CCA, s. 152CBG(4).

The guiding principles identified by the BCR echo similar concepts that the ACCC must consider under Part XIC of the CCA. A key objective of Part XIC is to promote the LTIE, which is one of the criteria the ACCC must consider in all telecommunication regulatory matters. When considering the promotion of the LTIE, the ACCC must have regard to the extent to which something is likely to result in the achievement of the following three objectives:

- promoting competition in the market for telecommunications services,
- achieving any-to-any connectivity between end-users, and
- encouraging the economically efficient use of, and investment in, infrastructure by which telecommunications services are supplied or likely to become supplied.⁵

The ACCC supports in principle the introduction of an explicit levy to subsidise non-commercial NBN services. The ACCC considers that a direct funding model will address the design principles identified by the BCR and should greatly improve the transparency and sustainability of the NBN non-commercial services within the Government's broader policy objectives.

The ACCC has previously argued that the LTIE is in many situations best served by the dynamic efficiency generated by infrastructure based competition.⁶ Infrastructure based competition allows rivals to differentiate their services and compete more vigorously across multiple elements of the supply chain. The ACCC considers the contestability principle identified by the BCR to be an important consideration to ensure any alternative funding arrangements do not diminish the potential for infrastructure based competition in the provision of NBN comparable services.

The ACCC notes that the BCR's consultation paper is seeking comments on specific issues related to the form and scope of industry contributions, including rules on which infrastructure owners are required to pay the levy and the basis on which the levy is to be applied. The ACCC has no specific comments regarding these matters, however, it is important that any potential implications on infrastructure based competition and retail service providers more generally are taken into account. In particular, it is important that rules around funding eligibility and the basis on which the levy is applied do not impose disproportionately higher costs on network owners (in a way that restricts competition between existing networks) or deter competing network owners from entering the market.

4 Cost measurement and financial modelling

The consultation paper proposes a range of cost measurement and financial modelling concepts that could be implemented to quantify the losses from NBN non-commercial services and to develop arrangements for funding these losses.

There appears to be two reasons why losses arising from fixed wireless and satellite services need to be quantified. The first is to provide advice to the Government now on losses that are expected to arise from fixed wireless and satellite services until 2040. The second is to determine, on a periodic

⁵ Section 152AB of the CCA

⁶ ACCC submission to the *Independent Cost Benefit Analysis Review of Regulation first issues framing paper*, March 2014 p.17.

basis, the amount of funding required from owners of high-speed broadband networks as a basis for setting the industry levy.

The consultation paper states that the BCR's preferred approach is to adopt a discount cash flow analysis to quantify losses from non-commercial services in favour of a building block approach. For the purposes of quantifying losses that are expected between now and 2040, the ACCC agrees that a discount cash flow analysis is appropriate. The ACCC also notes that the building block approach is based on similar concepts to discounted cash flow analysis and would also be an appropriate tool for this purpose.

As noted in the consultation paper, however, there is also need to develop a financial model that can accommodate updated forecast information and replace forecast information with actual data. This would enable ongoing funding requirements to be reviewed periodically and adjusted to reflect the best available information at the time. The ACCC considers this to be an important element of a future funding model given the long range forecasts involved, and would allow forecasts to be subject to closer assessment over time. The ACCC notes that the building block approach is well suited to periodic updating of forecast information and updating for actual information. Although the building block approach is more typically used for setting regulated prices, the ACCC considers that it could potentially be adopted in a funding model for NBN non-commercial services.

Further, the long term revenue constraint mechanism (LTRCM) specified in the SAU already provides a framework for defining and quantifying losses incurred by NBN Co. Although this framework applies to NBN Co at a global level and is designed for a different purpose (to give NBN Co the opportunity to recover losses later in the SAU term), the ACCC considers that there are many elements within this framework that could be considered in the development of a future funding model.

The following sections explain the building block approach and the relevant provisions of the LTRCM and how they could potentially be used to develop a framework for funding NBN non-commercial services. The ACCC provides these suggestions as only one approach that could be considered. The ACCC considers that there are likely to be other potential funding models not based on these concepts that would also be appropriate.

4.1 The building block model and the SAU's initial cost recovery account

The LTRCM adopts a building block approach to determine NBN Co's revenue requirement for each year of the SAU period. This amount represents the revenue that NBN Co must recover in that year to recover its operating costs, the costs of financing previous capital investments, a return of previous investments through regulatory depreciation, and an allowance for taxation costs. The overall objective of the building block model more generally is to provide regulated entities the opportunity to recover efficiently incurred operating and capital costs over the long term. The revenue requirement can be viewed as the annualised costs of providing services. In this regard, regulated prices that are based on revenue requirements are generally considered to be cost reflective.

NBN Co will not be able to generate enough revenue in the early years of the SAU to recover its revenue requirements, due to the large initial capital investment required and the small initial customer base. The LTRCM allows for unrecovered revenue (the difference between revenue

requirement and revenue received) in the early years of the SAU term to be included into the initial cost recovery account (the ICRA) for recovery by NBN Co later in the SAU term, when its customer base and demand for its services has increased sufficiently.

4.2 Potential application of a funding model for NBN non-commercial services

The ACCC notes the preference for using a discounting cash flow analysis to quantify the NBN non-commercial service losses. However, the ACCC considers that there would be merit in considering the use of a building block model, which could be applied at a more granular level to calculate revenue requirements for each technology platform, including fixed wireless and satellite. These would represent the annualised costs of providing services over fixed wireless and satellite. In the same way that unrecovered costs are currently calculated in the LTRCM, the losses associated with each platform could be quantified as the difference between the platform revenue requirement and the revenue received for that service in a particular year.

This approach would determine an annual measure of the losses from fixed wireless and satellite services. If a non-commercial platform was expected to be loss making for the duration of the selected timeframe, the annual loss calculated under this approach would represent the annual funding requirement for that platform. If a platform (or a geographic segment of that platform) is expected to be loss making in the initial years only and become profitable in future, this approach would allow initial losses to be rolled forward for recovery in later years. Quantifying losses in this way would have a number of other benefits and would address other issues raised in the consultation paper.

First, the method for determining losses for fixed wireless and satellite services would be consistent with the framework already used within the LTRCM. Although the ACCC recognises this is not a primary objective, it would likely simplify any future SAU variations (to the extent they are required).

Secondly, because the building block approach presents costs in annualised form, there would be no need to consider terminal values in the calculation of losses arising from non-commercial services and the issue of replacement capital investments not recovered within the target timeframe could be addressed.

Third, this approach would effectively adopt NBN Co's regulated cost of capital as the discount rate for calculating losses arising from non-commercial services. During the first 10 years of the SAU term NBN Co's cost of capital will be set at 350 basis points above the risk free rate. The ACCC considers that this provides a reasonable reflection of NBN Co's efficient financing costs, and provides a suitable basis for calculating losses from non-commercial services. This would also have the added benefit of ensuring that a consistent discount rate is used for both calculating losses from non-commercial services and the determination of allowable revenues through the LTRCM.

The main practical consideration in establishing such a framework for quantifying losses from non-commercial services is the need for an appropriate accounting separation framework. This would involve the separate identification and reporting of costs and assets associated with each technology platform. It would also require an allocation of common and indirect costs between technology types and reporting of revenues by technology type.

The ACCC has previously noted the importance of implementing an accounting separation framework. While NBN Co may need further clarity around the proposed funding model to complete its accounting separation, the ACCC would strongly support this process being undertaken as soon as practicably possible.

4.3 Other matters

The consultation paper raises a number of other matters relating to cost measurement and financial modelling. In response the ACCC makes the following comments.

- *Timeframes* – the ACCC agrees with the suggestion in the consultation paper that there is no single appropriate timeframe for assessing the commerciality or otherwise of particular services. The ACCC agrees with the proposal to adopt 2040 as an appropriate timeframe. This would coincide with the end of the SAU period and has previously been used by NBN Co in its corporate plans. Further consideration may need to be given to regulatory re-sets within the proposed time period, although this will depend on the final model that is adopted.
- *Commerciality at a granular network level* – the extent to which NBN Co’s fixed wireless services may become commercially profitable over the target period remains unknown. However, the ACCC supports the proposal to explore the possibility of identifying losses on a more granular level for fixed wireless services and for identifying segments of the fixed wireless network that are potentially profitable. This will allow direct funding to be better targeted and minimise the possibility of internal cross subsidies within the fixed wireless platform.
- *Treatment of common costs* – the ACCC supports the use of a fully allocated approach to allocating common costs between technology platforms. This approach is a well-accepted method for allocating costs, has been adopted in a variety of regulatory settings, including for Australia Post and in the electricity and gas industries. This approach has also been recently adopted in the ACCC’s draft decision in relation to Telstra’s fixed line services. The ACCC considers that a fully allocated approach is an appropriate way of allocating costs for the purpose of measuring losses from non-commercial services.

Concluding remarks

The ACCC looks forward to engaging with the BCR as part of its process of developing an appropriate funding model for non-commercial services and advice to Government.

The ACCC anticipates that as the consultation process and the BCR’s thinking on its preferred funding model develop the ACCC would have more detailed comments to provide.